The past generation of consoles had seen a major shift in the balance of power between console makers and the games publishers. In earlier generations, the console makers were dominant, enforcing exclusivity and imposing heavy royalty payments on the publishers. Consolidation among publishers (caused by rising development costs) and increased competition from different types of hardware platform had changed all that. Exclusivity ties had disappeared from most licensing contracts; most leading games titles were cross-platform. The only popular games exclusive to a single platform were typically those developed in-house by the console makers.

At the same time, the games publishers were also facing new pressures. The licensing fees paid by software publishers for exclusive rights to the intellectual property of media companies and sports organizations grew substantially between 1998 and 2002. The rights to a game based on a hit movie (e.g., *Harry Potter*) could cost several million dollars. For sports games, the major leagues (NFL, NHL, MLB, NBA, and FIFA) required an upfront payment, plus a royalty of 5 to 15% of the publisher's revenue from the game. They were also facing increased competitive pressure from software companies offering free games over the internet. Bigpoint, with some 150 million subscribers, offers games free but earns about $20 monthly per subscriber from the sale of add-ons and special features.

Not only did software sales exceed hardware sales; software was responsible for virtually all of the industry's profit. The console makers followed a "razors and blades" business model: the consoles were sold at a loss; profits were recouped on software sales (both games developed internally and royalties received from third-party games publishers). The result was strongly cyclical earnings for the platform providers: the launch of a new console would result in massive cash outflows; only with a substantial installed base would the platform provider begin to recoup the investment made.

The Console Makers

For the console suppliers, the period 2006–2011 had been a difficult one. Sony's experience with its PS3 demonstrated how the deteriorating economics of the console business meant that it was increasingly difficult to recoup the massive expenditures needed to launch a technologically ambitious new model. While Sony's original PlayStation and its PS2 had been highly profitable, since the launch of PS3, Sony's video games business had incurred substantial losses. While Microsoft had the satisfaction of achieving its goal of establishing itself as a major force within the video games business, the costs were high: it had incurred substantial losses since entering the video games business in 2001. As for Nintendo, despite winning the current round of competition in terms of unit sales, it had failed to achieve either the market dominance or the financial returns that market leaders had achieved during earlier generations.

Reluctance to incur the costs of developing new models was the major motivation behind Sony and Microsoft's desire to extend the lives of their current models. In 2011, both followed Nintendo in releasing motion-sensitive controllers for their consoles. The release of Microsoft's Kinect and Sony's Move coincided with a steep decline in Wii sales.

One bright spot was the growth in online, interactive game playing, which offered an additional revenue source for the console makers. Microsoft's Xbox Live and Sony's PlayStation Network earned revenues from subscriptions and third-party