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The Video-Game Shakeout

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It was as though Santa Claus had suddenly turned his sleigh in midflight and headed back to the North Pole. Atari, the leader of the glittery boom market for video games, suddenly took a jolt. After helping double the profits of the parent corporation Warner Communications, Inc., Atari announced that sales of its video-game cartridges had fallen below projections, contributing to a 50 percent drop in Warner's earnings. In addition, Perry Odak, the head of Atari's consumer-products group, was relieved of his duties. Then Mattel, the No. 2 company behind Atari in the electronicgames market, disclosed that it would actually lose money, in the fourth quarter. With that, hopes for another extraordinary Christmas season for some makers of video-games systems and cartridges quickly diminished -- and a shakeout of the entire industry seemed at hand.

Following Atari's nasty surprise, Warner Communications' stock plunged 36 percent and Mattel's shares fell by 37 percent. Investors also began an indiscriminate dumping of stocks that had even the faintest connection with video games. These included Coleco, a maker of systems and cartridges that nonetheless insisted its business had not slowed down, component suppliers like General Instrument and retailers like Toys R Us. The sell-off even managed to contribute to a general decline of all stocks late in the week: in two days the Dow Jones industrial average fell by 29 points. Worse yet, video-game manufacturers may suffer for some time to come. Imagic, a maker of the highly regarded and hot-selling Demon Attack and other cartridges, postponed a public stock offering scheduled for this week until after Christmas. Imagic hopes that its holiday sales will be successful enough to restore its chances of getting a good price for the issue.

But that may not be enough. Late last week some analysts were speculating that Wall Street may have soured permanently on video-game stocks. The reason? A pervasive feeling that if Atari, with all of its resources and experience, could no longer dominate the game market, perhaps no one could, creating the possibility of a wide-open scramble for market position among dozens of competing companies.

Whoops: The real surprise was that the shakeout was coming so soon -- the boom in video games is only about two years old -- and that it was Atari, the dominant player, that took the brunt of it. Top Warner executives said they had been unaware of any trouble until early last week when Atari officials at the firm's Sunnyvale, Calif., headquarters said that cartridge sales were falling short of projections and that several distributors had canceled orders after Thanksgiving Day. Atari's problem was not so much a lack of consumer demand for video games, but a market invasion by several new manufacturers, including such wealthy companies as General Mills (Parker Brothers) and Quaker Oats (U.S. Games). The newcomers concentrated on cartridges, the most profitable part of the market (cartridges that cost about $5 to make are sold at retail for an average of about $30). Most competing cartridges can be played on Atari systems, and although Atari has pursued some of its competitors in court (story right) many consumers find the competing games more fun to play.

Warner Communications could recover quickly; the company is well financed, game-player sales continue strong and its next batch of games might well set buyers' imaginations dancing again. At the worst, Atari will simply command a smaller share of a rapidly expanding market. But the sudden run of trouble won't soon be forgotten. If even a giant can be zapped in today's volatile market, the entire industry will go into next year with its finger near the hyperspace button.

LANGUAGE: ENGLISH

GRAPHIC: Illustration, The feisty contenders: Invading atari's space