

Strategic Management

Case Study:

Rivalry in Video Games

(Robert M. Grant)

Client: SEGA

„Strategic Management“

MBA-Entrepreneurial Management

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11. Juli 2004

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**„In future, there will only be two kind
of companies: fast ones and dead
ones!“**

David Vice

0 Introduction

In the recent years, there had been great revolutions in the technology-based and emerging industries as well as in the management of innovation. An example for this development is the great expansion in the market of “video games”. There are a few big players, which were dominating the world market in different sectors of the past, starting in 1970. In the different generations, technology market leadership went from one company to the next.

The present situation shows a hard and destroying competition for the market leadership between the big players. They fight for the biggest part of the world market. This isn't surprising, when knowing that every sales peak was surpassed by the following one till today. With each new game, the competitors try to win more customers. The games get more exciting, more realistic, more surprising, more eccentric to conquer customers of the competitors. To realise all this superlatives, with every launch of a game, more and more capacity is needed. On the other way producing software for video games has grown to one of the most interesting and important parts of the whole entertainment industry. The dominating company get the biggest part of the potential revenues. This is called a “winner-take-all”-industry.

The three main players in the market, Sony, Nintendo and Microsoft are fighting for the world dominance in this segment. Sony with PlayStation 2 wanted to keep the market shares they obtained with the first version of the game. Nintendo's “Super Mario Brothers” was favoured from younger users of video games. And at the present time, the giant Microsoft launched the market with their Xbox.

SEGA, one player in the market for video games, should get supported now by an useful strategic concept to make the right decisions for the medium- and long-term future.

1 Basic problem in the specific market

Markets which products and services are in introductory and growth phase are called “Emerging markets”. Technology driven markets are placed in this group. The market of video games is an emerging market, too. The management of technology and innovation is an important strategic issue for nearly every company. “Innovation involves the creation of new products and new industries [...], the enhancement of existing products [...], and the application of technology to industrial and business processes [...]”¹ That means, that innovation is much more than invention. Invention is just a component of innovation. Innovation is mostly the basis of competition and competitive advantage throughout the first stages of industries’ life cycles. However, just because innovation is important, it doesn’t mean necessarily the innovation brings enough cash-flow to a company. There is even no proof, that R&D intensity guarantees a higher rate of profit.² The follower could also earn far more profit than the first mover.³ According to the traditional economic theory, maximising its profit is the only objective of a typical firm.⁴ But innovation is not the only key issue to get successful in this kind of market. It is not enough, just programming video games. There are few complementary resources, which are needed, to get the profit of the innovative launched product. In this case it is essential to have enough cash to pay the high developing and marketing costs for new games. Having the product finished by human skills in designing and trading them, suitable distribution channels are necessary to sell the product. Because of the fast turnover in the product range the competitors has less lead time to get a (sustainable) competitive advantage and to improve the learning curve to turn the experiences into a cost advantage.

¹ Grant, Robert M.: Contemporary Strategy Analysis ; 4.Edition ; Blackwell Publishing Ltd., Cornwall, 1991, S.332

² Grant, Robert M.: Contemporary Strategy Analysis ; 4.Edition ; Blackwell Publishing Ltd., Cornwall, 1991, S.335

³ Palmer, David: MBA-Reader „Strategic Management“; Berlin School of Economics; SS 2004

⁴ Hardwick, Khan, Langmead: Modern Economics; 2. Edition; Longman Ltd., Singapore, 1986; S.17

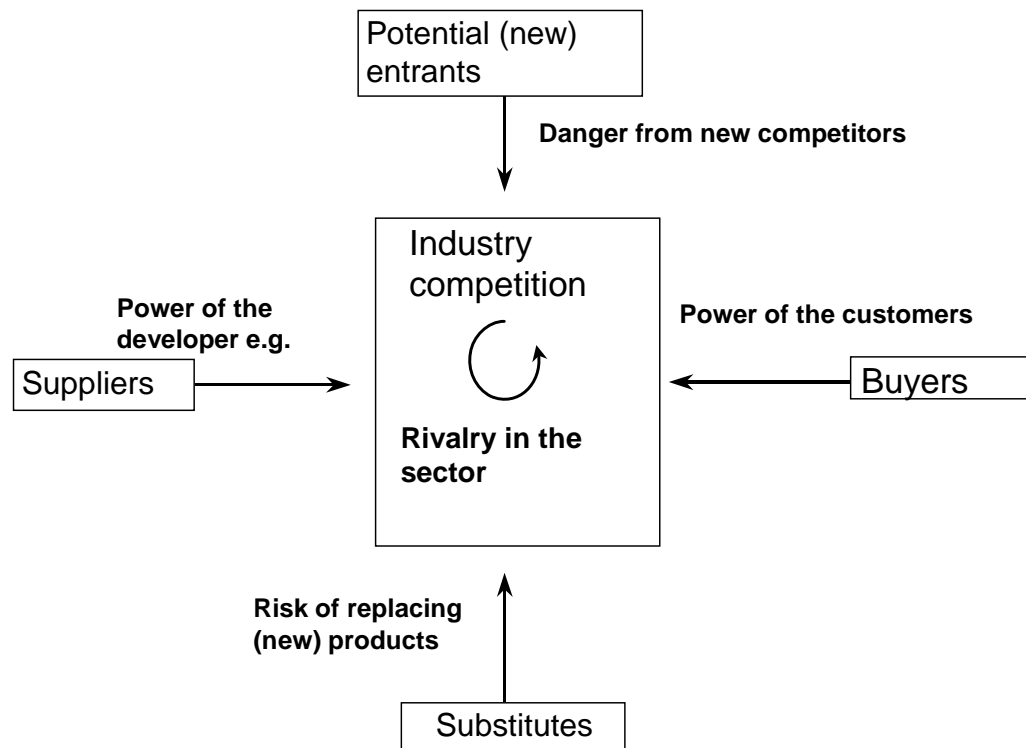
2 Analysis of the present situation

To find a realistic and successful strategy for the company in the future an analysis of the actual situation is needed to understand the important aspects.

There are a few management tools to get a structured image of the situation. One of this tools is the “Porter´s-Five-Forces”-Model. To understand the specific strengths and weaknesses of SEGA and get to know the chances and threats which could influence the company from outside a SWOT-analysis could make sense. These two management-tools should be used to get a better look at the actual situation.

2.1 Porters-Five-Forces

The management-tool “Porters-Five-Forces” analyses all kind of influences come towards the company.



The different forces should be considered in detail.

2.1.1 Industry competition

There are a few global players with potential distribution systems, good marketing and lots of capital in the present competition.

The market is known as a market with high developing costs for games and consoles.

Despite over 30 consoles launched the market since the early 70s, the market has consistently accepted only two or three systems at any time. This leads to the hard actual rivalry, because of the enormous investments in fixed assets and marketing, which had been done already. The rivalry gets higher, the stronger the following points:

- Many competitors with (nearly) the same products or services
- High fix-costs (e.g. developing costs)
- Less/no differentiation
- High strategic importance
- High barriers getting out of the market

Another problem for the competitors is the importance of the number of games. It causes a lot of development costs and creativity of the developers.

The trend to interactive games is still going on. This is an key issue for new consoles like Xbox and could get to an unique selling proposition for Microsoft in future.

2.1.2 Suppliers

The software-developers could be considered as the suppliers for the program. You need creative people, which are interested to create games especially for your kind of system. The personal resources (strong developers) are very an important part of the whole supply-chain of the products. These kind of suppliers are not as interested in money as other suppliers may be. The company they work for should be sexy and technical-orientated and not only commercial.

Other suppliers, e.g. for the hardware are not as important as the developers.

2.1.3 Potential entrants

The danger of potential entrants is not the biggest risk, because of the needed complementary resources.

There are many market entrance barriers, which are relevant for potential new entrants:

- Economics of scale

This means, that you have to sell a critical mass of the product needs to get sold to reach profitability.

When you want to start small you will not be successful.

- High capital investments

Like in the first point mentioned, you can't start such a business as a small player. The capital investments, which have been provided for development, marketing and production are very huge. A big player, which additionally has technical experience, is necessary to support the system.

- Distribution systems

But even if a company has the money and the technical experience in addition a distribution channel is needed, where you can sell the quantity of products you need for breakeven. A network of companies could be helpful.

- Aggressive reactions of the competitors

And when you have done well all the recent points, there could be an aggressive reaction of the established companies in the market. When there is no reaction by them, you are probably not a serious competitor.

All the mentioned aspects may show, there aren't really good possibilities for new companies to move into this market.

2.1.4 Substitutes

There is an enormous turnover-rate in the market of video games. The life-cycles of the different editions of the consoles and games get shorter and shorter. This implicates the

danger of new products from a competitor with a newer edition and decreasing revenues for the actual product-portfolio. Innovation seems to be the only way to run this business without losing market-shares. Or like David Vice said: “In future there will be only two kind of companies: fast ones and dead ones.”

2.1.5 Buyers

The customers are very powerful because of the standardised and not differentiated products (consoles and games). “It is hard for the average player to tell the difference.”⁵ To change the system is no problem for the user, because of the not extremely high costs of the consoles. The buyers’ information (like pricing) is very good because of the internet. The resulting profit-margins for the seller (according to the efficient market) get smaller and smaller.

2.2 SWOT-Analysis *SEGA*

The different strength and weaknesses of *SEGA* and the upcoming opportunities and threats out of the market should be analysed in the following SWOT-Analysis. The intern facts (strength, weaknesses) could be influenced by the company, towards the extern facts and developments you could only take a good position with the company and can not change them directly.

2.2.1 Strength

One of the experiences, *SEGA* has, are in Internet activities (with interactive games). The company was the technical Leader in the 128-bit-generation (less important than the step from 16-bit to 32-bit-generation). The core competence of *SEGA* is in software development (not in hardware).

⁵ Sathnam Sanghera: „Out of the box at last“, Financial Times, Creative Business section, November 20, 2001

2.2.2 Weaknesses

The biggest weakness of SEGA is that there's none capital left. There are high loans and debts (round about 500 Mio. \$) because of financing the marketing activities and the not achieved revenues. The failure of Saturn, no blockbuster-title, no killer-application like Lara Croft (PlayStation) are the basic problems of SEGA.

2.2.3 Opportunities

Looking at the market there were fast changing market-shares in the last decades. These developments were depending from the new generation of consoles and games. It seems, that every of the big companies can catch a big market-share with a great new console and games.

2.2.4 Threats

To use the opportunities, mentioned in the recent point, the companies need more and more money to run the business successfully. The selling price of the consoles failed to cover the cost of manufacture, let alone the cost of development. The received profits derived almost exclusively from sales of software.

3 Analysis of the specific items of the video games market

Not every problem mentioned for SEGA is important. There are a few key issues necessary for a successful position in the market:

The first aspect is the **new technology**, which had to be offered in shorter and shorter time-periods. This means rising developing costs for marketing and human resources.

Another aspect is the **consumers' desire for novel games**. That brings the customers to the competitor with the most, newest and most interesting games. The third point is the **complementary between hardware and software**, which leads to a competitive advantage in the new product cycle.

4 Offered possibilities to solve the problem

There are more possible ways SEGA could go. But it seems there is no way to go back to the market leadership.

4.1 Leave the market for video games

The first possibility is to **leave the complete market**. This could be done by selling the assets or shares to an strategic investor, maybe an competitor. Microsoft could probably use the experience of SEGA in the interactive games.

4.2 Merger with a big player

To **merge with a big player**. This could be a actual competitor or a company, which have the money SEGA needs to run the next life-cycles in the business. The question in this point would be, if there is an financial or strategic investor, who has the patience for a long lasting period until breakeven. Although being in a still growing market the profit margins are degreasing because of the enormous rivalry. It may be harder to find an financial than an strategic investor.

4.3 Specialisation

The last possibility could be specialisation. This could be done in a part of the value chain or in a niche market. This **part of the value chain** could be producing only software or hardware for example. A **niche market** could be a specific group of potential customers, which are not penetrated by the market leaders. It could also be a region, that isn't reached so far (which will hardly be possible in this sector).

5 Chosen solution “Specialisation” with explanations

Looking at the possibilities of solutions, mentioned in the last bullet point, there is more than one possible strategic concept. Probably it could be interesting to have much more information about the financial situation, the people who are working in the companies and so on. With the information we have, there is just one acceptable way to chose.

In the authors opinion SEGA should go the third way. There is no money left and the prices you get in a merger will probably be very low. Liquidation is not necessary in a growing market. There may be a possibility to get a position in the market.

But how should SEGA specialize?

It is a problem to go to regions, where the big players will not go, because there are reasons, why they don't. So the last possibility may be to specialize in a part of the value chain. SEGA has great experiences in programming software and developing interactive activities. They should specialize in this activity. The development of software and games should also be connected with Crossmedia-Marketing and cooperations with big player in different sectors. Depending to the revenues, the cooperation costs should be paid of. This improves the liquidity of SEGA and helps to save marketing-costs because of blockbuster-figures. These aspects may help to position the company in the future interactive video games-market. The interactive internet will be a key issue of the future market and SEGA could probably be with it.

6 Conclusion/Summary/Recommendation

The present situation of the market for video games is very interesting for all observers. The question, which player will give the standard for video games in the future is actual. The present market leader Sony could not be sure that Microsoft will let them run the business alone. The capital of Microsoft is an important issue, which could probably influence the market in a deciding way. The race will probably be decided when the interactive internet games are on the run. Microsoft with his experiences in software-development and Internet-activities can get the net-giant of the future. Sony could be the entertainment-giant at the same time, based on developing entertainment-electronics. Nintendo will probably be more present in the niche-market handhelds for children. The role of SEGA in this market will be decided soon.

7 Literature

- Grant, Robert M.: Contemporary Strategy Analysis ; 4.Edition ; Blackwell Publishing Ltd., Cornwall, 1991
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