

Video Game Industry

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The Rise of Nintendo

By 1990, Nintendo's stock market valuation exceeded that of Sony or Nissan


- 90% market share
- High penetration levels - 1 in 3 households in the US

Difficult Industry conditions

- Cyclical
- Counterfeit
- Rapidly evolving
- Price Sensitive

Nintendo Solution


- Cheap Hardware (Famicom / NES)
- Super hit games (Super Mario Brothers/ Legend of Zelda / Metroid)



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Compliments


<p>3rd party development of software</p> <ul style="list-style-type: none"> ◦ Control over content – Violence / explicit content ◦ Control over quality – manufacturing by Nintendo <p>Limit the number of titles per year per developer</p> <ul style="list-style-type: none"> ◦ Fly-by-night operators eliminated ◦ More focus on content by developers ◦ No developer becomes too powerful 	<p>Nintendo's in-house software development</p> <ul style="list-style-type: none"> ◦ Security chip to control the developers <p>Limit number of developers</p> <ul style="list-style-type: none"> ◦ Incentive to selected developers of assured business ◦ Lock-in – unable to develop for competitors ◦ Retaining good developers ◦ Competition among developers for license. Best get selected
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Customers

<p>Undersupplied the market</p> <ul style="list-style-type: none"> ◦ More desirable long queues ◦ Free publicity from the artificial scarcity <p>Stimulate secondary sales</p> <ul style="list-style-type: none"> ◦ Get the next best title instead of returning empty-handed <p>Resale price maintenance</p> <ul style="list-style-type: none"> ◦ No discounts ◦ Nullify the buyer power (Walmart Advantage) ◦ Legal battle against rentals 	<p>Better inventory management</p> <p>Increase WTP upfront by reducing the prices of the console</p> <ul style="list-style-type: none"> ◦ Customers uncertain of total value (hardware + software) ◦ The low initial investment is attractive ◦ Garner market share/penetration <p>The high price of software signals that it is of high quality</p> <ul style="list-style-type: none"> ◦ Low price = Low quality
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Suppliers

Used old technology

- Cheaper
- Not in high demand

Sourcing from several chipmakers


- Important customer for the chipmakers as very few takers for old technology

Game character developed in-house

- The bargaining power of Disney/Marvel/DC reduced

Assembly at Nintendo

- Imitation becomes difficult




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Substitutes

Keep them interested

- By giving footage in Nintendo Power
- A quota of games accepted by Nintendo now and then
- Market the cartridge using the 'Nintendo Seal of Quality'
- Highest installed console base – two-sided market




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The game of business

The game of business is all about value: creating it and capturing it

Nintendo Trumped Every Player in Its Value Net



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Dimensions

Vertical


- Raw materials and labor flow from supplier to company, where they are converted into products and services before continuing to the customer.
- The company needs both suppliers and customers to be viable.
- But most organizations often overlook the value of listening to suppliers.

Horizontal

- Often, organizations shape their strategy exclusively around what their competitors are doing.
- They miss out on key opportunities to connect and grow with potential complementors.
- Removing these blind spots can improve strategic choices

What Is The Value Net Model?

The Value Net Model argues that organizations and competition between organizations are not only desirable but also necessary when doing business. This is in stark contrast to traditional thinking, which argues that such competition impedes business success and profits.



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PARTS (elements) of the game

Players
 Added value
 Rules
 Tactics
 Scope

PARTS are the levers for moving the world of business

- You can change the GAME by changing any of the above levers



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Identify Players

Becoming a player changes the game

- Customer, Supplier, Complimentor, Substitutor

Are there opportunities for cooperation or competition in any of these relationships?

Would bringing in extra players (such as additional suppliers or new customers) create any more benefits?

Who stands to gain from forming a strategic partnership with you?

Would any of these players pay you to join them, if their gain was great enough?

- Cash Contribution to upfront expenses
- Guaranteed sales contract
- Access to people
- Access to information



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Calculate Added value

Your added value = size of the pie (when you are in the game) - size of the pie (when you are out of the game)

Added value measures what each player brings to the table.

- USP
- Supply & demand
- 5-forces

It helps you identify who has the most power, and helps you think about how you might increase the value you provide for others.



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Define Rules

Every industry has certain established and unwritten "rules" that must be followed

- Rules structure negotiations between buyers and sellers

Rules come from

- Custom
- Contractual arrangements
- The government

Rules limit what your organization can achieve.

- Rules can be changed to benefit customers
- Some rules cannot be changed

In games with rules, you need to anticipate the reactions to your actions



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Identify Tactics

Each player in the Value Net Model perceives your organization in a certain way

- Perceptions of the world, regardless of whether they are accurate, drive behavior

Tactics are actions taken to shape other players' perceptions

- Establish credibility
- Actions predictable?
- Perceptual map
- Pricing simple or complex



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Define Scope

Scope is the boundaries of your game, or market, but these can be extended by linking to other markets

- Recognize the links between games

Links through

- Players
- Added values (complements)
- Rules (most-fav.-cust.)
- Perceptions (threats, precedents)

There is always a larger game



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The rise of Nintendo

Nintendo reduced the added value of customers while maintaining prices in market through an artificial scarcity

Nintendo took the bargaining chip from the complementors by taking control of software through in-house development, security chip, NP

Nintendo's suppliers could not increase added value to the old technology, commodity like product and high branding of characters by Nintendo

Nintendo managed threat of entry through the large installed base and locked in developers

Nintendo increased its own added value while reducing the added value of others



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The rise of SEGA

With its 8-bit video game system, Nintendo expanded the market and became a monopoly

Post 1987, new 16-bit home video game technology began coming into the market.

- First to market was Japanese firm NEC. Second was Sega, who was a leader in Japanese arcade game business but unsuccessful in 8-bit market
- Sonic the Hedgehog + Low priced console – Fast build of user base, Higher royalty – no exclusivity contracts,

Nintendo was slow to react

- They had a choice of deterrent action, but they did not want to cannibalize 8-bit market
- By 1994, the worldwide market was split between Nintendo and Sega


Sega changed the scope of the game to become successful



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The rise of SEGA

	SEGA	NINTENDO
Players	Converted substitute (Electronic Arts) to compliment	Alienated players by rationing
Added Value	Sonic the Hedgehog	Higher console price, no backward compatibility
Rules	Favorable licensing agreement	Stringent license agreement
Tactics	MJ + Disney "Better than Competition"	Made false market claims
Scope	Arcade @ home (16-bit tech)	Stuck with 8-bit tech for fear of cannibalization



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The rise of Sony and fall of 3DO

3DO, a high-profile US start-up developed a 32-bit platform.

- Nintendo and Sega reduced prices of existing products & improved quality


3DO created a window of opportunity but was unable to exploit it

- They reduced the software royalty, no restrictions, access to library
- 3DO gave away the hardware technology for free. They wanted competition in hardware manufacturing so that prices would come down

Sony PlayStation introduced for more mature audience

- Proliferated video game titles
- Low priced software – CD ROMs, yet higher royalty for developers and more profits for Sony due to low manufacturing cost


Sony changed the rules of the game to become successful



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The rise of Sony and fall of 3DO


Cheap Hardware	Multiple Developers	Hit Games
<ul style="list-style-type: none"> 3DO gave licenses for free & hoped for competition among manufacturers driving down prices & establish 3DO as the technology standard Nintendo & Sega subsidised their hardware. 3DO was unable to respond as it was dependent on outsiders. No economies of scale. Adoption rate low as launched in US instead of Japan 	<ul style="list-style-type: none"> 3DO did not impose too many restrictions and kept the royalty low. The software was forced to subsidize the hardware. 	<ul style="list-style-type: none"> None Nintendo controlled Software. Software boycotted Hardware



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Nintendo Wii

WHAT THE NONCUSTOMERS CAN TELL YOU




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In 2006 the video game console industry was:

Dominated by three players: Microsoft, Sony and Nintendo

Facing flat growth

Focused on young users, predominately teenagers



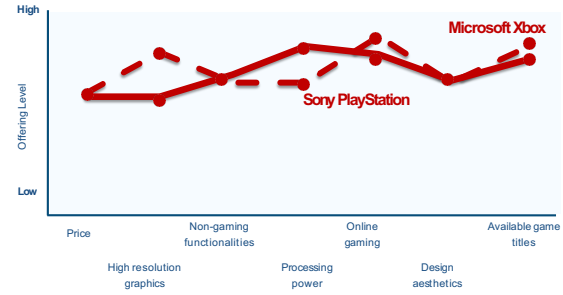
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In 2006, the key factors the video gaming industry competed on...
More buttons, futuristic console





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Video game industry 2006




Factor	Microsoft Xbox	Sony PlayStation
Price	Low	Low
High resolution graphics	Low	Low
Non-gaming functionalities	Low	Low
Processing power	Low	Low
Online gaming	High	Low
Design aesthetics	High	Low
Available game titles	High	Low



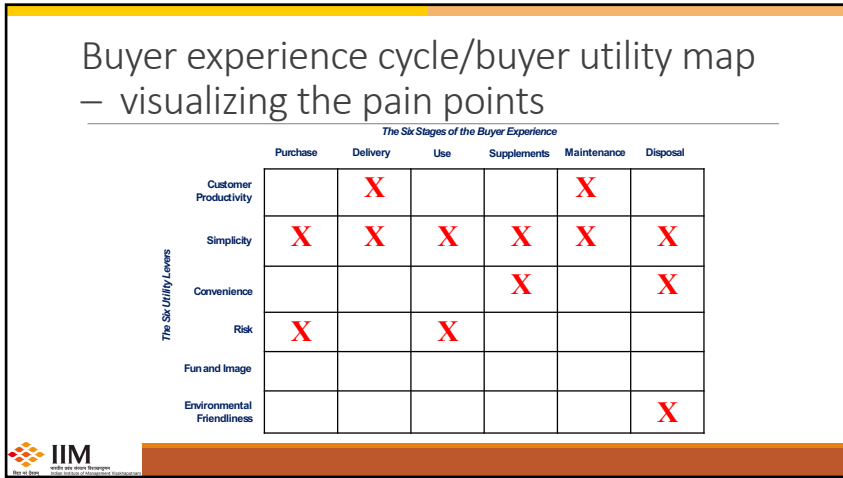
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What pain points prevented noncustomers from entering the video game market?

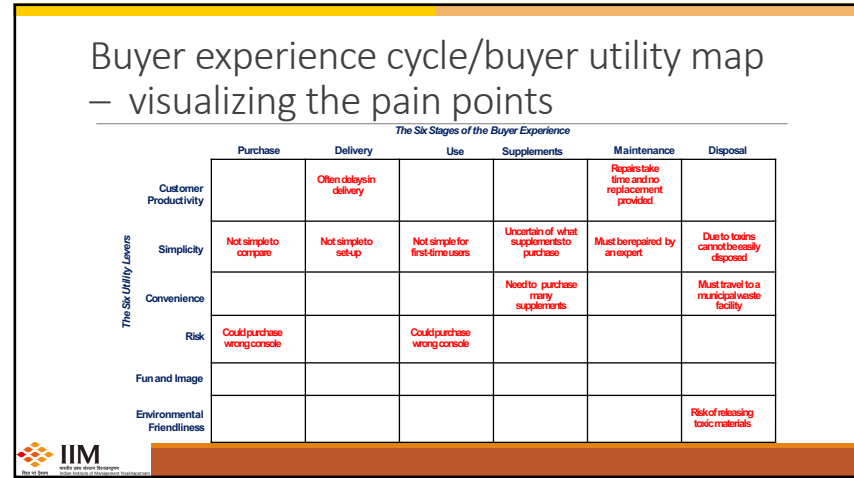
- Most games are designed for teenagers: very unappealing to adults.
- Controllers are very complex and difficult to use.
- Games take a long time to understand and advance levels.
- Expensive.
- The console is not stylish and doesn't look good in a family living room.



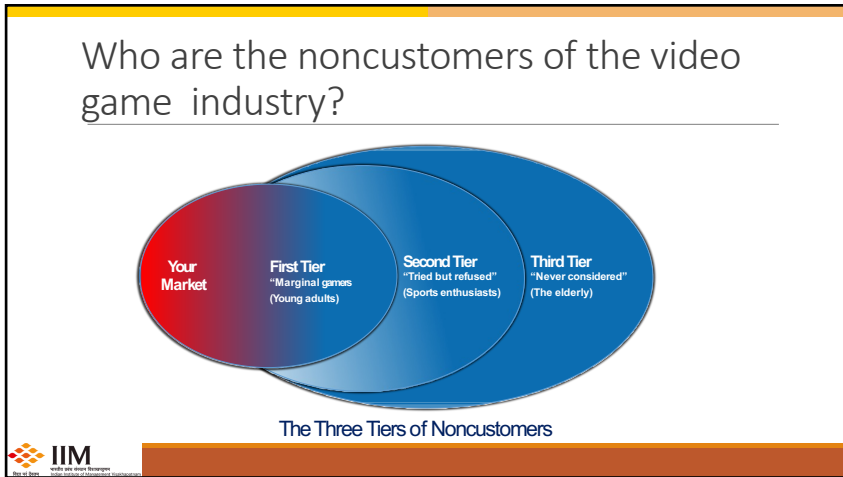
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It's the Wii!

The idea of the Wii console was thought up during the time of the GameCube release in 2001.

The Wii was first released in Japan on September 14, 2006.



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The Creator

The mastermind behind it all is Shigeru Miyamoto. He is a world-renowned videogame designer.

He is known as the "father of modern video gaming."



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Asian Invasion



The console was released on November 19, 2006. About eight days after, 600,000 Wii's were reported to be sold.

The first purchaser was Isaiah "Triforce" ("Zelda" reference) Johnson, who is in the black sweatshirt.



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Motion Sensor Action!

The Wii remote, or "Wiimote", interacts with a sensor bar by using accelerometers, infrared LED's, and triangulation.



In general, a player's Wiimote movements would determine their character's actions. A gamer would have to move in order to play.




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Better than the Rest

The Wii is the only console to focus on motion game play. It changes the concept of sitting down while gaming.







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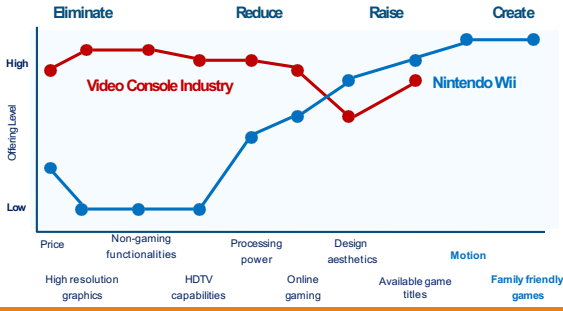
What did Nintendo do to unlock new demand from customers and noncustomers?

<p style="text-align: center;">Eliminate</p> <p style="text-align: center;">High resolution graphics Non-gaming functionalities HDTV capability</p>	<p style="text-align: center;">Raise</p> <p style="text-align: center;">Design aesthetics Available game titles</p>
<p style="text-align: center;">Reduce</p> <p style="text-align: center;">Processing power Online gaming Price</p>	<p style="text-align: center;">Create</p> <p style="text-align: center;">Motion Family friendly games</p>



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Nintendo Wii Strategy Canvas



Eliminate **Reduce** **Raise** **Create**

High


Low

Offering Level

Price Non-gaming functionalities Processing power Design aesthetics Motion

High resolution graphics HDTV capabilities Online gaming Available game titles Family friendly games

Video Console Industry Nintendo Wii




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Aiding the Elderly

The Wii may get the elderly involved with videogames.

Senior citizens at the Sedgebrook retirement community in Lincolnshire, England, line up to play "Wii Sports."

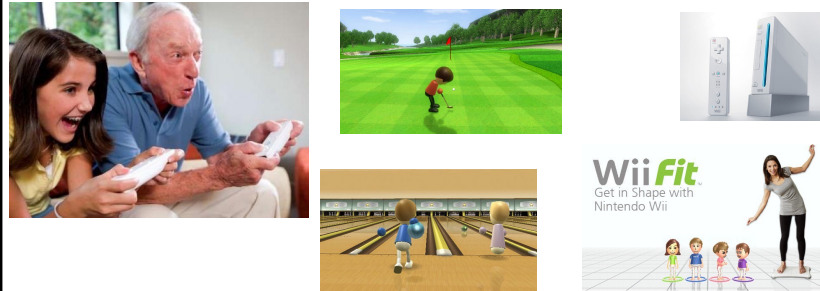


The residents of other retirement homes, such as the Sunrise Senior Living Centre, also have Wii fans.

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Unlocked new demand from noncustomers



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Free Samples, Anyone?

Nintendo brought 38 Wii's to Central Park on May 19th, 2008.

During this major event, the company celebrated the release of the "Wii Fit" and allowed the public to tryout the new game.



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Promoting a Healthy Society

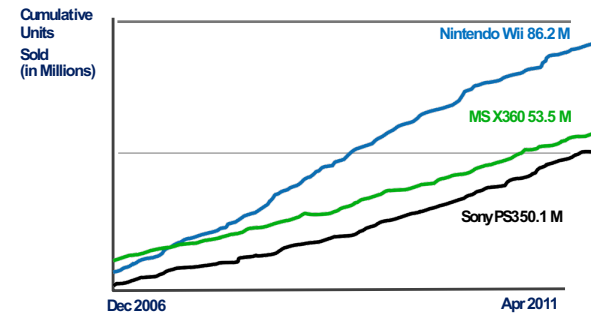
Wii Fit has about 40 different activities, including aerobic exercises and yoga.

1.8+ million copies were sold worldwide, making one person healthier at a time.



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Created an uncontested new market space in the video game industry



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It is a Goldmine

In only 1 ½ years, about 24 million Wii's had been sold worldwide, and Nintendo made a profit of \$190+ million from Wii related products.



The reincarnation of Nintendo

Wii launched at low price point

- **Eliminated:** High resolution graphics; HDTV capability; Non-game functions
- **Raised:** Design; available game titles
- **Reduce:** Processing power; online gaming; Price
- **Create:** Motion; Family friendly games

Wiimote has motion sensor action

- Changes the concept of sitting down while playing
- Got Senior citizens involved
- Fitness enthusiast attracted to gaming

Nintendo changed the Players to Succeed

Fighting the Standards War

The Emergence of Standards

STANDARDS, PLATFORMS, AND NETWORK EXTERNALITIES

Emergence of a dominant designs

- Model T in autos
- IBM 360 in mainframes
- Douglas DC3 in passenger aircraft

Emergence of technical standards

- Emerge in industries where there are network externalities.

Entrenchment of dominant designs and technical standards

- Learning effects: incremental improvement of the dominant design
- Switching costs
- Need for coordinated action by multiple players

Sources of Network Externalities

STANDARDS, PLATFORMS, AND NETWORK EXTERNALITIES

Users linked within a network e.g.:

- Telephone systems—only value of telephone is connection to other users
- On-line auction—value of auction depends on number of buyers and sellers participating


[Also, **social identification**—the desire to conform encourages imitative behavior]

Availability of complementary products e.g.:

- Most smartphone apps written for iPhone and Android—Blackberry and Windows dying for lack of apps
- In autos, more available spares and repairs for a Ford Focus or Honda Accord than a Kia, Proton, or Lamborghini

Economizing on switching costs e.g.:

- Office software (Microsoft Office vs. Lotus SmartSuite)




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Companies that Own Technical Standards

STANDARDS, PLATFORMS, AND NETWORK EXTERNALITIES

Company	Product category	Standard
Microsoft	PC operating systems	Windows
Intel	PC microprocessors	x86 series
Sony/Philips	Compact disks	CD-ROM format
ARM (Holdings)	Microprocessors for mobile devices	ARM architecture
Oracle Corporation	Programming language for web apps	Java
Rockwell and 3Com	56K modems	V90
Qualcomm	Digital cellular wireless communication	CDMA
Adobe Systems	Common file format for creating and viewing documents	Acrobat Portable Document Format
Adobe Systems	Web page animation	Adobe Flash
Adobe Systems	Page description language for document printing	Postscript
Bosch	Antilock braking systems	ABS and TCS (Traction Control System)
IMAX Corporation	Motion picture filming/projection system	IMAX
Apple	Music downloading system	iTunes/iPod
Sony	High-definition DVD	Blu-ray
Nissan, Toyota, PSA	Electric vehicle charging	CHADEMO



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Competing for Standards: Value Appropriation vs. Market Acceptance

STANDARDS, PLATFORMS, AND NETWORK EXTERNALITIES


Video Cassette Recorders

VHS Betamax

Maximize market acceptance ← → Maximize value appropriation

IBM-PC Apple Mac

Personal Computers




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Fighting Standards Wars

STANDARDS, PLATFORMS, AND NETWORK EXTERNALITIES

- Determine the potential for standards emergence**—analyze network externalities
- Assemble allies**—enlist partners (customers, complementors, competitors) to build a bandwagon
- Pre-empt the market**—build user base quickly: enter early, attract key customers, adopt penetration pricing
- Manage expectations**—use launch and pre-launch publicity and promotion to convince the market that you will be the winner
 - How can the winner sustain the standard?*
 - Don't fall behind on technology
 - Ensure backward compatibility
 - Meet threat of disruptive technology by offering customers a migration path
 - Reinforce standard with other resources—e.g. brand
 - What if you're a loser?* (a) ensure compatibility (b) go for niche



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