ISCTE Business School
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Nintendo's Pursuit for Profitability: A Pedagogical Case Study

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- Spine -

Abstract

The home video game console industry, like most high technology industries, is characterized by fast innovation, intense competition and a generally volatile environment. Since the mid-1990s, this industry has essentially been dominated by three major companies, Nintendo, Sony and Microsoft.

However, in recent years (since 2012) Nintendo's performance has been below expectations, with revenues falling, negative operating income for the last three years, and falling share prices. As a result, Nintendo's management has started, especially since the second half of 2014, a concerted effort to improve the company's fortunes. At the moment these efforts have resulted in better media coverage and a stop in share price fall.

It is still early to know if Nintendo's pursuit for profitability will succeed; nonetheless, it is both of import and interest to understand how companies seek to achieve superior performance, which is why Nintendo was chosen to be analyzed.

The aim of this project is to conduct a pedagogical case study on Nintendo, with a focus on how the company is attempting to return to profitability in the midst of intensified competition from its main rivals, Sony and Microsoft, and a growing threat from substitute products, namely mobile gaming.

Through the case study and the request for a strategic analysis, the project will present its target audience – management undergraduate students – an opportunity to understand Nintendo and its industry; as well as, give them the chance to put into practice some strategic management concepts and frameworks, which may prove to be useful in both their academic and professional careers.

Key Words:

Mark-Based View; Resource-Based View; sustainable competitive advantage; Nintendo.

Classification JEL System:

- **M10**: General Business Administration
- **L10**: General Market Structure, Firm Strategy, and Market Performance

Resumo

A indústria de consolas de jogos de vídeo, como a maioria das indústrias baseadas em alta technologia, é caracterizada pela inovação rápida, competição intensa e um ambiente geralmente volátil. Desde meados de 1990 que esta indústria é essencialmente dominada por três grandes empresas, a Nintendo, a Sony, e a Microsoft.

No entanto, nos últimos anos (desde 2012) o desempenho da Nintendo tem estado aquém das expetativas: com queda nas receitas; resultados operacionais negativos nos últimos três anos; e queda na cotação das ações em bolsa. A administração da Nintendo começou, especialmente desde o segundo semestre de 2014, um esforço concertado para melhorar a situação da empresa. Neste momento, tais esforços resultaram em uma melhoria na forma como a empresa é retratada nos media e na paragem da queda do preço das ações.

Ainda é cedo para se saber se a busca da Nintendo pela lucratividade será bem sucedida; no entanto, importa e interessa entender como as empresas procuram alcançar resultados superiores, e esta é a razão pela qual a Nintendo foi escolhida para análise.

O objective deste projeto é a realização de um estudo pedagógico sobre a Nintendo, com realce na forma como a empresa tenta voltar à lucratividade em meio a intensa competição com os seus principais rivais, Sony e Microsoft, e a crescente ameaça de produtos substitutos, como os jogos em telemóveis ou tablets.

Através do caso de estudo e a realização da análise estratégica, o projecto apresentará à sua audiência – estudantes da licenciatura em gestão – a oportunidade de entender a Nintendo e a sua indústria; e dar-lhes-á a oportunidade de praticarem alguns conceitos e ferramentas de gestão estratégica, eventualmente úteis nas suas vidas académicas e futuras carreiras.

Palavras-chave:

Visão baseada no mercado; visão baseada nos recursos; vantagem competitiva sustentável; Nintendo.

Sistema de Classificação JEL:

- **M10**: General Business Administration
- **L10**: General Market Structure, Firm Strategy, and Market Performance

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List of Abbreviations

BBFC - British Board of Film and Classification

CA&A - Corporate Analysis and Administrative

CAGR - Compound Annual Growth Rate

CEO - Chief Executive Officer

CES - Consumer Electronics Show

E3 - Electronic Entertainment Expo

EA – Electronic Arts

EAD - Entertainment Analysis and Development

EMEA - Europe-Middle-East-Africa

ESRB - Entertainment Software Rating Board

EU - European Union

Famicom - Family Computer

FIFA - International Federation of Association Football (FIFA - Fédération Internationale de Football Association)

GA - General Affairs

GDP - Gross Domestic Product

IPO - Initial Public Offering

MBV - Market-based view

NES - Nintendo Entertainment System

NFC - Near Field Communication

NYSE – New York Stock Exchange

PEGI - Pan European Game Information

PESTEL - Political; Economics; Social; Technological; Environmental; Legal

R&D - Research and Development

RBV - Resource-based view

ROB - Robot Operating Buddy

SCP - Structure-conduct-performance

SPD - Software Planning Development

SWOT - Strengths; Weaknesses; Opportunities; Threats

T&E - Technology and Engineering

TV – Television

USA - United States of America

USD - United States Dollar

USK - Certification of Entertainment Software (USK – Unterhaltungssoftware Selbstkontrolle)

VCS - Atari Video Computer System

VES - Video Entertainment System

VRIO - Value; Rare; Imperfectly Imitable; Organization

YOY - Year-on-Yean

1. Introduction

The video game console industry is characterized by constant change, innovation and fierce competition (Williams, 2002). One of its most iconic companies is Nintendo (Parr, 2012), a company founded more than 120 years ago, in 1889.

In its 125 year history Nintendo has gone from a company originally founded to manufacture and sell playing cards to a well-recognized technological company, one of the leaders in the highly competitive video game console industry (Fast Company, 2008).

Although innovative and one of the most successful companies in its industry, Nintendo's fortunes have recently taken a turn for the worse. Faced with changing trends in the industry (such as casual gamers turning to mobile gaming) and strong competition from Sony and Microsoft, Nintendo's sales and stock prices have been falling (Parr, 2012), and its top management is trying to come up with new strategies to halt the bad results (Schmidt, 2014).

The aim of this project is to elaborate a pedagogical case study on Nintendo, and especially focus on the way in which the company is attempting to return to profitability amid intensified competition from its main rivals, Sony and Microsoft, and the rising threat of substitute products (mobile gaming).

It is expected that by analyzing Nintendo's case, the target audience of this project – management undergraduate students – will have the opportunity to not only gain a deeper knowledge about the industry and company in question, but will also have the opportunity to practice the use of certain strategic management concepts and frameworks, which they will likely find useful in their university courses and future careers.

The strategic management frameworks which students are expected to practice are: the PESTEL analysis; Porter's five forces; Porter's competitive generic strategies; the VRIO and SWOT models.

The methodology used to conduct this project is roughly based on the indications of Eisenhardt (1989) and Hamel (1993) for the realization of a case study (detailed in the fifth chapter - Methodology) and the data was gathered from secondary sources.

The reminder of this project is structured in seven chapters. The next presents a historical overview of the video game console industry and that of Nintendo.

Chapter three identifies both the intended audience and the pedagogical objectives of the project. The fourth chapter presents the literature review and discusses the Market-Based View (MBV) and Resource-Based View (RBV) theories of superior company performance and presents also the PESTEL; Five Forces; Value Net; Porter's Generic Strategies; VRIO; SWOT; and TOWS models.

Chapter five, Methodology, indicates how the data for the compilation of the project was obtained and which steps were followed to compile the project. A brief discussion of the case study research method is also presented and a distinction between case study research method and case study teaching approach is offered.

The presentation plan; proposed strategic questions; answers to the proposed questions and resolution slides are presented in the sixth chapter, under the title Case Resolution.

The lessons from the case and managerial implications are presented in the seventh chapter and the limitation and conclusion of the project are discussed in the eighth and last chapter.

2. The Case Study

2.1. Case Description

In November 2013, the Bloomberg BusinessWeek website published an article written by Cliff Edwards and Takashi Amano with the title: "Is It Game Over for Video Game Consoles?" The article detailed the increasing survival problems the big three console manufacturers (Nintendo, Sony and Microsoft) face as sales drop sharply and competition increases.

It is not the first time the industry is faced with an apparent death sentence; in fact, the video game console industry is so volatile that there does not appear to be much space for more than a few companies to successfully compete in it at the same time[1] (Williams, 2002).

Since the mid-1990s the industry has been dominated by Nintendo, Sony and Microsoft, with market leadership frequently alternating between them as new consoles are released and yearly updates made.

With the exponential developments in technology, changes in customer consumption patterns, such as people playing more games on mobile devices, convergence in the communications, entertainment and information industries (e.g. Google offer all of these services), the current competitive landscape the big three console manufacturers face is vertiginously complex and challenging.

Although its main competitors have also been facing difficult times, Nintendo's have been worse, with the sales of its latest console, the Wii U, behind those of both Microsoft's console, the Xbox One and Sony's console, the PlayStation 4. According to industry analysts, the causes of Nintendo's problems are not only its direct competitors but also the rise of substitute products such as mobile gaming (White, 2013; and Parr, 2014).

The present case study seeks to describe the dynamics of the video game console market and the strategic choices Nintendo has been making in order to increase revenues, become profitable again and stop the decrease of its stock price.

Next an historical overview of the video game console industry is presented.

[1] http://www.paristechreview.com/2012/03/13/video-games-real-economic-wars/

2.2. The Video Game Console industry – Historical Overview

A video game console is an electronic system, also known as a platform, which outputs a series of video and sound signals through a television set to display a video game.[2] The video game console market belongs to the technology sector, hardware industry and to the consumer electronics sub-industry[3].

The supply side of the video game console market is composed of all the companies that manufacture and distribute video game consoles in addition to allowing third-party publishers to produce games for their consoles in return for a licensing fee. These companies are also known as first-party game publishers.

The idea of the video game console can be traced to the American engineer and inventor Ralp H. Bauer (Kent, 2001), who in the 1960s while working for Sanders Associates, an American defense contractor company (now part of BAE Systems) designed a series of video game consoles. One of Bauer's designs nicknamed the "Brown Box" was later licensed to Magnavox, an American consumer electronics company founded in 1917 to commercialize loudspeakers.

Magnavox launched the Magnavox Odyssey in 1972. This device, which was the first game platform to be connected to a TV is widely considered to be the first home video game console (Kent, 2001). The Magnavox Odyssey, was very primitive by today's standards, having no sound and only basic graphics. Beside these technical limitations, there was a lot of mismanagement in the pricing, promotion and distribution of the Odyssey, which undermined its overall success with customers (Kent, 2001).

However, the video game console market was to be successfully explored by another company, Atari. Atari, which is Japanese for "hitting the target", is an American company which was incorporated in June 27, 1972 by entrepreneurs Nolan Bushenell and Ted Dabney.

Atari started by copying Magnavox's game "pong"[4] and launching it on an arcade machine – an entertainment coin operated machine, usually installed in public businesses, such as bars

[2] http://www.ralphbaer.com/how_video_games.htm
[3] http://www.bloomberg.com/quote/7974:JP
[4] One of the earliest video games software, it simulated a tennis table game for two players.

and restaurants. – This led to the very first law suit in the history of video games[5], when Atari was sued by Magnavox and they settled out of court.

The second generation of consoles was inaugurated by another American company, Fairchild, when in 1976 it launched the Fairchild Video Entertainment System (VES). Atari responded by launching the Atari Video Computer System (VCS), which was later renamed the Atari 2600. This console went on to become one of the most successful of its generation.

The success of these early games encouraged many other companies to enter the market, and increasingly undifferentiated supply caused the first video game console market crash in 1977. Companies such as RCA and Fairchild completely left the video game console business while Atari and Magnavox continued, with the former going on to dominate the console market up to the early 1980s.

The 1977 market crash was followed by the 1983 crash; among the causes indicated for this crash are the flood of competing consoles, the competition from computers and effects from inflation (Kent, 2001). This time, American console manufacturers lost market and competitiveness and from here on Atari would never again regain its former glory. This time it would be a Japanese company that would dictate the rebirth of the video game console market with the launch of the first of the third generation consoles, the Famicom, short for Family Computer. The company in question was Nintendo.

In 1983 when Nintendo decided to enter the American console market it was already a successful video game console manufacturer in its home country, Japan. Due to the success of Famicom in Japan, Nintendo concluded that it would also be well accepted in the American market. In the end the investment gave good returns, however, the success was not straight-forward (Kent, 2001).

After failing to successfully reach a licensing deal with Atari, Nintendo decided to enter the American market on its own; and at the June 1985 Consumer Electronics Show (CES) unveiled its Famicom under the name Nintendo Entertainment System (NES). Due to the lack of growth in the American market, the NES was initially marketed as a toy and came accompanied by a robot called the Robot Operating Buddy (ROB) which took the role of a second player. The initial reception was tepid; however, Nintendo's marketing and management acumen, exemplified by decisions such as the restriction of the number of games

[5] http://www.pong-story.com/odyssey.htm#P8

published by third party developers as well as exclusive games for its console (this practice is now common throughout the industry), transformed the NES into the dominant console of its generation.

The fourth generation of consoles also known as the 16-bit generation (due to the processing capacity of the consoles produced in this period), is very interesting for many reasons; one of these is the fact that in 1988 Nintendo partnered with Sony in order to build a console that used Compact Discs (CDs) instead of the cartridges which were the industry standard. However, in 1991 after almost three years of partnership, and midway through the project, the partnership was terminated due to Sony's demands for more control (Sheff, 1994). Ironically, it was from the insight developed during this partnership that Sony decided to enter the video game console market and came to become one of Nintendo's main competitors.

The dominant consoles in the fourth generation were Nintendo's Super Nintendo Entertainment System (SNES) and Sega's Mega Drive console also known as the Genesis console.

The most important fact of the fifth generation was essentially the launch of Sony's PlayStation (PS) console, which established Sony as a major competitor and went on to become the most successful console of its generation. The competition in this generation was mainly between PlayStation (Sony), Nintendo 64 (Nintendo) and Sega Saturn (Sega). The failure of Atari's Jaguar console sealed the fate of the company as a non-entity in the console business.

This generation also saw the introduction of CD technology. Despite the fact that it is easier to pirate games on CDs, Sony's initial success can be attributed to this technology because it was cheaper to manufacture, write games on and distribute. Nintendo resisted the adoption of this new technology which alienated some game developers and gave Sony the upper hand (Sheff, 1994).

Xbox, the video game console from Microsoft entered the market in 2001, during the sixth generation, and with its broadband internet capabilities it inaugurated the Xbox LIVE service, which is an online service whereby through the Xbox players can switch to the internet and play and compete with other players all over the world. The Xbox was not the only console of the sixth generation to have an internet connection; in fact, Sega's Dreamcast console was the first console to have inbuilt capacity for internet connection; however, this console was not

successful, and it was the last console from Sega, which after this failure left the console market and became a software/game developer. Some industry analysts (Gifford, 2013) attribute the failure of the Dreamcast to Sega's uncompetitive cost structure (high fixed cost in relation to its competitors).

Despite Xbox's entrance and Nintendo's efforts to produce the GameCube which it expected would dethrone Sony's dominance acquired in the fifth generation, Sony launched the PlayStation 2, which became a huge success and the most successful video game console of the sixth generation. One innovative feature of the PlayStation 2 which gave it a huge advantage over its competitors was the use of Digital Versatile Discs (DVDs sometimes is also referred to as Digital Video Discs), which allowed for better graphics and contained much more information (Sony, 2011).

The seventh generation of consoles, which started in 2005 with Microsoft's launch of the Xbox 360, was completely dominated by Nintendo's Wii console[6]. Unlike the Microsoft Xbox and Sony's PlayStation 3 which had high technological developments in terms of graphics, sound and raw running power, Nintendo's Wii innovated in its controller, the Wii Remote. This remote has a technology that senses movement and allows the avatar to mimic the movements the game player does, allowing the player to exercise and move while playing. The innovation was so successful that both Xbox 360 and PlayStation 3 were forced to imitate in their updated versions, the Xbox 360 with Kinect and the PlayStation 3 with PlayStation Move.

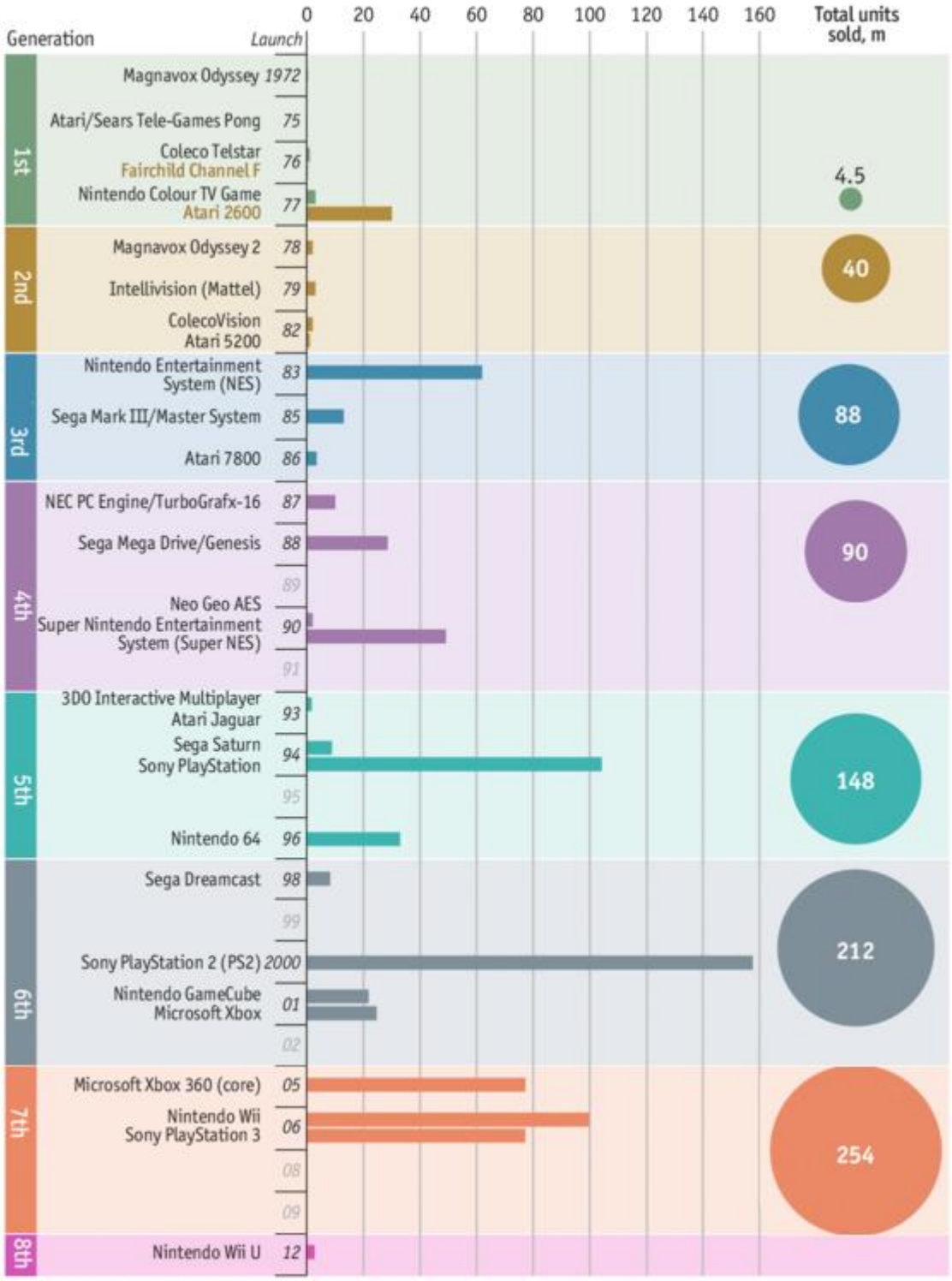
The current generation, the eighth, kicked off in 2012 when Nintendo launched the Wii U console, which was followed by Sony's PlayStation 4 launched on November 15, 2013 and Microsoft's Xbox One launched on November 22, 2013.

The eighth generation has not arrived with any major technological or conceptual breakthrough. It seems all the major players are trying to consolidate their positioning and find ways to compete better in this changing environment, where hardcore gamers demand ever more realistic graphs; casual gamers move to mobile gaming; and the dawn of virtual reality may have just arrived. Up to the moment, all information indicates that PlayStation 4 is the best-selling of the three (Statista, 2014).

[6] http://www.statista.com/statistics/268966/total-number-of-game-consoles-sold-worldwide-by-console-type/

All the video game console generations described in the text are presented, as a summary, in Figure 1.

Figure 1: Lifetime total Video Games Console Sold per Generation (millions units)

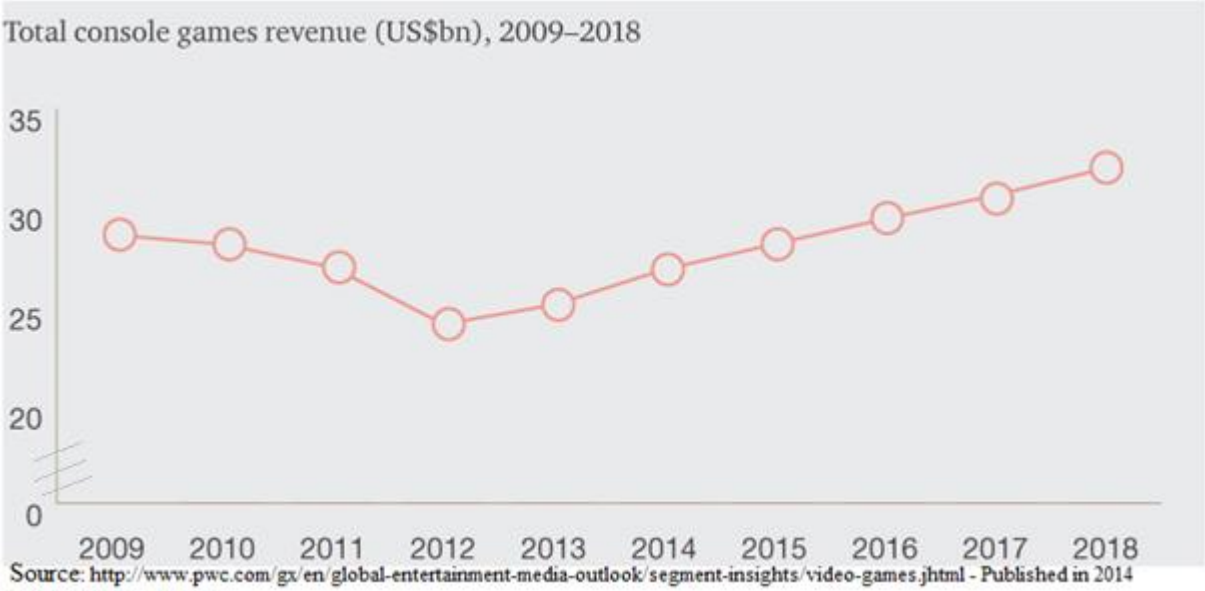


Source: Adapted from the Economist - May, 2013

In the 1960s, the video game console market did not yet exist; today, some valuations put it at about USD 44 billion (Gartner, 2013). From its inception up until at least 2010 the market has enjoyed an average annual growth rate calculated between 9% and 15% (Zackariasson & Wilson, 2010).

As Figure 2 shows, despite the total revenue drop from 2009 to 2012, the market has recovered and the growth trend is expected to continue for the foreseeable future.

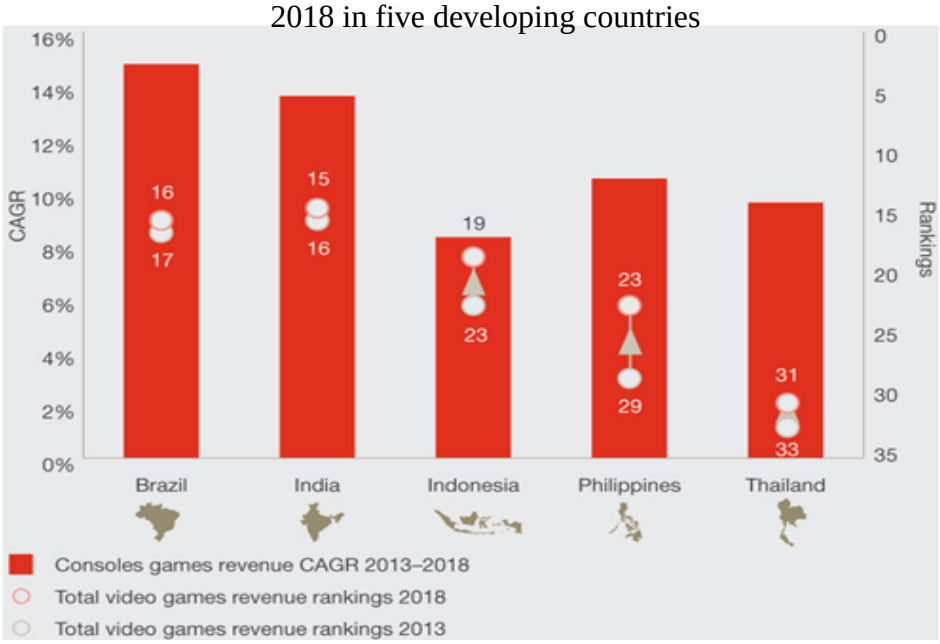
Figure 2: Video Game Console Growth



Source: http://www.pwc.com/gx/en/global-entertainment-media-outlook/segment-insights/video-games.jhtml - Published in 2014 Retrieved on 18-11-2014

According to PwC and as shown in Figure 3, the sources of most of the future growth are the developing countries, with Brazil and India leading the way.

Figure 3: Console games revenue (%) and total video game revenue rankings for 2013 and 2018 in five developing countries



Legend: CAGR = Compound Annual Growth Rate
Source: Global entertainment and media outlook: 2014-2018, PwC, Informa Telecoms & Media. Published in 2014

However, even though the source of most of the future growth is expected to be from developing countries, the biggest market for consoles is currently the developed world, as seen in Table 1, which represents estimated data from 2013.

Table 1: Estimate Global Game Market per Region in 2013 (Values in USD Billion)

Region	Market Value		YOY Growth
	USD	Perc.	
North America	8,2	32%	2%
EMEA	7,0	28%	4%
Latin America	1,1	4%	11%
Asia-Pacific	9,1	36%	11%
Total	**25,4**	**100%**	**6%**

Legend: EMEA = Europe-Middle-East-Africa; YOY = Year-on-Year
Source: Adapted from Newzoo Global Games Market Report - 2013

The global market is almost completely dominated by the big three companies in the console market, Nintendo, Sony and Microsoft. There is a perennial leadership change among the three, however, there is no sign that a new entrant may threaten the current market structure. Table 2 shows video game console shipment units (in millions), as well as the percentage of units, in relation to the total, of the last two console generations. This shows how the market is controlled by the referred companies.

Table 2: Console Shipment units (in millions) and market share (%) per product and per company as of May 2014

Company	Console	Units Shiped	Product %	Company %
Nintendo	Wii	100,7	35,31%	37,52%
	Wii U	6,3	2,21%	
Sony	PlayStatio 3	82,3	28,86%	31,70%
	PlayStatio 4	8,1	2,84%	
Microsoft	Xbox 360	82,3	28,86%	30,43%
	Xbox One	4,5	1,58%	
Others	Others/apps	1	0,35%	0,35%
Total		**285,2**	100,00%	100,00%

Source: Adapted from: http://www.statista.com/statistics/268966/total-number-of-game-consoles-sold-worldwide-by-console-type/

There is a complex structural relationship between the current actors in the market. This complex structure is created by a web of relationships which benefits all the current incumbents. Among the various means the industry uses to isolate itself from external competition are the special and exclusive contracts between content producers and console manufacturers (Marchand & Hennig-Thurau, 2013), which prohibit the creation of games for various consoles. Given that the quality and availability of games greatly determines the

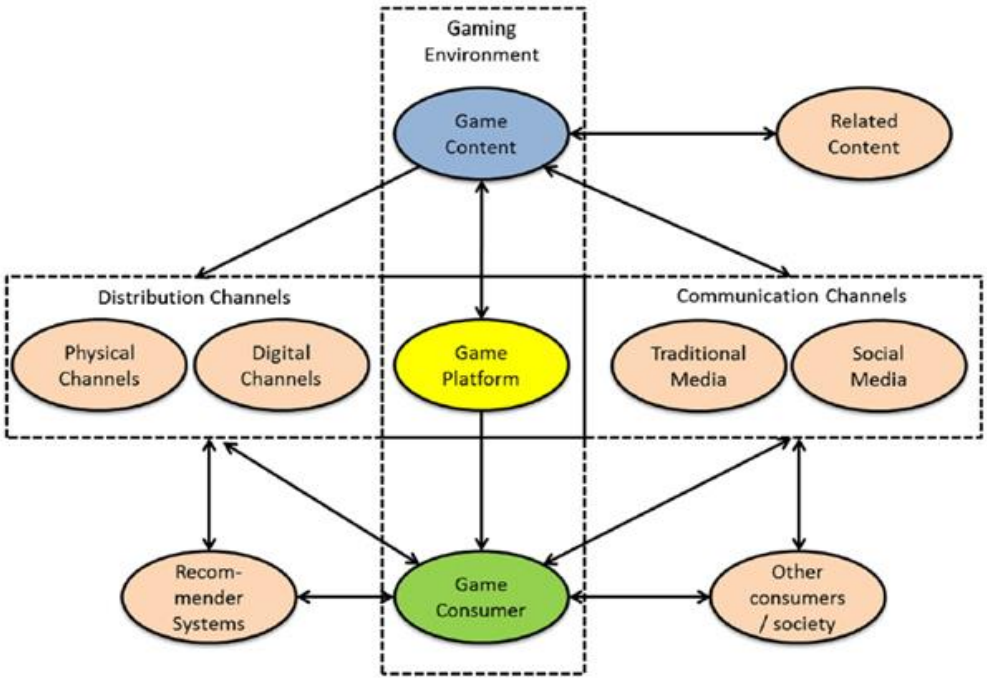
demand for a console, and that the demand for a console determines the willingness of content providers to produce exclusive games, this creates a kind of virtuous cycle which benefits the companies already in the industry.

As the pressure from customers for more realistic games increases so does the cost of research and development, human resources, promotion and distribution. In fact, producing console games has become as expensive as producing blockbuster movies (Ow quoted in Loftus, 2013; and Williams, 2002).

This structure discourages new entrants and incentivizes the incumbents to preserve the current value creation framework (see Figure 4). Despite this structure, recently two new companies have entered the industry, Ouya and Gamestick. However, their business model are not the same as those of Nintendo, Sony or Microsoft, especially because these two companies allow users to "hack" their games systems and develop their own content. Up to now, these companies do not seen to have the momentum or acceptance in the market to challenge any of the big three companies.

Figure 4 shows a value creation framework – which is the set of all activities involved in the creation of value for the end user (Magretta, 2012) – for the video game industry (Marchand and Hennig-Thurau, 2013). The Figure illustrates that for console manufacturers (game platform) the market is two-sided, with revenue coming both from software providers (game content) and the final consumer (Marchand and Hennig-Thurau, 2013).

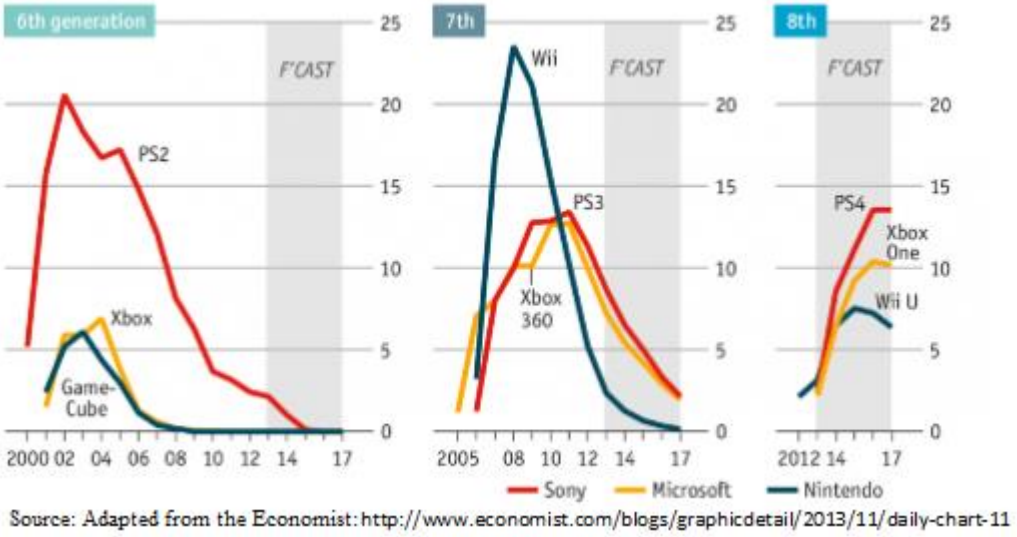
Figure 4: Marchand and Hennig-Turau's Conceptual Value Creation Framework in the Video



Source: Marchand and Hennig-Turau (2013)

Another element which characterizes the console business is that besides being a seasonal product (sold mainly during Christmas), it is a "cyclical business" (Ward, quoted in White, 2013), meaning that the supply and demand of specific consoles is determined by the technological capabilities they embody. Another element linked to the technological development of consoles is their life cycle, which is the phenomenon whereby the demand curve for a new product shifts outwards as the product becomes more widely known, but eventually, shifts inward as consumers' choices move toward other new and improved products (Brickley, Smith and Zimmerman, 2009). Each generation of consoles has its own life cycle (Marchand & Hennig-Thurau, 2013), typically lasting between 6 and 7 years. Figure 5 illustrates the sales life cycles of consoles of the sixth, seventh and eighth generation.

Figure 5: Console Life Cycle (millions units sold per year) - 2013



Source: Adapted from the Economist: http://www.economist.com/blogs/graphicdetail/2013/11/daily-chart-11

All these market specific nuances make the console market a very singular market. However another relationship which is very important for the console market is the relationship with the community.

Properly stated, the relationship is not exactly a direct one. What causes much debate about the video game industry are not the consoles per se, but the types of games available for them and the pervasive sexism and misogyny in gaming groups which up until recently were mainly composed of men (Parkin, 2014). However, as noted above, the quality and quantity of games available determines the demand for a console and vice-versa; and the number of women playing games has been growing, making about 48% of the gaming population (Grundberg & Hansegard, 2014), their exclusion from pro-gamers community (male dominated professional gaming organizations) may represent a loss in potential sales for

console companies. Pressure groups, from feminist groups to concerned mothers, have been lobbing government entities and retailers outlets to ban games depicting offensive content (sex, violence and strong language), especially those containing misogynic undertones (Stuart, 2014).

One of the biggest debates between the game industry and the community in general is with regard to the effects video games have on players' behaviors. While there are some scholars who stress the positive effects games can have, such as improving the capacity to remember briefly displayed objects, focus on specific activities and sensitivity to information in peripheral vision (Green & Bavelier, 2003), there are also many studies which claim that video games can be a cause of violent behavior (Ferguson, 2013). At the moment, there are no conclusive studies in relation to the behavioral effects of games on players (Ferguson, 2013).

In the United States of America (USA) a senate hearing mandated the constitution of and industry self-regulatory body, the Entertainment Software Ratings Board (ESRB). This agency voluntarily provides age-related categories as well as other indications regarding potentially offensive content in games (Ferguson, 2013).

In Europe there are also various institutions which regulate game categories and inherent restrictions. The United Kingdom has the British Board of Film and Classification (BBFC), Germany has the Voluntary Certification of Entertainment Software (USK – Unterhaltungssoftware Selbstkontrolle); and most of the European Union (EU) is regulated by the Pan European Game Information (PEGI).

The legal regulatory obligation for the gaming industry varies from country to country; for instance, while it is not illegal to sell games containing adult content (sex, violence and strong language) to underage children in the USA, it is illegal to do so in most European countries.

It can be said that the elements which determine and characterize the video game console industry are brand popularity, technological developments, the symbiotic relationships within the industry and the relationship with the community.

2.3. Nintendo

2.3.1. Company History

The Japanese entrepreneur Fusajiro Yamauchi established Nintendo Koppai in 1889 as a company to manufacture and distribute playing cards (Nintendo History, 2014). The Japanese translation for the company name is "luck-heaven-hall" (Kim *et al*, 2011) although other writers have translated it as "leave luck to heaven" (Sheff, 1994).

Nintendo was very successful at the card business; so much so that in 1951 the company name was changed to Nintendo Playing Cards Co. Ltd. In 1959 it celebrated an agreement with the American company Walt Disney to include Disney characters into its playing cards, and the move was a success.

Even in the midst of its success then president Hiroshi Yamauchi realized that the card market was too small and changed the company name to Nintendo Co., Ltd. to reflect the new business strategy of diversification. One year before the development of this strategy, in 1962, the company made its Initial Public Offering (IPO) both on the Osaka and Kyoto Stock Exchange.

During this phase Nintendo tried various ventures (hotels, taxis, toys, among others). Most of these efforts were unsuccessful and led to the almost bankruptcy of Nintendo; however, among the failures one venture not only survived but thrived and determined the direction of the company for the future to come.

That venture was toy manufacturing. Nintendo's first successful toy was the Ultra Hand, a toy designed by Gunpei Yokoi (Yokoi was given responsibility for toy design, on the spot, when - while still a maintenance engineer - during a break then company President Yamauchi found him playing with the prototype of what would later became the Ultra Hand) Gunpei started working for Nintendo as a maintenance engineer and went on to become one of the most influential figures in the video game industry as the brain behind many industry innovations, such as the Game Boy and the Control Pad (D-pad).

The rise and success of the toy business contrasted with the decline of the cards business. Nintendo started to increasingly dedicate itself to the toy business and incorporate electronics advancements into its toys. The success of this approach led the company to sign an

agreement with the American company Magnavox for the distribution of Magnavox's Odyssey in Japan, the first commercially viable video game console.

The Japanese success of this agreement encouraged the Nintendo to develop its own consoles and software. In 1983 Nintendo launched the Family Computer (Famicom) in Japan, which was later launched in the USA as the NES.

Since its debut in the video game console business, Nintendo has been a company in the forefront of innovation and creativity in the industry. The company is not only the undisputed leader in handheld games devices, it also has numerous lucrative game titles such as The Legend of Zelda series and the Super Mario series, for which, one Nintendo employee in particular, Shigeru Miyamoto, was instrumental.

2.3.2. Organizational Structure

The Nintendo organizational structure was highly influenced by its now departed President Hiroshi Yamauchi. Yamauchi was the great grandchild of the company's founder, Fusajiro Yamauchi, and came to the helm of the company in 1949 at age 22, after the death of his grandfather, Sekiryo Yamauchi (Sheff, 1994).

Yamauchi managed and steered Nintendo using a clear and uncontested autocratic leadership style (Sheff, 1994). He alone decided which products deserved further Research and Development (R&D) funds, manufacturing, market launch and advertisement, until as recently as 1994 (Kent, 2001). Early on he decided on a flat organization to avoid bureaucracy and instituted different internal research departments to foster internal competition and innovation, a structural feature which still exists today.

Yamauchi retired from direct control in May 2002 and transferred the title of President and CEO (Chief Executive Officer) to Satoru Iwata, who was at the time Nintendo's Head of Corporate Planning, and became the fourth person to lead Nintendo and the first without family ties to the Yamauchi's to do so.

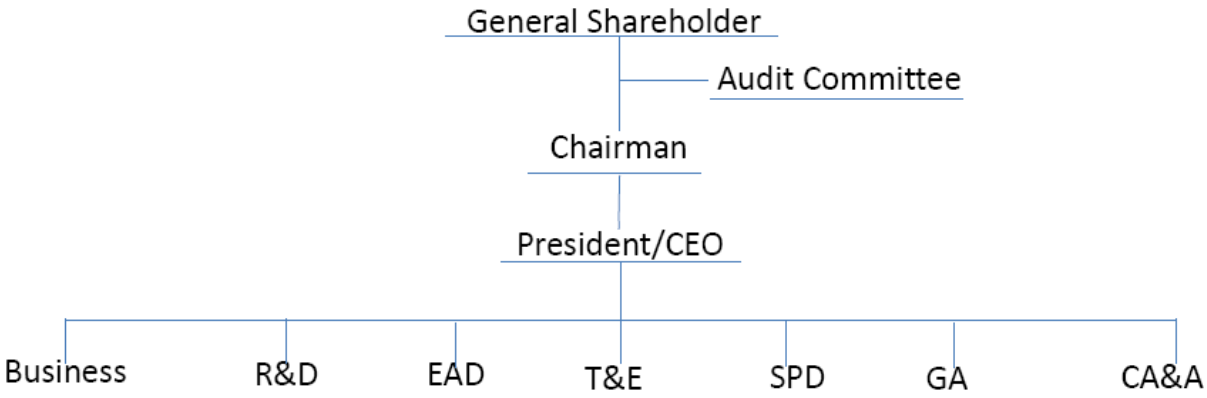
Nintendo has a Board of Directors with twelve members who report to the General Shareholders Assembly; and also reporting to the General Shareholders Assembly is the Audit Committee.

Below the Board of Directors is the Chairman and below him is the President/CEO, who in turn controls nine divisions: Business; Integrated Research and Development (R&D);

Entertainment Analysis and Development (EAD); Technology and Engineering (T&E); Software Planning Development (SPD); Manufacturing; General Affairs (GA); and Corporate Analysis and Administrative (CA&A). These divisions are further subdivided into functional departments.

The audit Committee is an independent division, directly reporting to the General Shareholders Assembly and with its own separate structure. Figure 6 represents a simplified design of Nintendo's organizational structure.

Figure 6: Nintendo's simplified organizational organogram in 2014



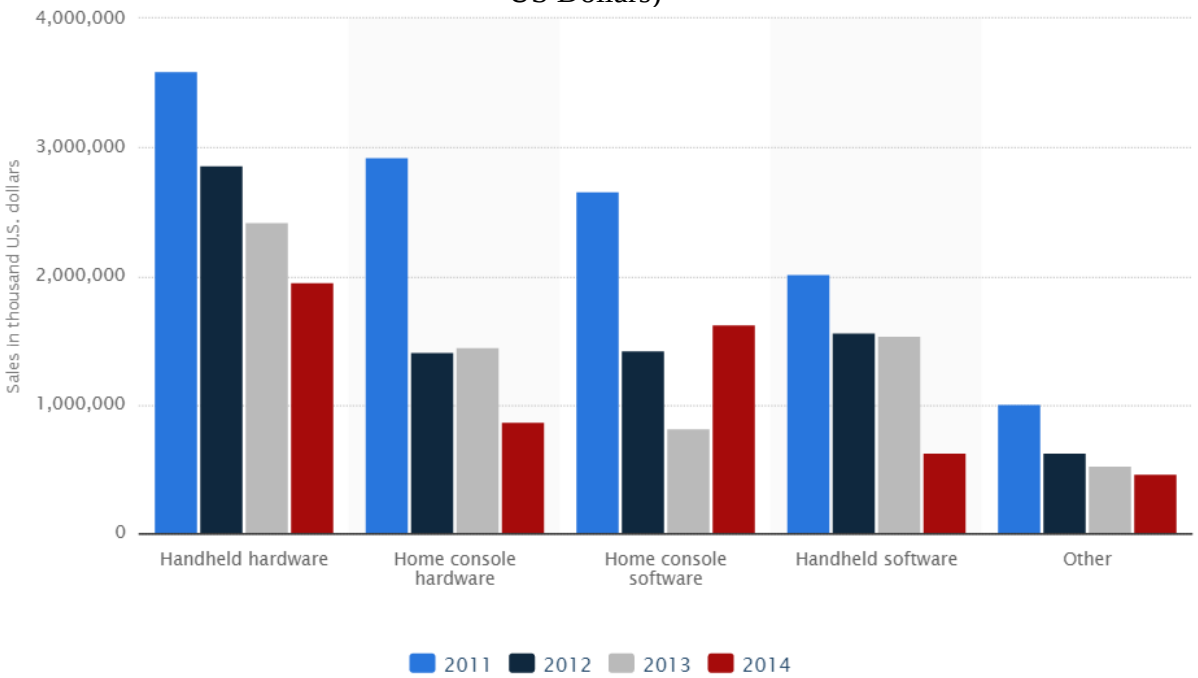
Source: Adapted from - http://www.n-sider.com/contentview.php?contentid=1227

2.3.3. Products

Nintendo has a range of products linked to the video game entertainment industry. However, all its products in this market can be easily grouped into four distinct categories, namely: the home video game console; the handheld game hardware; and the software, both for the game console and the handheld hardware. Figure 8 shows how much each product contributed to the company's revenues from 2011 to February 2014.

The element "others" mostly represents revenues from royalties from patented properties (e.g. movies based on Nintendo characters such as Super Mario). As Figure 7 shows, home consoles represent approximately 50% of Nintendo's revenue.

Figure 7: Nintendo's Revenue from 2011 to February 2014 by Product (In 1000 US Dollars)

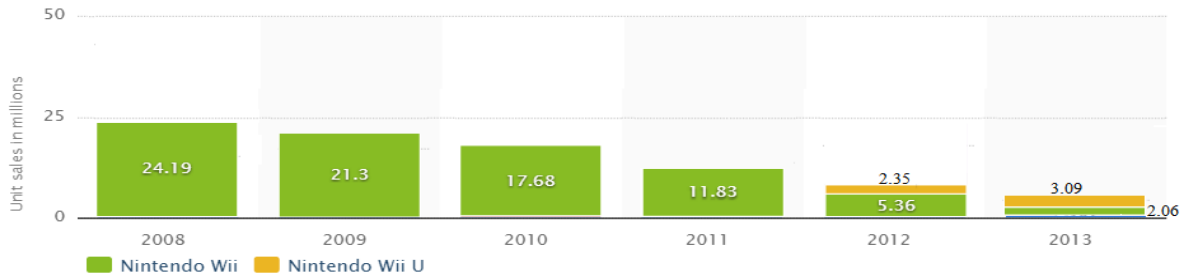


Source: http://www.statista.com/statistics/216629/nintendo-sales-by-products/ - Accessed on November 2014

Nintendo's latest console products are the Wii for the seventh generation and the Wii U for the eighth generation. The amount, in millions of units, of consoles sales from the seventh and eight generation is shown in Figure 8.

The Wii console (released on November 19, 2006) was considered revolutionary (Neal, 2013) and has been one of Nintendo's best-selling consoles of all times. Its innovative motion detection technology has since been adapted by all the other companies in the market. The Wii U (released on November 18, 2012), on the other hand, has so far had lukewarm results (refer to Table 2).

Figure 8: Nintendo's Console Sales from 2008 to 2013 (in millions of units)



Source: Adapted from - http://www.statista.com/statistics/276768/global-unit-sales-of-video-game-consoles/ - Accessed on November 2014

2.3.4. Challenges

Nintendo dominated the seventh generation consoles, and one year after the release of the Wii, Nintendo's shares were trading at 78,50 USD/Share, double the value of Sony's shares. However, Nintendo's financial fortunes have been falling since 2012, and the company has posted a negative operating income for the last three years, since 2012, see Table 3 (Bloomberg, 2014), and its share are currently trading at around 15 USD/Share (December 2014), see Figure 9.

Table 3: Nintendo's Revenues and Operating Income 2011-2014

Currency in Millions of US Dollars — As of:	Mar 31 2011 USD	Mar 31 2012 USD	Mar 31 2013 USD	Mar 31 2014 USD
TOTAL REVENUES	8,469.8	5,407.9	5,305.8	4,773.9
Cost Of Goods Sold	5,230.3	4,124.9	4,133.8	3,411.0
OTHER OPERATING EXPENSES, TOTAL	1,810.6	1,594.6	1,476.0	1,750.5
OPERATING INCOME	1,429.0	-311.6	-304.0	-387.6

Source: http://investing.businessweek.com/research/stocks/financials/financials.asp?ticker=7974:JP&dataset=incomeStatement&period=A&currency=US%20Dollar - Pubished and retrieved on the same date 03/12/2014

Figure 9: Nintendo's Share Price in the NYSE 2011-2014

Legend: NYSE = New York Stock Exchange

Source: http://investing.businessweek.com/research/stocks/charts/charts.asp?ticher=7974:JP – Published and Retrieved on 03-12-2014

According to sources linked to the industry (White, 2013; and Parr, 2014) Nintendo's profitability and stock price decline are a result of the following factors:

- General drop in consoles sales for the overall industry;

- Growing competition from mobile gaming (games played on phones, smartphones, tablet computers and other types of portable media players);
- The slow growth of social gaming (games played as a form of social interaction, e.g: family games).
- Nintendo's incapacity to retain casual gamers has part of its loyal customer base.[7]

Besides these points, industry specialists (Cramblet, 2014) blame Nintendo's predicament to the mismanagement of the Wii U launch, it was not accompanied by: the release of new blockbuster games (in house or from third parties); no massive advertisement campaigns were made; and no attempt to clarify the customers' perception of the differences between the Wii U and the previous console, the Wii. All these facts made customers believe that the Wii U was just a small upgrade of the Wii, and not a new console, and instead of buying an old console upgrade customers preferred to wait a little more for the next generation consoles, the Xbox One and the PlayStation 4. There are still other sources (Kohler, 2014), who claim that "*Wii U has staked out a weird middle ground that nobody seems to be standing on. On one flank it has the high-end videogame consoles, which are actually not that much more expensive than a Wii U. On the other are tablets and smartphones, which represent a much better value for more casual players"*[8].

Nintendo seems to lack a clear strategy to face the current technological changes the industry is undergoing, the company is almost always playing catch-up to its competitors; While Microsoft launched its online community network (a service that allows players to gather online and play, share things and buy products) – Xbox Live – in 2002 and Sony did it in 2010 – PlayStation Network -, Nintendo only launched the same service – Nintendo Network – in 2012.

The perceived lack of strategy is not linked only to the current products management but also to the future of the company, while Microsoft (based on the Azure cloud service) and Sony (with PlayStation Now) have been adverting their game streaming capabilities and Microsoft has just launched a program to build a virtual reality headset to ward-off possible threats posed by the Oculus Rift (a virtual reality headset launched by American start-up company Oculus VR), Nintendo is completely silent on these developments. Although game streaming

[7] http://business.time.com/2013/02/11/game-over-why-video-game-console-sales-are-plummeting/
[8] http://www.wired.com/2014/08/wii-u-name/

is a long term project and it is still in its infancy it has the potential to make consoles obsolete (Tweedie, 2014; and Makuch, 2014).

2.3.5. Industry Positioning

Nintendo's market positioning stems directly from the belief of its former President Hiroshi Yamauchi, who believed that people do not want to play complex, expensive and over the top high quality games (Sheff, 1994). He believed that people wanted to have fun and relax in an intuitive and inexpensive way. Thus, Nintendo spends more in games characters creation skills rather than on pure technological performance.

With this vision, Nintendo has been trying to position its console as a comparatively inexpensive device, easy to use and aimed at the whole family. It has been increasingly creating games without regard to age, gender or gaming experience, and it also has greatly expanded the "exergaming" experience, which is the combination of on-screen playing with physical activities.

Despite being criticized by some industry pundits as a brand for kids (Olson, 2006), Nintendo's President Iwata has publicly stated that he is proud that children are associated with his company, but also points out that the company serves a wide range of customers and its sports game titles are even recommended by doctors and exercise professionals (Gantayat, 2006).

2.3.6. Business Model

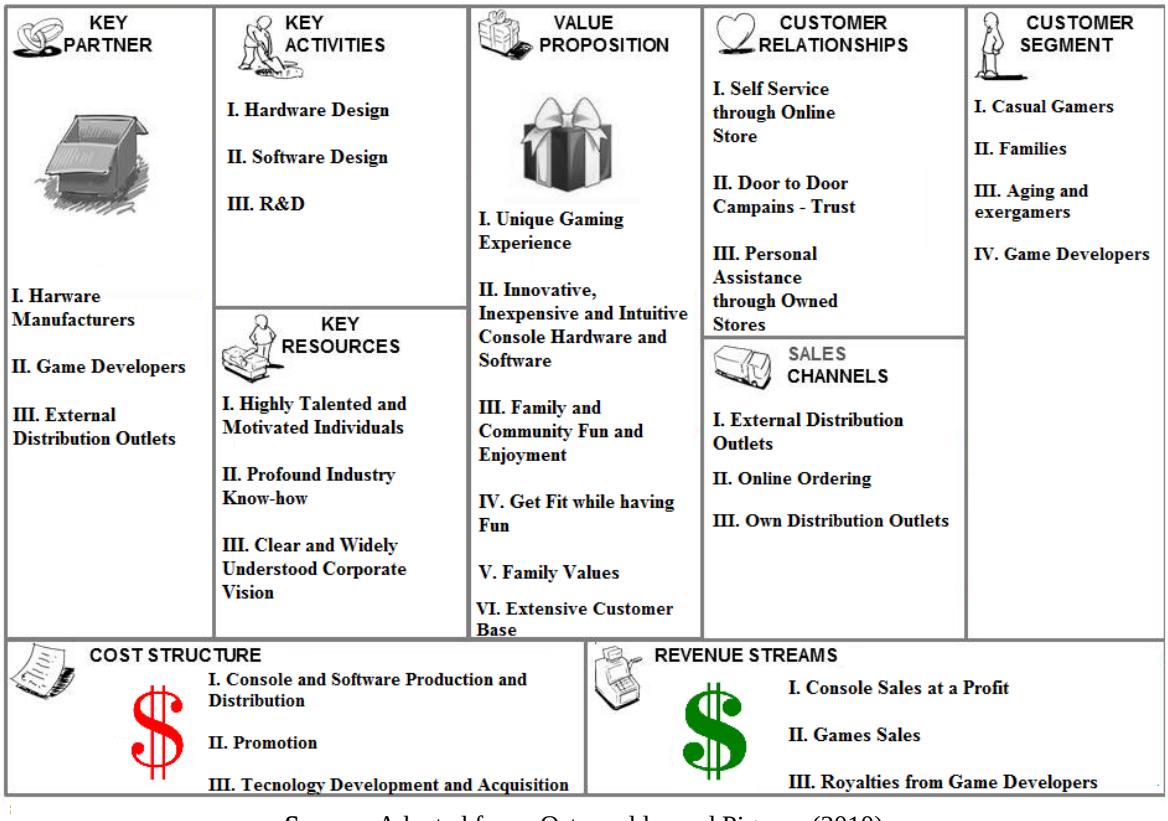
Nintendo outsources most of the hardware manufacturing for its consoles to various companies, which gives the company a greater flexibility for production variation as well as more control over the costs (Harding, 2008). Another important feature of Nintendo's business model is the exclusive contracts it has with software developers and retail distributors. These relationships help Nintendo to control its cost structure.

Exclusive software contents (games) are produced just for its consoles, sometimes sold separately other times bundled together with the console. All the external software content providers (game developers) pay a royalty fee to Nintendo for each game they produce to run in Nintendo's consoles.

By creating innovations such as the motion sensing remote, avoiding the costly technological upgrade wars (e.g. graphs upgrades), dedicating special marketing and promotions tactics

aimed at catering to all type of gamers, families and incentivizing "exergaming", having a slimmer cost structure and selling its consoles above production cost, Nintendo has changed the natural business model of the gaming industry, offering a value proposition based on emotions rather than on technical performance. Figure 10 shows, a template with a summary of Nintendo's business model.

Figure 10: Nintendo's Business Model Canvas



Source: Adapted from: Osterwalder and Pigneur (2010)

2.3.7. Resources and Competencies

By industry standards, even though Nintendo is one of the oldest companies in the market and was once the dominant force in the industry, its financial resources are very small and its business scope is much more concentrated when compared with its main competitors. Still, in absolute terms, the company has considerable financial resources.

Although it may sound like a cliché, in Nintendo's case it is true that its main resources are its people and a great understanding of the gaming industry. Nintendo has among its employees legendary people in the gaming industry such as its current EAD manager Shigeru Miyamoto, the designer Satoshi Tajiri; and in America it is represented both by Satoru Iwata and Reggie Fils-Aime, both known for their sensibility to latent customer demands.

Nintendo's ability to develop stories, characters and game concepts which are able to meet the latent demand of a wide audience before the rest of the competition is even aware these needs exist, are well known within the gaming industry (Schmidt, 2014).

2.3.8. Key Stakeholders

Nintendo's activities depend on the partnerships it forges with all the players in its environment, external and internal. The first and one of the most important partnerships the company has is the one with its own employees. As already stated, Nintendo employs some of the most innovative people in its industry. As of May 2014, Nintendo had about 5.000 employees all over the world (Forbes, 2014). Although the company laid-off around 320 European employees in August 2014 (Campbell, 2014), before that Nintendo had openly refused to lay-off its employees, and in 2013 its CEO accepted a 50% salary reduction (the other managers took a lesser reduction) instead of a restructuring plan (Polygon, 2013).

Other important stakeholders groups are its suppliers and game developers. Nintendo's software suppliers (game developers) include companies such as Activision and Ubisoft. Hardware suppliers include companies such as Samsung, NEC, MegaChip and AMD; Nintendo seeks to closely work with these partners and build as much leverage as possible through both joint product management and judicious awarding of contracts. Nintendo has created a seal of quality to attest that the products developed by its partners are of the highest quality and meet defined standards of performance excellence.

Nintendo does not strictly define a customer segment based on age, culture or class. It has a concept of affordability and user friendly devices and thus all the people who seek these qualities are part of their target. To reach its customers, retailers such as Amazon, Toys "R" Us and Walmart play an useful role in Nintendo's distribution network, but they are not indispensable because Nintendo operates all over the world and has many distribution options, include its own online and mortar-and-brick shops.

Competitors (especially Microsoft and Sony) are also an important element in Nintendo's strategy because they influence not only the price of Nintendo's consoles and games, but also the way Nintendo approaches the design, image and general choices within the industry.

2.3.9. Choices for Recovery

Since Nintendo's revenue, profitability and stock prices started falling, financial and gaming specialists have been advising the company to leave the home video game console industry and concentrate itself in producing games for other companies' consoles or for smartphones and tablets (Chiappini, 2013; Kohler, 2013; Klain, 2013; and Tassi, 2013).

Nintendo's management has not completely put aside these ideas (Makuch, 2013; and Gaston, 2013) but it refuses to turn into a software only provider, like Sega. In a 2013 interview reproduced by GameSpot's Martin Gaston (2013), Nintendo's CEO, Satoru Iwata, is quoted saying:

> " *it might make sense for us to provide our important franchises for other platforms, and then we might be able to gain some short-term profit … However, I'm really responsible for the long-term future of Nintendo as well, so I would never think about providing our precious resources for other platforms at all. Nintendo is a very unique company, because it does its business by designing and introducing people to hardware and software--by integrating them, we can be unique."*

Nintendo is not changing its core business but it has launched certain strategic initiatives to return to profitability (Plafke, 2014; Prasuethsut, 2014; Snyder 2014; Reisinger, 2014; Schmidt, 2014; Thier, 2014; Stuart, 2014). The steps Nintendo is taking to increase revenues, return to profitability and reverse the stock price fall, include but are not limited to:

- A share buy-back program using its enormous cash reserves and good solvability (no debt).
- The launch of a concerted advertising campaign, which included a successful appearance in this year's E3 expo;
- Launching new blockbuster games, including: Yoshi's Woolly World; Captain Toad's Treasure Tracker; Super Smash Bros; Mario Maker; and Mario Kart 8;
- Reminding (through advertisements in the social media and on TV) the gaming community about Nintendo's valuable catalogue of past games, which includes hit successes such as: Lego City Undercover; Pikmim 3; and Wonderful 101;
- Aggressive special offers, such as the Wii U and Mario Kart 8 bundle offering;

- Announcing an investment program in a new "health platform". (However, Nintendo's announcements about this program have been vague in relation to the amount invested, the specific function of the platform, and the timetable for the conclusion of the investment);
- The launch of a new app and improved internet connectivity, which will allow gamers to access their gaming platforms from smartphones or tablets (but does not yet allow for Nintendo games to be played on mobile devices);
- The launch of amiibo figures – which are toys figures based on Nintendo games characters, such as Mario – that use near field communication (NFC) technology to interact with video game software in Nintendo's multiple platforms;
- The announcement of a specific strategy to enter the Chinese market and take advantage of the recent pronouncement by Chinese authorities that the almost 14 year old ban on video game consoles is over. According to CEO Iwata quoted by Forbes (2014) *"[In China Nintendo] wants to make new things, with new thinking rather than a cheaper version of what we currently have. The product and price balance must be made from scratch*."

Most of this concerted recovery program has been started in the second half of 2014. As such, these efforts have not yet impacted (at least not yet in a noticeable way) revenues and profits, and some game specialists remain skeptical (Inagaki, 2014). Others, however, are more hopeful (Snider, 2014; Their, 2014; Klain 2014; and Stuart, 2014) and the latest average coverage of Nintendo in the specialist media has been generally optimistic. A new survey of the American market by HIS Technology and Networks (a specialized games intelligence company) indicates that consumers' "*Wii U purchasing intent*" has, in two months, increased by 50%; and the stock price is showing a consistent upward tendency since October 2014 (Bloomberg, Nov. 2014), a sign of investors' confidence in Nintendo's future.

As of the moment, December 2014, Nintendo is not yet out of trouble and its future remains unclear, at least for outside observers. Nonetheless, what is clear is that Nintendo has shown commitment to its values, resources, and capabilities to recover, remaining true to its core business instead of following the advice of various "experts" to just throw out its core business and follow the potentially easier path of serving others (Suciu, 2014).

3. Pedagogical Note

3.1. Intended Audience

Management undergraduate students enrolled in a strategy course are the specific intended audience of this pedagogical case study.

The project is a pedagogical case study which aims to describe, how Nintendo, a company operating in the video game console industry, is attempting to return to profitability in the midst of intensified competition from its main rivals, Sony and Microsoft, and a growing threat from substitute products.

The case study is especially designed for classroom (academic) analysis; it depicts a real situation and students are expected to apply certain strategic management frameworks in order to analyze and understand Nintendo's environment and choices.

3.2. Pedagogical Objectives

Since entering the home video game console industry, Nintendo has managed not only to survive but also to thrive, however, recent industry changes have seen the company's sales and share prices plummet and its top management is in search of ways to restore the company's profitability and competitiveness.

The case study and resolution of the proposed questions are expected to help students consolidate their knowledge about certain strategic management frameworks, namely: the PESTEL analysis; Porter's five forces model; the VRIO model; Porter's competitive generic strategies; and the SWOT framework. Thus, by the end of the analysis and discussion of the case study, students should be able to:

a) Use a PESTEL framework to analyze the general environment;

b) Conduct an analysis of the immediate industrial environment of a company using Porter's five forces model;

c) Use the VRIO model to identify a company's key resources and capabilities and their ability to create sustainable competitive advantages;

d) Identify companies' strategies in Porter's generic strategies framework.

e) Use the SWOT framework to match companies’ resources and capabilities with the external environment’s possibilities.

With the discussion of the pedagogical note concluded, the next chapter will be the discussion of the theoretical framework – literature review.

4. Theoretical Framework - Literature Review

4.1. The Concept of Strategic Management

Wheelen and Hunger (2012: 5) define Strategic Management as a "*set of managerial decisions and actions that determines the long run performance of a corporation*".

For Teece *et al.* (1997) the foremost quest of strategic management is to understand how companies achieve and sustain competitive advantage. It is said that a firm possesses competitive advantage when it can generate superior financial performance over a considerable period of time (Porter, 1985). Barney (1986: 657), in turn, defines this superior financial performance as a "*rate of return [on invested capital] greater than a normal return and [which] indicates that the firm is prospering*".

In its pursuit to understand the determinants of a company's sustained profitability, strategic management is influenced mainly by two lines of thought: the industrial-organization tradition influenced by economics; and the organizational-factors paradigm influenced by sociology and behavioral disciplines (Makhija, 2003; McGahan and Porter, 1997; Hansen, and Wernerfelt, 1989; McGee, and Thomas, 1986; Schmalensee, 1985).

The industrial tradition seeks to explain the profitability of a company by taking the external environment, more specifically the industry, as the basic unit of analysis (Porter, 1979; Hatten and Hatten, 1987). A famous proponent of this line of thought is Porter (1980), but there are other renowned authors such as Shepherd (1972), Hatten and Hatten (1987), and Shapiro (1989) who also support this thought tradition.

The main proponents of the sociological line of thought, also known as the Resource-Based View (RBV), include authors such as Wernerfelt (1984), Barney (1991), Rumelt (1991), Prahalad and Hamel (1990), and Peteraf (1993). These authors take the company as the basic unit of analysis. They claim that the bulk of the profitability of the company is determined by the resources and capabilities the company possesses (Priem, and Butler, 2001).

While there may be considerable differences between the two approaches, there are authors such as Conner (1991) who see them as complementary, going as far as to say that the RBV incorporates features of the market-based view. Indeed the integration of the two views seems inevitable and it can be identified in the works of Andrews (1971), Priem and Butler (2001), Collis and Rukstad (2008), and Bourgeois (1985). In fact Bourgeois (1985:548) affirms that:

"*the central tenet in strategic management is that a match between environmental conditions and organizational capabilities and the resources is critical to performance and that a strategist's job is to find and create this match".* - It can thus be affirmed that the difference between the two views rests more on the relative emphasis which is given to the external or internal conditions when determining the origin of superior company performance. And practitioners, business consultants in particular, have always incorporated both views when assessing business ideas, the SWOT (Strengths, Weaknesses, Opportunities and Threats) framework being a good example of an attempt to conciliate both views in one coherent model.

Next, the general external environment analysis will be followed by the discussion of the market-based view (with the industry as its basic unit of analysis), which in turn will be followed by the discussion of the resource-based view (with the company as its basic unit of analysis).

4.2. General/External Environment Analysis

The general environment represents the broader dimensions which are beyond the direct control of companies but which may represent a great source of opportunities and threats. An assessment of both the present state of the general environment and of its likely future shifts are of importance, and useful in the determination of a company's strategic choices. One commonly used technique for analyzing the general environment is the PESTEL analysis.

The PESTEL analysis serves as a reminder of the different environmental aspects which may affect a company (Lynch, 2012), and the acronym stands for these different dimensions; namely:

Political (P) – This dimension broadly encompasses all the relationship between businesses and government entities. Among others aspects, it analyses matters related to military stability, government ideological preferences, the relationship between the businesses and the government, such as subsidies legislation, government ownership of production factors, alignment of political parties and attitude toward monopolies and competition;

Economic (E) – This dimension monitors the likely impact changes in aggregated economic variables such as GDP (Gross Domestic Products), inflation, unemployment rates, price indexes and investment data , among others, have on businesses;

Socio-cultural (S) – This dimension is responsible for the analysis of anthropological issues such as cultural values, beliefs (e.g. acceptance of gay marriage), life style, fashion, demographic distribution, and religion;

Technology (T) – This dimension monitors the current and potential future use of scientific knowledge for economic purposes. Issues covered on this dimension include, but are not limited to, R&D investments, new patents and products, and speed of technological adoption;

Environment (E) – This dimension essentially deals with issues linked to the preservation of nature, such as waste disposal and energy consumption;

Legal (L) – This dimensions analysis how existing laws or proposed future laws will impact businesses and how such laws can be used for advantageous company positioning. Issues linked to this dimension normally include, but are not limited to, anti-trust laws, product safety and employment laws. This dimension is sometimes difficult to differentiate from the political dimension.

The above list is far from exhaustive. There are myriad indicators which can be considered within each one of the dimensions indicated. In any case, in a PESTEL analysis there is no need to describe all the possible elements, but only those the company considers important and worth analyzing (either due to their importance for survival and/or success, or due to their likelihood of change and possible resulting impact on company activities). Indeed, it has been argued that a PESTEL analysis is only as good as the analyst who conducts it (Lynch, 2012).

4.3. The Market Based-View (Industry Analysis)

The industrial-organizational approach is also known as the market based-view (MBV). This view rests on the assumption that firms are homogenous entities such that any differences between them are temporary and negligible, except when based on scale, which in any case is also insubstantial (Schmalensee, 1985).

The market based view explains the performance of a company through the industry structure. This model, developed by Mason (1939) and Bain (1956), called the Structure-Conduct-Performance (SCP), establishes that industry characteristics, such as entry barriers or the concentration of companies, determine the existence of superior return among industries.

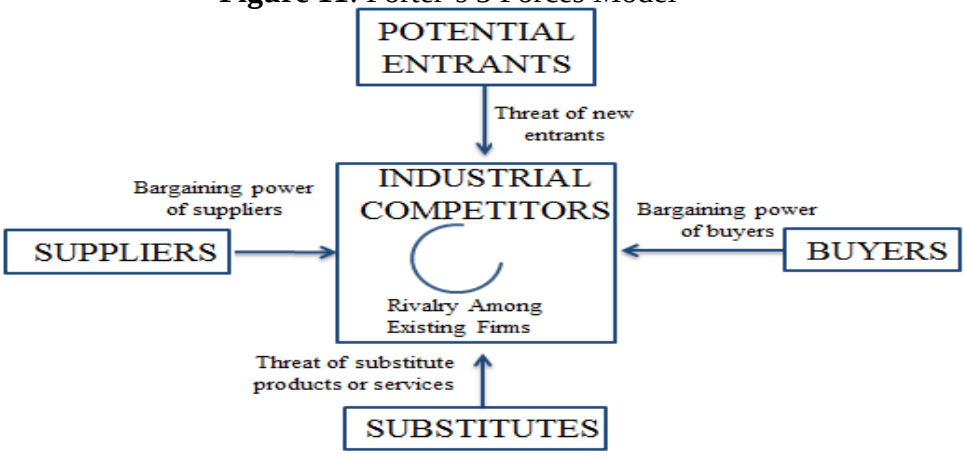
Porter (1979: 215) defines industry as a "*group of competitors producing substitutes that are close enough that the behavior of any firm affects each of the others either directly or indirectly*".

The analysis of the industry (external analysis) within the strategic management process is justified by the belief that industry is determinant to a company's potential performance, and Porter (1980) created a framework, which he called the "five-forces", that sought to fully explain how industry conditions could impact the potential returns of companies operating within it.

4.3.1. The Five Forces and the Value Net Frameworks

The five forces framework has become a reference in the industry analysis process. For Porter (1980), the competition within any specific industry is determined by five basic forces. The intensity of the interaction between those forces determines the attractiveness of the industry, and this intensity is not a product of coincidence or luck, it is a result of an intrinsic economic structure beyond the influence of the actions of competing companies (Porter, 1980).

Figure 11: Porter´s 5 Forces Model



Source: Porter (1980:4)

As shown in Figure 11, the five forces are composed of: the threat of new entrants; rivalry among existing companies; the threat of substitute products/services; the bargaining power of buyers; and the bargaining power of suppliers (Porter, 1980).

Threat of entry – This force influences industry profitability because new entrants bring new capacity and a desire for market share which may lead to excess production or price wars. The menace of new entry essentially depends on the industry's barriers to entry, which include but are not limited to: economies of scale; product differentiation; capital requirements; and

access to distribution channels. The greater the barriers to entry the higher the profitability of the industry, however, these barriers can change overtime.

Rivalry among existing competitors – This force refers to the struggle among companies for greater market share or returns, conducted through price, advertisement, location and the like. The intensity of this rivalry depends, among others: on the number of competitors within the industry; industry growth; the level of fixed costs; exit barriers; and level of strategic stakes (e. g. how important is for the survival of a company to sell a certain level of products). Variables which increase the intensity of the competition have an adverse effect on industry attractiveness.

Substitute products – Includes all equivalent products or services, from other industries, which meet the same basic needs. This force affects industry profitability by limiting the price companies can charge before customers move to another product.

Bargaining power of buyers – This force affects industry profitability by pushing prices down through requests for better quality, more services, and pitting competitors against each other. The strength of buyers' bargaining power depends on, among others: the volume of buyers' purchases in relation to seller's sales; the importance of the product for the buyer; and the buyer's switching costs.

Bargaining power of suppliers – The influence of suppliers affects the profitability of an industry through their ability to raise prices and/or reduce the quality of supplied products/services. The capacity of suppliers to do so depends on, among others: the number of suppliers available; the importance of the buyer for the supplier; and the desire or possibility of forward integration.

Porter (1980) points out that none of these forces are static; although their effects are consistent and persistent in the long run, they interact in a dynamic and fluid way. Although Porter (1980) points out the dynamic relationship within the industry, some authors, such as Brandenburger and Nalebuff (1997) claim that the five forces model focuses too much on competition, turning business into a zero-sum affair, where a company either loses or wins. For Brandenburger and Nalebuff (1997) besides competing, companies should also actively seek opportunities for cooperation. They call this rational behavior of simultaneously

competing and cooperating to enlarge the overall market value and create win-win situations, co-opetition[1].

To support the idea of co-opetition, Brandenburger and Nalebuff (1997) resorted to game theory and developed an analysis framework which they called the Value Net model (Figure 12). Brandenburger and Nalebuff (1997: 33) describe this model as:

> "*A complete map of a business' relationships; [which] helps counter limited thinking, focusing only on competition and forgetting cooperation … Value Net can help determine how to make a business more profitable. The Value Net can also help determine what makes a business more valuable".*

The Value Net model identifies four crucial parties which interact with a company within an industry: Customers; Suppliers; Competitors; and Complementors.

Customers – The parties to whom the company offers services or products in return for money.

Suppliers – The parties to whom the company pays in return for products or services.

Competitors – These can be defined according to two perspectives:
Customer perspective: A party is a competitor if "*customers value your product less when they have that [party's] product than when they have your product alone*" (Brandenburger and Nalebuff, 1997: 30).
Supplier perspective: A party is a competitor if *"it is less attractive for a supplier to provide resources to you when it is also supplying the other [party] than when it is supplying you alone"* (Brandenburger and Nalebuff, 1997: 30).

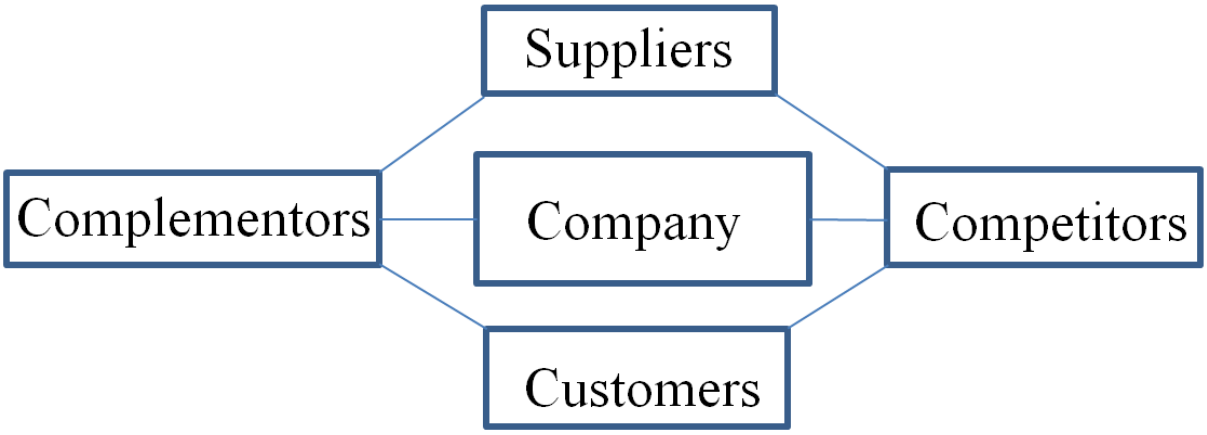
Complementors – These parties can also be defined according to two perspectives:
Customer perspective: A party is considered a complementor if *"customers value your product more when they have the other [party's] product than when they have your product by itself"* (Brandenburger and Nalebuff, 1997: 30).

[1] Co-opetition – a term coined by the American businessman Ray Noorda and adopted by Brandenburger and Nalebuff (1997) to denote the idea that companies should strive both to create and capture value.

***Supplier perspective**:* A party is considered a complementor if *"it is more attractive for a supplier to provide resources to you when it is also supplying the other [party] than when it is supplying you alone"* (Brandenburger and Nalebuff, 1997: 30).

Authors such as Carvalho and Filipe (2014), point out that Brandenburger and Nalebuff's (1997) model and Porter's (1980) model are not mutually exclusive, but should rather be applied or understood as complementary models, with Brandenburger and Nalebuff's (1997) model introducing an important new dimension within the industry, that of cooperation.

Figure 12: The Value Net Model



Source: Brandenburger and Nalebuff's (1997)

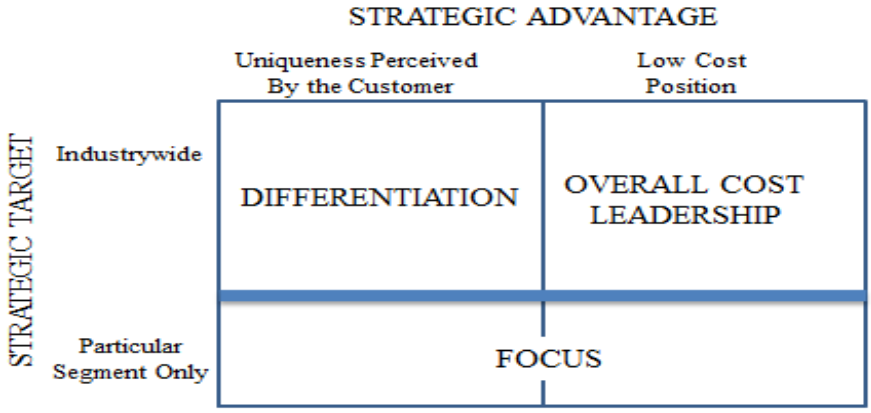
Despite arguing that the performance of a company is determined by its industry and identifying the industry forces that influence such performance, Porter (1979) had previously acknowledged, citing various studies (Demsetz, 1973; Shepherd, 1972; and Marcus 1969) that companies in the same industry have different levels of performance, when the logic of industry as the basic unity of profit determination would imply otherwise. Porter (1980) justified these differences by arguing that they were a result of companies' different positioning choices in relation to the five industry forces.

Thus, Porter (1980) defended that after diagnosing the industry a company should identify its strengths and weaknesses in relation to its position with regard to the industry forces. He then went on to design a framework of strategies which he claimed all companies should pursue in order to take full advantage of the industry forces, and which he called generic competitive strategies (Porter, 1980).

4.3.2. Porter's Generic Competitive Strategies

In order to take full advantage of industry forces and be able to attain sustainable superior performance, Porter (1980) proposed three possible generic competitive strategies: *overall cost leadership; differentiation; and focus*. Figure 13 is a representation of these strategies.

Figure 13: Porter´s Generic Strategies



Source: Porter (1980:39)

For Porter (1985: 17) each of these strategies is "*a fundamentally different approach to creating and sustaining a competitive advantage … Usually a firm must make a choice between them or it will become stuck in the middle".*

Overall cost leadership – This strategy involves an aggressive pursuit of cost reduction throughout the whole company structure. A tight and diligent managerial attention to cost in all areas of the company, R&D, sales, advertising, procurement, general overheads and so on is required in order to achieve this strategy. However, investments which in the long run help to reduce cost must not be overlooked, and thus, this strategy may also require high capital investments in the highest technologies available, design of products or processes for ease manufacture and mass distribution, as well as ease of maintenance and use. Other aspects such as quality and customer service should not be abandoned.

Indeed, a cost leadership strategy should not be confused with poor quality products or customer services. Cost leadership means meeting the needs of the largest group of customers possible at the lowest cost possible. This low cost derives not only from low cost materials but also from a shrewd management of the company's cost structure as related to what customers find valuable in the company's offerings.

Overall cost leadership creates superior returns by: allowing a positive return to be earned when other competitors have eliminated any superior results through rivalry; protecting the company against buyer pressure; protecting against pressure from suppliers because a low cost provider is better equipped to absorb additional cost increases; providing a barrier to substitutes and constituting an entry barrier due to economies of scale and cost advantages. Porter (1980) thus affirms that an overall cost strategy position allows the company to protect itself from all five industry forces.

Differentiation – This strategy means creating a product or service which is perceived industrywide as being unique (Porter, 1980). The differentiation approach can be conducted along various dimensions, among them: technology; design; dealer network; brand image; and so on.

Differentiation requires a perception of uniqueness and exclusivity, and the creation of such a perception generally forces a trade-off with a cost position due to the need for constant investment in R&D; advertisement; building brand loyalty; providing reliable and above the norm customer service; providing a sense of achievement, exclusivity and belonging to targeted customers; and so on. However, Porter (1980) notes that differentiation does not mean indifference to costs; it only means that costs do not determine or condition strategic decisions.

Differentiation allows a company to demand for its products a premium price above the average market price, however, for customers to be willing to pay the premium amount they must be able to clearly identify the differentiation factors and perceive them as being worth the premium they are being asked for. It is necessary to stress that the differentiating factors must be difficult to imitate, and that the premium price should be determined by customers' perceptions and not production costs (which should ideally be well below the selling price).

Differentiation also provides opportunities for superior performance by leveraging the five industry forces. Brand loyalty provides protection against accentuated rivalry; uniqueness, exclusivity and brand loyalty are powerful entry barriers; the lack of other equal options reduces both customers' and suppliers' bargaining power; and finally, the exclusivity factor also functions as a powerful defense against substitutes, which cannot provide the same psychological satisfaction as the original product or brand.

Focus – This strategy involves the concentration of all the company's resources and attention to the satisfaction of the needs of a specific, well identified customer segment.

Focus can be achieved by pursuing a highly differentiated way to meet the unique needs of a specific customer segment, or through low cost, by offering a particular customer segment a cost-efficient way to satisfy their needs (Porter, 1980). It is necessary to note that a focus strategy achieved through low cost is not necessarily the lowest cost in the industry but just the lowest cost in serving that specific, well identified segment of the market.

Focus strategies provide opportunities for superior performance through the same mechanisms differentiation and low cost strategies provide; however, this time restricted to a specific segment of the industry.

The main risk of not defining a specific strategy to guide decision making is to fall in between strategies, which Porter (1980) calls being "*stuck in the middle"*. According to Porter (1980), a company which is stuck in the middle has no specific and systematic long term idea on how to deal with the five forces, and as such can easily fall prey to companies which have considered ways to leverage the industry forces to their advantage.

Following a generic competitive strategy does not eliminate all risks, however; in fact, each strategy carries with it its own set of hazards. An overall cost leadership strategy is associated with problems such as: technological advancements which can make past investments or learning obsolete; product or marketing myopia due to excessive attention to cost; and excessive reliance on economies of scale as a barrier to entry. The differentiation strategy is prone to risks such as: a decline in customers' need for the differentiating factor; imitation narrowing the perceived differentiation; and a premium on the differentiated product so high that customers would rather opt for cost saving than to be loyal to a specific brand. The focus strategy does not only carry the risks of the other two strategies, it also has its own specific risks, such as: the difference in the needs of specific target and the general market narrowing or disappearing; or competitors finding "*submarkets within the targeted market and outfocus[ing] the focuser*" (Porter, 1980: 46).

Despite the fact that there are empirical studies that corroborate Porter's (1980, 1985) frameworks, such as Dess and Davi's (1984) and Hambrick (1983); Porter's (1980, 1985) work has been criticized (Hill, 1988) as being overly simplistic, and empirical evidence exists

that companies can successfully pursue more than one generic strategy at the same time without getting stuck in the middle (Hall, 1980 and White, 1986).

Porter (1980) also recognized that under specific and temporary circumstances, such as when all competitors are stuck in the middle or when a company pioneers a major innovation, the successful temporary pursuit of both differentiation and low cost is possible. However, Hill (1988) counters that, even in the long term, the sustainable pursuit of both low cost and differentiation is not only possible it is a desirable strategic approach in certain markets.

> *"[the simultaneous pursuit of differentiation and low cost is desirable] within emerging industries that are characterized by high growth, which have significant leaning and scale economies, and the potential to differentiate the product… Within mature industries that are experiencing technological change because the implied change in process gives rise to new learning economies. More generally, the simultaneous pursuit of [both strategies] is most likely to be consistent with superior performance in mature industries where all experience curve economies have been exhausted and several firms have achieved minimum-cost position"* Hill (1988: 411).

The idea of striving to provide a sufficiently differentiated product whilst trying to achieve the lowest cost among a group of competitors is sometimes called the "*best cost provider*" strategy, and is currently accepted in both academic and management circles as a valid idea. This strategy requires that the company have the resources to continuously innovate, consistently launch new products, and upgrade its systems and processes (Carvalho and Filipe, 2014). One company that is often indicated as following such a strategy is IKEA, the Swedish furniture retailer.

To explain superior company performance, Porter (1980, 1985) emphasized the external environment (industry) and ignored the internal environment (the company itself). As a result of the popularity of Porter's (1980, 1985) work, empirical studies were conducted to determine the extent and importance of the industry's influence on company performance. The most cited studies are Schmalansee (1985); Wernerfelt and Montgomery (1988); and Rumelt (1991). Schmalansee (1985) found that industry contributes 19.6 percent to company performance; Wernerfelt and Montgomery (1988) also found a close value 19.5 percent; Rumelt (1991) found the overall contribution amounted to 17 percent, but that only a small

fraction, eight percent, was due to long-term industry structure, the rest being created by temporary industry conditions.

Despite the inconclusiveness of the empirical studies, some scholars find the importance of industry as a determinant of company performance to be undeniable and suggest that it would be ill-advised to dismiss it (McGahan and Porter, 1997). However, others (Barney, 1986) find the attention to the external environment to be misplaced, and argue that the internal environment (the company's resources and capabilities) are the fundamental determinants of superior company returns. The next section discusses this perspective.

4.4. The Resource Based-View (Internal Analysis)

The resource based-view (RBV) seeks to explain companies' superior performance through their resources and capabilities, independently of the surrounding environment. In this line of strategic thought, sustainable competitive advantage can only be obtained through internal analysis. Barney (1986: 1231) expressed this idea by stating:

> *"[External] environmental analysis cannot be expected to improve the expectations of some [companies] better than others, and thus cannot be a source of [sustained competitive advantage]. However, analyzing a [company's] skills and capabilities can be a source of [sustained competitive advantage]. Thus, from the point of view of a [company] seeking greater than normal economic performance … strategic choice should flow mainly from the analysis of its unique skills and capabilities, rather than from the analysis of its competitive environment".*

In strategic management, internal analysis is conducted in the belief that company resources and capabilities are essential for superior performance and the frameworks used are supported by the RBV theories.

Three main lines of thought can be identified within the Resource-Based View (Barney, 2001): The line that compares the RBV with the SCP-based model (Barney, 1991; Conner, 1991; Rumelt, 1991; and Peteraf, 1993); the line that compares the RBV with classical microeconomics (Dierickx and Cool, 1989; and Peteraf 1993); and lastly the line that seeks to identify and measure the attributes of a company's resources and capabilities and how they relate to performance (Robins and Wiersema, 1995; Henderson and Cockburn, 1994; and Makadok, 1999). However, for Barney (2001) what matters is not the differences among these

approaches but what unites them, which is the belief or assumption that superior company performance is determined by the heterogeneous distribution of resources and capabilities among competing companies; and that these differences are long lasting.

For the resource-based model, superior performance is determined by the existence of resources and capabilities able to create sustainable competitive advantage. Barney (1991:102) defines competitive advantage as the implementation of a "*value creating strategy not simultaneously being implemented by any current or potential competitor"*, and it can be called a sustained competitive advantage if "*other firms are unable to duplicate the benefit of this strategy".* In Barney's view (1991: 102) the sustainability of a competitive advantage does not rest on how long (calendar time) it can give superior results; it has much more to do with the "*possibility of competitive duplication*". Thus, a competitive advantage is sustained as long as efforts to copy it have failed.

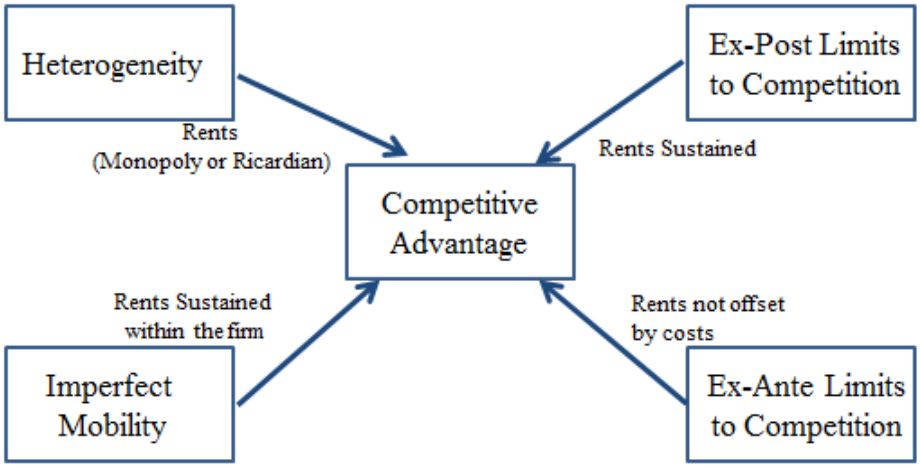
Peteraf (1993: 179) affirms that in the resource-based model the creation of a sustained competitive advantage (and therefore the creation of superior company performance) can only be achieved if four conditions are simultaneously present (see Figure 14):

- *Heterogeneity* – this is the basic condition of the model, "*the sine-qua-non condition of competitive advantage"*. This condition means that competing companies are endowed with different kinds of resources and capabilities, and those with superior resources and capability are able to produce more efficiently and to better meet customer demands and thus have superior performance;
- *Ex-post limits to competition* – this means that once a company has acquired a specific resource or capability that allows it to create superior performance there must be mechanisms within the market that impede other companies from copying it. Such mechanisms are called "isolating mechanisms" (Rumelt, 1984, quoted by Peteraf, 1993), and include property rights, information asymmetries and so on;
- *Imperfect mobility* – Peteraf (1993) considers immobile resources all those resources that cannot be traded; and imperfectly mobile, the resources which though tradable are more valuable within the company that presently uses them. Such resources include co-specialized assets (assets that must be used paired with others), resources associated with high transaction costs, or even resources "*for which property rights are not well defined*" (Peteraf, 1993:183) or idiosyncratic resources which can only be

used within one specific company (Dierickx and Cool, 1989; Meade, 1952; Bator, 1958 and Williamson, 1979; cited by Peteraf, 1993);

- *Ex-ante limits to competition* – This implies that for a company to have the chance to acquire a heterogeneous and superior performance creating resource or capability no competition for such a resource or capability must exist before the company acquires it; otherwise, the price of such a resource would reflect its future cash flow and the acquiring company would not be able to use it to create superior performance (Barney, 1986).

Figure 14: The Cornerstone of Competitive Advantage



Source: Peteraf (1993:186)

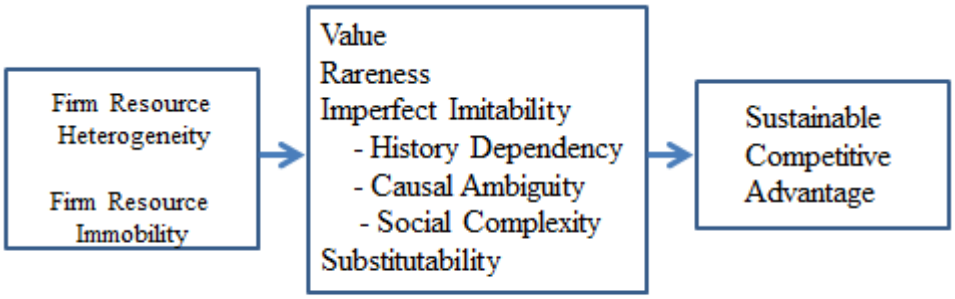
For Barney (1986) not all resources or capabilities are susceptible of creating the conditions outlined above. Resources such as financial strength, although important, are not per se enough to enable a company to create sustainable competitive advantage, because capital for instance is, in the right circumstances, readily available since "*if capital markets are efficient and well informed concerning the actual future value of a strategy, then funds will flow to firms wishing to enter a strategic factor market"* Barney (1986:1236). Barney (1991) also states that physical technology, however complex, does not constitute a strategic resource because physical technology (robots, machines or management systems) is replicable. Barney (1991) explains that for a resource to be strategic and thus able to create a sustainable competitive advantage it must possess the following qualities – it must be:

- *Valuable* – it must enable the company to create value and outperform competitors by enabling the company to exploit opportunities and/or neutralize threats from the external environment;

- *Rare* – this means it must be uncommon and hard to find within the competing environment;
- *Imperfectly imitable* - this means that it must not be something which competitors are easily or without cost able to duplicate or copy. The barriers to imitation can be derived from factors associated with the particular history and development course of the company – History Dependency -; or from the idiosyncratic relations within the company which nobody fully understands – Causal Ambiguity -; or yet from "*nontradeable assets which develop and accumulate within the firm … have strong tacit dimensions and are socially complex"* Peteraf (1993:183), - Social Complexity;
- *Non-substitutable* – this means that there must be no other equivalent resources which are not rare or imitable, otherwise competitors will resort to those resource and offset the company's possibility of creating superior results.

Figure 14 illustrates the ideas discussed above.

Figure 15: Relationship between resource heterogeneity, immobility, the VRIO and Sustainable Competitive Advantage



Source: Barney (1991:112)

In later works (Barney and Hesterley, 2012; and Hammel and Prahalad, 1996) another dimension which is not directly linked to any specific resource or capability but to the company itself was added: *Organization* – this represents the company's policies, practices, locations and procedures which enable it to capture and appropriate the returns created by its products or services without having to resort to third parties and lose part of the windfall in the process.

This framework for assessing a company's internal conditions to create sustainable competitive advantage came to be known as the VRIO model. With each letter standing for

each quality and the (Non) Substitutability dimension being absorbed and explained by the Imperfect Imitability dimension.

Barney (1991) goes on to affirm that resources and capabilities can be valuable without necessarily being able to be the basis for a sustainable competitive advantage. It is implicit within the RBV framework that the resources and capabilities which can originate sustainable competitive advantages are typically intangible, have a strong tacit dimension, are socially complex, and are difficult to analyze and comprehend often even for people within the company (Lippman and Rumelt, 1982; Dierickx and Cool, 1989; Prahalad and Hammel, 1990; Barney, 1991; and Peteraf, 1993).

The RBV model proposes two ways in which companies can obtain resources and capabilities in order to create sustainable competitive strategies (Makadok, 2001:387); these are: "*Resource picking and capacity building"*.

Resource picking is understood as the ability of the company to be more "*effective than its rivals at selecting resources*". This is achieved by "*developing systematically more accurate expectations about the future value of resources than other resource market participants have*" (Makadok, 2001: 388).

Meanwhile, to understand the concept of capability building it is necessary, according to Makadok, (2001 : 389) to understand the difference between resources and capabilities, which he gives by defining capability as a "*special type of resource - specifically, an organizationally embedded nontransferable firm-specific resource whose purpose is to improve the productivity of the other resources possessed by the firm*".

For Makadok (2001), in the process of capability building the manager takes on a role similar to that of an architect who designs and directs the construction of a system (the company) able to outperform its competitors. Linked to this concept is the idea of core competence, which is defined by Prahalad and Hamel (1990: 81) as "*the collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies*".

The RBV does not prescribe any specific set of strategies to achieve superior performance. Hamel and Prahalad (1989) argue that instead of having codified strategies, in order to achieve superior performance companies should possess strategic intent. Hamel and Prahalad (1989: 64) define the concept of strategic intent as an:

> "*ambition [which is] out of proportion to the resources and capabilities [of the company] … it encompasses an active management process that includes: focusing the organization's attention on the essence of winning; motivating people by communicating the value of the target; leaving room for individual and team contribution; sustaining enthusiasm by providing new operational definitions as circumstances change; and using intent consistently to guide resource allocations … Strategic intent is clear about ends, it is flexible as to the means – it leaves room for improvisation".*

The idea of strategic intent originates a gap between the out of proportion objectives and the meager resources and capabilities of the company, Hamel and Prahalad (1989) called this gap strategic stretch. The strategic stretch challenges a company to seek ingenious ways to fulfill its ambitions, for Hamel and Prahalad (1989) this process keeps the company innovative, allows the creation of competitive advantages and helps the achievement of superior company performance.

Like the market-based perspective, the RBV is not without its critics. Lado, *et al* (2006:115) discussing the criticisms leveled against the RBV state that: "*Critics, however, view the RBV logic as paradoxical, infused with contradictions and ambiguities".* Priem and Butler (2001) point out that resource value is determined outside of the RBV and go as far as to question the validity of the RBV as a theory.

Empirical studies (Schmalansee, 1985; Wernerfelt and Montgomery, 1988; Rumelt, 1991; and McGahan and Porter, 1997) have shown that at least 30% of company performance is due to idiosyncratic company characteristics.

Many scholars (such as Leonard-Barton, 1992; Kogut and Zander, 1996; and Miller and Shamsie, 1996) have been trying to clarify and show the importance of the RBV. In fact, even some critics recognize the importance of the RBV. Priem and Butler (2001:35), for instance, state that "*strategic management requires explicit attention to both the internal and external*" environment. And authors such as Hunt and Morgan (1995) have been trying to integrate both the market and the resource-based view in order to create a grand and unifying new theory of the firm.

With the differences between the theoretical arguments which justify the internal and external environmental analysis frameworks arguably established, the next section will discuss the

framework that seeks to summarize and integrate the elements of the external and internal environments in order to create a strategy that matches the business' idiosyncratic resources and capabilities with the surrounding environment's possibilities.

4.5. The SWOT Analysis

SWOT is an acronym for Strengths, Weaknesses, Opportunities, and Threats. The specific origins of the SWOT analysis are unclear; Chermack and Kasshanna (2007:386) affirm that: "[SWOT] as a *management tool was developed by Learned et al. (1965) from earlier efforts at the Harvard Business School*". While in a posthumous article Humphrey (2005:7) writes: "*SWOT analysis came from the research conducted at SRI [Stanford Research Institute] from 1960-1970 … The research was to find out what had gone wrong with corporate planning and create a new system for managing change. [The research was] led by Robert Steward, [the team] included Marion Dosher, Dr. Otis Benepe, Birger Lie, and me*".

Whatever its real origins, today the SWOT analysis is extensively used and is perhaps the most well-known strategic planning technique (Hill and Westbook, 1997). The SWOT framework emerged mostly from practice (rather than theory) and it was meant to be a technique that would find the best possible match or fit between companies' internal capabilities and their external possibilities (Chermack and Kasshanna; 2007). In addition, the factors (strengths, weaknesses, opportunities, and threats) are defined in relation to the competition and do not represent absolute values. Figure 15 is a representation of the conceptual SWOT framework.

Figure 16: Conceptual SWOT Framework Structure

	Internal Factors	External Factors
Favorable Factors	**Strengths**	**Opportunities**
Unfavorable Factors	**Weaknesses**	**Threats**

Source: Valentin (2001: 54)

Based on the SWOT framework, Weihrich (1982) designed the TOWS matrix (see Figure 16), which is a tool that seeks to *"systematically [identify] relationships between [the threats,*

opportunities, weaknesses and strengths], and [base] strategy on them". Weihrich (1982) thus indicated four possible relationships and their respective basic strategy:

1 – WT Strategy (mini-mini) – The aim of this strategy is to minimize both weaknesses and threats. This position is one that any company should seek to avoid, as it represents a precarious situation. Indeed, Weihrich (1982) affirms that a company in this position maybe facing bankruptcy.

2 – WO Strategy (mini-maxi) – In this position a company tries to minimize weaknesses while seeking to maximize opportunities. A company is in this position when its lack of resources or capabilities does not allow it to take advantage of certain opportunities. A company can overcome this situation by acquiring the necessary resources or capabilities through cooperation with other companies or through the retraining of its staff, or it can just leave the opportunities to competitors (Weihrich, 1982).

3 – ST Strategy (maxi-mini) – This position occurs when a company has sufficient strengths to deal with a threat from the environment. The company should seek to cautiously enhance and deploy its strengths while attempting to minimize threats.

4 – SO Strategy (maxi-maxi) – This is the ideal position for a company. This position allows the company to maximize its strengths while also maximizing opportunities.

Figure 17: The TOWS Framework Conceptual Structure

	Internal Strengths	Internal Weaknesses
External Opportunities	SO: maxi-maxi	WO: mini-maxi
External Threats	ST: maxi-mini	WT: mini-mini

Source: Adapted from Weihrich (1982)

Despite its popularity and simplicity, the SWOT framework faces some criticism. Humphreys (2007) says that when conducting a SWOT analysis managers easily misclassify factors, especially ignoring weaknesses and representing whatever the company lacks as an opportunity. Mintzberg (1994) argues that SWOT is one of the reasons that the strategic process is excessively approached as a formal, rational and predictable process. It has also

been suggested that SWOT is sometimes used to justify the implementation of already decided courses of action, instead of being used to generate new insights (Chermack and Kasshanna, 2007). Due to lack of support from research and theory, the SWOT framework does not indicate an adequate definition of factors; lacks prioritization; and it is prone to over-subjectivity/compiler bias. These facts often lead to a poor use of the framework, sometimes for purposes different from those it was designed for; and also allow for different companies to use it in different ways, which makes it difficult to assess the effectiveness of the technique (Hill and Westbrook, 1997; Pickton and Wright, 1998; Valentin, 2001; Chermack and Kasshanna, 2007; and Humphreys, 2007).

Attempts are being conducted, however, to overcome these perceived shortcomings of the SWOT model. Kotler (1991) suggests the development of other matrices which may allow the creation of levels of significance for each of the SWOT factors. These include: the Performance-Importance matrix – a device which seeks to assess how significant or important an identified strength or weakness is for a company; and the Opportunity-Threat matrix – a device which seeks to assess the probability and impact any external event has on the company.

Other authors, such as Valentin (2001) and Chermack and Kasshanna (2007), argue that when using the SWOT framework, the external factors should be supported by the MBV and the internal factors should be supported by the RBV, and that this should eliminate or at least alleviate the ambiguity and subjectivity originated by the lack of theoretical and research support.

With the theoretical framework discussion concluded, the next chapter will present the project's methodology.

5. Methodology

This project was compiled with data gathered from various secondary sources, which included articles from academic journals, professional news websites, specialized video game magazines and websites, consolidated accounts reports and press releases. This was followed by careful reading, selection, note taking, information triangulation, and analysis, before the final manuscript was written.

The elaboration of this dissertation roughly followed the methodology outlined by Eisenhardt (1989) and Hamel (1993) for the conduct of a case study research project. The methodology they indicate include these steps: first, the determination of the object or topic of study, which for this project was how companies achieve superior performance; second, choosing a case, and it is advised this should be done strategically so that it is pertinent to the object of study (Patton and Applebaum, 2003). For this project, the Nintendo Company was selected. Then the next step is to conduct a literature review, and for this project this step focused on a discussion of the MBV and RBV theories. Finally, based on the literature review, certain management tools were used to try to understand Nintendo's current situation and possible options, followed by considerations on what could be learned from the project and then its conclusion.

Although this project is not a case study research method in the strict sense of the word, it investigates the issues faced by an entity which is an ongoing concern using various sources of information, and according to Yin (1984) (quoted in Patton and Applebaum, 2003: 60) the case study research method is the ideal method to use when "*investigating contemporary phenomenon within a real-life context ... in which multiple sources of evidence are used"*, this justifies the use of the case study research method to elaborate this project.

The case study research method is useful for establishing causal relationships (Jensen & Rodgers, 2001), understanding how things happen in a certain way (Yin, 1994), and creating rich illustrations and descriptions which help further our understanding of phenomena in their natural environment (Otley and Berry, 1998; and Patton and Applebaum, 2003). However, the case study research method is also criticized for lacking rigor, being subjective, and strongly influenced by the researcher (Patton and Applebaum, 2003). Although these criticisms have merit, they do not invalidate the method; the lack of rigor can be overcome through data triangulation; and the subjectivity and influence of the researcher can be minimized by explicitly disclosing the identity of the researcher and making sure that the researcher

approaches the analysis with maturity, open mindedness, honesty and self-consciousness (Hamel, 1993; and Gummesson, 2003).

The case study research method (data collection for general inference purposes) should not be confused with the case study teaching approach (see 6.1 – Presentation Plan), a concept also used in this project because of its usefulness as a pedagogical tool that provides the possibility of bridging the gap between academia and practice, and encouraging the process of "learning by doing" through the analysis of a particular company or issue, and the applications of certain strategic management tools to assesses different options and possibilities (Simon, *et al.* 1996).

With the discussion of the methodology done, the next chapter of the project will be the discussion of the case resolution.

6. Case Resolution

6. 1. Presentation Plan

For Velenchik (1995: 31) a case study teaching method has three components: "*the case itself; the student's preparation for the case, and the discussion that takes place in the classroom*".

Hammond (2002) points out that the aim of a case study teaching method is not to find the right answers but to allow students to exercise and enhance their analytical capabilities by confronting real situations, although in a safer environment.

Thus, the educator's role should be to guide the students to relate the case at hand with the relevant management theory – the educator should encourage the students to connect the case with the theory. Without hampering the students' critical thinking the educator should strive to prod them to comprehend that they need the theory in order to understand certain aspects of the case.

The educator should emphasize that management models are more than frameworks to be uncritically applied. They represent a rich body of summarized theoretical knowledge (hence the name model) and have a defined logic behind them.

With this in mind, the presentation plan will be developed according to the following phases:

Phase 1 – Homework: In this phase students will be given the case study and be asked to prepare it at home. The preparation will include research on the home video game console market and strategic management frameworks. This phase should last approximately 180 minutes.

Phase 2 – Class Work

a) Group Discussion: Organized in groups of four or five students, a discussion about the case should be conducted within these groups. This should take about 30 minutes.

b) Class Discussion: After the group discussion the educator should ask each group to explain what they have understood about the case, these are general questions (such as the ones indicated below) the purpose of this is for the educator to grasp the extent to which the students have understood the context and the issues the company faces. Groups are expected to refute or accept each other's view of the case, with justification. The educator should have

a Socratic approach to questioning and answering students, never giving a direct answer (Yes/No). Questions in this section may include:

- What is the video game console industry?

- When did Nintendo enter the game console industry?

- How important are governments and civil society for this industry?

- According to industry analysts what caused Nintendo's problems?

- Does the fact that the industry is dominated by three companies affect the potential profit of the market? Why is it that the three biggest companies in the industry do not have the same profit levels? What is the source of these differences?

This questioning and prodding should implicitly relate the case study, the literature review and the proposed project questions. The educator should be able to conduct this section in about 90 minutes.

c) Theory Clarification: In this section the educator should clearly present the Structure-Conducts-Performance (Market-Based View) tradition and link it to the need for external analysis and Porter's (1980, 1985) frameworks. Then, she/he should address the Resource-Based view and link it to the need for internal analysis and the frameworks presented by Peteraf (1993) and Barney (1991). Then also address the SWOT analysis.

This section should last about 60 minutes.

d) Proposed answers: The last section should be dedicated to the indication of possible answers to the proposed project questions. This section should require about 30 minutes.

Table 8 summarizes the schedule for the presentation plan.

Table 4: Presentation Plan Schedule

Phases	Activity	Task	Time
Phase 1 Homework	Individual studying	Research - Case Study	180 min
Phase 2 Class Work	Group Discussion	Case study debate within each group	30 min
	Class Discussion	Case study Socratic debate for all the class	90 min
	Theory Clarification	Explanation of the MBV and the RBV	60 min
	Proposed Answers	Possible answers to the project questions	30 min
Total Class Time			210 min
Total study time			390 min

With the way in which the class can be conducted established, the next section will be to present the project’s proposed discussion questions.

6.2. Proposed Strategic Analysis Questions

Here, four strategic analysis questions are proposed in the hope that the attempt of their resolution may bring the students closer to the proposed pedagogical objectives of this project.

Question 1 – Assess both the external macro and immediate industry environments of the video game console industry;

Question 2 – Based on the information available and the VRIO framework, identify Nintendo's current key resources and capabilities which could be deployed to create a competitive advantage. Comment on the sustainability of this advantage;

Question 3 – Porter states that for a company to possess a sustainable competitive advantage it must follow one of the generic strategies he proposed. Assuming this is correct, identify which strategy Nintendo appears to be using at the moment. Justify your answer.

Question 4 – Conduct a SWOT analysis of Nintendo's current situation and advise the company on how it should pursue profitability.

The strategic analysis questions proposed are relevant because they seek to fulfill the pedagogical goals of the project. This is to say, there is a link between the pedagogical objectives and the analyses being requested, Table 5 illustrates this link.

Table 5: Match between the Pedagogical Goals and the Proposed Strategic Analysis Questions

PEDAGOGICAL OBJECTIVES	PROPOSED QUESTIONS
a) To use a PESTEL framework to analyze the general external environment. **b)** To conduct an analysis of the immediate industrial environment using Porter's five forces.	**Question 1** – Assess both the external macro and immediate industry environment of the home video game console industry.
c) To use the VRIO model to identify a company's key resources and capabilities and their ability to create sustainable competitive advantages.	**Question 2** – Based on the information available and the VRIO framework, identify Nintendo's current key resources and capabilities which could be deployed to create a competitive advantage. Comment on the sustainability of this advantage.

d) To identify a company's strategy in Porter's generic strategies framework.	**Question 3** – Porter states that for a company to possess a sustainable competitive advantage it must follow one of the generic strategies he proposed. Assuming this is correct, identify which strategy Nintendo appears to be using at the moment. Justify your answer.

e) To conduct a SWOT analysis.	**Question 4** – Conduct a SWOT analysis of Nintendo's current situation and advise the company on how it should pursue profitability.

With the case study related questions formulated, the next section will be to suggest possible solutions to them.

6.3. Proposed Resolution

Note: Before the classroom analysis of the case study, students are expected to independently consult additional sources; therefore, answers may contain information not described in the case. Furthermore, the solutions presented are not perceived as "the" right answers, but rather one of various possible solutions to the case.

Question 1: Assess both the external macro and immediate industry environments of the home video game console market.

Proposed Answer

a) Analysis of the external macro environment

PESTEL

The PESTEL model essentially gives the impact of macroeconomic variables outside the company's control. Due care should be taken to produce relevant and comprehensible information rather than produce an extensive list with too much information which decision makers cannot process and synthetize for meaningful decision making.

Political/Legal dimensions

The political dimension analyses variables such as political and military stability, and the dynamics between the public and the private sector. The legal variable is linked with the relationship between the law and business enterprises. In the political/legal dimension it can be considered that the following events will have a major impact in the home video game industry:

Lifting of the ban on the sales of video game consoles in China – In the beginning of 2014 China lifted its almost 14 year old ban on the sales of video game consoles. This opens up huge opportunities for console companies, who can now directly control and manage the Chinese market. For Nintendo, this is good because it represents a new market and an opportunity to expand its customer base. In fact, Nintendo has announced its intention to implement a specific strategy for the Chinese market.

Of course this opportunity has its challenges, such as the fact that consoles must necessarily be manufactured in China (a condition imposed by the Chinese government), other competitors such as Microsoft and Sony are also keen to enter the market, and the fact that

Chinese consumers are more acquainted with computer games rather than console games. Nintendo is aware of these market specificities and its intention of implementing a specific strategy for the Chinese market is seen, by specialist analysts, as a positive move and thus this event is seen mainly as an opportunity for Nintendo.

Censorship of game content – This element represents a negative effect, especially for companies such as Sony and Microsoft – Nintendo's main direct competitors - which allow their consoles to play games with adult or politically sensitive content (sex, language, violence). It can represent an opportunity for Nintendo, however, since its games boast a lot of educational and sports content. Nintendo should keep advertising this aspect of its business policy, especially in China where censorship is highly enforced. This would give the company a good image among parents, pressure groups and the government, which can be a good way to create brand loyalty and goodwill within the community.

Trademarks and Patents – Globally, over the years, there has been a growing trend to enforce international patent laws, with countries such as China and India trying to enforce the same compliance standards as the developed countries. This is generally good because it helps combat counterfeit games and consoles, as well as other products using trademarked characters, such as Mario. This is good for all the companies in the home video game console industry but especially so for Nintendo, which produces the bulk of its own software content. A reduction in pirated software means an increase in Nintendo's revenue stream.

Overall, the political dimension presents mostly opportunities for Nintendo, which may positively impact its customer base and share price.

Economic dimension

The economic dimension analyses the impact of variables, such as GDP, unemployment and inflation rates, among others. Events within this dimension that may have a significant impact in the home video game industry include:

The 2008 financial crisis – the economic downturn, originated by the 2008 financial crisis, hit the video game console's biggest markets (developed countries) with special gravity. The unemployment rates in most European countries are unusually high (compared to past years); in the American market, although it is recovering better than the European market, consumer confidence remains relatively low; and the Japanese market, is not showing any signs of significant economic growth, despite the country's current efforts. The lack of robust growth

or consumer confidence and the continued economic pessimism in most developed countries represents a special challenge for Nintendo, a company whose product is "sandwiched" between the easily available and less costly mobile games and its main competitors (Sony and Microsoft) focused on hardcore gamers. In hard economic times, casual gamers will most likely resort to mobile gaming and hardcore gamers will rather spend on more realistic gaming machines, specially designed to meet their needs.

The much **expected growth in developing countries** – China, India, Brazil, South Africa and Russia – is slowing down, and the forecasted sales growth of home video game consoles in these countries may not actually occur. This is a challenge for Nintendo.

Overall the economic dimension represents many challenges for Nintendo, with an expected negative impact on its sales growth, which of course may result in lower than expected revenues and decreased profitability, with the consequent loss of investor confidence and lower stock price.

Socio-cultural dimension

This dimension seeks to analyze variables linked to life style, fashion trends, and anthropological issues such as violence and equality among genders, among others. The events that may have a significant impact in the video game console industry include, among others:

Homogenization of consumption habits – one of the effects of globalization is the homogenization of consumption habits and lifestyles, which decreases the need for customization and allows for the possibility of effective product standardization for all markets. For reasons unknown to the public, Nintendo is currently unwilling to offer software and consoles which are compatible in all markets, but this represents a real growth opportunity which surveys shows customers have been waiting for a long time. This represents an opportunity for Nintendo, if not to originate new sales, to at least create good customer relations (by giving customers something they have been waiting for).

Changing demographics – this is a very important variable. The populations in developed countries are getting older, and they seem to be a good target for "exergames"; the population in developing countries is not only younger, their income level is also growing; and women are now a growing group of gamers, making up almost 50% of the total playing population in developed countries. These demographic changes are a huge opportunity for Nintendo to

increase its customer base. Nintendo is in a specially good position to exploit these opportunities because it already has plans for health related products; its products have middle range prices; and its software does not condone violence against women. All Nintendo has to do is design more games specifically aimed at these market segments.

Social violence – Violence is a huge social theme, especially in the video game community, and in the United State of America gun violence is a hugely debated issue at every level of society, academia, government and the media. The video game industry is sometimes blamed for this violence. Nintendo has always steered away from violent games, so this is a good time for the company to loudly advertise this aspect of its software content and create goodwill within the community.

Overall, the social dimension presents Nintendo with some opportunities, with possible direct impact on the extent of its consumer base, brand loyalty and possible sustainable revenue growth and increased profitability. This may lead to greater investor confidence and an appreciation of the company's stock market valuation.

Technological dimension

This dimension deals with R&D investments, or better yet, it deals with the creation and use of new or existent knowledge. The aspects of this dimension that may have a significant impact on the home video game industry in general, and on Nintendo in particular are, among others

High technological innovation – the high speed of technological change which characterizes this industry can be both a source of competitive advantage and a source of high costs; companies must decide how and when to incorporate certain technological innovations. When compared to its direct competitors, Sony and Microsoft, Nintendo has been reluctant to invest in high technology innovations. This policy seems to have been negative for the company, as hardcore gamers are opting for more technologically advanced games and consoles and casual gamers are opting for mobile gaming.

Spread of technological infrastructure – the spread of technologies such as the internet and the improvement of broadband infrastructure is generally good, as it allows console players to connect to each other; however, it also allows the streaming of games which may render the use of consoles obsolete. In addition, Nintendo is well behind its main competitors, Sony and Microsoft, in what pertains to streaming and online playing.

Overall, the technological dimension represents many challenges for Nintendo, with a possible impact on investment expenditure, and a possible decreased profitability on invested capitals (all things equals, an increase on investment will reduce return on invested capital – ROI), which will certainly have a negative effect on the company's short term stock price.

Environment dimension

This dimension concerns itself with the ecological impact companies' actions have on the natural environment and how the community respond to these company actions.

Pressure groups and customer awareness – video game consoles are known to use a lot of energy, and as such, more and more environmental groups are pressuring companies in this industry to change the level of energy consumption of consoles. Consumers are also becoming more and more concerned with the energy consumption levels of console (either for economic or environmental reasons). The environmental aspect presents an interesting marketing and strategic positioning point; however, Nintendo's standing regarding this issue is ambiguous at best.

Nintendo may be losing an opportunity to bolster its brand image with the general public. Creating an image of not only caring for family values, but also for the environment may be good for building goodwill with pressure groups and reinforcing brand awareness; lead to free and positive media coverage; improve reputation and consumer loyalty; and boost employees' motivation and commitment.

Overall, this is yet an inexpressive issue for this industry, but it does offer an opportunity for Nintendo to increase its media coverage.

All dimensions weighted, the external macro environment offers more opportunities than challenges for the home video console industry, especially for Nintendo.

b) Analysis of the immediate industry environment

Porter's Five Forces Model

This model allows the assessment of the dynamics within an industry. For Porter (1980), the strategic choices a company has depend on the relationship between the actors operating in

that particular industry. These actors include: suppliers; buyers; substitute products; new entrants and the rivalry among competing companies.

The model is based on the assumption that companies are homogeneous entities and their superior return on invested capitals is largely determined by how they can protect themselves against industry forces.

Bargaining Power of Suppliers - LOW

Console providers (Nintendo, Sony and Microsoft mainly) essentially deal with two types of suppliers**: the hardware suppliers** - to whom they outsource the manufacturing of consoles parts; and **the software suppliers** - from whom they obtain the game contents.

Hardware suppliers – Include all the companies that supply hardware parts for the consoles.

Nintendo uses a diverse number of suppliers (Samsung Electronics, NEC, AMD, Hosiden, MegaChips, Mitsumi Electric), and for some suppliers, such as MegaChip and Mitsumi Electrics, Nintendo's orders represent a considerable percentage of their annual sales revenues. These suppliers compete with each other to offer Nintendo the best deal possible, which gives Nintendo good negotiation leverage, and means the hardware suppliers have low negotiating power.

Software suppliers – Includes all those companies who provide game content.

For Nintendo these suppliers include well known industry icons such as: EA (Electronic Arts); Activision; and Ubisoft. Content suppliers have, to some extent, more power than hardware suppliers, given the fact that their product can be differentiated and their popularity with consumers can determine the success of a console. However, in Nintendo's case most of the iconic games for its consoles are made in-house. Because Nintendo produces many of its most successful games, outside developers do not have much bargaining power when negotiating with the company.

Overall, in this industry, suppliers (both hardware and software) have low bargaining power when negotiating with console providers, because console providers (Nintendo included) have much more options and are not dependent on any particular supplier.

Bargaining Power of Buyers - LOW

Console providers sells their products directly through their online shops or indirectly through retailers such as Amazon, Toys "R" Us, Walmart, and others. However, the final consumers are individuals.

Large retailers, such as Amazon and Walmart, may have some negotiating power due to their consumer reach; however, because content providers have a wide distribution network and can also directly sell from their own online shops, this limits the bargaining power of retailers.

The final consumers inherently possess some degree of power because without them there is no market. However, as non-organized individual entities and given the switching costs associated with changing from one console to another (to change from one console to another, the consumer does not only spend on the machines, which are relatively cheap, but also has to buy new games, which are not very cheap), this creates an overall environment where the final consumers' bargaining power is relatively low.

Overall, buyers have a low bargaining power when negotiating with console providers. This is due to console providers' wide retail network, final consumers' switching costs, and the low probability of backward integration or group organization of the final consumers.

Pressure from Substitutes Products - HIGH

The existence of substitutes is currently the biggest threat for console providers. The main substitute product is mobile gaming (cheap and easy games played on portable devices such as smartphones and tablets). Nintendo is reluctant to release its games on mobile platforms which it does not control, and casual gamers (the bulk of its customer base) are increasingly moving to mobile gaming, while hardcore gamers have never been Nintendo's main target.

Mobile gaming puts a lot of pressure on Nintendo, because from the casual gamer's point of view it represents a better value for money offer (many games are free to download, others come already built-in on portable devices); the companies offering these games are very successful (e.g. Rovio Entertainment); these games are also intuitive to play and easy to log-in to and log-off of (start play and stop play); and they can be enjoyed while away from the house.

Threat of Entry - LOW

The high cost of research and development; advertising; distribution; brand loyalty; and exclusive contracts for software content represent very high barriers for potential new entrants to the home video game console industry.

Nonetheless, two new companies have recently entered the industry, Ouya and Gamestick. However, neither their business model nor technology represents a threat for the main industry incumbents (their game devices are not exactly consoles but more of pen drives), and their main value proposition consists of letting users "hack" their system and create their own games, which can even be sold as apps on their online platforms.

Due to the barriers listed above, it can be considered that Nintendo faces a low risk from new industry entrants.

Intensity of Rivalry among existing Competitors - HIGH

Nintendo's main competitors are Sony and Microsoft. Each company's console has exclusive games, meaning a CD containing a game for one console, will not play in the other two; even for titles which exist for all three.

The three companies compete to enlarge their consumer base; this is done either by attracting new consumers to the industry or conquering consumers which belong to the competitors. The competition within the market is thus intense. While Microsoft and Sony tend to directly compete for the hardcore gamers, Nintendo tries to deflect this competition by targeting casual gamers.

Although the companies monitor each other's prices, they do not conduct direct price wars. The competition is based more on innovation, through technological improvements/breakthroughs, marketing and overall value chain management.

The element that makes this force high is essentially the fact that the competitors are equally balanced in terms of industry know-how and resources and capabilities.

Question 2: Based on the information available and the VRIO framework, identify Nintendo's current key resources and capabilities which could be deployed to create a competitive advantage. Comment on the sustainability of this advantage.

Proposed Answer

The VRIO model states that the creation of sustainable competitive advantage is only possible if the company possesses resources and capabilities which are valuable; rare; and imperfectly imitable and has the internal structure to collect the value created by these resources and capabilities. Furthermore, the model implies that these resources are difficult to understand and very seldom do they represent tangible assets.

This model is based in the assumption that companies are heterogeneous entities able to create superior returns on invested capital mainly from the leverage of its (internal) resources and capabilities independent of external conditions.

Nintendo is currently using these key resources to create competitive advantage: Financial resources; brand name; creativity/human resources; and organization.

Financial resources

Although Nintendo has been posting operating losses for three years in a row, meaning the company is in bad economic shape, the same cannot be said of its financial position. Financially, Nintendo is still a very solid company, with more than USD 8.6 billion of cash and equivalents, and zero debt (Bloomberg, 2014).

This good financial position does not only allow Nintendo to have access to cheaper credit terms, it also allows the company to conduct new investment programs in R&D, and execute financial restructuring such as share buyback programs.

However, it is worth noting that although valuable, financial resources are not rare or imperfectly imitable, and thus cannot be said to be a source of sustained competitive advantage. Nonetheless, they can help the company to compete in equal terms with its main competitors.

Creativity/Human resources

Nintendo is well known within the industry for producing intuitive consoles and games; and its skills in producing legendary game characters and story lines are accepted by specialist analysts as being Nintendo's main core competency.

This capacity for creativity is a result of Nintendo's human resources, which include legendary industry names such as Shigeru Miyamoto, Eiji Aonuma and Yoshio Sakamoto.

The creativity, talent, motivational potential, industry know-how and experience the indicated employees and others can transmit to younger generation Nintendo employees, and the potential these qualities have for translating into profits are not measurable and to some extent difficult to objectively analyze. This is a resource which is valuable, rare and clearly imperfectly imitable, which means that Nintendo's human resources are a potential source of sustainable competitive advantage.

Brand name

Nintendo's brand name is one of the most recognized and trusted brands within the industry (Schmidt, 2014). The company has existed for more than 120 years and it can be said that Nintendo saved the video game console industry from oblivion in the 1980s. Furthermore, Nintendo's dedication to quality and detail is well known. Loyalty to the brand is well established and documented within the industry[1].

Beside the fact that the brand is trademarked, which means it cannot be legally copied, the emotions consumers attach to the brand will be difficult for competitors to match or erase completely. This means that this is a rare and imperfectly imitable resource, and can possibly be a source of sustainable competitive advantage.

Organization

Nintendo is a company with resources and capabilities which enables it to exploit its creation without resorting to third parties. Nintendo has direct control over its R&D, product design, development, and distribution. The company is not directly dependent on any third party to generate or collect its revenue (it is necessary to note that all independence is relative, Nintendo is independent in the sense that the company does not need to relinquish part of its potential revenue to third parties in order to get its product to the market).

Nintendo also seems to have the necessary functional structure, which includes, among others the rewarding; control; communication; and training systems which allows the company to function as a whole and have the ability to appropriate the returns from its products.

From the above understanding of what constitute an organization (a mixture of both capacity to exploit an advantage and culture) it follow that such a resource is not rare (in the sense that the capacity to exploit an advantage can be created without much difficulty) but it is

[1] http://www.rankingthebrands.com/Brand-detail.aspx?brandID=32

imperfectly imitable (in the sense that to create an exact copy of Nintendo's culture is almost impossible).

This capacity to exploit its revenue generation potential to the fullest is a possible source of competitive advantage.

Comment on the sustainability of this advantage

With the exception of financial resources, the other three key resources/capabilities are able to create sustainable competitive advantages. This means that if Nintendo leverages these resources well, the company will once more be able to deliver sustainable superior financial results.

Table 6: Nintendo's VRIO Analysis - Summary

Resource or Capability	Valuable	Rare	Imperfectly Imitable	Exploited by Nintendo	Competitive Implication
Financial Resources	*Yes*	*No*	*No*	*Yes*	*Competitive Parity*
Creativity/Human Resources	*Yes*	*Yes*	*Yes*	*Yes*	*Sustainable competitive advantage*
Brand Name	*Yes*	*Yes*	*Yes*	*Yes*	*Sustainable competitive advantage*
Organization	*Yes*	*No*	*Yes*	*Yes*	*Competitive advantage*

Source: Own creation

Question 3: Porter states that for a company to possess a sustainable competitive advantage it must follow one of the generic strategies he proposed. Assuming this is correct, identify which strategy Nintendo appears to be using at the moment. Justify your answer.

Proposed Answer

Porter (1980) indicates that there are three potentially successful generic strategic approaches to outperform competitors in an industry: overall cost leadership; differentiation; and focus. Porter affirms that a company which fails to follow one of these strategies, or tries to follow them at once, will be "stuck in the middle", meaning the company will be in a poor strategic position and it will almost certainly have low profitability.

Industry specialists and consumers alike perceive Nintendo's products as being in between the high technology products of its main rivals, Sony and Microsoft, and those of mobile gaming.

Nintendo's consoles do not command a premium price, neither is its technological performance above average. This indicates that the company probably does not follow a differentiation strategy.

In the case study, Nintendo's cost structure is not described in enough detail to allow clear analysis; however, Nintendo's industry is a knowledge-based one, and cost leadership strategies in this type of industry are very rare (to attract talent they have to have reasonable incentives). Thus, it can be concluded, although again without certainty, that Nintendo is unlikely to be following a cost leadership strategy.

Nintendo's products are mainly aimed at casual gamers, but casual gamers is a loose definition – it can include every person that plays technology based games but is not looking for a heighted graphical/technological experience. Thus, the focus strategy as described by Porter (1980) can also be ruled out as a strategy for Nintendo.

It is likely then, that Nintendo is trying to use a "best cost provider" strategy, seeking to provide some differentiating features while at the same time trying to keep costs down, so as to be able to provide both differentiating benefits and low price.

Question 4: Conduct a SWOT analysis of Nintendo's current situation and advise the company on how it should pursue profitability.

Proposed Answer

The SWOT analysis is the identification and assessment of the strengths, weaknesses, opportunities and threats a company faces, with the intention of yielding strategic insights.

The strengths and weaknesses derive from the company's resources and capabilities and are known through an internal analysis. The opportunities and threats derive from the external surrounding environment and are identified through an external analysis.

Strengths

An internal analysis based on the case study indicates that financial resources are one of Nintendo's strengths, with more than 8 billion USD in cash and cash equivalent and no debt, this resource allows Nintendo to conduct a share buyback program that keeps the company's market value at a higher value that would otherwise be without such funds. Another element

that represents strength is the company's brand name; the Nintendo brand is well known and has recognized brand loyalty. Another source of strength can be Nintendo's workforce, due to their industry know-how and proven creativity. However, the recent lay-off in Europe, although unlikely to be a long term problem, may in the short term diminish workforce morale and thus weaken this specific strength.

Weaknesses

From the case study it can be understood that Nintendo lacks the high technology investment it needs to compete directly both with Microsoft and Sony to produce highly realistic games; it also lacks a specific strategy or plan to attract and keep casual gamers from migrating from its consoles to mobile gaming. Furthermore, Nintendo has not yet unveiled a coherent strategy to deal with the new trend of online and mobile gaming. Will the company license its characters to third parties? Will it build its own playing applications? How about streaming online games? These are all major questions which Nintendo's main competitors, Microsoft and Sony, are explicitly answering while Nintendo has not given, up to the moment, satisfactory answers to.

This is not to say that Nintendo has no strategy, the company may be keeping its strategic intend closely guarded to avoid imitation. However, for outside observers – investors included – given the information available it may appear that Nintendo has no clear strategy.

Opportunities

The opening up of the Chinese market is a good opportunity for Nintendo; the company has the right type of content and is willing to design a specific strategy for this market. If successful, the Chinese market will considerably add to Nintendo's consumer base. Another opportunity for Nintendo is that presented by changing demographics (more female players): with its educational, sports and non-violent content the company is in a good position to attract female players to its consumer base. Also, environmental awareness can be seen as an opportunity, which Nintendo can use to bolster its image among pressure groups and governments. All it has to do is to have a comprehensive program to scale back the energy consumption level of its consoles.

Threats

The most obvious threat Nintendo faces is the speed of technological change within its industry; Microsoft and Sony have invested heavily on potent consoles with realistic graphs to woo hardcore gamers while Nintendo's console graphs are always almost one generation behind. Another threat for Nintendo is the increasing predominance of mobile gaming. This is also linked to technological change: the more potent mobile devices become, the more suitable they are to be used as gaming platforms. Online game streaming also represents a threat for Nintendo, because if the trend is successful consoles may become obsolete and the company does not have any such service at the moment. As a final thought on the threats Nintendo is facing, there is the case of virtual reality; if products such as the Oculus Rift (a virtual reality headset which can be used to play video games), become successful, the way consoles are built and games are played will radically change; and up to the moment Nintendo shows an apparent lack of coherent strategy to deal with emerging trends.

Table 7: Nintendo's SWOT Analysis - Summary

	Internal Factors	External Factors
Favorable Factors	***Strengths***	***Opportunities***
	Financial resources	Chinese market
	Brand name	Changing demographics
	Workforce	Environmental awareness
Unfavorable Factors	***Weaknesses***	***Threats***
	Lack of technological investment	Speed of technological change
	Lack of coherent strategy for dealing	Substitute products (mobile gaming)
	with emergent trends (mobile gaming;	Virtual reality
	online streaming; and virtual riality)	Online streaming

Source: Own creation

Note:

As noted on the Literature Review, the SWOT framework does not define specifically what constitute a strength, weakness, opportunity or a threat, these factors are subjectively classified; furthermore, they are classified not in absolute terms but in relation to competitors. Thus, Nintendo's technological weakness does not mean the company does not possess advanced technology, it only means that when compared to its most obvious competitors

Nintendo is behind. Also the threats Nintendo faces are in relation to its perceived resources and capabilities; if Nintendo had a strategy that compensated the move of casual gamers to mobile platforms, then mobile gaming would cease to be a threat and perhaps even become an opportunity, just as the increase in female gamers is an opportunity because Nintendo's gaming content is not misogynic.

Advice on how Nintendo should pursue profitability

After conducting the SWOT analysis, a next step to indicate which strategy Nintendo should follow might be to conduct a TOWS analysis. However, this would not only be simplistic, it would also only give a solution for the short term, given that the strategies generated by the TOWS framework are inclined to meet only the perceived current threats and opportunities.

Another path would be to direct the company towards Porter's (1980) generic competitive strategies. However, like the TOWS matrix, Porter's (1980) generic strategies are designed to take advantage of current industry structure. This path may give good results, but with the high level of technological change present in this industry, such results would be unlikely to last for long; and as Nintendo's CEO, Mr. Iwata has already stated, the company is not in the business of looking for short term solutions.

It is necessary to note that within the MBV there is still the Brandenburger and Nalebuff (1997) approach, which argues companies should look beyond mere competition and seek also opportunities for cooperation. Following this perspective, Nintendo may want to consider looking into partnerships with companies such as Apple or Samsung or even Microsoft and Sony to pool their resources and launch joint products. Within the MBV theory this is a feasible strategy, co-operation with Samsung or Apple would mean the elimination of the threat of mobile gaming, but it could also mean that Nintendo's console business would be abandoned and the company would became solely a content provider. At the moment the company's management is not willing to entertain such an idea.

Although due to both lack of experience relating to the gaming industry and extended knowledge of the internal aspects of the company, added to an incapacity to foresee the future, it might be presumptuous to prescribe a specific strategy for Nintendo; it is however, not impossible neither presumptuous to indicate general guidelines.

Having in mind the SWOT framework, and the idea of finding the best possible fit between Nintendo's resources and capabilities with the external possibilities, we would propose any of the following strategies:

1. Acquisition – Use its cash resources to acquire a video game streaming company. Possible video game streaming companies that may be targeted for acquisition include: Kalydo; Playcast Media Systems; and Onlive.

With such an acquisition Nintendo would close the online gaming gap capabilities that exists between the company and its main competitors (Sony bought Gaikai, an online gaming company in 2012; Microsoft has in-house capability, the azure cloud service). This strategic choice would also secure Nintendo against the possibility of console obsolescence caused by better streaming technology.

Although an ideal strategic fit between Nintendo's cash resources and the threat of online streaming, this strategic choice brings its own risks, such as the difficulty of reconciling the organizational culture between the two companies. Nintendo should pay close attention to such possible difficulties.

2. Invest in its own cloud service platform – This strategic choice, although probably more expensive and time consuming than the option outlined above, would spare Nintendo the risks surrounding acquisitions and give the company the opportunity to build a system that is specifically designed to its needs and ends. This structure, although expensive, would give Nintendo greater leverage to have for the gaming industry what Netflix (an American company that streams movies in a pay-per-view basis) has for the movie industry. This choice would also put Nintendo in the forefront of technological development in the video game industry.

These two strategic options (acquisition and in-house development) are not only in accordance with the SWOT analysis above, they have also been proved realistic by the successful acquisition of Gaikai by Sony, and the financial feasibility of the in-house development of a streaming service by Nintendo has been discussed by Bleeker (2014)[2].

However realistic, the solutions provided above only address the current industry configuration; even if successfully implemented they will not give Nintendo lasting superior performance because its competitors are also pursuing the same choices. Given the facts

[2] http://www.fool.com/investing/general/2014/01/16/nintendo-could-be-the-next-netflix.aspx

related in the case study, including Nintendo's resources and capabilities and the challenges it faces, in order to pursue and achieve sustainable profitability, we propose Nintendo should follow a strategy based on the RBV theory.

Accordingly, the company should look beyond the current industry configuration; as well as the current customer-base configuration, casual gamers vs. hardcore gamers. Rather, the company should look principally to its resources and capabilities in designing its future.

The company should look to its core competencies, ability to create fantastic story lines and intuitive entertainment devices, and define its strategic intent. However, before the definition of its strategic intent, the company should decide its business purpose, either to remain an essentially entertainment company whether it wants to branch out into other businesses.

If the company decides to branch into businesses it can, for example, seek to find ways in which its core competences can be leveraged in industries such as:

- The military: How can simulated reality be used to aid the conduct of war[3]?
- Social Sciences: Can the spread of diseases be simulated on video games? Can the functioning of the brain and social interaction be realistically simulated?
- Physics: Can life in space be simulated (co-operation with the European Space Agency)?

There are many fields in which Nintendo's expertise can be applied outside entertainment. However, in case the company wishes to remain solely in the entertainment business, then though less numerous there are still plenty of choices:

- With people working longer hours and living more years what kind of content Nintendo can provide to entertain and provide romance to older people or very busy people?
- Can Nintendo provide content that can be used in university fraternity parties?
- Cooperation can also be sought with companies such as Disney (movies); organizations such as Fédération Internationale de Football Association (FIFA), which is the international federation of association football, the body responsible for the organization of the soccer World Cup (sports); and Cirque du Soleil (circus).

The problem with the RBV theory is that, unlike the MBV theory, it does not provide any specific action steps. What it provides is a wide range of possibilities and ways to think well beyond what exists now; which means that most of the time the suggestion of certain question

[3] http://www.livescience.com/10022-military-video-games.html

based on the RBV are dismissed as vague, wishful thinking or daydreaming even when done by renowned scholars (Hamel and Prahalad, 1994). The good side is if the correct questions are asked and answered the company does not need to worry with the industry configuration.

Thus, by recommending Nintendo to pursue profitability through the RBV theory and suggesting certain questions, there is no presumption that Nintendo should ask these same questions (certainly, with the experience and knowledge the company has they have other types of questions); what is implied is that, according to what is describe in the case study, the best way for Nintendo to find profitability is to look beyond the current industry structure and the only management theory that offer the adequate tools for this purpose is the RBV theory.

With the presentation of the proposed resolution concluded, the next section of the project will be the presentation of the resolution slides.

6.4. Resolution Slides

Question 1: *Assess both the external macro and immediate industry environments of the home video game console market.*

Slide 1

PESTEL Analysis

POLITICAL/LEGAL

- China lifts ban on video game console sales;
- Censorship of game content
- Improvement on international trademarks and patent protection laws;

ECONOMICS

- Negative effects of the 2008 financial crisis on developed countries;
- The expected economic boom in developing countries.

SOCIO-CULTURAL

- Globalization – homogenization of global consumptions habits;
- Changing demographics – opportunities for "exergames", growing consumer groups such as women.

TECHNOLOGY

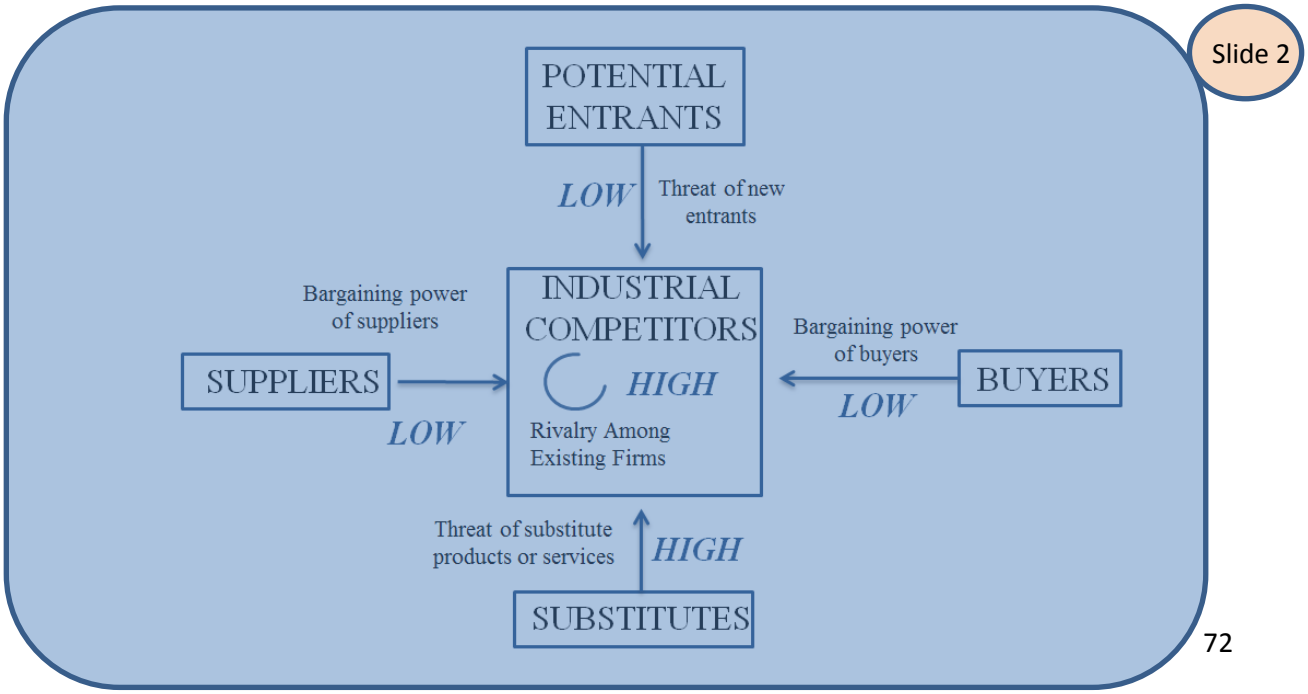
- High speed of technological change;
- Spread of technological infrastructures.

ENVIRONMENT

- Pressure groups and customer awareness – especially on energy consumption levels.

PORTER'S FIVE FORCES ANALYSIS OF THE HOME VIDEO GAME CONSOLE INDUSTRY

Slide 2



Question 2: *Based on the information available and the VRIO framework, identify Nintendo's current key resources and capabilities which could be deployed to create a competitive advantage. Comment on the sustainability of this advantage.*

Slide 3

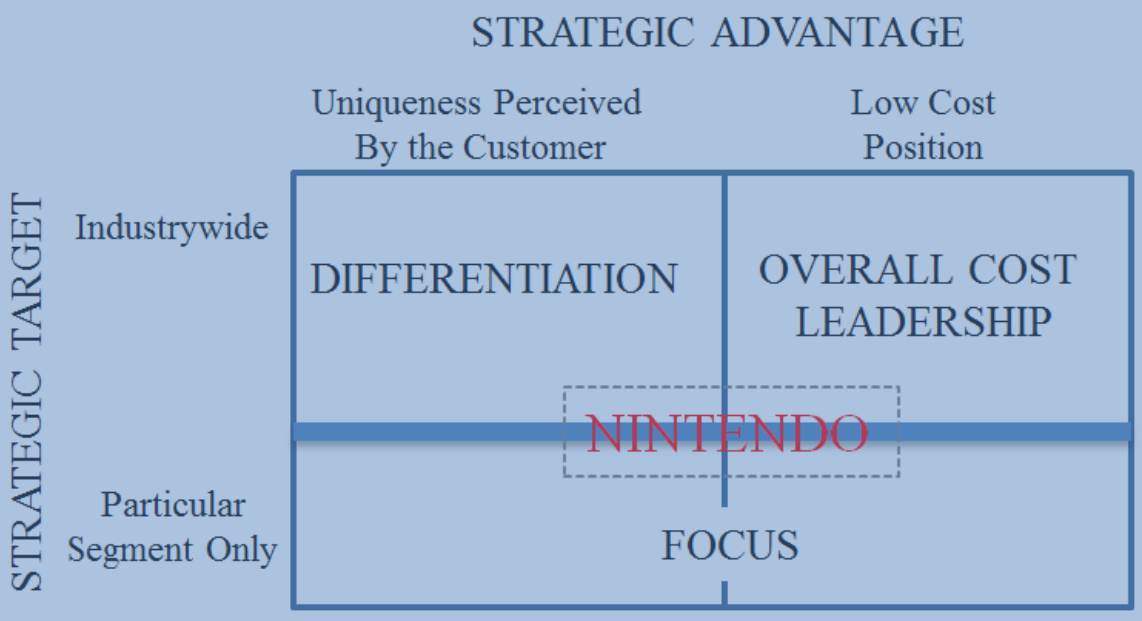
Resource or Capability	Valuable	Rare	Imperfectly Imitable	Exploited by Nintendo	Competitive Implication
Financial Resources	*Yes*	*No*	*No*	*Yes*	*Competitive Parity*
Creativity/Human Resources	*Yes*	*Yes*	*Yes*	*Yes*	*Sustainable competitive advantage*
Brand Name	*Yes*	*Yes*	*Yes*	*Yes*	*Sustainable competitive advantage*
Organization	*Yes*	*No*	*Yes*	*Yes*	*Competitive advantage*

Source: Own creation

Question 3: *Porter states that for a company to possess a sustainable competitive advantage it must follow one of the generic strategies he proposed. Assuming this is correct, identify which strategy Nintendo appears to be using at the moment. Justify your answer.*

Slide 4

The Three possible Generic Competitive Strategies for the Video Game Console Industry and Nintendo's probably Position within it



Nintendo's position in Porter's (1980) generic strategies framework is unclear; however, there is a probability that the company does not follow any of the prescribed strategies and could be considered "stuck in the middle". Or in another perspective, it could be seem as perhaps following a "best cost provider" strategy.

Question 4: *Conduct a SWOT analysis of Nintendo's current situation and advise the company on how it should pursue profitability.*

Slide 5

An internal analysis of Nintendo's resources and capabilities and an external analysis of the existing possibilities yielded the following strengths, weaknesses, opportunities, and threats:

	Internal Factors	External Factors
Favorable Factors	***Strengths***	***Opportunities***
	Financial resources	Chinese market
	Brand name	Changing demographics
	Workforce	Environmental awareness
Unfavorable Factors	***Weaknesses***	***Threats***
	Lack of technological investment	Speed of technological change
	Lack of coherent strategy for dealing	Substitute products (mobile gaming)
	with emergent trends (mobile gaming;	Virtual reality
	online streaming; and virtual riality)	Online streaming

Instead of trying find the ideal fit between its resources and capabilities with the external possibility, the company should seek profitability by defining a strategic intent that challenge the company to create products which are made not to meet current market structures but which make the best use of its core competency, the creation of intuitive and compelling entertainment systems.

With the resolution slides presented, the project will proceed with the presentation of the lessons from the case study.

7. Lessons from the Case Study

The outcomes of Nintendo's current decisions are still largely unknown; however, from a managerial perspective, there are two main lessons from the case.

The first lesson - from analyzing the case, it is fairly clear that companies, even successful ones, should not ignore the external environment. Competition can came from anywhere, from the most obvious adversary to adversaries which may not be obvious or even imaginable two to three years before they arrive in the market. While Nintendo could compete with its main competitors, Microsoft and Sony, by shifting to simpler and more intuitive gaming consoles, the company did not respond adequately to the sudden treat of mobile gaming; and from available public information there is no indications that the company already possesses a strategic vision of how to take advantage of the possibilities brought by greater internet connectivity. An earlier attention to the external environment could perhaps have helped Nintendo establish earlier and advantageous partnerships that could have allowed it to face internet connectivity not as a threat but as an opportunity. Such partnerships could have been made with Facebook, Google, Alibaba, Disney or even Samsung.

The second lesson - although the environment is important, Nintendo has shown that a company should not forget its internal idiosyncrasies and should not follow the easy path of the "me too strategy", copying successful rivals. Nintendo proved many times, - e.g. in 1959 when the company partnered with Disney to launch cards illustrated with Disney characters; in 1966 when it entered the toy industry with the Ultra Hand; and in 1983 when the company almost alone saved the video game console industry with the launch of the Famicom - that a company can resort to its resources and capabilities to forge new paths within competitive and ever changing environments. Nintendo has been reinventing itself for more than 120 years, and with the human and historical resources it possess, it seems likely that it will be able to continue reinventing itself in the near future.

This case has shown that, in the pursuit for profitability, certain management frameworks can be useful in assessing the external and internal environments and help the company in its strategic choices. For example:

- To understand the changes in the external (macro)environment a company can use the PESTEL analysis, which describes variables which the company does not control but

can greatly affect the industry business environment and determine the survival or death of an industry or business;

- For monitoring industrial variables, which are within the power of the company to alter or at least protect itself against – such as the danger of new competitors - Porter's five forces framework is an ideal tool;
- For deciding what to do now and in the future (strategic intent), independently of industry forces but rather based on the company's resources and capabilities, the VRIO model, which analyses the potential of a company's resources and capabilities for creating sustainable competitive advantage, is an appropriate model.
- When looking at the industry and positioning the company in relation to other companies, Porter's generic strategies may be a useful guide.
- When seeking to find a fit between external possibilities with internal capabilities, the SWOT model may be the most indicated framework to start with.

It is also implicit through the case that one of the reasons Nintendo has survived for more than 120 years may well be its commitment to quality, to its customers, its employees, and to a certain degree of conservative financial management (a large firm with no debt and huge cash reserves). This style of management culture appears to be helping the company in this moment of huge and challenging industrial shifts, by keeping staff motivation relatively high and allowing the implementation of a share buyback program despite the revenue drop.

With the lessons from the case study presented, the project's concluding chapter will be presented next.

8. Conclusion

The home video game console industry is characterized by constant changes and intense competition. Currently the industry is going through a major competitive shift, as the threat of substitute products grows and competition among established rivals intensifies even more.

The aim of this project was to develop a pedagogical case study on an iconic company of this industry, Nintendo. The project sought to address the company's strategic options as it strives to return to profitability amid intensified competition from its main rivals, Sony and Microsoft, and the rising threat of substitute products, such as mobile gaming.

The goal of the project was to give its audience – management undergraduate students - not only the opportunity to increase their knowledge of the home video game industry and especially Nintendo, but also the chance to practice the use of certain strategic management concepts and frameworks which may be useful in their academic activities and/or future professional endeavors. It is hoped that, by presenting a description of the home video game industry, as well as that of Nintendo, and conducting a review of the literature on the theories explaining the origins of companies' superior performance and then posing strategic questions relating the case study with the relevant management theory, the goal of this project has been largely achieved.

Notwithstanding the effort, the project has some limitations, which derive mainly from the difficulties in obtaining and verifying information, not only regarding the industry as a whole, but the Nintendo Company in particular as well. As its performance declines, Nintendo has limited the release of information, especially information related to sales figures. In addition, information about the technology sector is mostly available in websites and blogs whose trustworthiness is difficult to assess, while the dynamism of the industry brings new information almost every day.

These challenges notwithstanding, it is hoped that this pedagogical case study has shown that one attractive option available to Nintendo is to adopt a strategic vision based on the Resource-Based View of the Firm. Based on this theory, the company should delineate its strategic intent, and based on this strengthen its resources and core competencies, in order to launch products based not on already defined industry boundaries but based precisely on those resources and core competencies. This will give the company the opportunity to increase its economies of scope with minimum risk (because the expansion will be based on

its core competencies) and may allow it to develop partnerships that range from soccer, with FIFA; to movies with Disney; or theater in Broadway for instance; or even to circus with Cirque du Soleil for example. This is not difficult to envision because all these companies, though in different industries, are in the same business, entertainment; and Nintendo's core competencies are exactly in this area.

In conclusion, to return to profitability Nintendo should look within, and offer products based not solely on customers' current demands, but mainly based on its strategic intent and core competencies. Indeed, there may well be a ring of truth in Steve Jobs' words quoted by Isaacson (2011: 196) "*... Customers don´t know what they want until we've shown them".*

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