Case Synopsis

BUS 478 – D300

Group F

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Introduction

Nintendo Co. Ltd, founded by Fujisaro Yamauchi in 1889, began as a playing card business in Kyoto, Japan and, decades later, expanded to video game production. Nintendo released its first game console, the Nintendo Entertainment System (NES), in 1985 (Nintendo, 2013). The NES became an instant hit and set Nintendo to be a pioneer in the game console industry throughout the 1990s.

Gradual Decline

Nintendo enjoyed tremendous success as it continuously released new consoles: Nintendo 64, Game Boy, Game Boy Advance, GameCube, and more. However, the company faced increasing competition in the early 2000s from Microsoft's Xbox and Sony's PlayStation consoles and its market share started to decline. In 2003, Nintendo's share price fell sharply when Sony announced its PlayStation Portable (PSP), threatening the monopoly that Nintendo held on the portable console market (Kendall, 2009).

Change in Strategy

In an industry that competes based on delivering the latest technology, Nintendo's newly promoted president, Satoru Iwata, took the company in a new strategic direction to restore the company's former glory. Challenging the long-time video game market of boys, young men, and "serious gamers," Nintendo decided to change their strategy and target those outside their traditional demographic: women, seniors, and families (MaRS, 2010). Rather than focus on the latest graphics processors, hardware design, or engine speed, Nintendo took a new "fun and social" approach to gaming and released the Wii console. This new gaming system was based on body motions and was a simpler, less expensive hardware, which allowed it to capture a never-before tapped market of consumers who never thought they could "game." By creating higher product margins and expanding beyond their traditional market, Nintendo was able to make a comeback into the gaming console industry and regain its name as an innovative company.

Current Situation

Today, Nintendo has a market capitalization of $15.6 billion[1] (MarketWatch, 2013). The company is considered the third most valuable listed business in Japan, just behind Toyota Motor and Mitsubishi Financial Group. Aside from the head office in Japan, Nintendo has also expanded its business to the US, Germany, Canada, France, Netherlands, Spain, Australia and South Korea.

The Wii and The Wii U

Sales data on Nintendo's official website indicate that 99 million Wii consoles and 863 million Wii games software were sold worldwide in 2012. However, rivalry between Nintendo's Wii and other popular video game consoles, such as Sony's PlayStation 3 and Microsoft's XBox 360, is becoming increasingly intense. For the 2012 fiscal year, Nintendo reported its first annual loss of $5.6 million in the last three decades. The company's total operating income decreased from $1.8 billion in 2011 to a deficit of $393 million in 2012, a fall of 52% (Nintendo, 2012). Thus, in order to keep innovating and remain competitive in the gaming console industry, Nintendo has already launched its newest console, the Wii U, in the fourth quarter of 2012, a whole year ahead of the PlayStation 4 and the Xbox 720. The Wii U is said to be the successor of the Wii. To date, 3.06 million units of the Will U have been already sold worldwide (Nintendo, 2013).

Market Share

As of December 31, 2012, Nintendo enjoys a 43.5% share in the game console market in terms of unit shipment, from a mixture of the Wii, Nintendo DS, and Nintendo 3DS, as compared to Sony (38.8%) and Microsoft (17.7%). However, Nintendo has only 29.9% market share in terms of total revenue, which is less than Sony, who has 41.9% (ITCandor, 2013).

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[1] All figures in US dollars.

Company Strategy

Partnerships

Nintendo uses a licensing strategy to outsource video game development and profit via their extensive brand. Nintendo does develop software internally, but third party developmental partners create the majority of games produced. However, Nintendo maintains significant autonomy with the advertising and distribution of the games. This allows Nintendo to "maintain a degree of control over both the number of games produced and the content of those games" (NerdTrek, 2011). Nintendo also licenses its brand and intellectual property to firms such as Bandai and Kellogg (Nintendo, 2013). All products carrying Nintendo's name has the official Nintendo seal to verify the authenticity of the product (Figure 1).

Figure 1: Nintendo seal, retrieved from: http://www.nintendo.com/consumer/licensed.jsp

Expansion to New Markets

Nintendo operates a multi-domestic strategy in which products and even research and development is tailored to specific markets. The firm is divided into subsidiaries in which the parent company, Nintendo Co. Ltd, manages the global and Japanese operations while Nintendo of America, Nintendo of Europe, and Nintendo of Australia manages their own respective region. Nintendo recently started Nintendo of Korea and has entered in a joint venture with iQue LTD. to manufacture and distribute Nintendo products in the Mainland Chinese market. Finally, although Nintendo does sell its products online, its presence in this channel needs to be upgraded for further expansion of the business.

Differentiation and the Mass Market

Nintendo operates a differentiation strategy in an industry that rewards innovation and eliminates firms unable to keep up. Before the Wii, Nintendo was operating a focused differentiation strategy with a heavy emphasis on its target market. The introduction of the Wii opened Nintendo to the mass consumer market, allowing non-traditional gamers to find value in the product. However, with competitors catching onto Nintendo’s newfound market, new products such as the 3DS and Wii U have been created to sustain innovational advantage.

General Environment

Economic Recession

The video game industry in recent years has reached its maturity stage. Constant innovation and strong competitive advantages are necessary for competing firms to gain success in an industry that could be worth $83 billion by 2016 (Chapple, 2013). From an economic standpoint, the computer and video game software industry adds $4.9 billion to the U.S. GDP. However, since the 2008 recession, console and video game sales have been slumping. Consumers have less disposable income to purchase a new console every few years and the add-on games that are released alongside.

A Changing Industry

With virtually everyone owning a smartphone or a tablet nowadays, a new segment is now dominating the video game industry. Game companies are now investing in applications that reach the broad mobile market and can be purchased at a minimal price. This shift to mobility is a social change as consumers are now craving convenience and the marketplace for games and applications is gravitating from the retail store into the online realm. Nintendo and its main competitors, Sony and Microsoft, have already adopted this strategy into their existing infrastructure by providing past titles and additional content for purchase through online distribution.

Counterfeited Market

The video game industry is currently fighting to keep its intellectual property. With the emergence of the Internet and peer to peer sharing, the availability of pirated games has exploded. The industry is strongly fighting to prevent the usage of the “emulator” in which users can use flash roms to play games for free, either on a modified game console or on a personal computer. The industry is characterized by heavy governmental regulation for content and violence. Fortunately, this does not greatly affect Nintendo, who has internal controls that limit the amount of violence and nudity in its games. In fact, Nintendo’s internal controls have been one of its strengths in gaining a market leader role in the late 1980s. Nintendo limits the amount of games that third party developers can create on its platforms. This creates healthy competition and mitigates the risk of overcrowding the market with games; the main factor of the video game crash of 1982, during which industry revenues dropped from $3.2 billion to $100 million in just two year (Lambie, 2013).

Industry Environment

Bargaining Power of Suppliers

The bargaining power of Nintendo's suppliers is low, as Nintendo sources electronic hardware components from a wide variety of manufacturers. In the Wii console, for example, the DRAM comes from Samsung Electronics, the CPU from a joint development effort between Nintendo and IBM, the Sub-LSI from MegaChips, and the image processing LSI from NEC Electronics and AMD (Lytle, 2007). For some parts, like the AC adapter, Nintendo has multiple suppliers of the component.

Bargaining Power of Buyers

The bargaining power of Nintendo's buyers is also low, because Nintendo sells hardware and software products through a wide range of third-party retailers, including Amazon, Best Buy, Chapters, Costco, Future Shop, EB Games, Sears, The Source, Staples, Toys "R" Us, and Walmart ("Nintendo Retailers," 2013). Furthermore, Nintendo has a wide range of retailers that it uses to distribute products internationally in many different countries. Since each buyer is only one piece of Nintendo's complex downstream supply chain, each buyer has relatively little influence over Nintendo's distribution decisions. Some larger buyers, like Amazon and Walmart for example, do have more bargaining power than smaller ones, like The Source and EB Games.

Threat of Entry

The threat of new entrants in the console video games industry is medium. Existing competitors, like Sony and Microsoft, are well established and, like Nintendo, have gone through multiple generations of products. The established position of competitors makes it difficult for new entrants to break into the market, but there have been several examples of new entrants attempting to do so. The OUYA console based on the Android operating system held a successful crowd-funding Kickstarter campaign in 2012 that raised over $8.5 million in start-up capital, over 800% more than it was initially seeking (OUYA, 2012). OUYA's crowd-funding suggests that there may be significant demand for new entrants.

Threats from Substitute Products

The threat of substitute products is high. Nintendo's two major competitors, Microsoft and Sony, offer close direct substitutes to Nintendo's console products. Indirect substitutes to Nintendo video games also exist on the PC and Mac platforms. The console video games industry is currently an oligopoly, with multiple major players all producing effective substitutes. Nintendo is positioned as a price and innovation leader, but other companies are quick to mimic Nintendo innovations (such as with the Xbox Kinect and PlayStation Move motion-control products) and slash prices to encourage substitution in their favour.

Industry Rivalry

Industry rivalry in the console video games market is high. As an oligopoly, there is a high degree of competition between the three main players: Nintendo, Microsoft, and Sony. Competition from smaller, independent players and start-ups also contributes to the high degree of rivalry. Each of the major rivals spends vast resources on research and development, marketing, and advertising in order to compete more effectively with other rivals. The decreasing cost of electronic components and inputs also encourages rivalry, since it lowers R&D costs for established players as well as new entrants.

Internal Environment

Capitalizing on New Markets

Several years ago, Nintendo successfully carved out a new market segment. The release of the Wii in late 2006 was originally aimed at a demographic between ages 8 to 16 (Wikipedia, 2012). The wireless motion-sensing remote (in place of a traditional controller) that simulates live action play was a huge innovation in the console market. The ease of playing video games attracted new audiences: adults and the elderly. The console's rate of adoption was dramatically fast and nearly doubled the sales of the Xbox 360 by the end of 2009 (Schilling, 2010). With the Wii, Nintendo gained a new customer segment in leisure gamers in numbers that exceeded those of Sony and Microsoft, to establish a large install base. Nintendo is particularly strong in establishing cost efficiencies. The industry is saturated with dominant companies who opt to use penetration pricing to sell their consoles below cost in an effort to recoup their losses with video game sales. This is reliant upon gaining a large amount of users who, in turn, purchase a large quantity of games. While the Sony PlayStation 3 and Microsoft Xbox 360 are sold at more than $200 below costs, the Wii is priced at $250 and allows the company to make a profit of $50 (Schilling, 2010). The development of games also add to cost savings as it costs only $5 million to develop a Wii game compared to $20 million for a PlayStation 3 game, an incentive for third-party developers to create games for the Wii as well as other Nintendo products (Nintendo, 2013).

Internal Capabilities

Nintendo possesses a considerable amount of financial resources; they would be able to pay off their short-term debts with their cash at hand and have the opportunity to invest in developing new innovations to bring to their consumers. As it has been done time and time again in Nintendo's history, the development and launch of a successful product would rely not only on funding, but also on other tangible and intangible resources. Nintendo's product development is an example of quality execution in pooling organizational, physical, and technological resources together (Hitt et al., 2009). The existing patents and copyrights, coupled with strategically spread out manufacturing plants, pose a high barrier against imitating competitors. The success of a new product involves opportune timing of release to the market (such as in November to be ready for Christmas shopping), which has been historically successful due to the experience, and knowledge of Nintendo's upper management (Schilling, 2010).

Remaining a Competitive Force

Nintendo suffered a net loss of $624 million in the first three quarters of the 2011 fiscal year, but was able to recover from that to generate just under $1 million in net income at year end (Radd, 2012). The company has been experiencing a decline in sales for the third consecutive year, after posting a record high of nearly $12 billion at the end of 2009 (Nintendo, 2013). It is evident that the revenues from the Wii console have reached its capacity, therefore prompting the timely release of the Wii U at the end of 2012. The Wii U is the next big innovation from Nintendo; with a remote controller, it aims to capture some of the target segments of Sony and Microsoft. However, these two companies are in the midst of planning their new blockbuster console releases in 2013. It is speculated that Sony will release the PlayStation 4 in December (Sawh, 2013). Microsoft is anticipated to potentially release their Xbox 720 as early as April (Cnet, 2013). There is substantial threat that these two competitors will cut into Nintendo's current market share. The Wii U is an incremental innovation that builds onto the foundations of the Wii; with the core consumers being leisure gamers, these individuals may view that switching costs and reduced physical interaction of the console outweigh benefits that it brings. Additionally, it has been nearly a decade since Sony and Microsoft released their last console, resulting in greater product anticipation than the Wii U. A key opportunity available for Nintendo is to build on the success of the Wii, where they used a blue ocean strategy and introduced a new category of gaming to consumers, and make advancements in developing motion-sensing and interactive gaming consoles.

Main Strategic Challenges

With the highly competitive and volatile game console industry, Nintendo is facing high pressure from Microsoft, Sony, and other competitors. The release of the Wii U saw moderate success in selling 890,000 units in the US in its first six weeks despite a poor marketing campaign. In comparison to the release of the Nintendo Wii, which sold 600,000 units during its first week, the next generation console's success has been less than stellar (MacDonald, 2013). Since Nintendo released its console to the market early relative to the competition, the company appears to have the head start on the market. But this has instead left a hole in the market for buyers who are waiting for Microsoft and Sony's next generation consoles to be released in the upcoming year. Consumers were very receptive to the Wii with its innovative motion-sensing gaming approach but the competition was quick to develop their own alternatives - Microsoft's Kinect and Sony's PlayStationMove. Nintendo currently has a head start with the Wii U and will have to carefully manage it.

The mobile device market is growing rapidly which is shown through the success of smart phones and tablet devices sales. In 2012, Apple sold 125 million iPhones and 58 million iPads (Etherington, 2012); and Samsung sold 40 million Galaxy S III units (Osborne, 2013). These devices are also powerful video game platforms shown through the numerous games being sold in their respective application stores. The success of Angry Birds has shown that third-party development for smartphone platforms can be enormously profitable (Cheshire, 2011). Games for these devices are relatively inexpensive and easily accessible to the user, making them an easy substitute for Nintendo’s consoles and video games. With the smart phone and tablet market ever growing, Nintendo may have to diversify its video game offerings to meet this demand.

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