Sega Corporation: The dream and the plan to rise above

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ABSTRACT

This competitive marketing strategy case discusses the history of Sega Corporation, once a leader in the global videogame industry, and the company's strategic planning after the failed launch of the Sega Saturn, which caused a dramatic drop in its market share. The case focuses heavily on Sega's competitors as it was a highly competitive market at the time. Students should see that in markets with such heavy competition, it is easy for firms to rise and fall quickly. Additionally, the case shows that even with a stable and successful history, it is crucial that firms stay ahead of the curve in understanding its customers and exceeding their expectations.

Keywords: marketing, competitive strategy, Sega, videogaming

CASE OBJECTIVES

The purpose of this case study is to illustrate the competitive strategic planning elements and the different growth strategy alternatives for a business regarding its target markets and product offerings, including:

1. Performing a SWOT analysis
2. Understanding the key strategic issues leading to a company's competitive shortcomings
3. Thinking about the different strategies for a company in regard to long-term growth
4. Learning how innovation can be a competitive advantage
5. Applying the different elements of strategy for a low-market share company

The case is suitable for both undergraduate- and graduate-level courses in marketing, specifically, strategic marketing analysis, in areas where the students are studying marketing strategy and marketing planning.

INTRODUCTION

The 1970s is considered the golden age of video arcade games, introducing staples in the industry such as Pong, Pac-Man, and Space Invaders. This new age also allowed the programmers of such games to translate the physical earnings from coin-operated machines into investments for established companies such as Atari, Inc. specializing in electronic entertainment (Games Industry.biz, 2008). The 1970s also gave rise to the first generation of home consoles, or personal videogame units that could be used within the confines of a home or office. The period of the 1970s through to the late 1980s saw the rise of two more generations of consoles, with every generation bringing new competition and innovations along with it. If this two-decade span of development can be considered the birth and learning period for this infant industry, than the 1990s saw extreme growth issues, or growing pains, for many established companies. No other company exemplifies this as much as the Sega Corporation.

The mid-90s gave rise to the fourth generation of videogame consoles, and an intense rivalry rose between two juggernauts that had made names for themselves in the videogame industry: Sega Corporation (Sega) and Nintendo Co., Ltd. (Nintendo). By the late 1990s, major electronic companies took notice to this booming industry and decided to throw their weight behind electronic entertainment and engage the competition, most notably Sony Computer Entertainment, Inc. (Sony). It was at this time that Sega began to feel the pressure of competitors as well as the reality of failed products.

It was in 1997 that Sega was faced with a major growth issue, following the apparent disaster that was the Sega Saturn, the major competitor of Nintendo and Sony's primary fifth-generation console. Sega of America's president, Bernie Stoler, was then pressed by Sega's Japanese headquarters to essentially be the first to market and develop a new sixth-generation console. This would place Sega in a risky position due to the fact that a new generation release in such a short period of time would leave a massive gap for competition to innovate and surpass. On top of the competition catching up, if Sega's new videogame console release was a success, how would they deal with their in-house development of hardware and games? Lastly, could any alliances or investment in third party developers benefit the current situation?

BACKGROUND

A majority of the leaders in the modern videogame industry have roots dating back far before the rise of the generational home console rivalries, or "console wars" (Noble, 2009). Sega is a perfect example of such company, dating back to 1940. Sega's transition from a small-scale provider of coin-operated electronic entertainment to a multinational video game software and hardware development company spans over seven decades, with its fair share of successes and failures. Sega, originally titled Standard Games and then later Service Games, was founded in 1940 at Honolulu, Hawaii by three Americans named Marty Bromely, Irving Bromberg, and James Humpert. Their intention was to provide military servicemen with a means of entertainment during World War II (Sega History, n.d.).

In 1951, Bromely inspired the company to move to Tokyo, and Service Games of Japan (also known as Sega) was officially registered in May of 1952. An important aspect to keep in mind is the relationship between the United States (US) and Japan immediately following World War II. After World War II, Japan was a defeated nation. The loss of industry and human life had left the country economically unstable and although the US was there to support its growth, Japan's recovery would take time (Fahs, 2009). Therefore, the significance of Sega's founding fathers' joint decision to relocate to Japan aided much in the relationship building between nations at the time. Also contributing to this decision was the fact that the US had outlawed coin-operated slot machines in 1952, thus turning the Japanese market into an extremely lucrative business venture (Fahs, 2009).

In 1954, a New Yorker named David Rosen established a company called Rosen Enterprises and decided to undertake a business venture of his own, without any knowledge of Sega's, or Service Games', existence (Who's Got, 1999). While witnessing Japan's restructuring first hand while in the Air Force, Rosen saw an almost unlimited potential to invest in people and businesses throughout this tireless effort by Japan to rebuild. The evolution of products that Rosen began importing was met with great success, starting with importing portraits painted from photos ultimately to electromechanical arcade games. At this time, the arcade industry in the US was failing, with only pinball machines seeing any positive revenue. This allowed Rosen to purchase unused machines cheaply and shift its location to a newly discovered Japanese market, with none of the stigma left over from the failures of the arcade industry in the US at that time (Games Industry.biz, 2008).

In 1965, Sega Enterprises was established when Service Games merged with Rosen Enterprises. Service Games assumed the role of the parent company, while Rosen acted as the Chief Operating Officer (COO), a position he held until 1996 (Your Turn, 2013). The following year after the merger, Sega began designing and manufacturing proprietary arcade games to the Japanese market. One such game that ended up being a large factor in Sega's growth was Periscope, a gigantic machine costing nearly twice as much as other arcade games at the time. The cost did not deter success as the returns from Periscope were so positive that Sega began exporting games to the US, thus becoming one of the few international companies with a Japanese base. In 1969, after four years of growth, Sega Enterprises was sold to Gulf & Western Industries. Rosen still held his position as COO (Games Industry.biz, 2008).

The 1970s brought about the aforementioned golden age of the video arcade machines, which would lay the groundwork for the decisions and directions Sega has taken since. Digital videogames were quick to overtake mechanical games throughout arcades in Japan and the US and pinball machines alike (Your Turn, 2013). This also introduced new technology for usage

among the industry players, most important of which being the microprocessor. Sega would then go on to acquire Gremlin Industries, a San Diego-based company with the capabilities of producing microprocessor-based arcade games. Sega also began expanding distribution of their continuous proprietary successes. With the release and distribution of groundbreaking games such as Turbo, Zaxxon, and Buck Rodgers: Planet of Zoom, Sega expanded rapidly throughout the 1970s, not only becoming one of the major leaders of the arcade industry, but also able to acquire competitors' developers to garner even more creativity, an attribute Sega has always placed as a priority for company success (Games Industry.biz, 2008). Although the game industry was in full swing, it was clear to Rosen, as well as many other industry leaders, the industry could not sustain itself on physical arcades and poorly ported arcade games for home use. The initial evidence of this was the downfall of Atari beginning in 1983, resulting in a loss for Atari of $536 million (Games Industry.biz, 2008).

In the 1980s, following Atari's failed attempt at sustaining a home console market, both the Japanese and the North American arcade industry were witnessing a recession (System 16, n.d.). In conjunction with the plummeting home console market in both industries due to Atari's failed sustainability, two rival arcade industry leaders turned to the home console market as their primary area of focus. This would set the stage for the rivalry between Nintendo and Sega as laid out throughout this case, one which continues to this day. This could not be exemplified more than in the instance of both first complete consoles for the rival companies being released on the same exact day, July 15th, 1983 (Games Industry.biz, 2008). Sega released its first home console, the SG-1000, to a widely lackluster result. The issue was not only that Sega's console cost slightly more than Nintendo's, but also that its creativity and focus on innovation was completely lacking from Sega's first generation console. Needless to say, it was clear that Nintendo had garnered a substantial lead in the home console market with the Nintendo Entertainment System (NES) (Games Industry.biz, 2008).

Although the SG-1000 was considered by many to be a failure, it laid the groundwork for a much more successful console to compete against Nintendo, the Sega Master System (System 16, n.d.). The Sega Master System was released in Japan on October 20th, 1985 and in North America on June 1, 1986 (System 16, n.d.). Although three years apart, this placed Sega's console on the same playing field as Nintendo's in terms of specifications and price. This would also mark the clear beginning to the console wars between all industry rivals, as this would be the first instance that both Sega and Nintendo's console be on the same generational cycle, specifically third-generation consoles (Games Industry.biz, 2008).

In the 1990s, Sega experienced various levels of growth and ultimately retraction leading up to this case (Sega History, n.d.). By the time the third generation of consoles had reached their apex in the late 80s, Sega, as well as other industry leaders, prepared for the next evolution in technology and product offerings. The Sega Genesis was Sega's answer to the fourth-generation product line and although released in October 29th, 1988 in Japan, the Sega Genesis did not receive a worldwide release until November 30th, 1990 (Sega History, n.d.). Sega realized its faults with the previous SG-1000 and its subsequent minor upgrades and decided to produce a console with technological capabilities on par with other leading fourth-generation competitors (Sega History, n.d.). Sega also decided to overhaul their marketing efforts by targeting a slightly older crowd than Nintendo and other family friendly competitors had been known to target. The reasoning was that since the videogame/arcade industry's inception, the target market had always been viewed as extremely juvenile. By targeting a slightly older crowd, Sega was able to distinguish itself with an "in-your-face" style of advertising and aggressive marketing

campaigns. Sega realized this crucial marketing opportunity just in time for the Sega Genesis to establish itself as a strong fourth-generation competitor. Interestingly enough, this marketing position is still enacted in many of Sega Corporation's current business ventures (Sega History, n.d.).

From the mid to late 1990s the competition in the home console market continued to increase at a rapid pace. To make matters worse for Sega, another Japanese-based international electronics company decided to manufacture and produce a home console unit to compete with the industry leaders during the mid-90s (Games Industry.biz, 2008). This would culminate in the release of Sony's PlayStation (PS) console, set to compete during the various releases of fifth-generation consoles. In anticipation of the next console generation, Sega began development on the Sega Saturn, a 32-bit, CD-capable console unlike any current offerings. Development for the Saturn began in 1993 and continued for two years (Games Industry.biz, 2008). Achieving worldwide release July 8th, 1995, Sega continued its aggressive marketing strategy with the release of its fifth generation console (Scherpe, 2010). However, Sega experienced massive loses due to poor marketing and assumptions. First, Sega had announced a September release for the Saturn, and marketed it aggressively. Sega decided to surprise the market by releasing it months earlier in hopes that it would take the lead for this generation. Unfortunately Sega had priced the console $100 more than both Sony and Nintendo's consoles as they had not been released for sale yet (Who's Got, 1999). Second, this advance release of the Saturn also meant that Sega's selection of proprietary launch games were extremely lacking as the months cut were to be used for launch game development. Lastly, after all fifth-generation consoles were released all competitors began slowly dropping their prices, something the Saturn would have difficulty doing based on a complex system-board design that is unable to condense in a cost-saving manner. Ultimately, Sega naturally fell behind the competition, and by 1997 it was evident the Saturn issue would have to be addressed, merely two years after release at which point Sega had lost $267.9 million and laid off 30% of its workforce (Scherpe, 2010).

It was inevitable that a sixth generation of home consoles would be released over the next few years, not only from the major existing players, but Microsoft, another international electronics company, had made public their desire to manufacture and produce a home console to compete in the sixth generation as well. The only advantage Sega had when addressing the growth issue, was the fact that the Saturn had failed so early, and become "the other" console when compared with Nintendo and Sony by 1997(Scherpe, 2010). One glaring option Sega was facing was if the Saturn was to be discontinued, what would take its place in the sixth generation of consoles. Naturally, Sega's Japanese headquarters made its objectives clear that a new console would have to be developed. With the release of each generation of consoles comes with it a natural evolution in technology, for example on-board logistics gave way to cartridge which gave way to compact disc. Sega was astute at forecasting this evolution, which made it clear that a sixth generation console must consist and contain specifications closer to that of computers during that time. This would be the first instance that processing speed and graphical ability could be on par with personal computers, which were previously thought to be far superior in terms of processing and graphics. In the end, Sega was facing yet another thought decision, once again having the chance to be the first to market (Scherpe, 2010).

THE COMPETITORS

Nintendo Co., Ltd.

Since September of 1996, Nintendo has sold 2.6 million units of its high-technology videogame console, the Nintendo 64 (N64) (Browder et al., 1997). Additionally, it sold 2.7 million N64 units to the rest of the world (Browder et al., 1997). Nintendo requires a rigorous process for which videogames it wants to sell, unlike Sony who allows any game developer to sell games it develops. Thus, Nintendo has an overall of 40 videogame titles for the N64—a miniscule amount compared to Sony's PS videogame titles (Fitzgerald, 1997). However, Nintendo's marketing strategy for the N64 (and for most of its products) is to entice the younger audiences (e.g., young children and teenagers) and provide them with a few best-selling videogames than a cornucopia of mediocre ones. In fact, in April of 1997, seven of the 10 highest-selling videogames in the United States (US) were for the N64, including a videogame with Nintendo's company mascot, Super Mario 64 (Fitzgerald, 1997). Nintendo insists on using costly cartridges to run its videogames, because of its quicker performance than using CD-ROMs. Cartridges cost about $35 for a videogame developer, whereas CDs cost around $5 to $10 (Browder et al., 1997). Thus, the average N64 videogame price is around $60 to $70, which is a little bit pricier than Sony's average videogame price (Browder et al., 1997).

Interestingly, Nintendo's financial strength does not come from sales with the N64. The financial strength comes from its portable videogame console called Game Boy, a handheld 8-bit device that has a 1-megahertz processor. Since its 1989 release, Nintendo has sold 80 million units of this console, thus making it the best-selling videogame console in history (Croal et al., 1999). While the Game Boy's technology is inferior compared to its handheld videogame console competitors, such as Sega's Nomad (with a main processor of 8 bits, 7.67 megahertz and a coprocessor of 8 bits, 3.58 megahertz), its popularity with the target market does not come from its performance. Rather, its size, battery life, and its bundling with the highly addictive game of Tetris (i.e., a game of falling bricks) enticed consumers. Nintendo plans to bolster N64's sales by selling a device that connects it to the Game Boy, letting consumers project its Game Boy games to their television (TV) sets in high-resolution color (Croal et al., 1999).

Rumors have unfolded that Nintendo Co., Ltd. (Nintendo) is upgrading its 128-bit N64 with a 256-bit, 400-megahertz International Business Machines (IBM) PowerPC chip in its upcoming console, codenamed "Dolphin" (Croal et al., 1999). The new system was set to arrive in many US homes by 2000. Nintendo had not shown a prototype of the system or any demos of its videogames. However, the company confidently states that the Dolphin will achieve the same videogame graphics specifications of Sony Computer Entertainment, Inc.'s (Sony) PlayStation 2 (PS2) (Croal et al., 1999).

Sony Computer Entertainment, Inc.

Sony entered the videogame industry when Ken Kutaragi, a computer engineer working for Sony with a passion for videogames, proposed a videogame console that would combine the graphic capabilities of a workstation with Sony's CD-ROM drive. At the time, Sony Corporation was one of the leading manufacturers of electronics, and one of its product lines was the Walkman brand series of CD players. Nintendo supposedly contracted Kutaragi to set up a joint development team with Sony and Nintendo for the console that will be named the PlayStation

(PS) (Kunii, Brull, Burrows, & Baig, 1998). However, in 1992, Nintendo abruptly pulled out from the project. Kutaragi, now the head of research and development for the PlayStation, worked on the project alongside Sony's funding (Kunii, Brull, Burrows, & Baig, 1998).

Sony's marketing approach for PS when it released in December 1994 in the US was to sell it at a loss at $299 (Munk, 1995). However, the idea was not to make profit from the videogame consoles. Sony wanted to get the units into the hands of consumers, and then make money from sales of its videogames (around $49 to $69 per title) (Munk, 1995). The PS also had a creative promotional strategy. Sony largely ignored Nintendo's target audiences of teenagers and children and focused on older customers. Sony intended the PS to project an aura of hipness backed by its selection of racier, more complex videogame titles. Sony also enlisted athletes such as Terrell Davis, running back for the Denver Broncos football team, and Charles "Bo" Outlaw of the Orlando Magic basketball team to help promote its sports titles (Kunii et al., 1998).

Today, Sony has sold more than 7.8 million units of the PS which totaled to about $5.5 billion. The company also sold 236 million videogame compact discs (CDs) for the PS. In Japan alone, there are nearly 1,300 videogame titles. As mentioned previously, the PlayStation's financial strength came in its multitude offerings of videogames that catered to audiences of all ages compared to the N64 and Sega Saturn's carefully chosen limited number of videogame titles (Kunii et al., 1998). In addition, the PS's extra functionality as a CD player also provided a product differentiation from its competition (Chester, 2000).

Sony's future plans include bolstering its PS sales by offering a handheld game, codenamed "PDA" for personal digital assistant. The PDA will be sold for $30, and it functions as a memory card to store videogame save files. The PDA will also let consumers download software to allow them to play games in the PDA such as a digital-pet-care game (Kunii et al., 1998). In addition, Sony's next machine, the PS2, was expected to hit stores in 2000 . Sony has held a demonstration of the PS2 which uses a graphics chip called "Emotion Engine" that enables high-resolution graphics like never before. With this graphics chip, the PS2 will be capable of many aesthetic visuals to consumers such as emotions and hair strands flowing from avatars and characters, rippling water that reflects sunlight, swaying trees, and cascading fireworks. In addition, these graphics will not be prerecorded animations that all current videogame consoles do to present such high-resolution graphics (Croal et al., 1999).

Such new technology will require a large sum of money, however. Today, the average expenditure to produce a videogame on Sega's Genesis is about $200,000 (Croal et al., 1999). On the other hand, the PS and N64 average expenditures to product a videogame is about $2 million (Croal, 2000). Many videogame developers predict the expenditures for producing a videogame for the PS2 to at least $4 million (Croal, 2000).

THE MARKET

The videogame market is driven by the gaming platforms engineered by the top console manufacturers Sega, Sony, and Nintendo. It is the hardware that drives software development. It typically takes five years for new hardware to be released by videogame companies (Croal et al., 1999). In 1994, the videogame market had reached $6.5 billion, and Sega and Nintendo were the top console marketers in the US. The 32-bit PS system released by Sony in 1994 shook the market and created stiff competition for the two at the top, each with 16-bit machines, Sega Genesis and Nintendo Super Nintendo Entertainment System (SNES) (Fitzgerald, 1994).

Additionally, personal computers are becoming more of a threat as they are enhanced for gaming (Fitzgerald, 1994).

Just three years later, the current situation shows us that Sony now accounts for nearly 45% of console sales (Fitzgerald, 1997). Nintendo now holds 40% and its sales are quickly accelerating. Sega currently maintains less than 15% of the market, due to the disappointing Saturn release (Fitzgerald, 1997).

The current situation also shows us that the industry itself is changing. The videogame industry has begun to be lumped into a new market described as "interactive media" along with interactive TV, CD-ROMs, the Internet, and virtual reality. This new market offers countless opportunities to marketers of all types, including sports teams and players, books, movies, TV shows, and consumer goods who are looking for a new medium in which to advertise. And as the industry changes, so do the demographics that can be targeted. Videogames are becoming more appealing to older demographics, as well as to females (Williamson, 1995).

The global market for videogames is growing quickly. Sales of videogame consoles are projected to peak in Europe in 1998 (Ryan, 1998). Developing nations, such as China, are growing in sales as well, however, the growth rates are still slow. And while Japan has always been a good market, the country's financial woes have made them a difficult market for consumer electronics (Ryan, 1998).

THE DECISION

Bernie Stoler, Sega of America's president, has some difficult decisions ahead of him. Will Sega really be able to come back from the dead with the launch a successful new console? If Sega does launch a new system a year ahead of the competition, will the competitors use the time to enhance their systems even further before they are released? And what if Sega releases another failure? Will that be the end of Sega? Should Sega be pursuing other markets or should it make a change to its promotional activities. Or perhaps Sega should focus solely on software? Stoler needed to make a decision quickly as the pressure was on from the headquarters in Japan.

DECISION-MAKING QUESTIONS

1. If you were Bernie Stoler, what would you decide to do?
2. Do you think Sega should try entering new markets? Which ones?
3. Do you think Sega should change its promotional strategies?
4. What other ways could Sega increase market share in the US?

DISCUSSION QUESTIONS

1. Perform a brief SWOT analysis.
2. Briefly discuss Sega's two primary competitors and their differential advantages.
3. If Sega wanted to penetrate the same market with the same product, what could it have done?
4. If Sega wanted to develop its product line and sell it to the same market, what could it have done?

5. If Sega wanted to develop its target market with the same product line, what could it have done?
6. If Sega wanted to diversify its product line and/or target market, what could it have done?
7. Sega had a low market share during the critical decision period. What could the company do to increase its market share once again?

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