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New horizons or a strategic mirage? Artist-led-distribution versus alliance strategy in the video game industry

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ABSTRACT

In this paper we contribute to the debate between researchers who argue that the emergence of online distribution allows content producers in the creative industries to bypass powerful publishers and distributors, and other researchers who argue that this strategy cannot succeed without the complementary assets that these intermediaries provide. We use a case study of the Dutch Video Game Developer (DVGD) bringing to market an identical game using two different but comparable distribution channels as a quasi-experiment: in the first release DVGD used online distribution to reach consumers directly, whereas in the second it used an alliance with an established video game publisher. We find that, while the alliance required DVGD to share with the publisher a substantial fraction of the value appropriated by the game, the alliance strategy resulted in greater absolute financial performance and relative market performance compared to the self-publishing strategy. We conclude that the differences in performance can be traced back to specialized complementary assets required for successful commercialization.

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1. Introduction

Technological advancements have dramatically increased the ability of content producing entrepreneurs in the creative industries to commercialize their output directly to consumers without having to rely on powerful publishers and distributors as intermediaries. This change has meant that content-producing entrepreneurs can now singlehandedly publish their content onto online stores such as Apple's iTunes, Amazon's Kindle store, or Nintendo's WiiWare. The shift to what has been referred to as 'artist-led-distribution' (Clemons and Lang, 2003) has set off a debate on whether this tilts the fundamental balance power within creative industries in favor of content producers, or it represents an additional means of distribution with limited strategic potential (Bockstedt et al., 2006).

On the one hand, we have researchers that argue that such artist-led-distribution will revolutionize the creative industries, allowing content-producing entrepreneurs to bypass the traditional reliance on publishers, and appropriate the full value of their creativity (Bockstedt et al., 2006; Clemons et al., 2003; Clemons and Lang, 2003). At the same time, other researchers have been more critical, arguing that notwithstanding the opportunities offered by the Internet, the lack of complementary assets, such as marketing capabilities, relationships with gatekeepers, and organizational reputation will keep content producing entrepreneurs dependent on established publishers well into the future (Colombo et al., 2006; Gans and Stern, 2003; Mol et al., 2005; Rothaermel, 2001).

In this paper we contribute to this debate in the context of the video game industry. We examine the difficulties and opportunities entrepreneurial content producers face in commercializing their content using the online channel. Specifically, we look at a single case study of the Dutch Video Game Developer (DVGD) bringing to market an identical game using two different but comparable online distribution channels: in the first release DVGD used online distribution to reach consumers directly, whereas in the second it used an alliance with an established video game publisher. Our results show that the alliance strategy resulted in greater net revenues and higher relative market performance compared to the self-publishing strategy. Since an identical game was involved in both instances, we argue that the differences in performance can be traced to specialized complementary assets required for successful commercialization.

The paper takes advantage of this naturally occurring quasi-experiment to contribute to our understanding of the value creating

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interaction between content producers and publishers in the creative industries. Although some research has examined this relationship previously, most of this research has been conceptual (Bockstedt et al., 2006; Teece, 2006). Our paper therefore makes an empirical contribution to this area of research. It also makes a contribution to emerging empirical research on strategy in the online economy (Amit and Zott, 2001; Yadav and Varadarajan, 2005). Specifically, our study examines to what extent content producer strategies that were shaped by the traditional 'bricks-and-mortar' offline economy, have been rendered obsolete by technological advancements, i.e. online distribution. We provide evidence for the proposition that notwithstanding the much lower costs of online distribution in the creative industries, other factors, specifically, specialized complementary assets that are embedded in market knowledge, mass media selection, and relationships with gatekeepers – lead content producers to retain alliances with publishers as an important strategic option.

The structure of the paper is as follows: the next section provides a theoretical background on the advantages and disadvantages for small-sized, technology-based, firms to engage in strategic alliances with incumbent firms compared to independent commercialization strategies. This section is followed by application of these insights to the context of creative industries. Hereafter the methodology is discussed, after which the results of our study are presented. The paper ends with a discussion, conclusion, and directions for future research.

2. The role of specialized complementary assets in commercialization of innovations

In his seminal piece on Profiting From Innovation (PFI), Teece (1986) provides a framework for innovators to determine how they are best positioned vis-à-vis vertical competitors in the value chain for subtracting economic rents from their products. According to the framework, a firm should base its commercialization strategy on access to complementary assets, which are those assets or capabilities that go beyond the mere technical knowledge of the innovation itself (Teece, 1986, 2006). Complementary assets include tangible resources, such as financial capital (Malecki and Tootle, 1996), and intangible resources such as marketing skills (Teece, 2010), referrals and contacts (Stuart et al., 1999), and proprietary distribution channels (Teece, 1986).

By contrast to *generic* complementary assets that are easily obtainable in the market, and thus have limited strategic importance, *specialized* complementary assets are strategically important because they are not readily available in the market place (Barney, 1991; Rothaermel and Hill, 2005). Specialized complementary assets are usually inimitable, scarce, and difficult to reproduce. They are the product of idiosyncratic investments, are usually path dependent, and require significant time to develop. Their scarcity is often due to incumbent firms preemptively acquiring these assets, and then withholding availability to new entrants (Arora and Ceccagnoli, 2006; Teece, 1992; Teece et al., 1997). Research suggests that firms that lack the specialized complementary assets needed for successful commercialization of their innovations should secure access to these assets through acquisitions – if financial resources are adequate and suitable target firms can be found – or strategic alliances if willing partners are available (Gans et al., 2002; Teece, 1986, 2006).

Small-sized, technology-based, firms often find themselves facing large incumbent firms who exercise control over specialized complementary assets (Colombo et al., 2006; Rothaermel and Deeds, 2004; Street and Cameron, 2007). Since capital constraints prevent small firms from acquiring these specialized complementary assets, and "renting" these assets is often not a viable option (Arora and Ceccagnoli, 2006), access can only be granted by forming alliances with incumbents (Colombo et al., 2006; Gans and Stern, 2003; Rothaermel and Deeds, 2004; Teece, 2010). While this is generally seen as a positive strategic move (Prashantham and Birkinshaw, 2008; Stuart et al., 1999), the cost of the alliance might outstrip its advantages if the incumbent uses its market power to force the innovator to accept a distribution of economic rents that is highly unfavorable to the latter (Teece, 2006).

Technological advancements, such as the advent of online distribution, create new strategic options for small resource-strapped firms that face strong incumbents (Barras, 1990; Kretschmer et al., 1999). In the creative industries, in particular, the advent of online distribution means that entrepreneurial content producers (e.g. video game developers, music producers, or writers) no longer have to rely on specialized complementary assets owners such as publishing houses, and brick-and-mortar retailers, to reach their end consumer. Rather than engaging in alliances under tight economic constraints, small firms can now opt to bypass complementary asset owners altogether, offering their product directly to the consumer.

Having this option, however, does not automatically translate into a viable strategy. Researchers generally accept that specialized complementary assets generate additional sales (Arora and Ceccagnoli, 2006; Nerkar and Roberts, 2004). They also agree that specialized complementary assets are costly to create and maintain, and by the same token, are costly to purchase or rent. The critical question that must be addressed, therefore, is whether the cost savings of vertical strategic bypassing of established publishing actors will make up for the additional rents that can be generated through the use of the publisher's specialized complementary assets?

The next section provides an overview of this calculation. The succeeding section discusses the debate on the advantages and disadvantages of vertical bypassing versus alliances in creative industries. In particular, we examine the two opposing views: the first argues in favor of pursuing an independent, artist-led-distribution strategy, while the other favors the formation of strategic alliances. After identifying the specialized complementary assets that are important to success in creative industries, we propose that the relative performance of small-sized, technology-based, firms that lack the specialized complementary assets is higher when forming an alliance strategy as opposed to an artist-led-distribution strategy.

2.1. Why small firms should (not) form a strategic alliance

Spekman et al. (2000: p. 37) define strategic alliances as "close, collaborative relationships between two, or more, firms with the intent of accomplishing mutually compatible goals that would be difficult for each to accomplish alone." The complementary assets motive for alliance formation is particularly common to small-sized, technology-based firms that focus on commercially exploiting technological innovations (Eisenhardt and Schoonhoven, 1996; Gans and Stern, 2003). These firms possess distinctive technological competencies relating to a new product, process or service idea, that need to be used in conjunction with specialized complementary assets in order to generate economic returns. Small-sized, technology-based firms can benefit from specialized complementary assets of prospective partners when shortage of time and lack of resources, make it difficult to independently reproduce or imitate these specialized assets.

Apart from benefitting from the use of the specialized complementary resources that are made available by alliance partners, small firms also benefit from the implicit and explicit endorsement that an alliance with large incumbents usually brings (Colombo et al., 2006; Prashantham and Birkinshaw, 2008; Stuart et al., 1999). This can be particularly valuable in situations when the strengths

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