Nintendo: A Competitive Advantage Analysis

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Overview of the Strategic Analysis

The primary goal of a strategic analysis is to completely examine both the internal and external movements of a company in order to effectively make decisions and goals (*Strategic analysis,* 2023). There will be four sections. The first section is a summary of the focal company, Nintendo Co., Ltd. (Nintendo). The next section will dive into the external analysis, internal analysis, SWOT analysis, and competitive advantage analysis. The external analysis will thoroughly examine the macro-environment (via a PESTEL analysis) of Nintendo, as well as an examination of the industry utilizing the industry life cycle analysis and industry forces analysis.

The internal analysis will look at the current business model, value chain analysis, the integration process in the value chain, and VRIO analysis. A SWOT analysis will compile the strengths, weaknesses, opportunities, and threats that Nintendo faces, which are synthesized from the external and internal analyses. Finally, a competitive advantage analysis will be conducted through both quantitative analysis and qualitative analysis comparing Nintendo to its two main competitors: Sony and Microsoft. Through these analyses, the state of Nintendo's business operations will shed light on the potential strategies Nintendo could pursue. One key strategy is proposed that will allow them to potentially grow their revenues amongst their target demographics.

It is important to note that Nintendo is a large, diversified company. Their range of operations include hardware, software, mobile gaming, online platforms, licensing, merchandising, theme parks, and video production. The focus of this strategic analysis is on the console operations. At times, the other divisions may be discussed due to the interconnected nature of Nintendo's operations.

About Nintendo

Based on Nintendo's website, they produce a variety of video games and gaming consoles, such as Super Mario Bros, The Legend of Zelda, Nintendo Switch, and Nintendo Switch Lite. For fiscal year end 2022, total revenues equaled a little over 14 U.S. dollars (Nintendo, Inc). Regarding divisional revenues, Nintendo made 1 billion U.S. dollars with the release of the Super Mario Brothers movie in April 2023, which likely led to a 50% rise in their quarterly earnings (Kharpal, 2023). Looking at Figure #1 below, 70% of gamers are over the age 18 years despite the common stereotype that gamers are young children and teenagers. "The largest user group of Nintendo Switch, the company's most recent and highly popular console, is aged 20 to 25, with a significant portion of users well into their mid 40s. This is in contrast to the Nintendo 3DS, which is far more targeted to a younger audience of under 18s" (Carmely, 2023). By taking this information into account, Nintendo might benefit from shifting their target customer demographic, such as to individuals aged 18 years or older or expanding their customer base to a broad range between 5 and 50 years of age.

Looking specifically at the Nintendo Wii, the company was able to include motion control with games like Mario Kart. No other gaming company had done this until Nintendo game out with this. It had high customer satisfaction since a significant number of customers went crazy over this product. Nintendo dominated other companies in the market by producing expensive consoles that were not in the market before. As seen in figure #2, Nintendo was able to reach a younger audience with the release of the Wii.

Nintendo dominated other companies in the market by producing expensive consoles that were not in the market before. Looking at Figure #3, Nintendo has outperformed its competitors by a wide margin. Nintendo has 73% awareness and 47% popularity. EPIC Games has a 53%

awareness, a 20% distance between them and Nintendo. Electronic Arts comes in at a distant second at 32% popularity, a 15% difference between the company and Nintendo.

Figure 1

Current State of Nintendo Switch

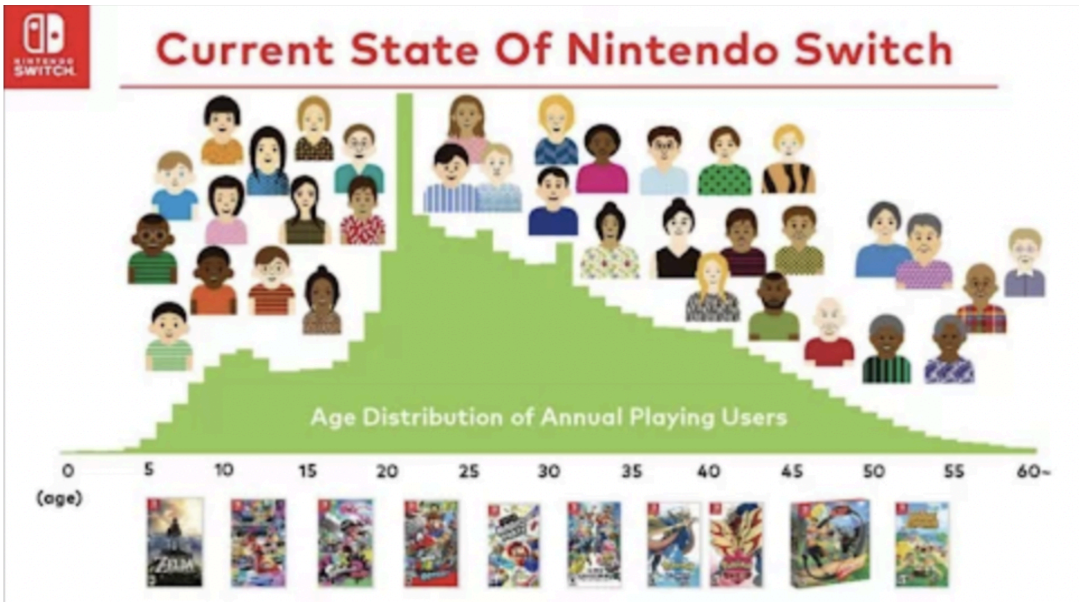


Figure 2

A younger audience playing Wii Tennis

Figure 3

Gaming companies that are the most liked

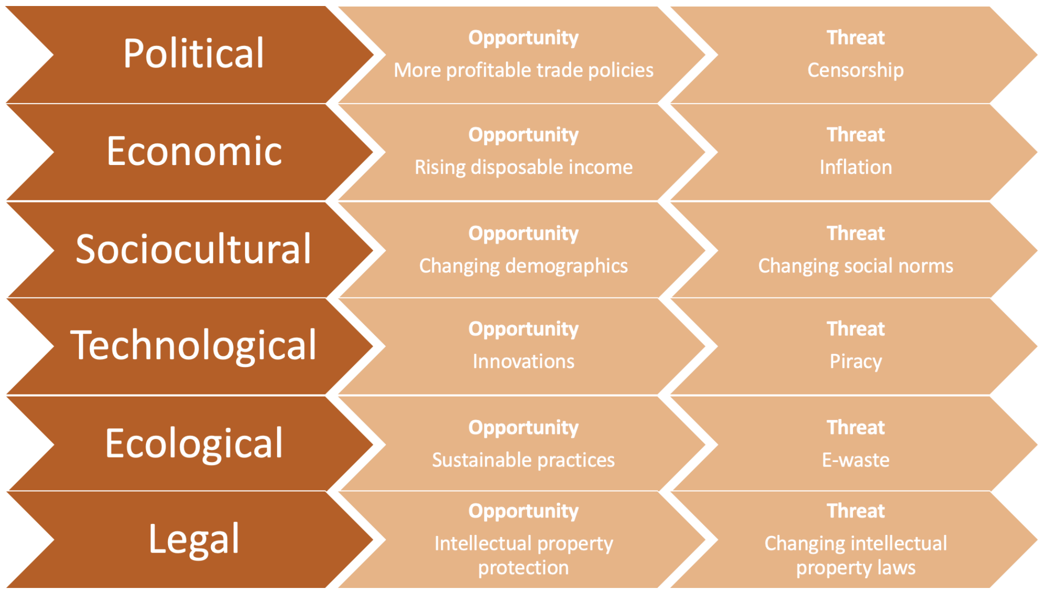
External Analysis

Macro-Environment Analysis (PESTEL)

In the most macro-level of the environment, the factors impacting business operations can create headwinds and tailwinds for a business. An analysis tool that can help scan the environment to identify the potential opportunities and threats is called PESTEL—an acronym for the six categories of factors, Political, Economic, Sociocultural, Technological, Environmental, and Legal (*What is a pestle analysis?*, n.d.). The diagram below displays one key opportunity and threat facing Nintendo for each of the PESTEL factors. In the next section, each factor is described in further detail.

Figure 4

Diagram of PESTEL



Political Factors

The opportunity of having more profitable trade policies with other countries will likely reduce import and export costs for Nintendo. In certain countries, video games are often subjected to censorship, this affecting the distribution of game content and consoles.

Economic Factors

In recent years, disposable income has been rising both nationally and internationally, which suggests that individuals are more willing to spend more money on entertainment. Unfortunately, inflation has been on the rise in recent years, which leads to rising costs for Nintendo and less people willing to spend on non-essential goods.

Sociocultural Factors

There has been an increasing popularity of ESports and gaming as well as a changing demographic. For example, there has been an increased usage of the game Animal Crossing among middle aged women. Sadly, changing social norms have taken a toll on the video game industry. Parents recently have been limiting the amount of screentime their children have, therefore lowering the volume of sales in the market.

Technological Factors

Innovation into augmented reality as well as virtual reality will likely lead to higher sales and net profit for Nintendo since both AR and VR have increased in popularity over the past few years. Unfortunately, the threat of piracy has grown in the past twenty years, this having the company's reputation possibly be negatively affected.

Ecological Factors

By taking the opportunity to expand to more environmentally sustainable practices, such as in manufacturing and packaging, Nintendo can reach more people and thus increase their sales. An unfortunate threat is the e-waste most gaming companies do. E-waste involves throwing away all of the electronics and disposable batteries instead of recycling those products.

Legal Factors

Nintendo has strong intellectual property protection on their popular games and products, such as Super Mario Bros, The Legend of Zelda, and the Nintendo Switch. Sadly, intellectual property laws are changing, thus making it more difficult to keep their existing intellectual property protection.

Synthesis of PESTEL

The single most important opportunity is the changing demographics in the gaming industry is experiencing. This increases the customer base exponentially, which leads to more potential sales and profits for Nintendo. The single most important threat identified is the changing social norms around video games. Addiction to screens has the potential to be a major problem. For example, internet cafes in Japan saw people spend twenty hours straight there. This is a problem for potential sales revenue because fewer individuals may use the products made and distributed by Nintendo.

Industry Overview

Key Drivers of Revenue

Nintendo has a variety of items that drive revenue, such as console sales, accessories, and video game sales. Console sales make up a majority of Nintendo's overall sales. Holiday seasons and new product launches particularly drive overall revenues. Accessories that are often sold with consoles, controllers likely being the most common, also help drive revenue. Thirdly, physical copies and digital downloads of video games, such as Super Mario Bros and The Legend of Zelda, also help drive revenue.

Key Drivers of Costs

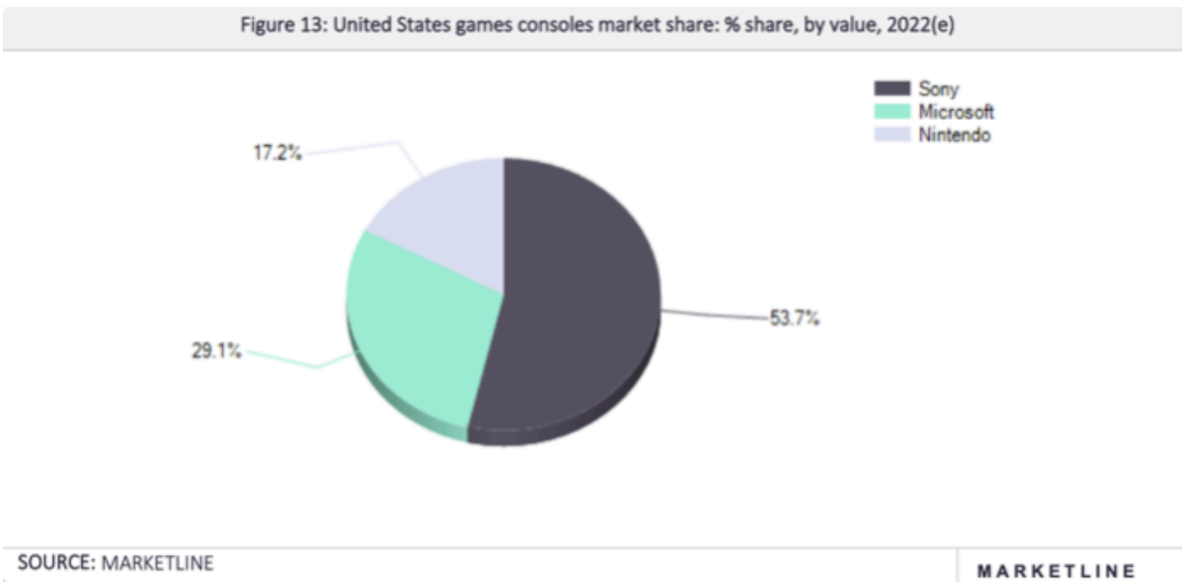
Key drivers of cost for Nintendo include development and manufacturing for hardware, development for software, and compliance with regulatory guidelines. Video game consoles require a significant amount of hardware and the costs for developing and manufacturing those pieces are large. Development for software is also costly since the areas of game design and programming fall into this category and both have significant costs attached to them. Thirdly, there are regulatory guidelines, such as intellectual property obligations and safety regulations, that need to be followed. These can incur costs that the company has to pay in order to stay open and in business.

Industry Strategic Groups

The diagram below looks strictly at the market share of gaming consoles in the United States in 2022. Nintendo's main competitors, Sony and Microsoft, make up 53.7% and 29.10% of the market share respectively. Nintendo makes up 17.2% of the market share in the United States while the remaining 3% are other companies in the industry.

Figure 5

Diagram of Video Game Console Industry by Market Share

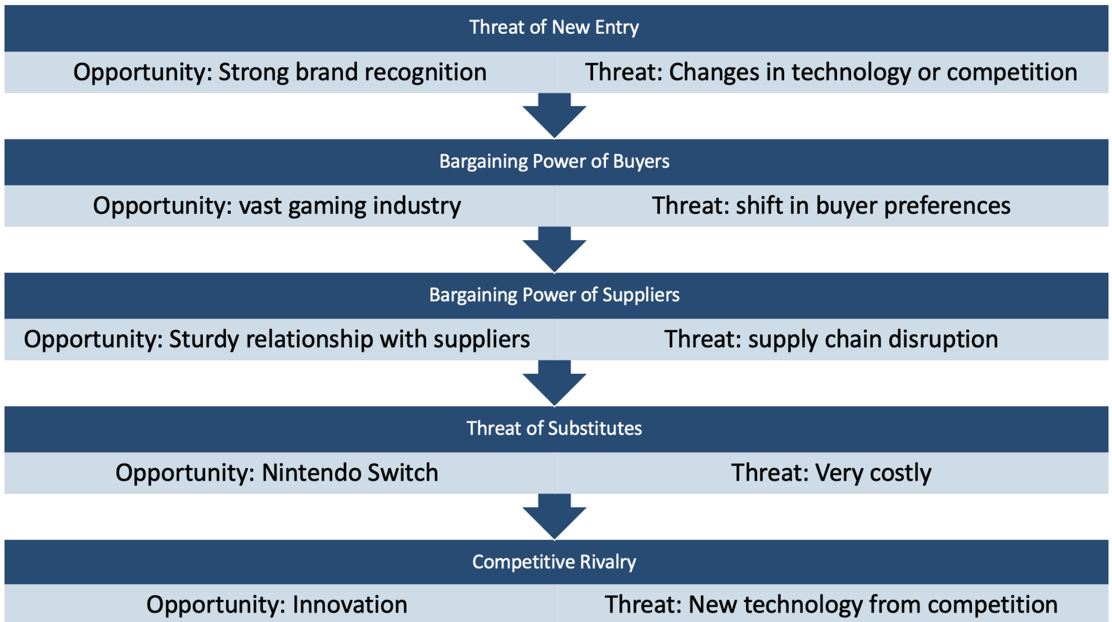


Industry Forces (Porter's 5-Forces) Analysis

An industry analysis would not be complete without an examination of the competitive pressures in the industry (*Porters 5 forces explained and how to use the model*, 2023). The Porter's 5-Forces framework can shed light on how these stakeholders create opportunities and threats for the industry at large and Nintendo, specifically.

Figure 6

Diagram of Porter's 5-Forces



Threat of New Entrants

Nintendo has strong brand recognition among buyers, thus making it more difficult for companies to enter the market. Unfortunately, companies enter the video game market and can make a significant impact in the market share. Advances in technology can also have the power to disrupt the current video game market.

Bargaining Power of Buyers

In the video game industry, there is competition from other companies, Sony and Microsoft being the major ones, that Nintendo has to tackle. The competition from other companies can lead Nintendo to innovate their products and provide competitive prices. Sadly, customers may change their preferences, which will lead to lower sales and profits for Nintendo.

Bargaining Power of Suppliers

Nintendo currently has a strong association with their current suppliers, which leads to lower chances of suppliers entering the video game market. Suppliers may have supply chain issues due to abrupt national and/or international events, such as the COVID-19 pandemic.

Threat of Substitutes

With the release of the Nintendo Switch, people were able to play video games anywhere and Nintendo was able to set themselves apart from their competitors. Unfortunately, it is very expensive to finance research and development as well as other expenses when developing new technologies.

Competitive Rivalry

In order to have a competitive advantage over their competitors, Nintendo needs to consistently innovate their products and services. Nintendo needs to take into account what their competitors, Sony and Microsoft, are producing in order to predict future profitability.

Synthesis of Porter's 5-Forces

The most important opportunity for Nintendo is leveraging aspects of the Nintendo Switch in order to set them apart from competitors. By producing this handheld console, Nintendo has a competitive advantage when compared to Sony and Microsoft since those companies have not produced a handheld device yet. The most important threat for Nintendo is keeping up with their competitors, Sony and Microsoft, in order to outperform financially. Their competitors have a large amount of money, therefore making the research and development budgets very high even though they are competing for the same market share as Nintendo.

Internal Analysis

Business Model

This section will focus on the video game console industry and the innovation-based business model that has been incorporated. The software industry tends to operate on a pay-as-you-go business model, whereby customers purchase the entire video game outright and take the product home for use (*What is the pay-as-you-go business model? the pay-as-you-go* *business model in a Nutshell*, 2023). While there has been movement towards freemium mobile gaming, the majority of Nintendo's software operates under a pay-as-you-go model. The business model is supported by a differentiation strategy based on Nintendo's spirit of innovation that creates unique products and features for consumers. By incorporating innovation into any business model, the company will be allowed to have a competitive advantage over companies in the industry and will make customers more likely to purchase their products. Along with this, innovation helps a company become more diverse in the products and services they provide instead of relying solely on a few key products and services. Nintendo has been able to successfully innovate with the Nintendo Switch, a gaming console that can be handheld as well as connect to a television. Nintendo's mission is to provide a positive gaming experience to a wide variety of individuals. By focusing on innovation, Nintendo will be able to make the greatest amount of people smile.

Value Chain Analysis

Primary Activities

The primary activities of Nintendo are their operations, services, and marketing and sales. While Nintendo produces the hardware pieces for their consoles, they also develop the games for said consoles. Before making both consoles and games open to the public, they are tested for quality and reliability. Secondly, Nintendo provides online technical support services as well as customer service in order to troubleshoot any problems consumers might experience with their products. Consoles and games also go through routine updates and maintenance, which only adds to the services that Nintendo provides. Lastly, Nintendo markets their products through events and partnerships with other well known companies. Nintendo also offers their games and consoles to be sold in a variety of wholesalers, such as Target and Costco. Nintendo also provides customer support even after the purchase of a product or service.

Support Activities

While Nintendo has a variety of primary activities, the company also has a diverse range of support activities, such as human resource management and technology development. As part of their human resource management, Nintendo has an employee culture that encourages creativity and innovation. Along with this, the company recruits and maintains their current staff in a variety of different fields, such as hardware design and game development. Secondly, Nintendo has invested in research and development (R&D), which has led them to create a unique experience for their games.

Integration Synergies in the Value Chain

Financial Dimension

Within Nintendo, there are various value chain activities that are connected by the appropriation of resources. In order to create a unique experience for users, these resources are primarily invested in technology and innovation. These then influence both structural and operational decisions within the company. Secondly, the sale of both hardware and software as well as services generate revenue. That revenue is reinvested into various internal departments, such as human resources and research and development. Lastly, the revenues of primary activities, such as sales from hardware and games, can be used to support human resources and research and development activities, which, in turn, helps drive revenues for the primary activities.

Technical Dimension

Nintendo massively values technological innovation, which is the reason it is at the center of the value chain within the company. Developments to Nintendo's technology affect the company's operations in every aspect and can be used to innovate and create new products, such as the Nintendo Switch. In turn, this enhances the customer experience and therefore increases the profits of the company.

Structural Dimension

Nintendo follows a hierarchical structure that coordinates with both the primary and support activities. This provides the company with a different approach to gaming. The structure that Nintendo currently uses makes communication between different departments possible, such as communication between marketing and product development. Along with this, the infrastructure set within the company provides guidelines for how decisions are made, such as for how resources are distributed.

Cultural Dimension

Nintendo places a powerful importance on creativity and innovation, which influences how Nintendo approaches certain departments, such as marketing. These long-term cultural values provide Nintendo with the framework for good customer satisfaction and quality, which affects its internal strategic decisions. These cultural values affect human resource activities since these individuals need to keep these values in mind when recruiting and training new employees.

VRIO Analysis

A company's strengths and weaknesses can be discovered by examining the key resources and capabilities within its business operations (Frue, 2022). A useful framework for examining these assets is the VRIO framework, whereby the asset is examined for being valuable, rare, inimitable, and organized into the company. The table below lists Nintendo's primary resources and labels each as a strength or a weakness.

Table 1

Nintendo's Resource Strengths and Weaknesses

List of Resources and Capabilities	Label as a Strength or Weakness
1. Innovation	Strength
2. Established Brand and Reputation	Strength
3. Stable Cash Reserves	Strength
4. Strong Partnerships and Marketing	Strength
5. Well Known Intellectual Property	Strength
6. Limited Third-Party Support	Weakness
7. Regional Challenges	Weakness
8. Dependence on Limited Franchises	Weakness
9. Challenges with Competition	Weakness
10. Lagging Online Services	Weakness

Synthesis of VRIO

While Nintendo possesses several strengths, their primary assets include their well-known intellectual property and innovation. Nintendo has a variety of well-known franchises, such as Pokemon, Super Mario Bros, and The Legend of Zelda, that have generated a committed fan base willing to purchase both games and merchandise as well as support media adaptations. This has created considerable revenue for the company. Nintendo has also been able to innovate with new products. For example, the Nintendo Switch has the ability to be a portable console as well as connect to a television. Nintendo's main competitors, Sony and Microsoft, have not moved into portable gaming, therefore making Nintendo the first gaming company to go into this market. The Nintendo Switch was able to set the company apart in a positive light and attract an even more diverse audience.

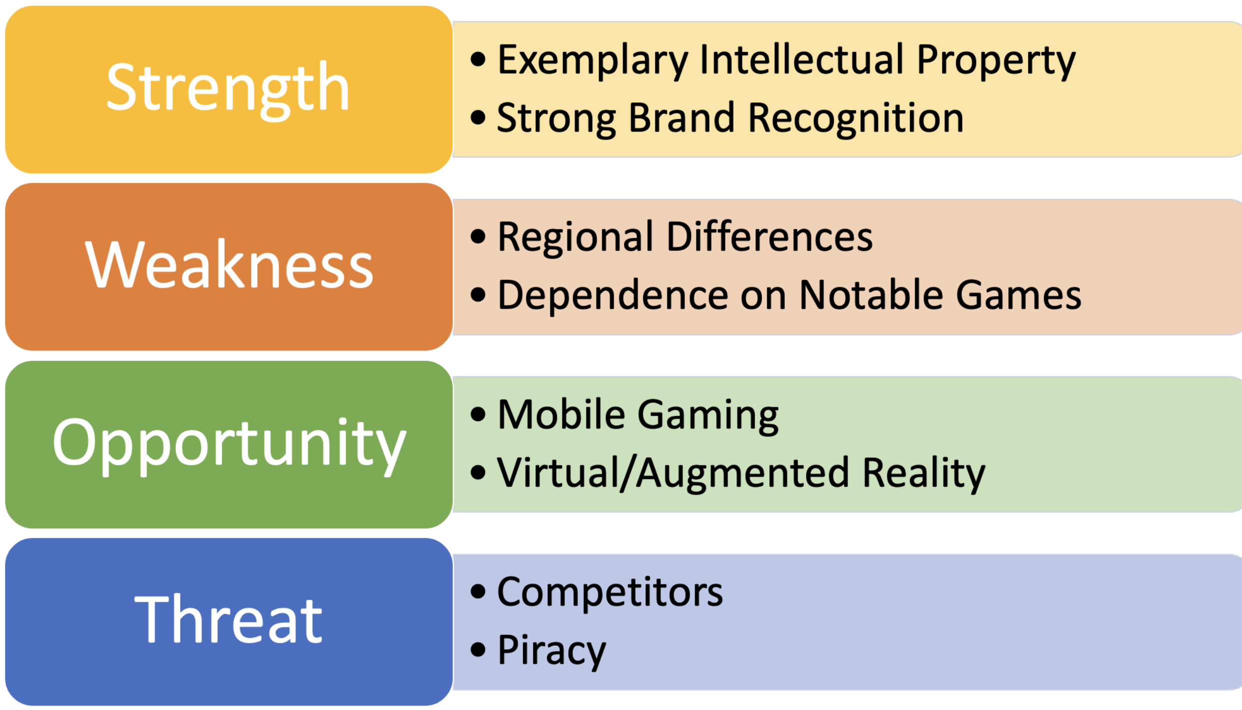
Secondly, Nintendo's key weaknesses are their limited third-party support and the challenges they face with competition. Since Nintendo has a limited number of third-party game developers, they are not able to have as wide of a game library when compared to Sony and Microsoft. Similarly, Nintendo also competes with the PlayStation, made by Sony, and the Xbox, made by Microsoft, in the market of gaming consoles. With the rise of mobile gaming, the handheld devices produced by Nintendo may cause decreased sales in the future.

SWOT Analysis

A SWOT analysis is a simple framework that compiles the key strengths, weaknesses, opportunities, and threats for a business (Kenton, *SWOT analysis: How to with table and example*). These factors have been identified through the various analysis tools in the external and internal environments. Below is a figure that summarizes these key SWOT factors previously described in the report.

Figure 7

Diagram of SWOT



Competitive Advantage Analysis

A company's advantages can be quantified and qualified by benchmarking their metrics against a competitor (Fallon, *What is benchmarking? uses and benefits in business*). In the next two tables, the relevant competitive advantage metrics for Nintendo in this console industry are compared against their key competitors, Sony (the maker of the console, Playstation) and Microsoft (the maker of the console, Xbox).

Quantitative Analysis

To begin the competitive advantage analysis, this report implements a quantitative approach. Nintendo is compared to Sony and Microsoft using five different financial metrics, which are common measures of economic success amongst large, publicly traded companies. Table 2 lists the metrics, and the synthesis section will explain the comparisons with more detail.

Table 2

Financial Ratio Comparisons Across Companies

Metric	Nintendo	Sony (Playstation)	Microsoft (Xbox)
Profit Margin	27.20%	6.51%	45.31%
Operating Margin	28.21%	9.19%	47.59%
Return on Assets	11.84%	1.87%	14.57%
Return on Equity	20.39%	11.54%	39.11%
Price to Earnings Ratio	19.30	18.25	33.44

Qualitative Analysis

The next part of the competitive advantage analysis is to compare Nintendo against Sony and Microsoft based on non-financial metrics. These different qualitative measures reflect the multitude of goals beyond the financial success of a company, such as customer-centric, employee well-being, and environmental impact goals. Table 3 lists the metrics, and the synthesis section will explain the comparisons with more detail.

Table 3

Competitive Metrics Comparisons Across Companies

Metric	Nintendo	Sony (Playstation)	Microsoft (Xbox)
Customer Service	4.10	4.10	4.00
Environmental, Social, and Governmental	AA	AAA	AAA

Employee Satisfaction	3.90	3.90	4.50

Synthesis of Competitive Advantage Analysis

Looking at Table 2, Nintendo appears to be lower than Microsoft but greater than Sony across all metrics given. Nintendo has a low profit margin when compared to Microsoft. This suggests Nintendo does not manage and control their costs as well as Microsoft or that the company is in a highly competitive industry. When compared to Sony, Nintendo has a high profit margin, which implies Nintendo can generate more profit relative to the revenue being brought in when compared to Sony. This could also indicate that Nintendo can more effectively manage costs as well as provide a stronger competitive advantage and have more sway over the pricing of their products.

Secondly, Microsoft has a greater operating margin when compared to Nintendo. This indicates that Microsoft is better at managing their operating expenses in relation to the revenue being brought in by the company. Per United States dollar generated, Microsoft is earning a greater percent of profit when compared to Nintendo. Along with this, a high operating margin suggests that Microsoft is more efficient in managing the costs related with management and operations. When compared to Sony, Nintendo has a significantly greater operating margin. This suggests that Nintendo is better at managing their operating expenses in relation to the revenue being brought in by the company. Per United States dollar generated, Nintendo is earning a greater percent of profit when compared to Sony. Along with this, a high operating margin suggests that Nintendo is more efficient in managing the costs related with management and operations.

Looking at Return on Assets, Microsoft has a greater value when compared to Nintendo, which suggests that Microsoft can generate more profits for every one unit of assets more efficiently. Nintendo, when compared to Microsoft, is less efficient and effective in using their assets to generate earnings and does not utilize their assets as well. On the other hand, Nintendo has a significantly greater Return on Assets when compared to Sony. This implies that Nintendo can generate more profit for every one unit of assets more efficiently than Sony. Nintendo, when compared to Sony, is more efficient and effective in using their assets to generate earnings and utilizes their assets better.

Fourthly, Return on Equity is a good metric to use to evaluate a company. A higher Return on Equity is considered beneficial since it indicates the company can utilize their equity and generate profits from said equity. Microsoft has a greater Return on Equity when compared to Nintendo, suggesting Microsoft is better at utilizing their equity to bring in profits. When comparing Nintendo to Sony, Nintendo utilizes their equity more efficiently to generate profits.

Looking at the Price to Earnings Ratio in Table 2, Microsoft has a greater ratio than Nintendo. This considered, a low Price to Earnings Ratio suggests there may be concerns about Nintendo's future, especially that the company may be operating in a mature or even declining industry on the business cycle. Nintendo's stock may be undervalued when compared to its earnings and investors may not have high expectations for growth in the future when compared to Microsoft. Looking at the comparison between Sony and Nintendo, Nintendo has a greater Price to Earnings Ratio. This suggests that investors are willing to pay more for a share of stock in Nintendo and expect more growth in this company when compared to Sony. A high Price to Earnings Ratio when compared to competitors could indicate that their stock is overvalued, therefore making investors take a more cautious approach before purchasing Nintendo stock.

Moving to Table 3, Nintendo has a rating of 4.10 stars out of 5 stars total for customer service while Sony has a rating of 4.10 and Microsoft has a rating of 4.00. This implies Nintendo has greater customer services representatives and training when compared to Microsoft while having the same services when compared to Sony. Looking at Environmental, Social, and Governmental metric, Nintendo received an AA rating while both Microsoft and Sony received AAA ratings. This metric evaluates how well a company manages the financial risks associated with Environmental, Social, and Governmental compliance. Any company with either AAA or AA ratings are considered leaders. Any company with either A, BBB, or BB rating is considered average. Any company with either B or CCC rating is considered laggard. Considering Nintendo has a AA rating while Sony and Microsoft have AAA ratings, suggesting Nintendo is still a leader among its peers in the industry but is not as much of a ladder when compared to Sony and Microsoft.

Lastly, Nintendo has an employee satisfaction rating of 3.90 stars out of 5 stars total while Sony has a rating of 3.90 stars and Microsoft has a rating of 4.50 stars. Nintendo and Sony are very similar in providing a relatively positive workplace culture. Considering Microsoft's rating is 0.60 stars above both Sony and Nintendo, Microsoft has a better workplace culture and employees are more satisfied as a result.

Strategy Formulation

Across all quantitative metrics described in Table 2, Nintendo has a competitive advantage over Sony, but not over Microsoft since Microsoft significantly outperformed Nintendo. In the long run, this advantage is not sustainable if Nintendo keeps up with their current business model. If the company continues to innovate and stay ahead of their competitors, they may have a sustainable advantage but Nintendo may eventually hit a wall. An example of Nintendo not innovating enough is their release of the WiiU in late 2012 since the profit margin was in the negative due to the lack of innovation. Another example is the release of the Gamecube in late 2001. This product is widely considered a failure since it had to compete with two widely used and popular consoles: Sony's Playstation 2 and Microsoft's Xbox.

Along with this, Nintendo has the opportunity to address their weakness of their limited third-party support. If Nintendo can incorporate popular games, such as Grand Theft Auto or Call of Duty, as well as acclaimed apps, such as Netflix or Spotify, on their consoles, the Nintendo Switch being the most well-known, Nintendo can increase their sales. Revenues can be added if this is addressed. There would be more costs because Nintendo would have to put more money into updating their systems to accommodate these games. By adding well known games and apps to their existing products, Nintendo can dominate the living room. This has the potential of being high revenue and low costs. Looking through the app store for Nintendo products, the first 20 results are well known games, but then fall off after that since there are not very many well-known games after the popular ones, such as Super Mario Bros and The Legends of Zelda.

Lastly, there are goals and corporate objectives of allowing third party access to their consoles. By allowing third party access, there is a possibility of increased perceived value among consumers, which leads to the increase of customers purchasing their goods and services. Increased sales and profit would be a direct result. Nintendo can expand into the entertainment market by providing other apps, such as Netflix and Spotify, on their consoles. Microsoft's Xbox has Peacock and HBO Max in their system, suggesting Nintendo may have success in this new market. Nintendo could increase the subscription price instead of the price of the console since it would be a monthly stream of revenue for the company. This would allow Nintendo to grow their online store at relatively low costs. With more third-party support, Nintendo may have to hire more people in Human Resources, reevaluate budgets in the accounting and finance department, have a larger marketing team, invest more into manufacturing, or purchase better chips. Their supply chain costs and marketing costs may slightly increase. Typically, costs rise when a company is implementing a process. The corporate objectives identified in this analysis are to grow revenues, lower costs, stabilize revenues, and expand the customer market.

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