Electronic Arts Case

Group D

Monday and Wednesday 11:00-12:15

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Industry Analysis: Dominant Economic Features

Definition of Software Publishers Industry

According to the United States Census Bureau, Electronic Arts would fall under the Software Publishers Industry (NAICS code 511210, SIC 7372). The definition of this industry is as follows in the North American Industry Classification System: “This industry comprises establishments primarily engaged in computer software publishing or publishing and reproduction. Establishments in this industry carry out operations necessary for producing and distributing computer software, such as designing, providing documentation, assisting in installation, and providing support services to software purchasers. These establishments may design, develop, and publish, or publish only” (United States Census Bureau, Software Publishers Definition). Electronic Arts (EA) does, in fact, make up one of the world’s largest independent developers, publishers, and marketers of video games.

Market Size, Growth Rate, and Industry Life Cycle

According to research provided by Thompson, author of the EA case, in 2005, the video game industry made up a $35 billion global market (Thompson 2007). In 2005, the United States alone made up $7 billion in sales out of the $35 billion. The United States also had 228.5 million unit sales which included video games played on PCs and games played on video game consoles as well as handheld gadgets (Thompson 2007). The market was expected to grow even more to record-setting amounts of $58 billion by 2007. This analysis was based on the fact that shoppers would be rushing to buy Sony’s new Playstation 3, Microsoft’s Xbox 360, or Nintendo’s Wii. These sales were then
projected to decline in 2010 because the novelty of the new consoles would taper off (Thompson 2007). Many factors come in to play in terms of growth of the video games industry from 1990-2006. First, the amount and variety of video games began to expand over the years so many different tastes could be satisfied as well as age groups. In addition, graphics became substantially greater, video games could now be played on a myriad of entertainment devices, and Hollywood movie studios began to collaborate with video game developers to bring popular action movies alive through a video game. Video games could also be played online which provided more head-to-head competition with other players across the globe. The demographics of video games were also changing. Young adults continued to be interested in video games even after their teenage years. Game categories now expanded to teen and mature due to the increase of adult users. While the video game industry had expanded, competition became extremely vigorous. With customers demanding high quality graphics, only video game software businesses that could offer cutting-edge technologies with innovative game features could prosper. The businesses also had to be sure they marketed the items appropriately and were able to deal with increasing budgets due to development, advertising, and sales promotion. Appendix A below from the U.S. Census Bureau’s Hot Report of the Software Publishers Industry shows an increase in the employees per establishment from 2002 to 2007. This shows that the industry had grown in size and had required additional workers. However, the establishments in the industry group have decreased due to the highly competitive structure of the video game software business where only those who can effective manage their financial resources can survive. Most likely, the industry is in the early maturity and slowing growth stage. Employees per establishment, as shown by
Appendix A have increased by 29%. More workers need to be brought into video game publishing establishments to meet the growing needs of the expanding marketing that now serves children, teenagers, and adults.

Scope of Competitive Rivalry

Electronic Arts managed to come out on top in 2007 as the world’s leading independent developer, publisher, and marketer of video games with fiscal year sales reaching $3.1 billion. This was an incredible feat considering the competitive rivalry amongst video game software businesses is extremely high. As time went on, companies such as Sony, Nintendo, and Microsoft were making their own games to compete against independent games publishers just like Electronic Arts. Even well-known companies like Disney and Fox began making video games to expand their growth. It was extremely important that competitors managed to offer cutting edge technologies to improve game features to capture the users attention, continuously introduce new titles, allow the customers to be confident and trustworthy toward the company, have effective marketing tactics, complete game development in a timely manner, and many other tricky attributes. Electronic Arts managed to take advantage of all of the necessary qualities that make a successful video game publisher. Successfully completing all of these pertinent tasks while maintaining a positive financial budget allowed Electronic Arts to survive in the competitive industry. Based on the Appendix A, it is obvious to see that not many of the independent game publishers managed to prosper and survive in the market. However, while Electronic Arts received high sales in 2007, their profits had decreased slightly from 2004-2007. This is due to consumer changes in purchasing video games, slow transitions to next-generation video game platforms, and higher costs caused by the
developing of the new technology games. Newly introduced game consoles and high-speed broadband Internet still gives the video game publishing industry hope for greater profits in the future.

**Degree of Vertical Integration**

Electronic Arts publishes, develops, distributes, and markets their video games that can be used for in-home video game consoles and several other devices. EA is partially integrated because EA participates in only select stages of the industry’s value chain. EA goes to outside supplies to manufacture their goods. Sony, Nintendo, and Microsoft’s preapproved manufacturers produce the packaged games for EA titles played on their platform and third-party vendors handle the production of EA’s PC-based game titles (Thompson 2007). This includes pressing the CDs or DVDs and printing the user manuals and other materials that are involves in packaging and shipping. Electronic Arts also sells their goods through different retails stories worldwide. Some of these stores include Wal-Mart and Target, as well as electronic specialty stores like Best Buy, and specialty retailers like GameStop. Outlets such as online sellers, cellular handsets, and other manufacturers in other industries were used as distribution channels. EA’s competitors, Activision, Take Two Interactive Software Inc., THQ Inc., and Midway Games Inc. are vertically integrated the same way. They work on developing and distributing the video games, but they use outside retailers to sell their products around the world. Also, the case never mentioned that any of EA’s competitors manufactured their supplies in-house either.

Being partially integrated benefits EA because it allows the company to focus it on what it does best and what helps it receive the most profit. EA’s strategy is to
concentrate on developing new technology games that will attract buyers. EA also had a good relationship with its suppliers that did not set them back in terms of development time. Shipment of orders were received in two weeks, and costs for simple tasks such as pressing a disk or packing cost EA less than $2. This allowed EA to keep a small amount of inventory to lower holding costs. Also, distributing to outside retailers was beneficial to the company because stores like Wal-Mart and Target are extremely well known and are located across the globe. This helped their products become easy to find and identifiable. In fact, 94% of EA’s North American revenues came from packaged goods sales to retailers. Some of EA’s revenue was even generated from the merchandise sold on their website. The other distribution channels are likely to grow over time as the internet and portable devices become more popular.

**Ease of Entry/Exit**

The ease of entry into the Software Publishers Industry is extremely low because of the high degree of knowledge and technological know-how required for success. Not only is a strong background in video games software development a necessity for a new entrant, an extremely strong financial backing is required. As time has progressed, customers demand greater graphics while playing video games. This has greatly increased the costs needed to develop new video games. A stream of new titles with mass appeal must continuously be produced to catch the eye of the consumer, and marketing efforts are needed to aid in the increase of customer awareness of the product. These tasks also cost a large amount of money. Television advertising alone for a game costs a company close to $2 million. In terms of exiting, many firms in the industry have not been able to compete with the demanding costs and constant development of new
technologies. A company needs to have an ever-increasing budget to stay in the market, and by referring back to Appendix A, it is evident that establishments have exited the market from 2002-2007. Companies like EA, Activision, and Take Two Interactive Software have managed to stay in the industry with innovative games and constant new development which maintain their sales and allow them to keep their financial status.

Technology Innovation

Technology innovation is key for firms in the Software Publishers Industry. With such a strong demand for broader game content to satisfy the growing demographics of video game players and the increased desire for games to produce a high quality in terms of graphics and play, firms need to be on the breaking edge of technology at all times. Implementing actors’ voices into games, creating additional scenes from well-known motion pictures, and allowing games to be played over the internet are other attributes that have now become necessary for firms to process. Constantly revamping and introducing new areas of technology innovation can make or break a firm in the Software Publishers Industry. Even if a firm misses out on the opportunity in a single market segment, such as online gaming, this could cause the company to fall beneath its competitors. EA has managed to stay on the brink of technological innovations through hiring professionals in the area of video game development, exploiting opportunities for digital downloads, producing in-game advertising of different products to increase revenues, increasing the ability for consumers to play games on the go, and increasing the number of games that could be played by massively multiplayer online gamers. R&D is extremely important for EA to continue its competitive advantage and allow the company to penetrate to the top of the software publishing industry. Next generation products and
first-to-market competition is an extreme threat to EA, so the firm needs to be sure to constantly work on developing new technology innovations.

**Product Characteristics**

With technology increasing and demands for higher quality streaming into the video game software publishing industry, it is important for product characteristics to expand beyond just the regular video game console. Video games must also be able to be played through wireless phones and other handheld devices as well as over personal computers and the internet. EA has managed to penetrate all of these outlets to meet the needs of the consumers. Products should also meet the needs of each demographic of buyers. For example, products should include games that are available for children to play as well as mature adults. However, companies, such as EA, may not focus on all market niches of video games. EA prides itself on designing games that are free of certain mature content such as profanity and sex. Products of the industry should also contain leading technologies that allow for a more realistic gaming experience. Nintendo’s Wii games allow players to have a unique, lifelike experience because players must physically imitate what they would like their character on the screen to do. Another characteristic that has recently developed is the need for games that allow players to compete head to head with others across the globe. These types of games have a never ending story feel that captivates players and continues to spark their interests.

**Economies of Scale**

Because there are constant innovations in product and technology that firms must keep up with, there are few economies of scale that can be leveraged. It is important for
firms to keep up with the ever-changing world of technology to maintain control in the market. Costs continue to either stay the same or increase due to the need for innovation. Companies with large scale operations have an advantage over small-scale firms because they are able to obtain higher skilled workers, pay for constant change in developmental costs, and produce newer products at faster speeds.

**Learning and Experience Curve Effects**

The video game publishing industry has significant learning and experience curves because steep knowledge is requisite for success. EA has attracted digital animators, programmers, and creative individuals who were excited by EA’s high pay to its worker and attractive stock options. These professionals bring strong ideas to the floor which the company can take advantage of which creates a cost advantage of the company. With highly skilled employees, less time is taken to generate protocols and fewer ideas will be discarded. “Learning by doing” is not a learning/experience curve that would be useful in this industry. With such a high competition in the market, there is not time for employees to be constantly trained each day. A product needs to be produced almost immediately, so it can be reviewed by the rest of the company and this leave very little time for training.

**Capacity Utilization**

Because EA effectively utilizes an efficient supply chain and does not hold an excessive amount of inventory in the shop, EA manages to effectively utilize capacity. This helps save warehouse costs. These costs savings from storage and volume discounts help EA use money for more important costs such as technology and R&D. Most sales
of a game occur 60-90 days after its initial release, so there is no need for EA or its competitors to hold certain games in inventory longer than needed.

**Industry Profitability**

Net profits reached their highest level in 2004 for EA, and it is important that profits continue to escalate and do not level out or decline due to transition complications with new technology, new platforms, and new markets. If firms plan to be highly profitability in the software publishing industry, they must be ready for drastic changes and should adjust to the needs of the consumer. While the sales of EA reached the highest in the world in terms of independent developers in 2007, high costs due to technological development could be getting in the way of receiving the necessary profits. If the industry continues to stay relatively the same, then firms can expect a rise in profit as they find out what works best for the current situation and what changes will yield the greatest profit.

**Competitive Analysis: Porter’s Five Forces Model of Competition**

**Rivalry among competing sellers**

EA Games directly competes with several different competitors including: console manufacturers, Sony, Microsoft, and Nintendo, twenty other independent game developers such as Activision, Sega, Atari, Square Enix, Take Two Interactive, and THQ, media giants such as Disney, Fox, Viacom, online entities such as Yahoo!, Popcap, MSN, and Real Networks, Massively Multiplayer Online Games producers such as NCsoft and Blizzard Entertainment, and cell phone game producers including Gameloft, Infospace, Mforma, Sorrent, and Verisign (Thompson Jr., Stickland III, and Gamble, 2008). Rivalry
intensifies among these firms because many employ new ideas to appeal to different segments and boost market standing in these areas, there are zero to low switching costs, the diversity of competitors from around the globe drives new creative gaming, and the number of competitors that are equal in size and capability to EA has increased. Rivalry among these firms is weakened because the market is fast-growing, the number of firms is great thus diminishing the effect of strong competitive moves, and the product-lines are highly differentiated and appeal to a variety of diverse segments. Considering many smaller firms have started to exit the market while many of the well-established publishers continue to make sizable profits in highly-differentiated segments, rivalry is classified as “moderate or normal” as “maneuvering among industry members, while lively and healthy, still allows most industry members to earn acceptable profits” (Thompson Jr., Stickland III, and Gamble, 60, 2008)

**Potential New Entrants**

While many opportunities for rapid industry growth and profit exist, the threat of new entrants in the video game software market is somewhat limited because of sizable barriers to entry and learning/experience curves. The profits draw new entrants to the industry, however, they shortly discover that they do not possess “sufficient expertise and resources” to become successful as exemplified by “small game developers...struggling to absorb the rising costs of developing games in preparation for wide-scale market adoption of the new generation of consoles” (Thompson Jr., Stickland III, and Gamble, C-231, 2008). These firms also “were more capital constrained, had less predictable revenues and cash flow, lacked product diversity, and were forced to spread fixed costs over a smaller revenue base” (Thompson Jr., Stickland III, and Gamble, C-231, 2008).
Notable barriers to these new entrants include: sizable scales of economies of scale in production and operations, learning curves, strong brand loyalty to established publishers, high capital requirements, and difficulty establishing networks of distributors and retailers. While profit incentives continue to lure new entrants into the market, these extremely formidable barriers simultaneously prevents and deters new entrants from exerting strong competitive pressure.

**Substitute Products**

According to the text, three main factors determine the strength of the competitive force exerted by sellers of substitute products: whether substitutes are readily available and attractively priced, whether buyers view the substitutes as being comparable or better in terms of quality, performance, and other relevant attributes, and whether the costs that buyers incur in switching to the substitutes are high or low (Thompson Jr., Stickland III, and Gamble, 64, 2008). According to the text, “the video game software business was part of the broader entertainment business...that competed for the leisure time and discretionary spending of consumers against such other forms of entertainment as motion pictures, television, and music” (Thompson Jr., Stickland III, and Gamble, C-217, 2008). While an argument is made that movies, television, and music exert a strong competitive force because they are readily available and attractively priced and cause buyers practically no switching costs, many consumers do no associate these varying media to compare to the same type of performance and interactivity that games offer; therefore they serve completely different functional purposes. For this reason, it is more logical to view the substitute products as exerting a low competitive force on the industry.


**Suppliers**

According to the text, suppliers can exert considerable bargaining power under the following conditions: industry members incur high costs to switch purchases to alternate suppliers, needed inputs are in short supply, a supplier has a differentiated input that enhances the quality or performance of a product, there are only a few suppliers of a particular input, and some suppliers threaten to integrate forward into the business of industry members. In the video game software publishing industry, the three main suppliers, Nintendo, Sony, and Microsoft, exert one of the strongest competitive forces as they all three have a considerable amount of bargaining power over independent publishers. First, all three suppliers grant the license and technology from their platforms to the independent publishers such as EA Games. With three highly differentiated consoles, independent publishers face high switching costs to switch from platform to platform (while past practice of publishing for multiple systems still continues, many publishers are moving towards specific titles for specific consoles). Second, as previously mentioned, software publishers often find differentiated inputs that can make the software perform in different ways. For example, if EA Games develops a game for Nintendo Wii, the license and technology that Nintendo grants the publisher will create a completely different technology than say the same title for Microsoft’s Xbox 360. Software publishers must now decide specifically which supplier will grant the inputs that give a title the desired result; moreover, this differentiation means that suppliers now maintain exclusive licenses for diverse and unique technology (if EA Games wants a motion-based game, only Nintendo will function as a supplier of the license and technology requisite for the finished product which inevitably increases Nintendo’s bargaining power and ability to charge substantial royalty fees). Finally, the suppliers
have for a considerable amount of time employed forward vertical integration to develop and market “games for their respective platforms” (Thompson Jr., Stickland III, and Gamble, C-214, 2008). As pointed out by a Square Enix executive on balancing the relationship with Sony’s PlayStation 3 and other consoles, software publishers want “a more balanced market share distribution among [suppliers] Sony, Microsoft, and Nintendo [to] weaken the long-standing leverage that platform manufacturers had in demanding sizable royalty payments from game publishers who wanted to create games for their platforms” (Thompson Jr., Stickland III, and Gamble, C-214, 2008). Because the number of suppliers are relatively limited, possess differentiated inputs, and have forward integrated to the software publishing level, suppliers have considerable bargaining power. It is also worth noting that EA Games also has third-party vendors as suppliers who handled the production of EA’s PC-based game titles. These suppliers have lower competitive pressure and bargaining power because EA has “many sources of supply for all the functions that were outsourced to third-party suppliers” which often allowed them to negotiate “volume discounts” (Thompson Jr., Stickland III, and Gamble, C-228, 2008).

**Buyers**

On a large scale, buyers have moderate bargaining power because they can and often do switch brands willingly without switching costs based on the title and genre of the game they want to play, they often have information from game reviews on the products, prices, and costs, and have the discretion of whether and when to purchase games (used and rental copies are frequent examples of moderate buyer bargaining
power); however, on a smaller scale, if a buyer wants a specific title and genre
(sometimes specific characters such as Mario), the bargaining power will be reduced.

After evaluating the collective strength of the competitive forces, it becomes clear
that the video game software publishing industry is extremely profitable – once a firm
gains the requisite learning and experience curves necessary to penetrate the market.
Although there are limitations to dealing with suppliers that are vertically integrated
forward and demand royalty payments, should a firm gain experience, it will enjoy high
levels of profitability because of rapid industry growth, competitive forces preventing
new entrants, and weaker forces from substitute products and buyers.

**Industry and Competitive Analysis**

*Industry Driving Forces*

- **Emerging new Internet capabilities and applications** – One of the most important
driving forces of a highly technological industry, emerging new internet capabilities
and applications is absolutely changing the way the industry is shaped. For example,
during the infancy of video games, simple graphics were acceptable. Today, games
are expected to have high definition graphics, intuitive functionality, and, most
importantly, multiplayer online gaming. While last generation consoles didn’t focus
as heavily on the use of internet, the new internet capabilities driving force will
continue to shape the industry and force firms to adapt to the new trends; or else cease
to exist.
• **Product Innovation** – Similar to emerging internet capabilities, product innovation is an absolute driving force in evolving the video game industry. While last generation consoles competed primarily on graphic and internet capabilities, consoles such as Nintendo Wii have proven that new changes in the industry can actually expand the potential target markets. With intuitive interface and new innovations, software publishers must adapt to the changes in the market and deliver the products that consumers want.

• **Changes in who buys the product and how they use it** – Expanding beyond product innovation, changes in who buys the product and how they use it proves to be an important driving force in shaping the industry as exemplified by the Nintendo Wii. As the casual gamer became targeted with the Wii, the video game industry changed forever. Instead of primarily teenage boys purchasing games, a plethora of role types previously untapped are now starting to engage in the video game market including young women and the elderly; moreover, these new gamers are using video game systems as a means of convergent technology as several next-generation consoles can play movies, music, and television. As technology continues to converge, video game products are adapting; moreover, changes in the demographics that buy video games and their functional uses with the games is shaping the way software publishers must think and act to compete successfully.

• **Diffusion of technical know-how across more companies and more countries** – Considering the complex nature of video games and their evolution, technical know-how is a continuous driving force for the industry. Games have evolved from simple
sprites and sounds to robust 3D environments with sophisticated online functionality; moreover, as the frontiers of technology continue to evolve, the information flow from company to country must also. While gaming always was a globalized industry, the amount of new international markets that have recently opened to software publishers is numerous. Software publishers must be able to transfer knowledge from country to country, use the knowledge to push innovation and game development, and localize games as the industry continues down this path.

**Key Success Factors**

Key success factors are the product attributes, competencies, competitive capabilities and market achievements with the greatest impact on future competitive success in the marketplace. For the video game industry, the following are the key success factors:

- **Expertise in a particular technology or in scientific research** – As video game software continues to evolve with hardware capabilities, the software publishers must keep up with the knowledge and expertise of this type of technology in order to deliver the innovation that consumers expect. This expertise translates into more effective and efficient research and development activities and eventually better games. Ultimately the knowledge and expertise of game design and publication serves as an extremely high barrier to entry for new entrants because of the intense scripting, design, and development that goes into not only developing a game for a local market but for the world at large. Without this
ability to fully understand the complex product, firms won’t stand a chance in delivering a consumers’ expectation.

- **Breadth of product line and product selection** – Product differentiation is a significant key success factor in the video game industry because consumers inevitably want a variety of elements including high definition graphics, sophisticated online capabilities, and intuitive functionality. As consoles continue to evolve and differentiate from one another, software publishers must decide how they can build a product line that meets and satisfies a variety of diverse market segments. Providing breadth of product line and product selection is a key success factor because it establishes the brand which in turn allows consumers to feel more comfortable with a new game. In addition, consumers expect a variety of product lines that will simulate movies, real-life experiences, and fantasy realms. Without a diverse product line, firms will not be able to satisfy all market segments, will not be able to leverage overhead costs for gaming facilities and animation software, and will eventually have to settle for competition on price rather than differentiation (which allowed firms to charge premium prices and make strong profits in an effort to manage sustainable competitive advantage).

- **A talented workforce** – Without the animations, game programmers, project managers, and business professionals, the video game software publishing industry wouldn’t work – it’s simply too complicated. The production of video games, as indicated by the case, demands the best and brightest artists, designers, programmers, and other individuals who come from a variety of backgrounds.
The workforce ultimately contributes to the quality of the game and the creative innovations that will appear to the consumer. Unlike other industries, software publishers cannot survive and generate sustainable competitive advantage without a talented workforce.

Appendix B contains the unweighted competitive strength assessment and Appendix C contains the weighted competitive assessment. Of the key success factors, expertise was weighted the heaviest with a 0.7 weight because of the barriers to entry not having such knowledge creates. Breadth of product line and product selection, 0.2 weight, was second-most important because innovation and differentiation is an important (but not as important as having the knowledge to create games) key factor in a firm’s success in the industry. Finally, a talented workforce was the third most important key success factor with a 0.1 weight because the talented workforce comprises the individuals who will actually carry the expertise and come up with innovative and intuitive ideas. After evaluating the case, it became clear that all major competitors had the expertise in developing the technology requisite for success both domestically and internationally (without having at least a strength rating of 7, the firm would more than likely not exist). Take Two and Midway lacked diversity in their portfolios as they targeted primarily only the “mature” segment while Activision, EA Games, and THQ all received strong ratings in appealing to a variety of different segments (EA Games chose not to target the mature segment so it had a slightly lower strength rating of 9 compared to Activision and THQ’s 10). Finally, all of the major competitors have a talented workforce with EA Games excelling with one of the broadest, talented, and largest workforce out of all major
competitors. Due to financial issues, Midway has fallen behind in talent capabilities and innovative opportunities.

Financial Key Success Factors

Besides traditional key success factors, consideration of financial key success factors helps put the company’s financial abilities in perspective.

- **Gross, Operating and Net Profit Margins**
  These margins are used to benchmark the companies directly against each other. They will outline exactly how a company translates every dollar in sales to its overall bottom line.

- **Product Costs per Costs of Goods Sold**
  This ratio was created to identify what percent of total costs are incurred by the actual products being produced. This will show which company is the most effective and efficient in production.

- **Development Costs per Total Sales**
  This ratio is used to determine how much each company spends on R&D per each dollar of sales. With development costs skyrocketing for the entire industry, this ratio is crucial in determining adequate cost control.

- **SG&A Expenses per Total Sales**
  This ratio will assist in determining how much a company spends (per dollar of sales) for expenses other than product and development costs. In an atmosphere with high costs, it is important to find how well a company controls its ‘controllable’ costs.
• **Current Assets**

These figures are crucial in determining a firm’s overall cash position.

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<td>Group D - Mason Shattuck</td>
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<th>Activision</th>
<th>THQ</th>
<th>Take Two Interactive</th>
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**Evaluating Company Resources and Capabilities: SWOT Analysis**

**SWOT Analysis**
**Strengths**

EA began operating in 1982 which is much longer than a lot of the competition they are currently facing. The longevity of the company has built a strong and reputable brand in the video gaming industry. EA is develops a considerable amount of different products, games, etc in the video game industry; proving the strong branding efforts they conduct. EA also has a unique ability to localize the games they create. This is crucial because with this ability it will be released in multiple countries and in multiple languages; therefore avoiding lost valuable time that can be utilized getting foreign markets familiar with EA products.

When one typically thinks of the video gaming industry, they would assume that the target is teenage to college student age males; however that is not the case with the current generation of gaming. Gaming attracts a wide variety of people, mostly males, between the ages of 16-41. This leaves EA games numerous options to be able to market to the target audience. JAMDAT and EA formed an acquisition in which EA takes over JAMDAT and EA benefits from their skill in that particular distribution network because it gives them a leg up against their competitors.

**Weaknesses**

EA is losing market share because they only offer specific games that cannot compete with other games in which they do not have and cannot offer to their consumers. EA Games has four separate brand names that satisfy different segments; some of the more focused segments only focus on the “hard-core gamer” while they pay little attention to the “casual gamer.” This greatly lessens the chance that casual gamers will go to EA over some competing brand.
Opportunities

By continuing to strengthen relationships with Nintendo, Microsoft, and Sony, EA can continue to leverage its position as a market leader and keep new entrants out of the market as well as extending its software consumption on multiple platforms. EA has not only teamed up with established brands but they also have a number of online transactions or online sales that earn them revenue, digital download, microtransactions, subscriptions to online game play and MMOG. All these transactions are in a sense like a bonus to the consumer because not only are they getting the game but they are also enhancing their gaming experience.

EA games is the general company, however, it has four brands that target specific segments and what they want and need from a game. EA Sports is perhaps their largest brand and it focuses on professional college sports. EA is a non-sports related brand who is more interested in games like Harry Potter, The Sims 2, etc. EA Sports Big is the brand that focuses on the extreme sport aspect such as soccer, skiing and snowboarding. Lastly, Pogo are the free, online games that are available for download that are more along the lines of card games and puzzles versus action and sports. The benefit of these four brands is that it hits all the necessary “hard-core gaming” targets so that they have EA to go to regardless of the game type. While these four brands provide reach to many segments, EA can continue to explore and refine new ventures that have failed in the past such as online business as a means of expanding market segments and subsequent profits.

While the sales of games are the most common form of revenue for EA Games, two relatively new revenue streams have yet to be tapped: in-game dynamic advertising and online game play subscriptions. The first venture, in-game advertising, is a very
sophisticated method of advertising that is estimated to grow from “$75 million in 2006 to $1 billion by 2010” (Thompson Jr., Strickland III, and Gamble, C-229, 2008). With in-game advertising, gamers find many of them to add realism (and subsequent value) while providing EA Games with additional revenue beyond the sale of the game. In terms of online game play subscriptions, EA Games could develop games and then collect consistent revenues beyond a one-time sale of a game.

One last opportunity is the fact that when it comes to purchasing games, it comes in seasons it seems. Around the holidays toward the end of the year, sales account for 40% to 50% of the annual sales; it seems that consumers feel that holidays are the perfect time to purchase consoles and games for loved ones. EA would know at this particular time put more than normal inventory into stores to meet the demand of the consumers.

**Threats**

When evaluating the competition of EA, it is obvious that the competition is employing a lot of the same strategies; a prime example of this would be Take Two Interactive software. The competition is intense and will only continue to grow more intense as more companies begin to catch on that EA’s strategy is effective. One thing that EA lacks though is the appeal to a particular segment in the market. EA does not promote games that are rated mature; they in fact design games that do not have excessive violence or sex, they like to keep it clean. Although EA gets an A+ for morals and it looks really good for their brand image, they are still missing out on a whole segment that could give them a large profit.

Of course when considering external threats, every company must consider a shift in the market environment because now it is always changing. If a new technology
comes out that transforms the video gaming industry, EA risks not being able to keep up if there is no more demand for the product. If this happens, this means that the whole company quickly adjusts with the shift, lag behind and barely hold on or completely drop out of the industry all together.

**Summary**

Overall, Electronic Arts does a fantastic job utilizing their strengths and opportunities. They do have their weaknesses and threats however, based off their financial performance from 2000 to the 2007, the seemingly negative impacts have not hurt EA financially. Looking through their performance of 7 years, it appears that in almost every area the numbers have positively increased every year and seem to be in better shape as they progress as a company.

**Resource Based Theory**

EA games have a competitive advantage against their competitors because it is far too costly to copy specific tasks that they do. For example, a company must build a reputation in order to be able to bundle their name with large suppliers such as Nintendo, Sony and Microsoft that are also well-known for their ability to use forward vertical integration to develop top-selling games. Due to copy right laws, games specific to EA are protected, therefore so is EA’s creative ideas. The intellectual property that EA produces generates sustainable competitive advantage because it cannot be duplicated, is extremely valuable, it is rare, and the organization has used research and development ventures to capitalize on it.
Evaluating Company Resources and Competitive Capabilities: Strategic Cost Analysis

Porter’s Value Chain Analysis

Primary Activities

It is essential that consumers of EA Games see value in the products that EA produces and bundles with. In order to appeal to the consumer at all it is essential that brand or the product relates the consumer properly. EA utilizes their “ability to localize games or launch games on multiple platforms in multiple countries in multiple languages” to effectively reach the consumer. By doing this, they are able to release the same game on the same day in number of countries and languages; it is with this ability that truly separates them from their competition.

In order to get a new game approved and released, they must develop a new game from scratch and put together a series of prototypes that will get presented to EA managers and executives who will ultimately decide which idea will get put through or which idea will fail. While developing the game, EQ obtains intellectual property or other materials that are licensed from different mediums such as a video game of a film will have scenes or voice clips of the actual actor/actress. It is important to remember that regardless of the game, EA only creates games that it will be proud of; in other words, a game that is not full of violence or sex. This adds value to consumers like parents and young children because the content of video game is appropriate for them to view.

EA is unique in the sense that it is not just one brand but in fact four separate brands EA Sports, EA, EA Sports Big and Pogo. EA Sports is the brand that has a series
of realistic sports simulation games such as Professional and College sports. EA is the brand that has mostly non-sports related games like Speed and the Sims, etc. EA Sports Big is the extreme sports brand that includes sports like snowboarding, soccer, etc. Lastly, Pogo is used for the downloadable and online games, such as card games, puzzle games etc. Pogo, however, can be used to just play free games, or the consumer can upgrade to Club Pogo while paying a subscription or download from Pogo-to-go.

EA distributes games through various channels, they distribute through retailers, online sellers, cellular handsets and other manufacturers that bundled with EA games. By providing their customers with these 4 different channels it allows them access to the product easily. The better they are at distributing their product through these distribution channels the more efficiently they serve the consumer which overall helps the consumer to return to purchase an EA product.

EA games usually stays between the common price ranges of $39.99-$59.99 for newer titles. Research shows that business is best towards the end of the year, around the holidays and lowest in the months of April, May and June. This is valuable to the consumer because it helps insure that the product will be there for them when they need it, regardless of the busy season or not. EA Sports is perhaps the most marketed out of the four brands because it is the easiest to market to the target market which is 16 to 40 year old males.

EA uses two different types of suppliers; first they use Sony, Microsoft, and Nintendo that produces packaged games for the EA titles played on each system. Second, they use third party vendors to handle the production of the titles. Ultimately, EA’s goal was “to maintain and grow its leadership position in games for the platforms”
(Thompson Jr., Strickland III, and Gamble, 2008). In order to do so they used a number of different techniques that will help them earn a profit such as in-game advertising. All this at first may not be of value to the consumer until post purchase when they realize how reliable and good the product is.

**Support Activities**

While evaluating the support activities of Porter’s Value Chain analysis for EA Games it was obvious that certain factors were more dominant then others. One of the most important support activities concerned the area of research and development; while looking over the Financial Summary between the years of 2000 to 2007, it is obvious that starting at $256 million in the year 2000 to $1,041 million seven years later that as years pass and technology advances so does their efforts to better their products for their consumers.

Secondly, EA games in the year 2006 had approximately 7,200 employees, while 4,000 of those employees are outside of the United States. They understand that in order to remain the top video game company in the industry that they must have the latest and most knowledgeable digital animators, programmers and creative individuals. By hiring these creative individuals that mostly have a background in the television or film industry previously, they will be able to keep up with growing demand for the latest video games.

Lastly, looking at 7 year financial statement it is seen that every year the general and administrative expenses have raised, implying that there has been growth in the company. This growth can have something to do with a number of new employees, new potential projects, and staying current with the latest technology.
Benchmarking

Benchmarking is a tool that allows EA to determine whether its performance of a particular function or activity represents the “best practice” when both cost and effectiveness are taken into account; to benchmark where EA needs to be it needs to look at its competitors strategies against their own. In comparing the costs of EA and their main competitors in an analysis, it is shown that the best practice for EA is that it exploits the opportunity for digital downloading. This is a very useful function because it is cost effective due to its digital nature therefore cutting out manufacturing and packing costs. EA has also begun offering free demos at EA.com for popular games on different systems, such as Xbox Live. By allowing the consumer to get have a taste of the game before they purchase it is a great way to get them coming back for the whole game and it is then when you make a profit.

To continue to benchmark in EA, they need to pursue the mindset of every cent counts! EA figured out a way to build revenues with little cost and a decent return, called “Microtransactions.” These microtransactions are small purchases where the gamer can purchase more clothes for his/her character for a particular game, extra designs for a race car, etc. These little purchases really add up in the end and they are great for the consumer because it gives them more options while leaving EA with higher revenues.

Finally, to successfully execute benchmarking for EA, suppliers Sony, Nintendo, and Microsoft had approved that EA can be licensed. When this occurs, it is branding EA while also getting their product out there for the consumers to experience. Licensing from these brands better positions a company in the mind of the consumer.
Electronic Arts Profitability Analysis 2002-2007

Gross Profit

Electronic Arts (EA) has shown very strong GRM’s for the years reported. There is no immediate cause for concern. EA does not have a major problem containing its overall sales.

Operating Profit

EA Has had an alarming rate of decline for OPM. The company has suffered through ever-increasing development costs. EA has a significant issue with controlling its
operating expenses. If this issue is not corrected immediately, profitability will be threatened.

**Net Profit**

As with the company’s OPM, Net Profit is also rapidly decreasing. This is cause for concern, and the company absolutely needs to control its cost structure. If this is not corrected, EA will definitely suffer and shareholders will not be thrilled.

**Return on Assets**

The company also displays a very poor ROA. Even more alarming, ROA has been decreasing over the past four years. The company’s high R&D costs are forcing pressure on the use of assets. The company shows a very poor ROA and may face sure losses in 2008.

**Return on Equity**

EA is not pleasing its shareholders by any means. ROE has decreased from 21.54% four years ago to just 1.88% in 2007. This is an incredible rate of decline. I would not ‘stay on’ with the company after seeing these returns.

**Earnings Per Share (Basic)**

EPS have decreased over 133% from all-time highs in 2004. Currently, EPS come in a $0.25, unsatisfactory at all levels.

**Overall Profitability Breakdown**

While the company is still profitable, this surely will not last unless the company can implement cost control measures. Increasing costs have almost completely robbed the
company of profitability. If this issue is not addressed, EA will not remain profitable in future years.

**Liquidity Analysis**

**Current Ratio**

The company shows a strong current ratio and brings no cause for concern. The company may find some saving grace in the fact that it has a strong asset position. Although this could easily deteriorate given the potential loss of future profits

**Net Working Capital**

The company holds acceptable levels of fixed assets. There are no alarming increases or decreases noted, and there is no cause for concern. However, the company may need to improve or regulate some of its property, plant and equipment in order to counter uncontrollable costs.

**Business Strategy Analysis: Porter’s Generic Strategies**

In terms of business strategy a broad differentiation strategy is the best descriptor of EA and the video game software industry as a whole. The main business decisions that developers can control to increase sales and profit include innovative technologies, user game play (actions and content that players control experience that make the game fun), platform availability, partnerships and co-publishing, and marketing and distribution decisions. Though some of these decisions can affect price or cost, they all mainly have to do with how the product is offered to the end customer. They still need customers to
purchase their software through retailers to attain revenue and cover costs. How the developers are able to sell their products is by offering customers a differentiated product.

The way that EA specifically differentiates their product offerings is through four product lines and four distinct brand names for each. EA sports, EA, EA Sports BIG and POGO are the separate distinct brands that EA offers and each has a segment that they target. EA sports has been one of the staples of EA for many years. These include many “franchise” titles as Madden NFL, Tiger Woods PGA golf, World Cup soccer and others. EA is mostly a coverall that includes Need for Speed, The Sims 2, and the Harry Potter Series. EA Sports BIG is for arcade style sports games that aren’t as realistic and try to be more extreme. POGO is EA’s online and downloadable segment where there are casual free games as well as subscription based online services.

The four circumstances that give a broad differentiation strategy the best opportunity to succeed are:

1. When buyer needs and uses of the product are diverse
2. There are many ways to differentiate the product or service and many buyers perceive these differences as having value
3. Few rival firms are following a similar differentiation approach
4. Technological change is fast-paced and competition revolves around rapidly evolving product features

Since video game developers are practically if not completely in all of these situations and are able to control elements in these situations, it is why they employ differentiation strategies. EA does a good job of differentiating in each of these situations. With buyer needs, preferences and uses they provide the customers with very significant diverse
offerings. Through the four different brands they’ve created, they have a wide product offering that satisfies their buyers. This also leads to the many ways there are to differentiate the products. With video games this is the epitome of business strategy. Everyone is continuously trying to bring the best groupings of features, styles, game play, characters and innovative ideas to each new game. EA does well with this especially in its leading sports division where each year they bring new rosters, schedules, stadiums and other features to their games. In the third situation it’s hard to say that few firms are following the differentiation approach, when all of them are at least partly using this approach but you can say that they are using different differentiation approaches. EA is primarily concentrating on sports games, Activision on characters, THQ with wrestling and children games, and Take Two focuses on mature audience games. Finally, video games have always been an industry that relied heavily on new and innovative technology. In the circumstance where technological change is rapid video game developers have to continuously integrate the newest technology to appeal to customers. The most recent of these developments has been the motion technology used with the Nintendo Wii, the online capabilities of Xbox 360 and Playstation 3, and the integration of high tech gaming in mobile phones and devices like the Ipod touch.

In the video game software industry there is little to non-existent competition between software developers in terms of price or for a few reasons. There isn’t a market for “premium” games and there are only “value” games after the initial release and price cuts are made. This is primarily because the consoles and PCs that the software is run on have almost complete control on what these independent developers charge, as well as timing of release and royalties paid to the platforms. Other restrictions on pricing include
that independent developers go through retailers to reach the end customer and don’t have control on what they charge as well as when and how much of a pricing adjustment they can make after the initial release of the software. Retailers are able to choose when they want to make price cuts to a product as well as how much. Retailers also have limited shelf space and hold only a certain number of titles which gives them the power on determining price with developers and platforms. The average life of a video game on the shelf is only 120 days and they usually have price cuts after only several weeks. Video game developers continue to compete for the attention of game players and as more and more games are released for consoles there’s continually stronger competition between developers for sales. Again these are all reasons that video game developers continue to strive to differentiate themselves with the newest technology, most realistic visual graphics and most creative stories, characters and game play.

**Business Strategy**

**Vertical Integration**

EA has an established business model and it has been working for 28 years. This business model at this time does not include much or any vertical integration. EA continues to be a link in the supply chain which is not a bad place to be but there are possibilities in this industry for vertical integration. EA is simply the creator, designer and developer of video game software. This business model does not include packaging, pressing nor shipping of these products, neither does it include distribution or physical retail outlets for consumers. The only direct sales that EA embraces is through online purchases at EA.com which continues to be a growing outlet for businesses as a whole,
but it’s only one outlet. Possibilities for EA to vertically integrate would include backward integrating or acquiring some of the material and packaging manufacturers as they use regional distributors and rack jobbers, this would help save on some costs. Another possibility is to integrate forward and move EA into distribution or retail outlets which could include their own brick and mortar stores. These stores could possibly create a new competitive advantage for them over the other development competitors and would be a way to increase sales or revenues as well as increase market share.

**Transaction Cost Economics**

Transactional costs in the video game industry include the production of the product at a preapproved manufacturer and moving product to retailers. The costs that are incurred are generally attributable to a common supply chain, but it also includes some extra fees and costs. The first cost that is incurred is the application process to consoles for their approval to manufacture a game for their system. This process increases costs for developers in terms of royalty fees, time, labor and cancellation costs if the prototypes are not approved. Then there are the margins and fees associated with getting the video game on the shelf at a retail location. There is limited shelf space as well as limited windows for video games to be available and desirable to consumers. Shelf space is fought over with marketing dollars, as developers have to make their game a “hit-title” even before it hits shelves. These costs make every supply chain transaction and unit sold to a consumer especially valuable to video game developers.
**Cooperative Strategies**

There are a few cooperative strategies that EA has employed to grow its company’s sales and market share. The first cooperative strategy that they employ would be the co-publishing that they engage in with other mostly smaller game development companies. Here they would either help the other company by taking their interactive game and publishing, marketing and distributing it on their behalf. This helps EA grow through more titles and revenue while simple providing service to these smaller partners. Another cooperative strategy is the partnership that EA has with Japan based Sony who helps sell and distribute EA products. Finally, there are many sports related partnerships with NFL, NCAA, Tiger Woods (PGA), NBA, World Cup soccer and NASCAR racing which all receive licensing fees for their content but help spur sales with endorsement by big-name sports stars. These relationships are continuous strategies employed by EA and have been paying off with continuous control of the market.

**Offensive Strategies**

EA employs many offensive strategies and has many lined up for the future as well. Some of the strategies that EA has engaged in include partnering with licensed stories, characters and stars to be the exclusive game developer for their franchises. These partnerships include the Sports organizations above, as well as Warner Brothers and J.K. Rowling for the Harry Potter Franchise and many other movie studios, music studios, performing artists, etc. EA also continues to attempt to create and develop the most recent and innovative products which will give them a duration of competitive advantage.
There are also many strategies that EA plans to employ now and into the future. These include digital distribution, growing revenues from additional content transactions, use of in-game advertising, grow subscriptions for online game-play, growing cellular handset revenues, expanding international segments and sales, exploit the growth of MMOGs, decrease reliance on game content licensed from others and increasing games with wholly owned content. Digital Distribution will continue to grow as a very viable form transaction with customers and EA should not ignore those possibilities. Being able to grow their revenue through new forms is also a huge strategy to pay attention to, which includes the online games, cellular handsets and global markets. All of these strategies are well thought out and will help EA continue to be the market leader in the industry.

**Defensive Strategies**

There aren’t many defensive strategies available for these video game developers to employ but there are always possibilities. Acquiring licensed properties is a great way to keep competitors from creating rival games with similar content. Continuing to grow market share by partnering with other publishers, expanding into new markets and so on, are all great ways to cutoff avenues that other competitors will try to take to grow or enter the market. Another would be to stand strong as the indisputable market leader in video game development and to let all other publishers know that any action of attack will always be retaliated.

**First Mover Advantages**

Again, first mover advantages are not a huge part of the video game software industry but there are a few that exist. Some of the first mover advantages in recent years
have come with innovative new game play which is why every developer continues to make that the number one priority. Some of the new first mover advantages in this industry have been music-based gaming, online competition between players, and MMOGs. Again the advantages with these innovations are only short lived as they are very easily and quickly copied by other developers. If there are any first mover advantages that EA will have to utilize it will have to come in the form of future product innovations and only their developers could say what those innovations will be.

**Issues and Recommendations**

**Issue #1:**

Since there seems to be more goods being produced to account for the increase in sales, there should be a greater amount of efficiency in production. This efficiency should deal with lowering the average cost per unit through production. Fixed costs should be shared over an increased number of goods, so there is no need for costs to continually increase over time. Instead, R&D costs are continually rising which is creating a slight problem for EA financially. Profits should be increasing due to economies of scale, but they are actually decreasing even though the company is selling more products.

**Recommendation #1:**

EA needs to organize its R&D costs. They need to evaluate these costs and decide if there are any that are rendering useless. As pointed out in the case, only the top 20% of games actually make money and the rest are pretty much garbage. Perhaps there is a project EA has been working on through R&D that is simply not pulling through.
This idea should be abandoned or a new profitable idea should be put in its place. Currently EA lets its staff develop an idea and if it doesn’t seem like it will work, they will just pull the plug. EA needs policies and procedures in place to help brainstorm ideas to a degree but not spend unnecessary research and development funding and time on projects that may get eliminated after substantial effort. It is important for EA to continue to create new ideas so new software can be placed on the market, but these costs are affecting the firms overall profits they could be producing through economies of scale. EA needs to develop stronger research and funding allocation procedures to insure that research and development costs are controlled without sacrificing innovation.

**Issue #2:**

It appears that EA’s main focus is on sport games while its competitors are looking at a broader target market and are catering to many other groups.

**Recommendation #2:**

Since EA is at the top of the pack in terms of independent video game publishers, they should use defensive tactics to bring down the competition even more. Perhaps they could come out with a music game similar to Guitar Hero that should compete with Activisions’s Guitar Hero franchise. To compete even more with THQ Inc., EA could work on creating more kid friendly games. Although the EA Sports product line is working well for EA, if they differentiate their titles even more to patch the competitors they could weaken what strength the others in the market creating a greater profit and competitive advantage for EA. As technologies continue to converge, new opportunities are present for EA to pursue and generate more revenue. EA has little to no presence in
online gaming and mobile gaming and should consider new areas to explore to
differentiate the brand. Acquiring struggling developers or establishing strategic
alliances with firms that have experience in these areas will help EA establish a foothold
in a new venture.

**Issue #3:**

EA has Microsoft, Sony, and Nintendo as its suppliers as preapproved manufacturers that produce the packaged games for EA titles played on their platforms. It is unfortunate that EA must rely on their companies as suppliers because essentially they are competition to EA since they are forward vertically integrated. By paying additional money to these well-known video game console and game makers, EA is helping them to produce even greater quality games which could essentially help companies like Microsoft, Sony, and Nintendo beat out EA’s current shelf items. These suppliers also maintain strong bargaining power that controls EA.

**Recommendation #3:**

It is important that EA keeps a good relationship with these suppliers because they allow EA to make games for them, and they understand what needs to be done in the manufacturing process so games work for their particular console. EA needs to continue focusing on establishing strong relationships with these suppliers to maintain lower royalty costs and presence; however, EA should also use caution in making sure none of the product lines become too focused on one supplier. In addition, strategic alignment of hit games on select systems can balance the popularity of the suppliers and give EA some counter bargaining power in exchange for popular titles. While maintaining relationships
is good, EA also needs to explore untapped segments such as mobile phone gaming and online gaming where the firm may be able to develop just as profitable games without the generous royalty fees.

Works Cited


Appendices

Appendix A

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<th>Industry Ratios</th>
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Revenue per employee ($) | 358,391 | 290,170
Revenue per $ of payroll ($) | 2.96 | 2.96
Annual payroll per employee ($) | 121,178 | 97,937
Employees per establishment | 45 | 35
Revenue per capita ($) | 427 | 359
Establishments per million residents | 26 | 34

**Appendix B**

A. An Unweighted Competitive Strength Assessment

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<tr>
<th>Key Success Factor/Strength Measure</th>
<th>EA Games</th>
<th>Activision</th>
<th>Take Two Interactive Software Inc.</th>
<th>THQ Inc.</th>
<th>Midway Games Inc.</th>
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<td><strong>24</strong></td>
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**Appendix C**

B. A Weighted Competitive Strength Assessment

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<th>Key Success Factor/Strength Measure</th>
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