

## **New Horizons or a Strategic Mirage?**

### **Artist-led-Distribution versus Alliance Strategy in the Video Game Industry**

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#### **Abstract**

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

## **1. Introduction**

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

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

In this paper we contribute to this debate in the context of the video game industry. We examine the difficulties and opportunities entrepreneurial content producers face in commercializing their content using the online channel. Specifically, we look at a single case study of the Dutch Video Game Developer (DVGD) bringing to market an identical game using two different but comparable online distribution channels: In the first release DVGD used online distribution to reach consumers directly, whereas in the second it used an alliance

with an established video game publisher. Our results show that the alliance strategy resulted in greater net revenues and higher relative market performance compared to the self-publishing strategy. Since an identical game was involved in both instances, we argue that the differences in performance can be traced to specialized complementary assets required for successful commercialization.

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

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

of our study are presented. The paper ends with a discussion, conclusion, and directions for future research.

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

In his seminal piece on Profiting From Innovation (PFI), David Teece (1986) provides a framework for innovators to determine how they are best positioned vis-à-vis vertical competitors in the value chain for subtracting economic rents from their products. According to the framework, a firm should base its commercialization strategy on access to complementary assets, which are those assets or capabilities that go beyond the mere technical knowledge of the innovation itself (Teece, 1986; 2006). Complementary assets include tangible resources, such as financial capital (Pemaratne, 2001; Malekci and Tootle, 1996), and intangible resources such as marketing skills (Teece, 2010), referrals and contacts (Stuart et al., 1999), and proprietary distribution channels (Teece, 1986).

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

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

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

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

additional rents that can be generated through the use of the publisher's specialized complementary assets?

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

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

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

Apart from benefitting from the use of the specialized complementary resources that are made available by alliance partners, small firms also benefit from the implicit and explicit endorsement that an alliance with large incumbents usually brings (Colombo et al., 2006; Prashantham and Birkinshaw, 2008; Stuart et al., 1999). This can be particularly valuable in situations when the strengths of small firms and the merits of their products are hard to assess (e.g., highly uncertain market, absence of reputation of small firm). In these circumstances, the establishment of a relationship with a reputable firm can signal to other actors in the value system (e.g., suppliers, distributors, retailers, and consumers) that the small firm is trustworthy, and that its offerings are of good quality (Meyer et al., 1997; DiMaggio, 1988; Stuart et al., 1999).

The advantages of alliances with large incumbents that own specialized complementary assets must, however, be considered against the difficulty of negotiating and obtaining adequate returns. Owners of specialized complementary assets are adept at negotiating complex contracts that offer attractive terms upfront, but in several respects often turn out to be disadvantageous for the content producers.

First, content producers often lack the experience needed to understand the nuance of contracting downstream value chain activities. They are therefore more likely to sign agreements that will surrender significant revenue stream to their more experienced partner. Second, market sales often depend on the owner of specialized complementary assets exerting maximum efforts in promoting and distributing the product. Such efforts are difficult to specify in contracts, and are often also difficult to monitor. Content producers are therefore exposed to the risk that complementary asset owners do not fully live up their promises and act opportunistically by cutting back on their commitment if they believe these resources are employed better elsewhere. Finally, even after the alliance has been agreed, relying on large incumbents for critical resources also puts small firms at risk of opportunistic exploitation that

is difficult to control using a multi-contingency contract (see Williamson, 1991; Prashantham and Birkinshaw, 2008).

This risk is of particular concern when alliances deal with fungible and reproducible resources such as knowledge, or require access that may reveal trade secrets. It is further complicated by the hazard of long-term resource dependence and the sharing of economic rents. From a long term perspective, an additional hazard of partnering with a large incumbent is that a small firm can become overly dependent on larger partners that control resources crucial for commercialization. When the incumbent's market power is derived from having control over important specialized complementary assets, small firms might also end up handing over the lion's share of the value appropriation to the large incumbent (Rey and Tirole, 1997).

## *2.2. Artist-led-distribution versus strategic alliance in creative industries*

The fundamental choice between following an artist-led-distribution strategy and a strategic alliance strategy has previously been studied in settings in which this issue has particular salience, namely the creative industries. Some scholars have argued that small-sized, entrepreneurial content producers in these industries can dispense with incumbent publishers altogether, pursuing a direct-to-market, or artist-led-distribution strategy. Others, however, argue that publishers perform a vital function that is as important in the era of online distribution as it was during the time when reaching final consumers required the movement of physical products across a complex supply chain. The following sections explore both views.

### *2.2.1 Independent commercialization strategy: Artist-led-distribution*

A number of researchers have argued that online technologies such as the Internet will revolutionize creative industries and allow entrepreneurial content producers to independently publish and fully appropriate value of their creativity, making incumbent publishers obsolete (Bockstedt et al., 2006; Clemons et al., 2003; Clemons and Lang, 2003). Their argument flows from a decoupling of information goods from physical media, resulting in publishers losing their ability to appropriate revenue streams from physical reproduction and distribution. In addition, as the costs of reproduction and online distribution of digitizable content become negligible, publishers' scale-based resource advantages that create entry barriers are largely eliminated.

Since the value appropriation of creative content disproportionately accrues to publishers, entrepreneurial content producers are motivated to bypass the publisher and offer their content directly to the consumer to achieve higher profit margins (Mol et al., 2005). The advent of digital distribution channels therefore allows entrepreneurial content producers to shift to artist-led-distribution, making the position of publishers progressively uncertain, and their future untenable (Clemons and Lang, 2003).

### *2.2.2. Alliance-based commercialization strategy*

Another group of researchers have argued that although online distribution channels may tilt the balance of power in favor of entrepreneurial content producers by eroding entry barriers, the ability to reach consumers does not necessarily improve sales performance: Consumers still face information asymmetries when it comes to selecting from the variety of offerings. Reducing these information asymmetries require specialized complementary assets that cannot easily be developed in-house or obtained via contracting (Caves, 2000; Kretschmer et al., 2001). The only viable alternative available to content producers is

therefore the formation of strategic alliances with incumbent publishers that control these assets (Mol et al., 2005).

To understand why complementary assets retain their importance even in environments where content producers can directly reach consumers it is important to bear in mind that consumers in creative industries often turn to professional reviewers for ‘expert’ opinion when making their product selection (Lampel and Shamsie, 2000; Priem 2007; Wijnberg and Gemser, 2000). In principle, these external experts are expected to review and provide opinion on all, if not most, product offerings. In practice, external experts are more likely to review product offerings that are brought to their attention by publishers and distributors – in part because publishers and distributors often have long-standing relationships with reviewers, and in part because in general reviewers take it as a given that their time and effort is better spent on evaluating products that are more likely to be widely distributed.

Indirectly, therefore, publishers perform the important role of selecting and certifying quality for consumers (Clemons and Lang, 2003). In this role they undertake the crucial task of reducing the information asymmetry that may exist between content producers and key actors in their industry (Caves, 2000). In conjunction with this activity, they also seek to promote the content. Once selection has been made, publishers usually commit resources to draw market attention to the product. Market attention contributes to market performance, but it also has the added impact of signaling to other actors that the product meets the quality standards expected by established industry players.

### *2.3. Specialized complementary assets in the creative industries*

The calculation of whether the advantages of partnering with owners of complementary specialized assets outweigh the risks depends very much on how the

industry's value chain characteristics provide the basis for creating sustainable competitive advantage. Creative industries require a range of complementary assets for successful commercialization of new products (Caves, 2000; Hirsch, 1972). Based on a review of the literature we identify four prevailing specialized complementary assets which are deployed by incumbent publishers for increasing the probability of successful commercialization, and that content producers can access by forming alliances.

The first specialized complementary asset is a **large portfolio of content**. Firms that operate in creative industries generally face winner-takes-all markets in which competition leads to highly skewed market share distribution (De Vany, 2004; De Vany and Walls, 1996). Since the success of individual products is difficult to predict upfront, nor easily explained ex-post (Broekhuizen et al., 2011; Caves, 2000), publishers rely far less on internal product evaluation when selecting which products to launch, preferring instead to follow the principle of "let the market decide" (Hirsch, 1972). In other words, they release as many products as their resources will allow, and then actively support only those products that demonstrate consumer appeal.

To sustain this strategy publishers often amass large game portfolios. Large portfolios increase the probability of having 'hits' that will offset the low revenues that are generated by less successful games. In addition to hedging financial risk, large portfolios also provide bargaining power against platform holders who facilitate digital storefronts, and thus can be used to negotiate preferential 'shelf spacing' and higher revenue margins. Finally, another advantage of having a large portfolio is the ability to lower transaction costs for consumers. As Kasper and Streit (1998: p. 231) point out, suppliers of experience goods often compete by reducing transaction costs for buyers by offering catalogues that consumers can conveniently peruse, as opposed to undertaking the costly process of searching for products that meet their preferences across multiple retail points. In the case of digital distribution,

these catalogues give publishers the added advantage of cross-promoting content. This cross-promotion is often linked to recommendation engines that direct consumers to other offerings within the catalogue based on their past purchases and preferences.

The second specialized complementary asset is **superior marketing skills and assets**. The oversupply of content that is characteristic of creative industries presents publishers with the challenge of attracting public attention (Caves, 2000). Since consumer awareness of these products hinges almost exclusively on mass-media coverage, successful publishers leverage and cultivate their relationships with the mass media with a view to obtaining favorable reviews in magazines and newspapers (Elberse and Anand, 2007). This is done not only by appointing staff whose job is to get to know journalists that review new products, but also by purchasing advertising space in the same media outlets. More recently, the rise of websites and social media has opened new promotional channels that should in principle reduce the power of incumbency. In practice, however, the sheer number and diversity of these information sites favor incumbent publishers that have the resources necessary to develop a marketing campaign that targets these sites individually.

The third specialized complementary asset that plays a crucial role in successful commercialization of content is having **relationships with gatekeepers**. Content becomes successful by the virtue of selection by gatekeepers that control *access* to the market, and by institutional actors that *evaluate* released content (Lampel et al., 2000). In the video game industry, platform owners act as access gatekeepers, granting or denying content access to their platforms. When it comes to deciding which games should be given access, platform owners usually rely on publishers' advice and support. They attribute to publishers superior market-sensing qualities, i.e. publishers are assumed to have extensive knowledge about supply side variables in terms of what content is being offered and selecting the most

promising content. Due to these qualities, they are able to maintain closely-knit relationships with access gatekeepers to stimulate the chances of acceptance (Mol et al., 2005).

Strong relationships with access gatekeepers are a necessary but not sufficient condition for ensuring publishers' strategic success. In the creative industries, product market selection is also strongly influenced by institutional actors such as mass-media critics and award-giving bodies that evaluate and broadcast product quality (Eliashberg et al. 2006). These evaluations exercise strong informative and persuasive impact on consumers, and by extension have the capacity of creating a bandwagon effect that can radically change the revenue potential of games (Elberse and Anand, 2007; Gemser et al., 2008).

Lastly, having a **reputation or reputable name** is an important intangible asset for successful commercialization. In markets in which the quality is uncertain but strictly ranked, reputation is a valuable asset, as it provides a signal of quality in the eyes of consumers (Caves, 2000; Spence, 1973). If entrepreneurial content producers closely cooperate with incumbent publishers, the publisher acts as an endorser for content producers that have not (yet) established their reputation. The publisher confers legitimacy by signaling to consumers and other important market parties, such as mass media, platform owners that the content producer is a legitimate partner to work with (Rao et al., 2008). For a new content producer this joint stamp of approval by the publisher and the platform owner is often an indispensable first step towards establishing a viable position in the industry.

To conclude, this paper argues that the key premise for forming an alliance is whether the lower return that content producers receive for each unit sold will be offset by higher market performance as a direct result of capitalizing on the incumbent's specialized complementary assets. The success of a commercialization strategy thus is a function of the availability of the specialized complementary assets, and the value the content producer is able to appropriate from the product's market performance. Within the boundaries of the

prevailing empirical context, i.e. a situation in which entrepreneurial content producers lack specialized complementary assets, we posit that the strategic alliance strategy allows content producers to tap into the publisher's specialized complementary assets, resulting in additional rents that are higher than the costs of partnering with the publisher.

### **3. Methodology**

#### *3.1. Empirical setting: the market for digitally distributed games*

The video game industry is an industry with considerable economic and technological significance. In 2010 the worldwide market for console video games and systems comprised \$38.4 billion (IDG, 2011a). Installments in the latest generation video game machines, released between 2005 and 2006, are all equipped with digital storefronts. Nintendo's WiiWare, Sony's PlayStation Network, and Microsoft's Xbox Live Arcade form a collective market of \$1.9 billion in the year 2010. Collectively, taking into account other digital gaming platforms such as Steam, Apple's Appstore, and Facebook's social gaming platform, the market for digitally distributed games is calculated at \$20 billion in 2010 (IDG, 2011b).

These technological advancements have several consequences for the business models of video game developers, and for the industry's value chain. Digital distribution channels can be used by the content producing community to bypass barriers to entry. Indeed, lower entry barriers to market have led to an increase in the number of content suppliers and lower online retail prices. Industry experts are speaking of an 'App clutter' as the number of games available on certain platforms has risen past 100,000. The resulting price competition is putting pressure on the profit margins of new entrants. There are some success stories of independent content distributors, but these are few and far between. Surprisingly, notwithstanding the odds against succeeding on their own, the independent development community is largely of the opinion that publishers no longer fulfill a vital role in

commercializing content. Indeed, many go as far as to declare the ‘death’ of publishing as a business model.<sup>1</sup>

### *3.2. Case study approach*

A case study methodology fits the exploratory investigation of a contemporary phenomenon and matches the research design of the study at hand (Yin, 2009 Flyvbjerg, 2011). In choosing our methodology we follow other researchers who use a case study approach to investigate emerging business practices in nascent markets (e.g. Haefliger et al., 2010; Jacobides and Bilinger, 2006; Ozcan and Eisenhardt, 2009; Santos and Eisenhardt, 2009). Our research question examines the tradeoff between creative content producers commercializing their products directly to consumers without the benefit of specialized complementary assets, as opposed to commercializing their products through a strategic alliance with publishers who can put these specialized complementary assets at their disposal. In line with the criteria laid out by Wieviorka (1992) and Thomas (2011) for case methodology, this question identifies commercialization of new creative content as the analytical or theoretical context, and released video games as the population from which a “characteristic unit” is selected to undertake a case study. We picked one video game to study that fulfilled Flyvbjerg’s (2011: p. 307) description of a “critical case” - a case that permits a deduction of the type “If it is valid for this case, it is valid for all (or many) cases.”

### *3.3. Data collection*

We approached a video game developer that we call Dutch Video Game Developer (DVGD) for data.<sup>2</sup> The firm was selected because of its similarities with other small-sized

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<sup>1</sup> <http://whoneedschilling.com/> - Last accessed, 06/04/2012.

<sup>2</sup> The video game industry’s global production chain is centered on three geographical hotbeds; United States, Japan and Europe in which the United Kingdom and France play focal roles (Johns, 2006; Storz, 2008). Although the Netherlands has a lively game development industry (expected market volume of € 703 million in 2012) with

content producers in the video game industry. Traditionally, the firm worked with international publishers such as Electronic Arts and Capcom based on the physical, work-for-hire, distribution business model. As in the case of other international content developers, DVGD explored the opportunities and challenges brought forward by the online distribution by the prospect of greater independence and higher economic returns.

Our empirical setting is the repeated commercialization of one game, which to preserve confidentiality we call '*Chicken's Tale*', using two alternative commercialization strategies: an artist-led-distribution strategy, and a strategic alliance strategy with an incumbent publisher. DVGD has allied itself with a reputable publisher that has several best-selling games in its portfolio. It is also critically acclaimed with a BAFTA and an Apple Design award. DVGD collaborated exclusively with the publisher for the commercialization of *Chicken's Tale*. The alliance was established by formal agreement between both parties, in which the publisher's ultimate payment depends on the game's success.

By focusing on a single firm that commercializes near identical content onto two comparable channels, we conduct a naturally occurring quasi-experiment in which producer and content differences (i.e., differences in producer capabilities and quality of content), which may affect the products' performance, are minimized. Furthermore, by analyzing both the specific actions and the relative success measures for each channel, we can meaningfully compare the financial and market performance from each strategy.

Data were collected from multiple sources (cf. Webb et al., 1966). These included proprietary sales-tracking databases monitoring sales activity, and semi-structured face-to-face interviews that lasted between 30 and 60 minutes with employees (11) and co-founders (2); email communication with publisher and platform owners, and company documentation

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some internationally renowned firms (e.g., game developer Guerrilla with its popular *Killzone franchise* and digital distribution specialist W!Games), most of the 250 firms have yet to achieve international recognition from publishers and consumers alike. The advent of the online channel provides the Dutch videogame developers with an opportunity to increase their chances of international exposure.

such as contracts and business plans. We also obtained data from email conversations between DVGD and the publisher and the platform owners, and participant observations held between March 2009 and August 2009. The embedded and multifaceted design of the study in conjunction with triangulation of the data adds to the robustness of the findings (Eisenhardt, 1989). To increase the validity of our findings, the interpretations of the data have been cross-checked by the co-founders of the firm.

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The sales tracking period for both releases was 125 days from release. At the time of the games' release (May 2008 and May 2009 for the artist-led-distribution and the strategic alliance strategy respectively), the distribution channels onto which the content was released were comparable in terms of installed base (around 40 million users), phase in the channels' lifecycles (<1 year old), and geographical scope (North America, South America, Europe, and Australasia). We measure performance both in terms of how well the games perform in their respective markets using industry metrics, and in terms of revenue generation after publisher fee deductions.

## **4. Results**

### *4.1. Artist-led-distribution strategy*

**Specialized complementary assets.** Analysis of in-house availability of complementary assets shows that DVGD lacks important assets for successful commercialization. Firstly, in its ten years of being operative, DVGD developed on average

one video game a year. This is in mark contrast to incumbent publishers who release on average between 40 and 50 games each year.<sup>3</sup>

Secondly, DVGD did not have a formal marketing budget, neither was there any expertise in marketing or promotional activities. Having traditionally relied on marketing performed by publishers, the firm's founders never invested in marketing, intellectually or monetarily. The founders lack a broad skills set that is often necessary for startup success (Lazear, 2005), having specialized from the outset in information technology and software design. For the artist-led-distribution commercialization of *Chicken's Tale*, the founders therefore recruited an intern to assist with marketing responsibilities such as writing a press release, plotting out a pricing strategy, assisting in promotional activities, and approaching the mass media for writing reviews. As a database with relevant contacts was absent, DVGD lacked access to mass media that have the ability to select and certify content through favorable product reviews and features. This turned out to be a major hurdle for bringing *Chicken's Tale* to the attention of the media in the artist-led-distribution. The process of securing reviews for *Chicken's Tale* was for this reason ad-hoc and uncoordinated.

Furthermore, whereas DVGD was in close contact with technical staff at various platform owners, the firm did not have strong relationships with marketing staff at these organizations, an important drawback when the functional divisions between technical and marketing functions in firms is taken into account. An analysis of email exchanges revealed that DVGD also attempted to persuade the platform owner to feature its content onto the digital storefront, but ultimately did not succeed.

Finally, despite DVGD previously establishing relationships with international publishers, and introducing several games to the market, DVGD did not have a strong reputation in the industry. Publishers saw the firm as a team that could deliver quality content,

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<sup>3</sup> <http://www.infendo.com/ea-to-reduce-yearly-game-output-by-40/> - Last accessed 06/04/2012.

albeit at a price above market standards, but not an organization that could deliver ‘hit’ games. Much to the annoyance of the company’s staff, DVGD’s games, *Chicken’s Tale* included, had repeatedly been nominated for the national industry awards, *Dutch Game Awards*, yet never gotten the expert consecration the staff hoped for.

The results demonstrate that at the time of the artist-led-distribution strategy, DVGD did not have in place a large portfolio, marketing capabilities or a large promotional budget, did not have access to important access and evaluator gatekeepers, and was not able to demonstrate its reputation as a high-quality developer.

**Performance.** *Chicken’s Tale* sold for an average selling price of €9.00 throughout its lifecycle. The average selling price was slightly lower than the market average of €9.54 on the respective online distribution channel (Table 1). Figure 1 shows that the most apparent surge in sales occurred at day 14, when sales jumped from 296 to 1,265 units per day (+427%). This spike is attributed to a sequential launch of the game first in Europe followed by the United States. The sequencing was caused by unforeseen differences in submission procedures between the European and North American offices of the platform owner, and had not been chosen purposefully. Recurring spikes in the game’s performance are attributed to increased shopping activity during weekends on the digital platform. In total, the game sold 20,961 units, generating total revenues of €88,347.

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According to industry expert Simon Carless (Carless, 2009), who provides an analysis of relative success in terms of units sold per online distribution platform, the artist-led-

distribution *Chicken's Tale* resides in the low-end of the market in terms of cumulative sales.<sup>4</sup> Within the distribution channel's sales standards, *Chicken's Tale* co-exists with the bulk (60% lower end of the market) of the products that are considered as unsuccessful and sell no more than 25,000 units (Table 1).

#### 4.2. Strategic alliance strategy

**Specialized complementary assets.** In the strategic alliance strategy, DVGD partnered with an incumbent publisher to commercialize *Chicken's Tale* on a different but comparable distribution channel. The partnering meant that *Chicken's Tale* could be commercialized with the help of the publisher's specialized complementary asset position.

The publisher's large portfolio (>40 games) put it in a strong bargaining position during negotiations with the platform owner, and increased its ability to obtain favorable reviews from mass media. Furthermore, in conversations with both DVGD and the publisher it became apparent that a significant share of *Chicken's Tale's* sales had been generated by customers of other games in the publisher's portfolio through cross-selling promotional campaigns.

The publisher's marketing capabilities were put to use prior to the content's release to create a 'buzz' around the game. A six week timeline composite of promotional activities was planned and acted upon in order to generate maximum awareness. Various methods were used including organizing promotional contests, securing product previews, and arranging for media interviews with game's developers. The publisher increased media attention post-release by securing product reviews and by bringing product updates to the attention of the

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<sup>4</sup> At the time of analysis Simon Carless was chairman of the highly respected *Independent Games Festival* and publisher of online publication *Gamasutra* with a readership in excess of one million unique visitors per month. DVGD's marketing plan reveals that the firm recognizes and adheres to the metrics provided by Carless.

press. Setting and monitoring the pricing strategy was another large part of the publisher's marketing capabilities.

For the first 41 days after release the game was sold for €3.99. Thereafter, starting on day 43 until day 56, the product had a price discount period and sold for €0.79. Sales jumped from an average of 400 units per day to 6,400 units during this period (see Figure 2). The price discount period was followed by a transition price of €1.59 for the 20 days hereafter. Average units sold per day dropped to 1,700 units per day. Finally, in the remainder of the sales tracking period, the product was sold for its original price of €3.99.

The publisher's relationships with gatekeepers resulted in a large boost in sales and revenues. Despite being essentially identical to the first release, when the publisher contacted prominent evaluators for product reviews, *Chicken's Tale* received significantly higher evaluations compared to the artist-led-distribution strategy.<sup>5</sup> This was a boost to the game with significant market impact since studies that show a causal relationship between the mean scores of video game reviews, and their market performance (Binken and Stremersch, 2009). An additional boost, subsequently, resulted from the publisher's staff visit to the platform owner. The publisher's staff convinced the platform owner to feature *Chicken's Tale* on its online storefront through preferential product placement.<sup>6</sup> The effect of the feature was immediately noticeable and its effect on sales pertained for two weeks. Sales jumped from 390 units to 1,385 units sold per day in response to the feature (+355%).

The results demonstrate that as a function of the established strategic alliance, DVGD was able to use the publisher's specialized complementary assets, in particular the publisher's

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<sup>5</sup> An unpaired Student's *t*-test demonstrated that the mean review scores for the artist-led distribution strategy is 79%, whereas it is 86% for the strategic alliance strategy. The mean difference is significant at the 10% significance level.

<sup>6</sup> Platform owners can decide to showcase content on the platform's storefront website. In what amounts to tacit endorsement, consumers are presented with prominently displayed content when they log into the website. Decision rationales for featuring content are erratic yet depend on an ever changing agenda for showcasing the platforms' most prospective content to consumers. Close-knit relationships with platform owners allow publishers to match their release schedules and lobby in accordance with these agendas to increase the probability of having their content featured.

large portfolio, its marketing competencies, and relationship with gatekeepers, to successfully re-launch the game on the second distribution channel. The endorsement of DVGD by the publisher also led to reputational benefits for the game developer.

<<<INSERT FIGURE 2 ABOUT HERE>>>

**Performance.** The publisher sold 135,288 units during the 125 days sales tracking period with an average weighted selling price of €1.45. The average selling price was slightly above the €1.32 average selling price for the Top 10 bestselling games on the platform. According to Carless (2009), the number of units sold can be considered successful respective to the platform's standards. Due to strong competition on the platform, 95% of the content published fails to sell over 5,000 units. The publisher was paid a 10% fee per unit sold in the first month from release and a 15% fee thereafter, totaling €14,847. Total net revenues generated from *Chicken's Tale* for DVGD accumulate to € 95,516.

#### 4.3. Results comparison

Figure 3 provides a comparison of the number of units sold when DVGD used artist-led-distribution versus strategic alliance. To facilitate interpretation we log-transformed the number of units sold. Examining Figure 3 it is clear that not only does the strategic alliance release generate significantly higher sales by comparison to the artist-led-distribution strategy from the product's launch, but also that this strategy delivers consistently higher sales throughout the rest of the tracking period. Thus the evidence supports the conclusion that the pre-release activities by the publisher pay off in terms of higher number units sold . This is further supported by Table 2 which summarizes the case study's findings and the financial results of both commercialization strategies. The lower average selling price for the strategic

alliance strategy as compared to that of the artist-led-distribution strategy is a result of the common pricing strategies on each platform rather than being due to differences in content. Despite the lower average selling price and the publisher fees (€14,847), the strategic alliance strategy resulted in €7,169 higher net cumulative revenues. The higher performance of the strategic alliance strategy is not only noticeable when analyzing the number of units sold (135,288 units against 20,961 units), but also through classification of relative market success as defined by Carless (2009): 5% top end of the market for the strategic alliance strategy versus 60% lower end of the market in the case of the artist-led-distribution strategy.

<<<INSERT TABLE 2 AND FIGURE 3 ABOUT HERE>>>

## **5. Discussion**

In the creative industries, incumbent publishers seek positions in which they extract value from others in the chain by virtue of controlling access to specialized complementary assets and downstream markets (Rey and Tirole, 1997). Technological advancements, specifically online channels of distribution, allow upstream firms to bypass firms that have previously controlled access to markets. According to authors favoring an artist-led distribution strategy, since the digitizable content can be distributed at virtually no cost, it should not only reduce the power of publishers, but in the long run should eliminate their function entirely (Bockstedt et al., 2006; Clemons et al., 2003). Indeed, many content producers, not only in the video game industry, have concluded that their future depends on developing direct-to-consumer business models (Rayport and Sviokla, 1995). However, notwithstanding the persuasiveness of this view to researchers and practitioners alike, commercial success has been mixed at best.

The explanation for this empirical finding may be attributed to a constrained view of how value chains work. Rather than following a static view in which content producers can capture more value by skipping stages and clawing back the value that was previously appropriated by publishers, it seems that a more dynamic view is necessary. In the creation and appropriation of value, Teece (1986; 2006; 2010) sees value chain stages not as additive but as interactive. Value is not always created in one stage and then transferred to the next. Instead, it is often jointly created when one part in the value chain provides specialized complementary assets that allow another part to enhance the value of its basic product. From this perspective, artist-led distribution business models that bypass publishers often only consider one of their value functions, distribution, but ignore other functions such as selection, certification and promotion that are created through the publisher's specialized complementary assets, and that are important to success. To build successful business models that market directly to consumers, it is not sufficient for content producers to go online, they must also build or acquire these specialized assets.

The difference between an additive and interactive view of the value chain, at least in the case we examine in this paper, comes down to whether the specialized complementary assets generate sufficient value for upstream content producers. This is generally a difficult question to answer empirically, since the interaction between content and specialized complementary assets is idiosyncratic. Every creative product is unique (Caves, 2000), so the way in which they combine with complementary assets is usually unpredictable and often not well understood even by the owners of these assets. One way to assess the contribution of specialized complementary assets would be to control for the one-of-a-kind property of creative contents by releasing the same content with, and without, relying on specialized complementary specialized assets.

Researchers are rarely in the possession of resources needed to conduct such an experiment, let alone have access to confidential sales and revenues data. We were fortunate to be given access to a content producer that had undergone precisely this experience. Our results show that while our content producer had to forgo substantive value to the publisher, it still came out ahead because the total value created by combining their operation was much greater than the value created by distributing the game directly to the market.

The evidence clearly supports the view first proposed by Teece (1986; 2006) that value chains are interactive, in the sense that different stages in the value chain complement each other and create synergetic effects for the end consumer. The evidence also suggests that building online direct-to-consumer business models in the video game industry, and perhaps in creative industries more generally, may not be as easy as was assumed during the pioneering phase of the Internet. Specialized complementary assets matter, and there is no obvious way in which new technologies can replace them.

The full consequences of the Internet on the actors' roles within the value chain go beyond what is studied in this paper. To understand the influence of the Internet on the evolution of the institutional structure of the video game industry and the vertical scope of content producers and publishers, we rely on the work of authors such as Jacobides and Winter (2005), Langlois (2003) and Sturgeon (2002). To do this, we must consider the industry's value chain before the advent of the Internet. The industry's value chain at that point relied on physical distribution of video games which consumers bought in retail establishments. For consumers, transaction costs associated with this method of shopping included the costs of finding and visiting the store. If they came with a specific game in mind, they were confronted with the risk that the game was out of stock. On the other hand, if they were exploring, they had to browse through a collection that was limited by the available shelf

space. If they were not happy with what was on offer, they had to incur the costs of visiting other retail establishments.

Even when consumers made the extra effort of going elsewhere, they were unlikely to find greater diversity. The economies of physical distribution and retailing militated against product diversity, partly because a wider range of games is more costly to stock, but mostly because retailers looked to publishers to select and market products that will maximize sales per unit retail space. Publishers, for their part, screened out games that had low potential for becoming best sellers, and poured marketing and promotion resources into those that did. All together this created a ‘winner-takes-all’ competition that entrenched the power of incumbent content producers, and tended to shut out new entrants (Caves, 2000).

The online channel removed the constraints imposed by physical distribution and retailing, and in theory presaged the decline of publishing as a crucial part of the value chain. In practice, this did not turn out to be the case. Publishing may no longer control physical access to retailing, but it continues to fulfill an essential role in determining the success of video games. A plausible explanation for this can be found in Langlois’ (2003) distinction between static and dynamic transaction costs analysis. The static transaction costs analysis framework, which originates from work by Coase (1937) that was developed further by Williamson (1975), argues that when market transaction costs rise firms will internalize activities, whereas they will externalize activities as internal governance costs rise. This static framework ignores the evolutionary dynamics of markets, specifically it overlooks how the evolving market context shapes the interaction of transactions with the environment in which they are embedded (Jacobides and Winter, 2005; Langlois, 2003). Thus, market transaction costs may rise, but after a short time (in historical terms), they will often fall again. The fall is often due to institutions and technologies that initially caused transaction costs to rise, begin to adjust, and in the process bring down transaction costs.

The interaction between transactions and their environments that Langlois (2003) describes as ‘dynamic transaction costs’ provides an explanation for the continued resilience of incumbent publishers. In our case, however, transaction costs for consumers first fall (lower reproduction costs and price, and lower search costs), and then rise (cost of search). The emergence of online distribution opened the way for low transaction costs interaction with consumers, as consumers can directly download their favorite video games at lower prices. However, the amount of online games offered by content producers has significantly risen, as publishers’ scale-based resource advantages that formed entry barriers have been eliminated. This rapid expansion in the number of new products being launched into the market reversed the drop in transaction costs by increasing consumers’ search costs. In effect, online distribution which held out the promise of giving all content producers, small and large, a level playing field, actually created information congestion that made it harder for consumers to find and select a game of their choice, and then transact. As transaction costs rose, the publishers which seemed increasingly irrelevant to many in the industry, reestablished their role as selectors, evaluators, and marketers.

What publishers could not do, however, is reestablish their previous power over distribution. Online distribution meant that content producers now had alternatives to physical distribution. Publishers’ strategy therefore changed to reflect the fact that they no longer have the ability to block content producers from accessing markets if they are unwilling to accept the terms being offered. Instead, publishers now have to rely almost entirely on contracting their specialized complementary assets to content producers on short, or long-term basis, depending on the kind of alliance envisaged.

## **6. Research limitations and future research**

Our research has certain limitations that must be addressed, but that also offer avenues for future research. Our interpretation is ultimately based on one case and one industry. Larger sample studies are needed before we can arrive at the conclusion that video game producers that lack complementary assets will generally fare better by following a strategic alliance strategy. The same holds for generalizing this finding to other industry contexts. We suggest a product and organizational approach to addressing the relative success of commercialization strategies. The first is to study relative product performance of the chosen commercialization strategies of a large amount of product introductions, using variables such as expert scores and awards as quality indicators; and, marketing expenditures and portfolio size as controls. The other approach is survivor analysis of content producers. Specialized content production is a high risk business in most creative industries. As in our case, many content producers use both artist-led-distribution and strategic alliance strategies with publishers. The question that inevitably arises is whether content producers that rely more on artist-led-distribution are less likely to survive than peers that form alliances with publishers. A single case study design is insufficient to provide an answer to this question. Nor is it likely that one commercialization strategy will always be superior to the other. There are contingencies such as firm reputation, or the stage of the industry life cycle, that can impact commercialization in such a way as to tilt the overall success of each strategy. Obtaining deeper understanding of artist-led-distribution versus alliance strategy clearly requires sample studies with proper controls for firm and market factors.

Our paper examines a transition period in the evolution of the video game industry. It does not, therefore, address the long-run configuration of the industry architecture of the video game industry (cf. Jacobides et al., 2006). In an attempt to overcome the dependence on specialized complementary assets controlled by powerful incumbents, entrepreneurial content producers may try to mobilize resources into the development of these specialized assets and

in time learn how to mimic publishers' assets and alter the degree of specialization between actors and the power structures within the value chain (Pisano and Teece, 2007; Stevenson and Gumpert, 1985). Previous studies have shown how new entrants in nascent markets have successfully strengthened their position vis-à-vis competitors through actively shaping the industry architecture (Ozcan and Eisenhardt, 2009; Santos and Eisenhardt, 2009). Future research should address the issue of content producers' attempts to shape the industry architecture in favor of their market position vis-à-vis publishers' market power and their effectiveness in doing so.

Finally, we believe that our study should be extended to other creative industries. In the music industry, for instance, music labels, the equivalent of publishers in our case, own different bundles of specialized complementary assets. There is considerable controversy as to which of these bundles (e.g. talent development, production, promotion, and relationships with gatekeepers), add substantial value to upstream content producers (i.e. artists), and which do not (Lam and Tan, 2001). By the same token, independent film production has for many decades sought to bypass studio distribution (Cunningham and Silver, 2012). The advent of online distribution has been energetically pursued by independent film producers as a way of breaking away from their dependence on the major Hollywood studios, but as of now their efforts have run up against the reality that film distribution is much more than simply making content directly available to the public (Finney, 2010).

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**Table 1. Differences between distribution channels**

		<b>Artist-led-distribution channel</b>		<b>Strategic alliance distribution channel</b>	
<b>Market performance metrics (Carless, 2009)</b>	Low	6,000 - 25,000 units	60% of all products	100-1,500 units	85% of all products
	Average	25,000 - 50,000 units	30% of all products	1,500-5,000 units	10% of all products
	High	50,000 - 350,000 units	10% of all products	5,000 - 1,500,000 units	5% of all products
<b>Installed base</b>		42,500,000 users		37,000,000 users	
<b>Average selling price</b>		€ 9.54		\$ 1.89 (€1.32)	

**Table 2. Summary of the case study findings**

	<b>Artist-led-distribution strategy</b>	<b>Strategic alliance strategy</b>
<b>Portfolio of content</b>	Small portfolio of ten games. Limited means for cross-promotion.	Large portfolio of 40+ games. Cross-promotion through product portfolio.
<b>Marketing skills and assets</b>	No marketing expertise or formal budget available.	Publisher’s marketing expertise and budget.
	Static pricing strategy.	Dynamic pricing strategy resulted in top 10 listing.
	No pre-release marketing activities.	Pre-release marketing activities: promotional contest, developer interviews, and product previews.
	No access to mass-media actors.	Access to mass-media actors.
<b>Relationships with gatekeepers</b>	Limited access to evaluator gatekeepers. Few but favorable product reviews in magazines and on websites (79%).	Access to evaluator gatekeepers. Reasonable amount and even more favorable product reviews in magazines and on websites (86%).
	Limited access to access gatekeepers. Unsuccessful attempt to ask platform owner to feature product.	Relationship with platform owners resulted in favorable product placement in storefront of platform.
<b>Reputation/ Reputable name</b>	Absence of strong reputation in the eyes of mass media, evaluator gatekeepers and platforms; no awards won or hit product produced.	Strong reputation in the eyes of mass media, evaluator gatekeepers and platform owners; Apple and BAFTA awards won, hit product produced.
<b>Overall access to complementary assets</b>	Low	High
<b><i>Financial performance</i></b>		
<b>Total units sold</b>	20,961	135,288
<b>Relative market performance</b>	60% lower end of market	5% top end of market
<b>Net revenue</b>	€88,347	€95,516

