

Study on Entry Strategies of Game Companies

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Abstract. Firms utilize various entry modes in entering host countries: license, joint venture (JV) and wholly-owned subsidiary (WOS). This study attempts to construct relationship between strategic motivations and mode choices of Chinese online game companies. Based on analysis of previous research on transaction analysis and dynamic capability approach, the motivation matrix of target capabilities (production or publishing) and purposes (development or exploitation) is developed. For each cell of the matrix, propositions on entry mode are developed.

1 Introduction

Outward FDI of Chinese game companies is more aggressive and pervasive, and one of the typical oversea destinations is Korea. According to my newspaper survey, since 2010 they have entered Korean market utilizing various entry modes: a licensing contract, JV and WOS. The number of game companies entering Korea is 21 in 2012. Interestingly enough, five firms use JV and WOS modes at the same time and one even uses all three modes.

This study attempts to find out internationalization strategies of Chinese game companies and to construct the relationship between the strategic motivations and their entry mode choices in Korean market. The online game industry is an interactive entertainment industry made up of a peculiar combination of a culture-related creative sector and a technology-intensive service sector. This exploratory research can clarify the motivations and determinants of Chinese game companies' international strategies.

The production industry and the publishing industry have quite different characteristics, even though both are regarded as knowledge-intensive service industries. The value-chain of game production includes stages of developing game design, producing graphic art assets, writing client/server programming, etc. On the other hand, game publishing provides gamers with a variety of services including distribution of game titles and patches, database operation, consistent support to gamers, marketing and promotion, etc.

Both industries require a plenty of technical knowledge but they are quite different in terms of knowledge transfer mechanism and innovation patterns. Game production has a characteristic of, so called, a hard-service industry in which production and consumption can be separated, whereas publishing is a pure soft-service industry with the inseparable trait [1]. Game development process can be codified in manuals,

program codes, graphic art assets, while publishing activities are mostly tacit and not easily documented because they are related to a specific market intertwined with culture, industrial regulations and social norm. In addition, since innovation in publishing activities results from co-production with users [2], it is very important to have constant contacts with gamers and to build experiential knowledge through hand-on publishing activities.

2 Propositions

The dynamic capability approach (DCA) seems to be effective to explain Chinese outward investment. Dynamic capability is a capacity to extract rents from current resources as well as build new competencies [3]. The approach views firms' strategic decision as not only utilization of existing rent-seeking capability but also learning and developing new capability. The latter is a main motivation of internationalization of Chinese game firms [4]. Chinese online game companies consider two strategic dimensions when they deploy resources internationally. First, they consider whether they go out for either seeking deficient resources or utilizing spare resources. Second, they put their strategic focus on either game production (a hard-service function) or game publishing (a soft-service function). The 2x2 matrix at Table 1 shows motivations and target functions of Chinese firms' entry modes.

Table 1. Matrix of game firm entry modes

	Production (hard-service)	Publishing (soft-service)
Capability development	1-a	2-a
Capability exploitation	1-b	2-b

1a: Hard-service + capability development

Collaborative entry mode is an important vehicle for knowledge acquisition and inter-firm learning [5]. In obtaining proprietary technology, firms are more likely to make a partnership with incumbent firms or to acquire existing firms in a host country rather than to start new operation from scratch. They can access partners' entire package of competitive advantage to upgrade their products or develop new products. JV provides an appropriate vehicle for facilitating the transfer of knowledge that firm cannot acquire in the market. Luo [4] empirically shows that in a dynamic market, JV mode is positively associated with capability building. In particular, since most hard-service knowledge related game production such programming technology and graphic assets are relatively codifiable, and teachable [6], they are more likely to learn and absorb necessary knowledge with support of partners through JV or acquiring existing firms.

Proposition 1. A game production firm prefers a collaborative entry mode when

it pursues capability development in a host country.

1b: Hard-service + capability exploitation

Determinants of entry mode choice for manufacturing firms can be applied to hard-service firms. The analysis of capability exploitation of hard-service firms in a host country has two considerations. One is transaction cost concern and the other is rent generation concern. The transaction cost approach predicts that if partners' opportunism or dissemination risk is high, the transaction cost of collaborative modes such as license agreement or JV is so high that collaborative modes are less preferable. If the cost resulting from dissemination risk of losing decreasing technological competencies is high, higher control entry mode such as WOS is more preferable [4]. Internalization through WOS can protect their program source codes and art assets from being copied or imitated by partners. They want to maximize profits as well as to reduce costs incurred during exploitation process. Thus, they compare the internal organization cost of WOS with the transaction cost of JV or license agreements.

Proposition 2. A game production firm prefers a high control entry mode, when it pursues capability exploitation in a host country.

2a: Soft-service + capability development

In general, a JV partnership with superior local firms is preferred when a firm seeks to build its capabilities in a host country. Considering characteristics of a soft-service it is by definition difficult to make an articulated drafting of a partnership contract and to absorb partners' knowhow. Thus, the greater is tacit component of firm-specific knowhow, the more it will favor a high control entry mode. Kogut and Zander [5] prove that for uncodified knowledge, the preferred vehicle is transfer between wholly owned units (p. 635).

Proposition 3. A game publishing firm prefers a high control entry mode, when it pursues capability development in a host country.

2b: Soft-service + capability exploitation

In order to fully exploit tacit knowhow in a foreign market, a firm that owns it is forced to use a full control mode of operation [4]. Some studies also show that non-separable service firms will favor a WOS mode of entry in foreign markets. Their explanation of WOS preference is that where separability is low, quality problems resulting from partnership may be overcome by keeping transactions within WOS rather than JV. A firm entering a host country need to customize soft services to client needs, which requires more experiential knowledge of foreign market and clients, and soft-serviced firms are more likely to opt for a high control entry mode. Their consistent findings are that when capability is exploited in the host country, soft-service sectors prefer a high-control mode such as WOS. It is partly because knowledge transfer is not easy and partly because a need for onsite quality assurance is so strong that low-control modes cannot exploit their full capabilities.

Proposition 4. A game publishing firm prefers a high control entry mode, when it

pursues capability exploitation in a host country.

3 Conclusion

Entry mode choice mainly depends on the host market's situation. For markets with large and high profit potentials WOS is preferred, while for markets with small and less profit potentials JVs or license agreements are preferred. Holding a high control mode at a small market is not a feasible option since the hierarchical organization costs of a WOS are higher than the potential profit. However, in going to overseas markets with huge profit potential, the decision would be completely different. Establishing a WOS is the best way for profit maximization if one wants to exploit its publishing capability.

Reference

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