CASE EXAMPLE

# *Final Fantasy* captures Lara Croft: acquisitions and alliances in electronic games

During 2009, Japanese games maker Square Enix launched a series of radical strategic initiatives. Famous for its role-playing games such as the *Final Fantasy* series, Square Enix established strategic alliances with the strategy games developers Double Helix and Gas Powered Games in the United States and Wargaming.net in the United Kingdom. Most radically, it also acquired the British Eidos Group, famous for the Lara Croft games. Square Enix President Yōichi Wada commented: 'Our goal is to become one of the top ten players in the world's media and entertainment industry. Since the games market is global, both our contact with our customers and our game development must become global too'.

*Source*: iStockphoto.

At the same time, the basic economics of the games industry are changing, with rising costs due to growing technological sophistication. A typical modern game can cost from $3,000,000 (about €2,000,000) to over $20,000,000 to develop.[2] Games generally take from one to three years to develop. Yet only one in twenty games is estimated ever to make a profit. In other words, the risks are very high and the necessary scale to compete is rising.

## The Japanese games industry

Square Enix's strategic moves came at a challenging time for the Japanese games industry. The Japanese had enjoyed two decades of domination built on the worldwide success of Japanese consoles such as the Sony PlayStation. But the growing success of Microsoft's Xbox gave an opportunity to American games developers to return to the console market. Indeed, American games developers found that their development skills were more transferable in the new cross-over markets, where games needed to be developed for PCs, consoles and mobile phones alike. Moreover, the Americans had the advantage of proximity to Hollywood, bringing in new creative talent and offering opportunities for film tie-ins. At the same time, Japan's ageing population was shrinking the market for traditional electronic games.

Square Enix's Yōichi Wada recognised the predicament of the Japanese industry vis-à-vis the Americans:

> In the last five to ten years, the Japanese games industry has become a closed environment, with no new people coming in, no new ideas, almost xenophobic . . . The lag with the US is very clear. The US games industry was not good in the past but it has now attracted people from the computer Industry and from Hollywood, which has led to strong growth.[1]

## Square Enix's strategy

Square Enix itself is the creation of a merger. Square had been founded in 1983, and in 1987 launched the first of its famous *Final Fantasy* role-playing game series. Enix had been founded in 1975, and launched its role-playing *Dragon Quest* series in 1986. The two companies merged in 2003, after the financial failure of Square's film-venture, *Final Fantasy: the Spirit Within*. Yōichi Wada, President of Square, became the president of the new merged company.

Square Enix's strategy is based on the idea of 'polymorphic content'. Its various franchises (*Final Fantasy, Dragon Quest* and so on) are developed for all possible hardware or media rather than any single gaming platform. Square Enix games can be played on consoles, PCs, mobile phones or online, and spin-offs include TV series, films, comics and novels. In 2005, Square Enix bought the Japanese arcade-game company Taito Corporation, famous for its *Space Invaders* game. *Space Invaders* versions have appeared on PlayStation, Xbox and Wii consoles, as well as PCs.

By 2008, Yōichi Wada was presiding over a company that was increasingly diversified, with sales of ¥136bn (about €1 bn) and just over 3,000 employees. However, it was still overwhelmingly Japanese (85 per cent of sales at home) and lacked scale by comparison with competitors such as Electronic Arts and Activision, respectively four and three times as large. On the plus side, Square Enix was reportedly cash rich, with a 'war-chest' available for acquisitions of about Y40bn (about €300m).[3] During the summer of 2008, Square Enix made a friendly bid for the Japanese game developer Tecmo, whose fighting games *Ninja Garden* and *Dead or Alive* were popular in North America and Europe. Tecmo rejected the bid. Wada began to look overseas.

## Lara Croft falls

Eidos is a British games company best-known for the action-adventure games series, *Tomb Raider*, starring the extraordinary Lara Croft. However, during 2008, disappointing sales for *Tomb Raider: Underworld* drove its share-price down from £5 (~€5.5; ~$7.5) to around 30 pence. Eidos' founder and chief executive, Jane Cavanagh, was forced to resign. The company declared losses of £136m (about €149m), on sales of £119m (down from £179m two years earlier). In April 2009, Square Enix bought the company for £84m (about €92.4m), a premium of 129% over Eidos' current market value. Given the declining success of the *Tomb Raider* franchise, many speculated that Square Enix had overpaid for its first overseas acquisition.

The acquisition of Eidos did offer Square Enix global reach, however. About one third of Eidos' sales were in the United States and 40 per cent in Europe, excluding the United Kingdom. Eidos also brought Square Enix its first studios outside Japan, with studios in the United Kingdom, Denmark, Hungary, the United States, Canada and China. Yōichi Wada commented: 'It is significant that we have opened a window for creative talents worldwide.'

Wada chose to keep Phil Rogers, the new Eidos chief executive, in place, along with the rest of his management team. Wada described a new Group structure, in which Square Enix, the arcade business Taito and Eidos would each be stand-alone divisions: 'Our aim is to implement a hybrid management structure which avoids the extremes of being either too global or too local'.[4] He continued: 'The Group's management and administration departments will be integrated, while our product and service delivery will be established locally in each territory to maximise our business opportunities through better understanding of local customers' tastes and commercial practices.' Wada also recognised the new strength that Eidos brought in action-adventure games, by contrast with Square Enix's traditional core of role-playing games. He declared his commitment both to sharing technologies across the businesses and to sustaining particular strengths: 'While promoting shared technology and expertise amongst our studios, we will also develop products which reflect the unique identity of each studio, regardless of locality.' Wada also commented on the nature of the skilled games developers he was acquiring: 'It is always difficult to manage creatives anywhere in the world. We want to cherish the Eidos studio culture but change it where it is necessary.'[5]

One thing that Square Enix was quick to do was to end the Eidos distribution agreement with Warner Bros for its products in the United States. Square Enix regarded itself as strong enough to do that itself.

## Strategic alliances

At the same time as acquiring Eidos, Square Enix cemented three significant strategic alliances. In the United Kingdom, Square Enix tied up with the strategy game developer Wargaming.net (famous for the *Massive Assault* series) in order to produce the World War II game *Order of War*. This would enter the market at the end of 2009 as Square Enix's first global product release. In the United States, Square Enix formed partnerships with Gas Powered Games (producer of the *Supreme Commander* strategy game) and with Double Helix (producer of the *Front Mission* strategy series). Together with the Eidos acquisition, these partnerships significantly extended Square Enix's range beyond its traditional core in role-playing games. They also extended the company's geographical reach. Yōichi Wada commented: 'We see great opportunities in North American and European markets, both of which are expected to be maintaining sustainable growth over these coming years. Therefore it is crucial that we create alliances with proven developers such as Gas Powered Games in order to serve these significant markets better by providing products and services in tune with customer tastes.'[6]

All three of these new partners were relatively small (around 100 employees each), privately-owned and had their origins as start-ups during the 1990s. To take one example, Gas Powered Games had been founded in 1998 by Chris Taylor and colleagues from the games developer Cavedog Entertainment. Chris Taylor had spent his whole career in games, with his first game *Hardball II* released in 1989. In an interview, Chris Taylor explained his motivation for setting up his own company, Gas Powered Games:

> I had that dream really from the day I first walked into my first full time job as a games programmer. I wanted to be the guy running the company. . . . We've created our own original IPs (intellectual properties) consistently. Some are great, some are not so great, but the fact is you have to keep throwing darts at the board. You have to keep trying to make great stuff, and you can't do that if you're inside of a large megalithic corporation to the same degree . . .[7]

Chris Taylor described how Square Enix, traditionally a role-playing company, and Gas Powered Games, more a strategy game developer, were working together on their first venture, *Supreme Commander 2*:

> One of the things that we took as a cue from Square Enix was the way they embrace character and story. We were all into that, so that was easy. When we asked them, 'How should we develop our game to work with their philosophy?', they said, 'Don't do that because we want you to do what you do. You make games for the Western market, and we're interested in making games for the Western market.' So if we changed, we would be missing the point. Which was terrific, because that meant we could do what we loved to do, make great RTS (real-time strategy) games . . . and if we tried to change them in any way, we'd be moving away from the goal.[8]

## A games enthusiast's view

In the space of a few months, Square Enix had transformed its profile. From its base in Japanese-style role-playing games, it was developing a significant presence in strategy and action adventure. It had studios across the world. Its various games titles were big across Asia, Europe and America. Games enthusiast Randy commented on a gamers' website:

> Square Enix publishing a western-developed game? Is the far-reaching JRPG (Japanese role-playing game) developer dumping the androgynous boy-heroes and shovel-wide swords for WWII fatigues and M1 Carbines? No, not entirely. But they *are* bringing Wargaming.net into the fold to do it for them. First, Square Enix buys out the house that Lara Croft built, and now they're into real-time strategy war games. *Nothing in this life makes sense anymore.*[9]

*References*:

1. M. Palmer, 'Square Enix views Eidos as a jump to next level', *Financial Times*, 28 April 2009.
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3. 'Square Enix needs to show growth scenario to market', *Nikkei*, 9 October 2007.
4. Joint interview with Yoichi Wada and Phil Rogers, www.square-enix.com, 26 May 2009.
5. M. Palmer, 'Square Enix views Eidos as a jump to next level', *Financial Times*, 28 April 2009.
6. 'Square Enix and Gas Powered Games announce strategic partnership', *Newswire Association*, 12 November 2008.
7. P. Elliott, 'Foot on the gas', *gamesindustry.biz*, 19 August 2008.
8. X. de Matos, 'Interview: Chris Taylor on Supreme Commander 2', *joystiq.com*, 9 June 2009.
9. Randy, 'Square Enix tries hand at WWI RTS with Order of War', *Gaming Nexus*, 17 April 2009. Italics in original.

### Questions

1 Explain why Square Enix chose alliances in some cases and acquisitions in others.

2 How should Square Enix manage its Eidos acquisition in order to maximise value creation, and how might that management approach change over time?

3 What are the strengths and weaknesses of the alliance strategy, and what problems might Square Enix anticipate over time?