

# Gaining Insight into Membership Strategy: Competitive Advantage by Shaping Institutions

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Competitive Advantage by Shaping Institutions**

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### **Abstract**

Institutions matter greatly in the development of competitive advantage. Different institutional strategies to manipulate and shape institutions are discussed in the literature. This paper aims at extending the existing conceptual model of membership strategy. Despite being referenced frequently, the concept of membership strategy is not well developed. This is surprising because what is referred to as membership strategy has become very popular in various industries. We propose and develop a theoretical model that explains a firm's opportunity to protect itself against dominant institutional pressures and, additionally, to create competitive advantage by implementing a consumer centric membership strategy. Practical examples are discussed to clarify theoretical interrelationships. The main illustrative case focuses on Blizzard Entertainment, an American developer and publisher of video games.

## Introduction

Apart from the unchallenged fact that institutions matter, a new quality of insights into institutional theory emerged in the strategic management literature during the past years. Starting with the “iron cage”, explaining the forces leading to isomorphism (Meyer & Rowan, 1977; DiMaggio & Powell, 1983), the conclusions regarding institutions and their role in strategic management have expanded notably. The first approaches highlighting the strategic relevance of institutions were concerned with firm responses to institutional processes and simultaneously introduced the ability to resist or even manipulate institutional demands (Oliver, 1991). Thereafter, theoretical developments shifted from the notion of gaining legitimacy (Deephouse, 1996) to enhancing legitimacy (Zimmerman & Zeitz, 2002), and to gaining sustainable competitive advantage (Bresser & Millonig, 2003). Different institutional strategies to manipulate and shape institutions are discussed today, including lobbying and co-optation (Oliver, 1991), as well as membership and standardization (Lawrence, 1999). Lawrence (1999, p. 169) offers a broad definition of the term institutional strategy: “(...) institutional strategies represent attempts by actors to change the nature of competition in their industry (...)”. The membership strategy is an example of institutional strategies that represents a firm-level attempt to manipulate and establish institutions so that a firm may derive advantage. Despite being referenced frequently, the concept of membership strategy has not been developed any further than Lawrence’s (1999) initial approach. This fact is surprising because the membership strategy is very popular in various industries today.

This paper aims at extending the existing conceptual model of membership strategy. Two kinds of membership strategies are distinguished: First, the traditional producer centric approach which implies a firm’s intention to build up a membership with vertically related firms or even competitors (Lawrence, 1999; Bresser & Millonig, 2003). Second, the consumer centric approach representing a firm’s attempt to involve actual or potential customers in a membership structure. This latter form of membership strategy has been largely neglected in the literature. Our theoretical model explains a firm’s opportunity to protect itself against dominant institutional pressures and, additionally, the possibility to create competitive advantage by using a consumer centric membership strategy.

Several practical examples will be discussed to clarify theoretical interrelationships. The main illustrative case focuses on Blizzard Entertainment<sup>1</sup>, an American developer and publisher of video games. Blizzard Entertainment started its Consumer-Centric-Membership Strategy in 2004 with the release of the massively multiplayer online role-playing game (MMORPG) *World of Warcraft*. In developing this product, Blizzard Entertainment introduced changes to the distribution and payment systems and their gaming service system *Battle.net* that can be described as highly entrepreneurial for this industry. It will be shown that Blizzard Entertainment actively used a membership strategy to resist institutional pressure and to gain competitive advantage. Based on the findings of this illustrative case, questions for future research will be addressed.

### **Analyzing Membership Strategy**

The first conceptual characterization of membership strategy in the context of institutional theory was introduced by Lawrence (1999, p. 171): “Membership strategies involve the definition of rules of membership and their meaning for an institutional community.” In this sense, a membership strategy is a cooperative endeavor of different actors in the same industry. The strategy aims at legitimizing a specific coordinated behavior in the context of an industry. The cooperation is based on rules of membership that define access to the membership group as well as the desired and acceptable behaviors of members. Thus exclusive boundaries separate the members from other actors in the institutional field, and to the extent that the membership strategy is successful, it exerts institutional pressures on non-members.

Examples of firms applying this type of membership strategy focus on the cooperation between several competitors in an industry. Lawrence (1999), e.g., examines the Canadian forensic accounting industry. In this example various forensic accounting firms cooperated and established a membership system in order to establish professional rules for their business requirements. Bresser & Millionig (2003) analyze the German meat-processing and marketing association *Neuland*. German meat producers are able to join the *Neuland* membership to gain privileged access to ecologically conscious consumers. To become a member, meat producers have to adhere to strict rules on how to keep and feed their

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<sup>1</sup> Blizzard Entertainment was part of Vivendi Games, a division of the international media conglomerate Vivendi. A merger in 2008 led Blizzard Entertainment to be a part of the holding company Activision Blizzard, which is still a division of Vivendi.

animals. Similarly, *Neuland* retail outlets have to adhere to strict rules to obtain membership status. Both examples deal with the cooperation between competitors or vertically related firms, so that this type of strategy can be defined as a **Producer-Centric-Membership Strategy**. This paper, however, focuses on a different approach: the membership between a firm and its actual or potential customers which can be referred to as a **Consumer-Centric-Membership Strategy**. This concept of membership strategy implies a firm's active approach to establish a system of membership ties with their customers. If successful, such a membership strategy will become an institution in a particular market<sup>2</sup> that can exert pressures on consumers and competitors alike.

### **Modelling Consumer-Centric-Membership Strategy**

To understand how the Consumer-Centric-Membership Strategy can influence actors, a basic, simplified model will be introduced. The model contains all relationships between a focal company and its customers, competitors and other institutional actors that shape the sum total of institutional expectations within a field. In very broad terms, institutions can be defined as behavioral expectations that can be sanctioned if violated (Jepperson, 1991, p. 145; Bresser & Millonig, 2003). Thus, at any given point in time, a multitude of institutional expectations is operating in a field, depending on different competitors, consumers and other actors. However, some institutional actors and expectations are more powerful than others and create dominant institutional pressures on other actors in the field. Dominant institutional pressures must be adapted to or neutralized. Arguably, in competitive markets consumer expectations frequently exert strong (dominant) pressures. A Consumer-Centric-Membership Strategy aims to protect the company against a dominant institutional pressure and thus neutralize its effect. By influencing other institutional actors, in this case the firm's consumers, the company indirectly tries to shape and manipulate the institution to its own advantage. Integrating consumers into a system of membership relationships provides the opportunity to affect their behavioral expectations. As a prerequisite for a membership strategy to succeed, i.e., to gain members, the strategy has to be exclusive and attractive for their potential members by offering valuable advantages. *Figure 1* summarizes the described elements and relationships.

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<sup>2</sup> For the purposes of this paper, the terms institutional field, industry and market will be used interchangeably because the advantages resulting for firms that adopt a membership strategy are of interest, not the specific boundaries of a larger institutional setting.

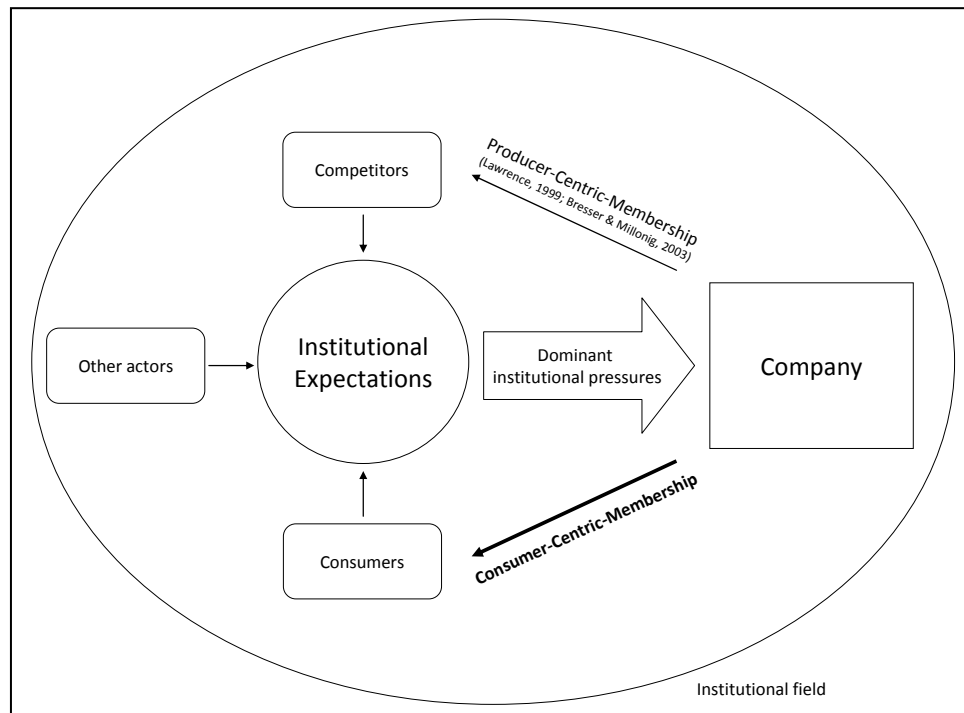


Figure 1: The Impact of a Consumer-Centric-Membership Strategy in an Institutional Field

Apart from its purpose to reduce a dominant institutional pressure, a successful Consumer-Centric-Membership Strategy can also result in establishing a new institution. An effectively implemented membership-network between a firm and its customers can become institutionalized by representing a model that consumers expect from all competitors within an industry because of the benefits that can be derived from a membership system. Thus, a successful membership system can be regarded as an institution that creates pressures on competitors. Competitors are forced to respond to the new threat developed by an institutionalized membership system, e.g., by imitation, avoidance or resistance (Oliver, 1991). The protection against the dominant institutional pressure, the establishment of a new institution, and the resulting pressure on competitors can generate a temporary competitive advantage for the company using the Consumer-Centric-Membership Strategy (see Figure 2).

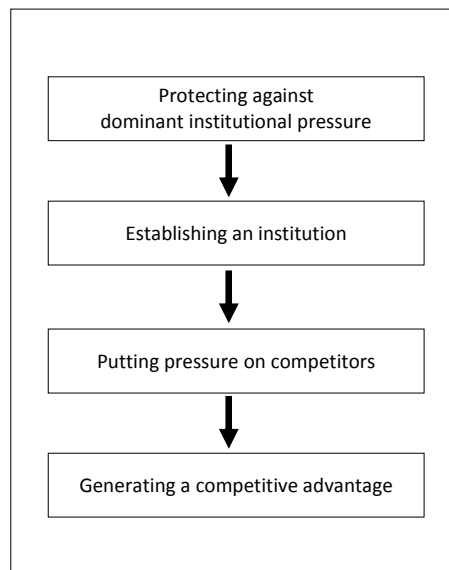


Figure 2: Goals of a Consumer-Centric-Membership Strategy

### The Case Of Blizzard Entertainment

Blizzard Entertainment, founded in 1994, is a leading and most popular video game developer and publisher. The diffusion of broadband internet technology has strongly affected the video game industry during the last years. The lack of prosecution of the violation of digital copyrights combined with the lack of public acceptance of such copyrights has established a general perception in the public community that pirate copying or illegal downloading of software, music, and other digital products is commonplace and even legitimate (BBC News, 2004). Thus, interestingly, an unlawful activity, i.e., pirate copying, has become institutionalized. As a consequence, the dominant institutional pressure for the video game industry results from the widespread perception and expectation that pirate copies and illegal filesharing are acceptable behaviors that, for the most part, will not lead to sanctions.

In 2004 Blizzard Entertainment released their massively multiplayer online role-playing game (MMORPG) *World of Warcraft* and introduced their Consumer-Centric-Membership Strategy at the same time. For the first time in Blizzard Entertainment's history, the company charged fees for the gameplay instead of the game itself. The classic distribution of video games has been based on selling a physical gamecopy (cd or dvd) to the customer, who could use it without any access or time restrictions. In contrast, the usage of *World of Warcraft* is limited to a membership in Blizzard Entertainment's gaming service *Battle.net*. While the game itself



is effectively free of charge<sup>3</sup>, the membership and, therefore, the restriction to use the game is charged with a 15\$ monthly fee. In addition to this change in the model of payment (user fee instead of product price), a major change in the way the game is distributed was introduced. While customers can still buy a physical game copy at video game retailers, Blizzard Entertainment also offers a free download as part of the *Battle.net* membership. With respect to the main threat to the video game industry, i.e., the perception that pirate copying is acceptable and normal, this step was crucial. Pirate copying or illegal downloading of *World of Warcraft* instantly became a futile activity because the product was available for free from the producer Blizzard Entertainment. In addition to obtaining the game, the *Battle.net* membership also offers exclusive and valuable advantages for its members. The main advantage is the connectivity of all members and products Blizzard Entertainment offers. The membership provides the opportunity to play *World of Warcraft* with thousands of users all over the world and creates a social community accessible by all members. Additionally, the game itself is updated by Blizzard Entertainment, and additional content “gets patched” (is introduced) continuously. This updating of the base product is facilitated by the continuous stream of revenue based on the monthly membership fee. Blizzard Entertainment’s Consumer-Centric-Membership Strategy has achieved major success in the video game industry. In 2010, *World of Warcraft* reached the impressive number of 12 million active members worldwide (Blizzard Entertainment, 2010). This success is remarkable given the rather short product life cycles in the video game industry (Beeson, 2002).

The major intention of Blizzard Entertainment’s Consumer-Centric-Membership Strategy has been to protect the company from the dominant institutional pressure (pirate copies and illegal filesharing) of the industry. The *Battle.net* membership has been widely accepted by consumers in the video game industry all over the world and, thereby, became an institution in and by itself. The success of this institutionalized membership strategy now creates pressure on Blizzard Entertainment’s major competitors, and forces them to react. For example, Valve Corporation, an American video game developer, enhanced its distribution network *Steam* and introduced a Consumer-Centric-Membership Strategy recently. The protection against the dominant institutional pressure as well as the pressure on competitors arising from Blizzard Entertainment’s institutionalized membership strategy have generated a (temporary) competitive advantage for Blizzard Entertainment. This

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<sup>3</sup> The purchasing price is around 15\$ and includes 30 days of gametime, which equates to a value of 15\$.

advantage is reflected, for example, in a 34.9% revenue increase based on 5.5million (new) members only one year after the release of *World of Warcraft* (Vivendi, 2005, p. 20, p. 138). Today most video game publishers try to establish similar types of membership systems with their customers.

Beyond the video game industry, Consumer-Centric-Membership Strategies can be identified in several other industries. For example, Apple Inc. has established an iTunes membership and thus changed the nature of digital music distribution. With its digital media player application, *iTunes*, and its integrated *iTunes store*, Apple uses a Consumer-Centric Membership Strategy to sell digital music to *iTunes* members.

### **Conclusions And Research Implications**

Institutional theory has become an essential part of strategic management research. Yet, an important institutional aspect of high practical relevance, i.e., the membership strategy is neglected although it may be an effective tool to manage the external institutional context. Firms in many industries use a Consumer-Centric-Membership Strategy to face and shape institutional pressures. This paper has shown that a Consumer-Centric-Membership Strategy can protect a firm against dominant institutional pressures and also generate a temporary competitive advantage by establishing a new institution. We analyzed the potential benefits of a Consumer-Centric-Membership Strategy mainly from an institutional perspective in this paper. The benefits can also be explained from a more resource based perspective: the membership-network and its inherent reputation can be seen as a valuable and rare resource that, though imitable, can result in a temporary competitive advantage (Barney, 1991, 2007). Thus, extending our line of thinking by a resource based logic appears promising. Similarly, complementing our line of reasoning with ideas relating to the possibility of first mover advantages (Lieberman & Montgomery, 1988, 1998) is a potentially useful way to further our understanding of membership strategies. For example, firms that introduce a Consumer-Centric-Membership Strategy to an industry may enjoy technological leadership advantages and/or establish consumer switching costs.

Arguably, our constructs and ideas add to the well known problems of operationalizing theoretical constructs developed by institutional theory (Oliver, 1997; Dacin et al., 2002), most notably, the need to measure dominant institutional pressure as well as the existence and intensity of Producer-Centric- or Consumer-Centric-Membership Strategies.

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