

# Strategic Management & Competitive Advantage

## CONCEPTS AND CASES

SIXTH EDITION



Jay B. Barney / William S. Hesterly



**“VALUE. RARITY. IMITABILITY. ORGANIZATION.”**

## What Is It?

This book is not just a list of concepts, models, and theories. It is the first undergraduate textbook to introduce a **theory-based, multi-chapter organizing framework** to add additional structure to the field of strategic management.

“VRIO” is a mechanism that integrates two existing theoretical frameworks: the positioning perspective and the resource-based view. It is the primary tool for accomplishing internal analysis. It stands for four questions one must ask about a resource or capability to determine its competitive potential:

1. **The Question of Value:** Does a resource enable a firm to exploit an environmental opportunity, and/or neutralize an environmental threat?
2. **The Question of Rarity:** Is a resource currently controlled by only a small number of competing firms?
3. **The Question of Imitability:** Do firms without a resource face a cost disadvantage in obtaining or developing it?
4. **The Question of Organization:** Are a firm’s other policies and procedures organized to support the exploitation of its valuable, rare, and costly-to-imitate resources?

## What’s the Benefit of the VRIO Framework?

The VRIO framework is the organizational foundation of the text. **It creates a decision-making framework for students** to use in analyzing case and business situations.

Students tend to view concepts, models, and theories (in all of their coursework) as fragmented and disconnected. Strategy is no exception. This view encourages rote memorization, not real understanding. VRIO, by serving as a consistent framework, connects ideas together. This encourages real understanding, not memorization.

**This understanding enables students to better analyze business cases and situations—the goal of the course.**

Within each chapter, the VRIO framework makes it possible to discuss the formulation and implementation of a strategy simultaneously.

Because the VRIO framework provides a simple integrative structure, we are actually able to address issues in this book that are largely ignored elsewhere—including discussions of vertical integration, outsourcing, real options logic, and mergers and acquisitions, to name just a few.

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EDITION

6

# STRATEGIC MANAGEMENT AND COMPETITIVE ADVANTAGE

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Concepts and Cases

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# Dedication

This book is dedicated to my wife, Kim, and our 11 grandchildren: Isaac, Dylanie, Audrey, Chloe, Lucas, Royal, Lincoln, Nolan, Theo, Cade, and Townes. They help me remember that no success can compensate for failure in the home.

—*Jay B. Barney*

This book is dedicated to my wife Denise and my soon to be 14 grandchildren: Ellie, Owen, Emerson, Cade, Elizabeth, Amelia, Eden, Asher, Lydia, Scarlett, Charlotte, Amos, and Claire.

—*William S. Hesterly*

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# Preface



## NEW TO THIS EDITION

### What Should Be Included in a Strategic Management Text?

A very interesting question. Some books seem to think that the answer to this question is: Everything. And so, they get longer and longer each edition. Nothing dropped, plenty added.

We have taken a very different approach:

- Topics that are now covered more completely in non-strategic management texts are dropped.
- Models or frameworks that have proved to be theoretically unsound or empirically not substantiated are dropped.
- Strategic management models that provide important insights that have emerged over the last few years are added.

The result of all these changes is that the sixth edition of our text is just about the same length as the first edition, although the content of the sixth edition is dramatically different than all prior editions.

### What Have We Dropped

Two elements have most obviously been dropped from this edition. In both cases, this decision was made, not because these are unimportant topics, but rather, because they are so important that non-strategic management text books have been written to address them.

- The “Strategy in the Emerging Enterprise” feature in each chapter has been dropped. As entrepreneurship teaching has become more important, these topics have been receiving enhanced coverage in entrepreneurship texts.
- The “International Strategies” chapter has been dropped. Again, this is not because international strategy is unimportant. Rather, it is so important that entire texts are dedicated to this topic.

### What Has Been Added

By dropping these two topics, we were able to add two new chapters to this edition, while keeping the length of the book more or less the same.

- **Chapter Six: Flexibility and Real Options.** This chapter summarizes the latest theoretical and empirical work on the value of strategic flexibility. It describes the settings under which flexibility will create value, and how that value can be estimated.

CHAPTER

# 6

## Flexibility and Real Options

### LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- 6.1 Define strategic flexibility and real options.
- 6.2 Specify the conditions under which strategic flexibility and real options will be valuable for firms.
- 6.3 Identify when strategic flexibility and real options can be a source of sustained competitive advantage.
- 6.4 Identify the organizational challenges associated with implementing strategic flexibility and a real options strategy.

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### Why Is Netflix called Netflix?

For the first ten years of its existence, everyone had one question about Netflix: Why was Netflix called Netflix? Everyone got the “flix” part of the name—“flix” was slang for movies, and from its founding in 1997, Netflix was in the movie distribution business. Its business model was to take orders for DVD rentals online and then fulfill those orders by delivering DVDs to consumers through the mail. But the “net” had nothing to do with how Netflix distributed its DVDs. A better name for Netflix might have been “Mailflix” or “Letterflix.”

In fact, Netflix was very successful at this DVD by mail distribution model. By 2000, it was challenging the leader in the DVD rental business—Blockbuster. Blockbuster had retail stores that consumers would visit to rent DVDs. They would also have to return these DVDs to the same store. Having DVDs delivered through the mail eliminated these two trips and, except for delays while rented DVDs were sent through the mail, was infinitely more convenient than renting DVDs at retail stores.

In the late 1990s, Blockbuster had tried to duplicate Netflix’s DVD distribution model. It failed. Apparently, the fulfillment logistics in the DVDs by mail business—though perfected by Netflix—were very difficult for Blockbuster to imitate. Rather than trying to duplicate Netflix, in 2000 Blockbuster tried to buy Netflix for \$50 million. The founders of Netflix—Reed Hastings and Marc Randolph—declined the offer. Instead, Netflix continued its operations in the DVD rental business, continuously exceeded

## LEARNING OBJECTIVES

After reading this chapter, you should be able to:

- 7.1 Define explicit and tacit collusion and explain why collusion is typically inconsistent with social welfare in an economy.
- 7.2 Describe how collusion can create economic profits.
- 7.3 Describe different ways that collusive agreements can fall apart, and how it is possible to use the attributes of an industry to anticipate how sustainable these agreements are likely to be.
- 7.4 Describe two unique challenges associated with organizing to implement a collusion strategy.

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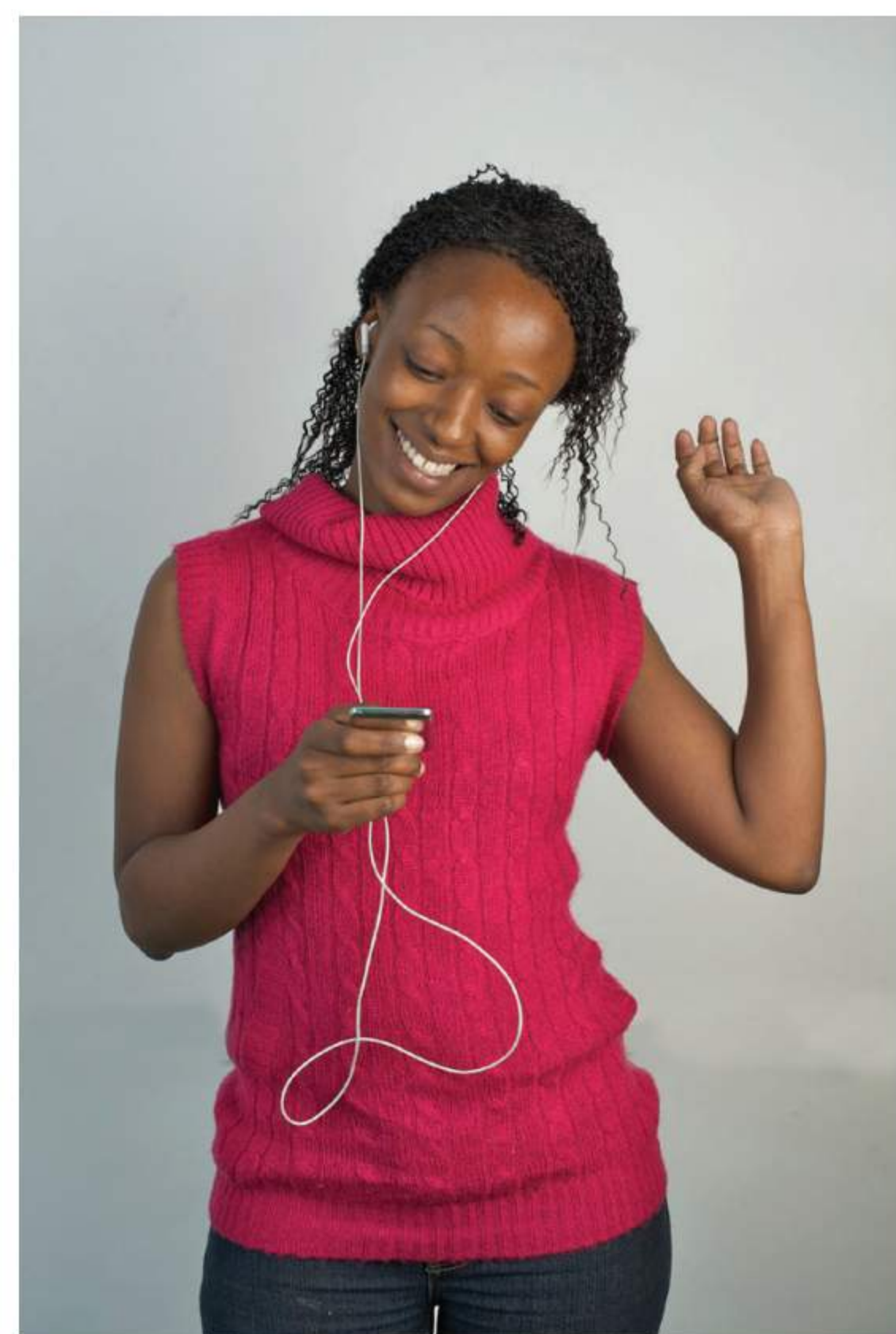
## A Gas Station Conundrum

Consider the following scenario. Think of it as a chance to apply all the theories and frameworks discussed in this text so far.

You own and operate a gas station on a busy street corner in your town. There are other gas stations in your city, but they are located over ten miles away. You sell a well-respected brand of gasoline, one that is supported by a national advertising

Of course, all the opening cases and examples used throughout the book have been updated or changed, as have the supporting cases and instructor's manual. New opening cases include:

- “Go, Pokémon, Go” in Chapter One: This case discusses how the Pokémon altered reality game was created, and asks if this product will be a source of sustained competitive advantage.



- “How Attractive is the Music Streaming Industry?” in Chapter Two: Music streaming services are very popular, but very few make money. Why is this the case, and what impact will this have on the strategies of these firms?
- “When a Noun Becomes a Verb” in Chapter Three: Why has Google gained a competitive advantage, and will they be able to sustain it?
- “Is it Soup Yet” in Chapter Ten: Alphabet has organized itself into a multi-divisional corporation, but will this help this company, and its operating divisions—including Google—grow and maintain their competitive advantage.



New supporting cases include: McDonald's, Collusion in Major League Baseball, Torrey Nano (a fictional case), and Activision's Crush on Mobile Gaming.

- **Chapter Seven: Collusion.** This chapter explores the economic—and ethical—implications of explicit and tacit collusion. Even if a particular firm chooses to not engage in collusion, it must still understand this strategy and its economic consequences, because some of its competitors may choose this strategy.

These two chapters have all the teaching elements (Learning Objectives, Opening case, Research made Relevant feature, Strategy in Depth feature, Ethics and Strategy feature, Challenge Questions, and a Problem Set) and are supported by cases, just like the other chapters in the book. However, they explore important strategic options that receive less attention in other texts.

## What Remains the Same

All the chapters in the book—beginning with Chapter Three—are still organized around the VRIO framework. Students at all levels continue to find this framework helpful in thinking about and applying what can be a very complex topic—strategic management.

We also continue to integrate the latest theory and empirical research into the text—but in a way that helps students apply these concepts in a real world setting. Consider just two examples:

“VRIO” – an integrative framework (see next page for details).

- Broad enough to apply in analyzing a variety of cases and real business settings.
- Simple enough to understand and teach.



### Research Made Relevant

Rita McGrath and Ian MacMillan argue that under conditions of uncertainty, managers should invest in a diversified range of projects that parallel many of the real options discussed in this chapter. These projects can be arrayed as in Figure 6.1.

In this figure, **technical uncertainty** refers to the extent to which managers understand the process by which a new product or service will be developed before that process is undertaken. Low technical uncertainty exists when managers know what kinds of skills and other



The Value of Real Options Thinking

resources they will need to develop a new product or service, the cost of acquiring these skills and resources, how to manage them effectively, and so forth. High technical uncertainty exists when managers do not know these things about a new product or service.

**Market uncertainty**, in Figure 6.1, refers to the extent to which managers understand how a new product or service will be received in the market. Low market uncertainty exists when managers know the price at which a product or service is likely to sell, the likely size

- The “Research Made Relevant” feature in Chapter Six’s discussion of flexibility and real options presents a simple—yet remarkably powerful—way of calculating the value of a firm’s strategic options

- The “Research Made Relevant” feature in Chapter Nine’s discussion of the value of economies of scope cites the most recent research—some published in 2017—about this important issue.

We have also kept our most popular supporting cases, including True Religion, Harlequin, Walmart, and Starbucks among others. With only a couple of exceptions, the revised cases are shorter. In shortening the cases, we have mostly cut out historical and other peripheral background material. Two of

the new cases, Collusion in Major League Baseball and Torrey Nano, require students to apply concepts from the new chapters in the book on collusion and flexibility. As has been true of all of the editions, the vast majority of the cases deal with companies and industries that students will find familiar and, we hope, stimulating to analyze and discuss.

With the introduction on the chapters on strategic flexibility and real options (Chapter Six) and collusion (Chapter Seven), the book continues to include the most up to date conceptual and analytical material in the field of strategic management, while presenting that material in an accessible and applicable way.

### Research Made Relevant

In 1994, Lang and Stulz published a sensational article that suggested that, on average, when a firm began implementing a corporate diversification strategy, it destroyed about 25 percent of its market value. Lang and Stulz came to this conclusion by comparing the market performance of firms pursuing a corporate diversification strategy with portfolios of firms pursuing a limited diversification strategy. Taken together, the market performance of a portfolio of firms that were pursuing a limited diversification strategy was about 25 percent



How Valuable Are Economies of Scope?

higher than the market performance of a single diversified firm operating in all the businesses included in this portfolio. These results suggested that not only were economies of scope not valuable, but, on average, efforts to realize these economies destroyed economic value. Similar results were published by Comment and Jarrell using different measures of firm performance.

Not surprisingly, these results generated quite a stir. If Lang and Stulz were correct, then diversified firms—no matter what kind of



## Solving Teaching and Learning Challenges

Some MBA and undergraduate business programs teach strategic management early in the curriculum, to give students a broad strategic perspective before they begin specializing in particular functional areas. Others teach strategic management later in the curriculum, after students have taken a deep dive into one or more functional areas.

Students in these different programs bring very different skill sets to the strategic management course. This book accommodates faculty and students in both kinds of programs.

### Teaching in a “Strategy First” Curriculum

Faculty who teach in “strategy first” programs can emphasize the core text material in each chapter—and the associated cases—and de-emphasize the “Strategy in Depth” and “Research Made Relevant” features. This core material does not require much background in other business functions, and when it does, the required background is explained in detail. However, there is enough substance in this material to enable students to read and analyze the cases, and to apply strategic management ideas throughout their curriculum, and into their career choices.

### Teaching in a “Strategy Last” Curriculum

Faculty who teach in “strategy last” programs can broaden their emphasis to include the “Strategy in Depth” and “Research Made Relevant” features. These features include most of the technical, economic, and mathematical discussions in the book—discussions that build directly on knowledge students should have received in their functional classes. These materials make it possible for students and faculty to go into much more analytical detail in discussing the cases, and help demonstrate how the ideas developed in other functional areas are relevant in strategic management.

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## Developing Employability Skills

Students who take the strategic management course often ask—how can this course enhance my employability? This question is answered in Chapter One of this book.

The VRIO framework is not just a tool for analyzing sources of competitive advantage for firms, it can also be used by students to assess whether or not they have a competitive advantage in the labor market. Consider the following:

- Is a student's knowledge of how to discount a firm's cash flow likely to be a source of competitive advantage in the labor market? This skill is valuable, but—because every business student in the world learn this skill—it is not rare, and thus will only be a source of competitive parity for a student.
- Is a student's ability to derive projected cash flows and an appropriate discount rate from a deep understanding of a firm's strategy likely to be a source of competitive advantage in the labor market? This skill is also valuable, but—in my experience—it is more rare, and thus potentially a source of competitive advantage.
- Which is more likely to be a source of competitive advantage for a student in the labor market: The ability to recite the "Five P's" in marketing or the ability to leverage their unique work experiences—either in a full time job or an internship—with their education to analyze a firm's marketing strategy? The VRIO framework suggests the latter, not the former, approach will more likely be a source of competitive advantage.

Competing for a great job in the labor market is just another form of competition. Students who want to gain a competitive advantage in that market must build valuable, rare, and costly to imitate capabilities. As described in Chapter Three, these capabilities will typically need to be socially complex, path dependent, or causally ambiguous.

Put differently, this book is not just about corporate competitive advantage in the product market, it is also about a student's competitive advantage in the labor market.

## Instructor Teaching Resources

At the Instructor Resource Center, [www.pearsonhighered.com/irc](http://www.pearsonhighered.com/irc), instructors can easily register to gain access to a variety of instructor resources available with this text in downloadable format. If assistance is needed, our dedicated technical support team is ready to

help with the media supplements that accompany this text. Visit <https://support.pearson.com/getsupport> for answers to frequently asked questions and toll-free user support phone numbers.

This program comes with the following teaching resources.

Supplements available to instructors at <a href="http://www.pearsonhighered.com/irc">www.pearsonhighered.com/irc</a>	Features of the Supplement
Case Teaching Notes authored by William Hesterly from the University of Utah	<ul style="list-style-type: none"> <li>• Case-by-case summaries</li> <li>• Examples and activities not in the main book</li> <li>• Study questions</li> <li>• Teaching plans</li> <li>• Case analysis and discussion</li> </ul>
Instructor’s Resource Manual authored by Ram Subramanian from the University of Florida	<ul style="list-style-type: none"> <li>• Chapter-by-chapter summaries</li> <li>• Teaching points</li> <li>• Lecture guides for accompanying PowerPoint slides</li> <li>• Answers to challenge questions and problem sets in the book</li> </ul>
PowerPoint Presentations authored by Ram Subramanian from the University of Florida	<ul style="list-style-type: none"> <li>• Slides include graphs, tables, and equations from the textbook.</li> <li>• PowerPoints meet accessibility standards for students with disabilities. Features include, but not limited to:                             <ul style="list-style-type: none"> <li>▪ Keyboard and Screen Reader access</li> <li>▪ Alternative text for images</li> <li>▪ High color contrast between background and foreground colors</li> </ul> </li> </ul>
Test Bank authored by Ram Subramanian from the University of Florida	<p>Over 1000 true/false, multiple choice, short answer questions with these annotations:</p> <ul style="list-style-type: none"> <li>• Difficulty level (1 for straight recall, 2 for some analysis, 3 for complex analysis)</li> <li>• Section number and name</li> <li>• Learning objective</li> <li>• Application type</li> <li>• AACSB learning standard (Ethical Understanding and Reasoning; Analytical Thinking; Information Technology; Diverse and Multicultural Work; Reflective Thinking; Application of Knowledge)</li> </ul>
TestGen <sup>®</sup> Computerized Test Bank	<p>TestGen allows instructors to:</p> <ul style="list-style-type: none"> <li>• Customize, save, and generate classroom tests</li> <li>• Edit, add, or delete questions from the Test Item Files</li> <li>• Analyze test results</li> <li>• Organize a database of tests and student results</li> </ul>

# Acknowledgments



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Jay Barney is currently a Presidential Professor of Strategic Management and holds the Lasonde Chair in Social Entrepreneurship at the Eccles School of Business at the University of Utah. He received his undergraduate degree from Brigham Young University, and his master's and Ph.D. degrees from Yale University. Previously,

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Most of Professor Barney's research focuses on how firms can gain and sustain competitive advantages. He has published over 100 articles in a variety of outlets, including the Harvard Business Review, the Sloan Management Review, the Strategic Management Journal, the Academy of Management Review, the Academy of Management Journal, and has published six books, including a novel titled *What*

*I Didn't Learn at Business School: How Strategy Works in the Real World* (with Trish Gorman). He has published some of the most widely cited papers in the field of strategic management.

Professor Barney has won several awards for his research and writing, including the Irwin Outstanding Educator Award for the Business Policy and Strategy Division of the Academy of Management, the Scholarly Contributions Award for the Academy of Management, and three honorary doctoral degrees—from Lund University (Sweden), the Copenhagen Business School (Denmark), and Universidad Pontificia Comillas (Spain). He has also been elected to the Academy of Management Fellows and the Strategic Management Society Fellows and has won teaching awards at UCLA, Texas A&M, and Ohio State.

Professor Barney has also served as an officer of the Business Policy and Strategy Division of the Academy of Management, as a member of the board and later an officer of the Strategic Management Society, as an Associate Editor at the *Journal of Management*, as a Senior Editor at *Organization Science*, as a Co-editor at the *Strategic Entrepreneurship Journal*, and currently serves as Editor at the *Academy of Management Review*.

Professor Barney consults with companies and other organizations to help identify and leverage their sources of sustained competitive advantage. His over 50 clients have included Honeywell, Hewlett Packard, Texas Instruments, Koch Industries, Nationwide Insurance, Cardinal Health, and Columbus Public Schools.



## WILLIAM S. HESTERLY

William Hesterly is the Associate Dean for Faculty and Research and the Dumke Family Presidential Chair of Strategic Management in the David Eccles School of Business, University of Utah. After studying at Louisiana State University, he received bachelors and master's degrees from Brigham Young University and a Ph.D. from the University of California, Los Angeles.

Professor Hesterly's research on organizational economics, vertical integration, organizational forms, and entrepreneurial networks has appeared in top journals including the

*Academy of Management Review*, *Organization Science*, *Strategic Management Journal*, *Journal of Management*, and the *Journal of Economic Behavior and Organization*. His research has been mentioned on the front page of the *Wall Street Journal* and was featured prominently in Malcolm Gladwell's 2010 *New Yorker* article, "Talent Grab."

Professor Hesterly's research was recognized with the Western Academy of Management's Ascendant Scholar Award in 1999. Dr. Hesterly has also received best paper awards from the Western Academy of Management and the Academy of Management. Professor Hesterly has served on the editorial boards of *Strategic Organization*, *Organization Science* and the *Journal of Management*. He also served as the Senior Editor of *Long Range Planning*, the leading European journal in strategy.

Professor Hesterly has previously served as Associate Dean for Academic Affairs, Department Chair, and also as

Vice-President and President of the faculty at the David Eccles School of Business at the University of Utah. He was a founding member of the Strategic Human Capital Interest Group in the Strategic Management Society as well as a co-founder of the Utah-BYU Winter Strategy Conference.

Professor Hesterly has been recognized multiple times as the outstanding teacher in the MBA Program at the David Eccles School of Business and he has also been the recipient

of the Student's Choice Award. He has also received the outstanding teacher awards in both the EMBA and PhD programs at the David Eccles School of Business.

Professor Hesterly has served as a consultant to *Fortune* 500 firms in the electronic, office equipment, paper, telecommunications, energy, aerospace, and medical equipment industries. He has also consulted with smaller firms in several other industries. He has taught in a variety of executive programs, both in universities and corporations.

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\*Source: 2016 Student Survey, n 490

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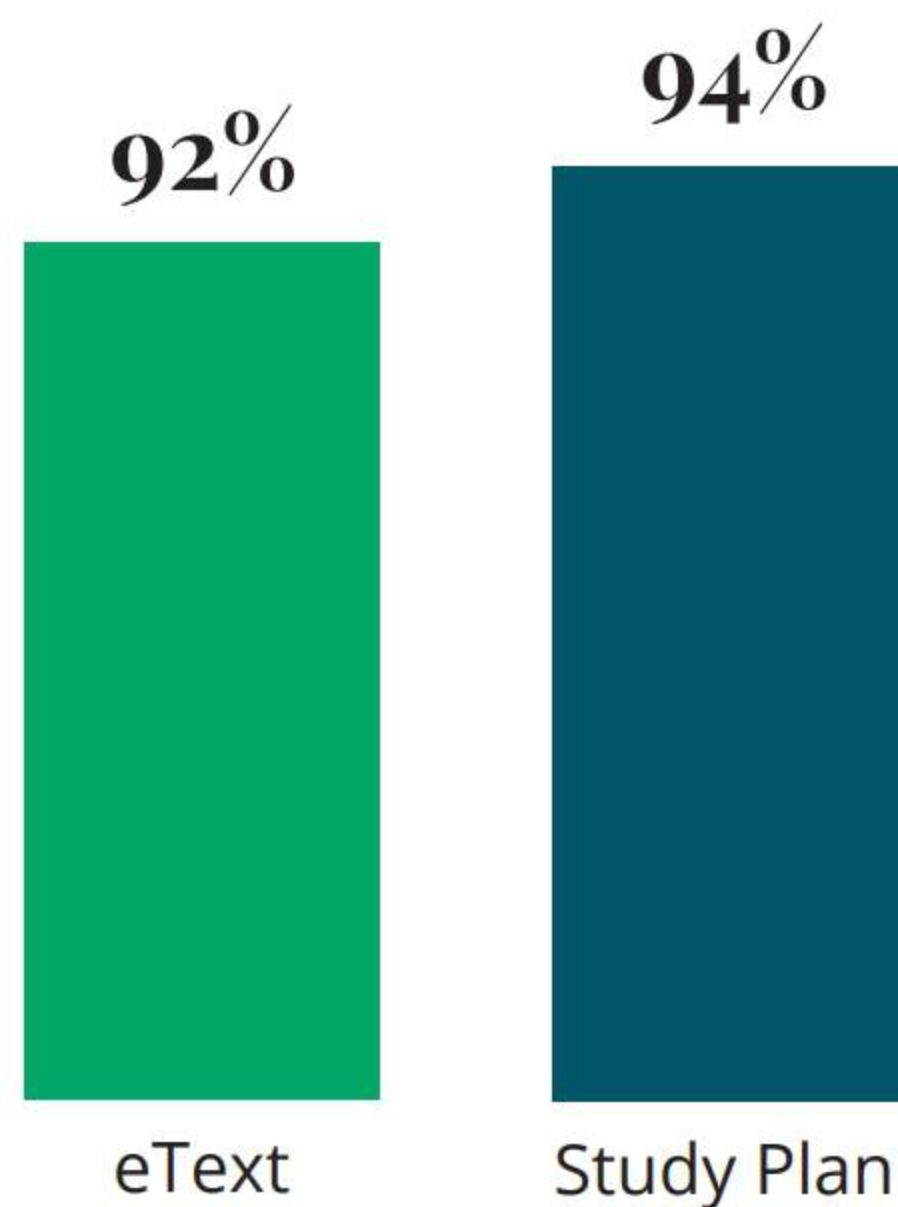
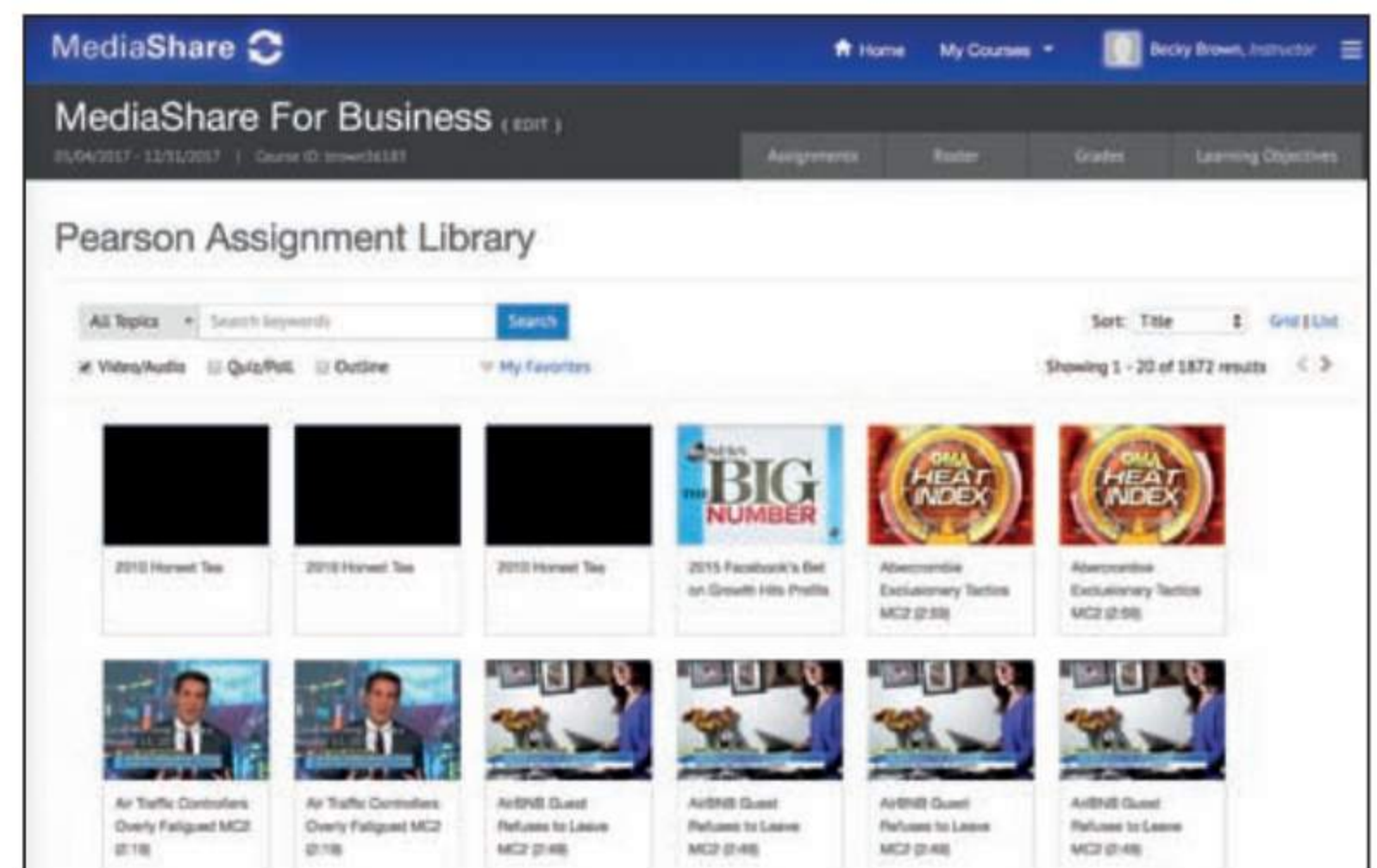
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— Katherine Vicente, Student at County College of Morris

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## What's Out?

Models, concepts, and topics that don't pass a simple test:

"Does this help students analyze cases and real business situations?"

## What's In?

"**VRIO**" – an integrative framework (see next page for details).

- Broad enough to apply in analyzing a variety of cases and real business settings.
- Simple enough to understand and teach.



VRIO



VRIO



VRIO



VRIO

## The Results?

Provides students with the tools they need to do strategic analysis.

Nothing more. Nothing less.

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PART

# 1

## THE TOOLS OF STRATEGIC ANALYSIS



# What Is Strategy and the Strategic Management Process?

## LEARNING OBJECTIVES

*After reading this chapter, you should be able to:*

- 1.1** Define strategy and describe the strategic management process.
- 1.2** Define competitive advantage and explain its relationship to economic value creation.
- 1.3** Describe two different approaches to measuring competitive advantage.
- 1.4** Explain the difference between emergent and intended strategies.
- 1.5** Discuss why it is important for you to study strategy and the strategic management process.

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## Go, Pokémon Go

Pokémon Go has had the most successful launch of any mobile app. Ever. By far. Within 30 days of its July 2016 worldwide launch, Pokémon Go had been downloaded 130 million times. Within 90 days of its release, those downloads had increased to 500 million, and the game had generated \$600 million in revenue. Within a month of its release, Pokémon Go was more widely used than Snapchat, Tinder, Twitter, Instagram, Facebook, or any other of the most successful mobile apps. Since its release, millions of Pokémon Go players have been wandering the world, searching for Pokémon to capture as they try to complete their Pokédex. The total distance that these people have walked while playing the game is equal to the distance from the planet Neptune to the sun.

Pokémon Go combines both content and technical elements. From a content point of view, Pokémon Go is a successor to the original Pokémon series of video games and related products. Pokémon was first developed for Nintendo's mobile gaming device, GameBoy. Released in the United States on September 30, 1998, it created a world of fanciful creatures, with equally fanciful names—Pikachu, Lugia, Slowking, Zapdos. Players captured various Pokémon—by Throwing a Pokéball at each—and then trained them to compete in a Pokémon League where their competitive prowess could be put on display.

The original Pokémon combined competition, fantasy, and collecting in a way that captured the minds of many gamers. Its success helped establish Pokémon—a concept co-owned by Nintendo, Game Freak, and Creatures—as a powerful brand in



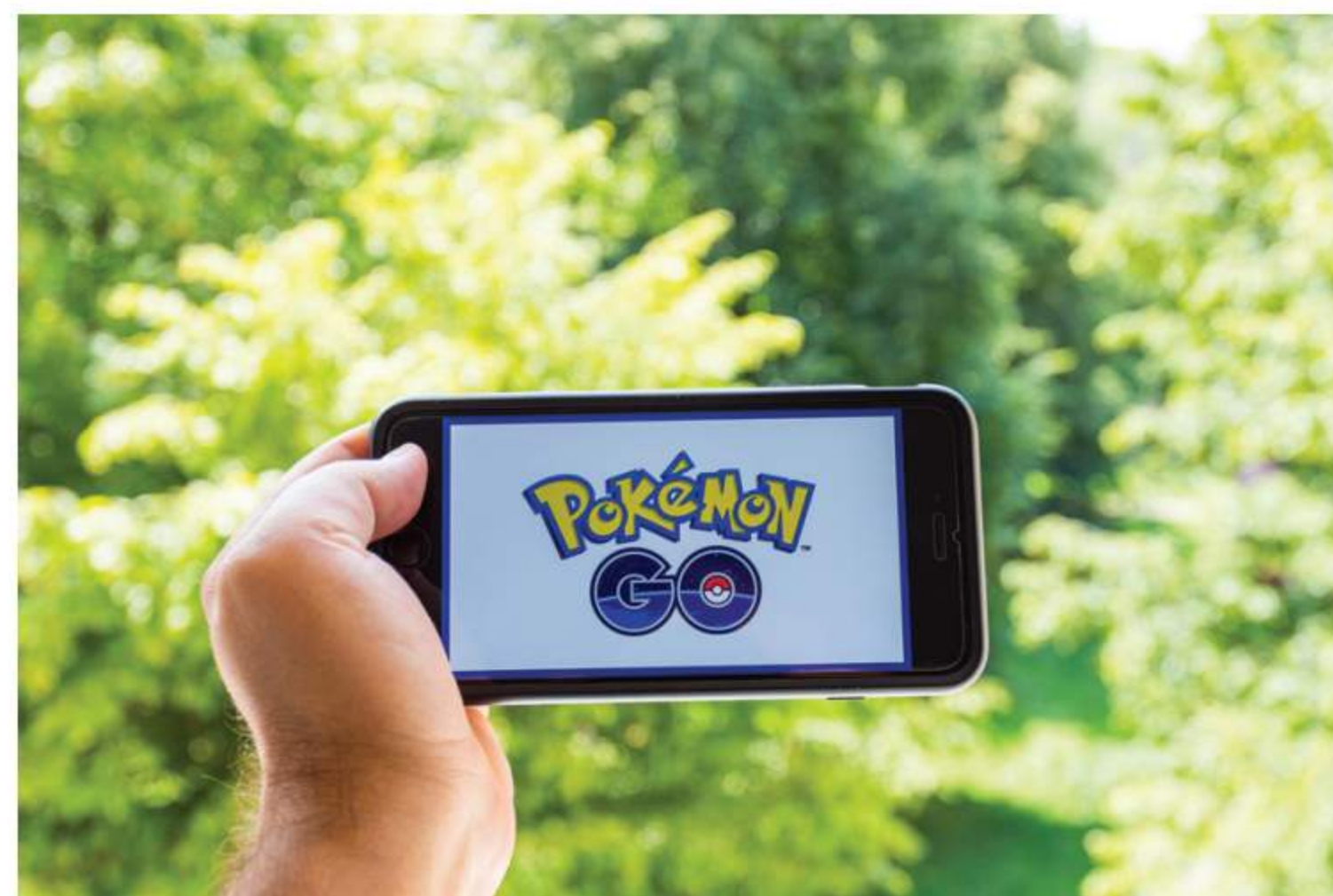
the video game industry. Through the early 2000s, Nintendo introduced successive versions of the Pokémon game along with ancillary products, including books, cards, videos, and chat rooms.

Many of the elements of the original Pokémon game can be found in Pokémon Go. However, these elements are enhanced through the “augmented reality” game technology of Niantic Labs. Niantic Labs was originally part of Google. Founded in 2010 by John Hanke, Niantic Lab’s first product—Field Trip—was a mobile app that used Google Maps to guide users to unique and hidden things around them. In October of 2013, Niantic Labs published its second app, Ingress. A fantasy game, Ingress was the first app to use “augmented reality,” an approach that combined elements created by the game with real world phenomena. Though hailed as a technical success, Ingress was only moderately successful.

In October of 2015, Google spun out Niantic Labs as a separate company. Google, Nintendo, and Pokémon Company together invested \$30 million in the newly independent firm. Niantic Labs raised another \$5 million from venture capitalists and business angels. On April Fool’s Day, 2014, Niantic Labs announced the “Google Maps Pokémon Challenge.” A collaborative effort of Google, Pokémon, and Niantic Labs, this challenge leveraged Niantic’s Ingress technology by inviting players to discover Pokémon in the game’s augmented reality. The surprising popularity of this challenge led to the development of Pokémon Go. Pokémon Go, in turn, was released to most of the world in July of 2016.

All those associated with Pokémon Go have done very well financially. Nintendo’s market value jumped to as high as \$42 billion—although it dropped once it became clear that Nintendo has only a modest ownership stake in Pokémon Go. Niantic Labs’ value rose to over \$3.6 billion. Firms like Apple—who sells more smart phones for people to play the game—anticipates that its revenues will increase by \$3 billion because of Pokémon Go. And small firms, who can pay a modest fee to put a Pokémon in or near their place of business, have seen increases in revenues.

Of course, none of this has happened without challenges. In the early days, Pokémon Go servers had a hard time keeping up with demand. Certain locations have been inundated with gamers looking for particularly rare Pokémon. Some locations—including cemeteries and other memorials—turn out not to be a good place to play the game. And some players have focused so intensely on the game they have been involved in accidents, some of which have been fatal.



Liubomir Paut-Fluerasu/Alamy Stock Photo