Growth and Portfolio Model

In the 1970s much of strategic management dealt with size, growth, and portfolio theory. The Profit Impact of Marketing Strategies (PIMS) study was a long term study, started in the 1960s and lasted for 19 years, which attempted to understand the effect of market share. Started at General Electric, moved to Harvard in the early 1970s, and then moved to the Strategic Planning Institute in the late 1970s, it now contains decades of information on the relationship between profitability and strategy. Their initial conclusion was unambiguous: The greater a company's market share, the greater will be their rate of profit. The high market share provides volume and economies of scale. It also provides experience and learning curve advantages. The combined effect is increased profits. According to Tom Peters, "PIMS provides compelling quantitative evidence as to which business strategies work and don't work."

The benefits of high market share naturally lead to an interest in growth strategies. The relative advantages of horizontal integration, vertical integration, diversification, franchises, mergers and acquisitions, joint ventures, and organic growth were discussed. The most appropriate market dominance strategies were assessed given the competitive and regulatory environment.

There was also research that indicated that a low market share strategy could also be very profitable. Schumacher (1973), Woo and Cooper (1982), Levenson (1984), and later Traverso (2002) showed how smaller niche players obtained very high returns.

The management of diversified organizations required new techniques and new ways of thinking. The first CEO to address the problem of a multi-divisional company was Alfred Sloan at General Motors. GM was decentralized into semi-autonomous "strategic business units" (SBU's), but with centralized support functions.

Strategic Business Units (SBU)

With time the companies have expanded a lot. And it is no longer justified and possible to bind the entire business into one strategy. So the emergence of concept of business unit and business unit

level strategy. This is a concept relevant to multi product and multi business organizations. In such a situation the business has to form manageable number of strategically related group and then go for strategizing. Historically widespread business grouped them as per geographical vicinity i.e. territory based. But these groups may be handling more than one business or products each or more than one of them can be operating in one area only. So Strategic Business Units (SBU) emerged out as an improvement over the old concept. A SBU is a related business that can be treated as a unified entity for the purpose of strategic planning. Grouping into SBUs generally remove the vagueness and confusions.

Once the corporate strategy is decided, now strategy has to take the form at unit level, the strategic planning processes at the unit level consisting of the following steps:

a) Formulating the business mission.

b) SWOT analysis that deals with external environment analysis (opportunity and threat analysis) and internal environment analysis (strengths and weakness analysis).

c) Goal formulation.

d) Strategy formulation.

e) Programme formulation.

f) Implementation

g) Feedback and control.

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The above stages are more or less resemble the stages of corporate strategy planning.

Strategic Planning Tools to assign resources to each SBU

The organization is managed as a 'portfolio' of businesses with each serving a clearly defined product-market with a clearly defined strategy. Each SBU in the portfolio develops a strategy tailored to its capabilities and competitive needs, but consistent with the overall organization's capabilities and needs. The total portfolio is managed to serve the interests of the whole (balancing growth in sales, earnings, assets and risks). The business portfolio is the collection of businesses and products that make up the company. In portfolio analysis, management evaluates the

businesses or products for their strategic fit in meeting company objectives. Strategic planning tools are useful to managers in assessing an organization's overall situation and making basic resource allocation decisions.

The two main reasons for business portfolio analysis are to allocate resources among units effectively and to develop growth strategies for growing the units and adding new units to the portfolio. The first step in business portfolio analysis is to identify the appropriate units of analysis, strategic business units (SBUs) or products. The next step is to assess the attractiveness of the SBUs or products and decide how much support each deserves. Alternative actions include build (increase market share), hold (maintain current market share), harvest (increase short-term cash flow regardless of the long-term effects) and divest (sell or liquidate the business). The 2 most useful and popular portfolio modes are The Boston Consulting Group approach and The General Electric Model

BCG Matrix

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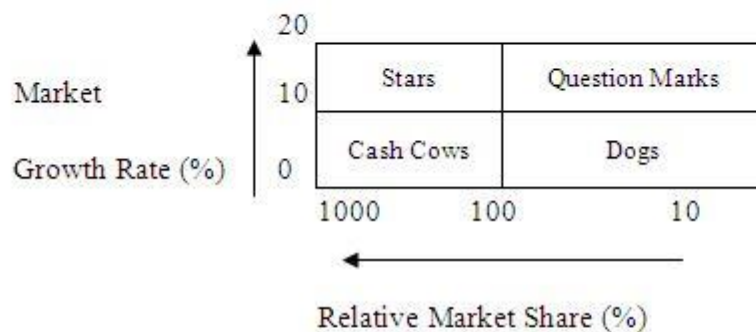
The BCG Matrix or the Boston Consulting Group Growth-Share Matrix is one tool that can be used to assess the attractiveness of SBUs. SBUs are classified according to two factors: its market share relative to competitors, and the growth rate of the industry in which the SBU operates.



As could be seen above, SBUs are plotted on a matrix with two axes.

- On the vertical axis, market growth rate indicates the annual growth rate of the market in which the business operates and provides a measure of market attractiveness.
- Relative market share measured on the horizontal axis is the SBU’s market share relative

to its nearest competitor that serves as a measure of the company's strength in the market. The relative market share of 1000%, 100% and 10% indicate that the SBU has 10 times, same or $1/10^{th}$ market share of its nearest competitor respectively.

Plotting a company's SBUs on this matrix allows for some basic resource allocation decisions. It is important to watch the movement of SBUs across the matrix over time. Based on whether each of these is high or low, the four quadrants of the matrix are defined as Stars, Cash Cows, Question Marks, or Dogs each indicating different type of business.

Question Marks

Also called "Problem Children", these are the businesses that operate in high-growth markets, but have low relative market share. Most businesses start off as question marks when they enter existing high-growth markets where there is already a market leader. The company has to spend a lot of money on all production factors needed for expansion of the business. A question mark requires a lot of cash both to keep up with a rapidly growing market and improve its share position. The term question mark is given to such type of business, as the company has to question itself whether to spend money on it. Strategy must decide between further investment to move question marks to star status (differential advantage) or to phase out the product.

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Stars

If the question marks are successful, they become stars. A star is market leader in high-growth market. Star name for this type of business is appropriate as it is the star performer at the marketplace. But that does not mean stars always contribute huge cash flow, as they often require heavy investment to build and/or maintain share in rapidly expanding markets that may eat up the revenues. The strategy is to build or even maintain or hold its position as long as possible.

Cash Cows

When the market's growth rate plummets to less that 10%, a star becomes a cash cow if it still maintains market leadership. Cash Cows are low growth, high share businesses that should be

"milked" as cash cows have the ability to generate more cash than can be reinvested profitably in its own operations and the extra revenues can be used for investment in other businesses. The strategy is to defend market share. Also, they are possible candidates for a harvest strategy. A cash cow is appropriate as it contributes a lot of cash in the company's coffer for 3 reasons:

- The company does not have to finance capacity expansion as the market growth has slowed down
- The company enjoys economies of scale through acquired business experiences and capacity utilisation
- The company operates at higher profit margins

Dogs

These are the businesses that have weak market shares in low-growth markets. They generate low profits or losses. Dogs are often targets for divestment, but may still be profitable and/or contribute to other organizational goals. The strategy is to minimize expenditures.

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Decisions based on BCG Matrix

The company after understanding of its various businesses by above-mentioned definitions must determine whether its portfolio is healthy. An unhealthy typically has too many dogs or question marks and/or a few stars and cash cows. The company should also monitor the moving positions of their businesses as any business is transformational and passes through successive stages of question mark, star, cash cow and finally dog. Then the company has to determine what objective, strategy and budget to assign to each SBU. 4 strategies can be pursued:

Build: The objective is to increase market share. This strategy is appropriate for question marks for they have to increase their market shares in order to become stars.

Hold: The objective is to preserve market share. This strategy is appropriate for cash cows on order to continue positive cash flow.

Harvest: The objective is to increase short-term cash flow by reducing costs at a faster rate than any potential sales drop. This strategy is appropriate for dogs and question marks.

Divest: The objective is to sell or liquidate the business because resources can be better used elsewhere. This strategy is appropriate for dogs and question marks.

The General Electric Model

McKinsey & Co prepared the nine boxes for General Electric, which became popular and is better known as GE Business Screen or GE Strategic Business Planning Grid. This model is very similar to the BCG matrix in the sense that the vertical axis represents industry attractiveness and the horizontal axis represents the company's strength in the industry or business position. These parameters are necessary in the sense that any company's success depends on the extent of ease and promptness it enters attractive markets and has the required business strengths to succeed in those markets. One difference from BCG matrix is that the GE approach considers more than just market growth rate and relative market share in order to determine market attractiveness and business strength. The industry attractiveness index is made up of such factors as market size, market growth, industry profit margin, amount of competition, seasonal and cyclical nature of demand, and industry cost structure. Business strength is an index of factors like relative market share, price, competitiveness, product quality, customer and market knowledge, sales effectiveness, and geographic advantages. GE matrix is divided into 9 cells, which form 3 zones.

- The most desirable SBUs are those located in the highly attractive industries where the company has high business strength. Strategically, the SBUs located in the 3 green cells in the upper-left corner are those in which the company should ***invest and grow***.
- The SBUs in the yellow cells along the diagonal running from lower left to upper right are overall medium in attractiveness. The strategy is to ***protect*** or allocate resources on a selective basis.
- The SBUs in the red cells on the lower right corner have low overall attractiveness. A ***harvest*** strategy should be used in the two cells just below the three-cell diagonal. These SBUs should not receive substantial new resources. The SBUs in the lower right cell should not receive any resources and should probably be ***divested*** or eliminated from the portfolio of the organization.

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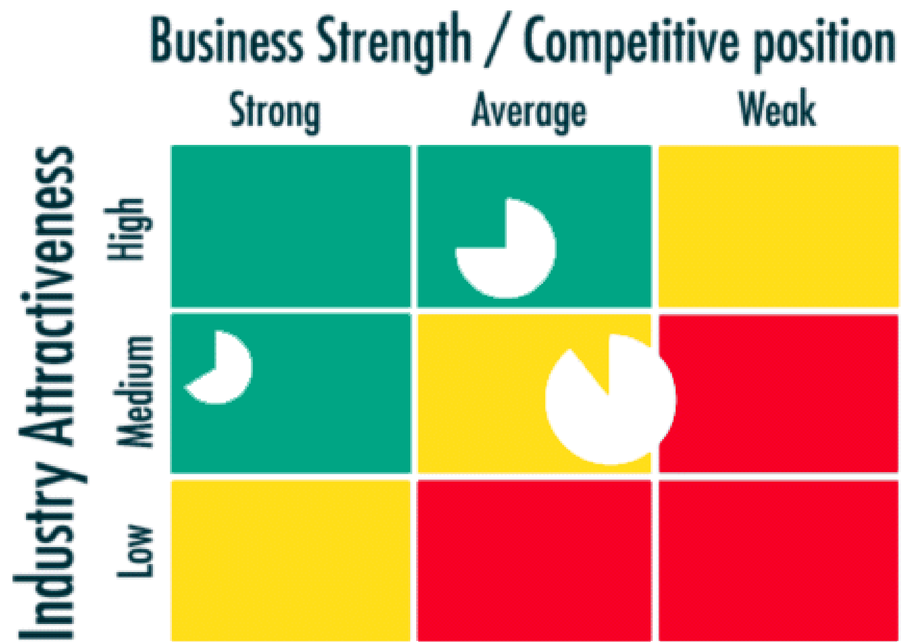

	Invest/Grow
	Selectivity/Earnings
	Harvest/Divest

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Decisions based on GE Model

Management should also forecast each SBU's expected position both in short-term as well as long-term in view of product life cycle, competitor's strategies, economic cycles, threat of substitutes or new entrants.

The specific strategies for 9 situations are:

		Business Strength	
Industry Attractiveness			
	High	Medium	Low
High	Invest heavily for growth	Invest selectively and build	Develop for income
Medium	Invest selectively and build	Develop selectively for income	Harvest or divest
Low	Develop selectively and build on strengths	Harvest	Divest

Shell Directional Policy Matrix

This model sets the company's competitive capabilities against the prospects for sector profitability in a 3-by-3 matrix; each of the nine cells contains a recommended strategy. Like Boston model, it has been designed to assess business or strategic business units, but it can be applied to products too.

		Prospects for sector profitability	
Company's Competitive Capabilities			
	Unattractive	Average	Attractive
Weak	Disinvest	Phased withdrawal	Double or quit
Average	Phased withdrawal	Custodial	Try harder
Strong	Cash generation	Growth	Leader

Industry maturity/competitive position matrix

This was proposed by the consultants Arthur D Little. The vertical axis cites a number of criteria from 'dominant' to 'weak' and the SBU is then entered into the appropriate box along the horizontal axis, depending upon the life-cycle stage the overall industry has reached. It is perhaps a slightly subjective set of measures, but at least it does give the analyst an immediate point of reference, and its utility is perhaps more one of comparing one company or SBU against another, rather than a practical marketing planning tool. It is depicted in following figure:

	Embryonic	Growth	Maturity	Ageing
Dominant				
Strong				
Favourable				
Tentative				
Weak				

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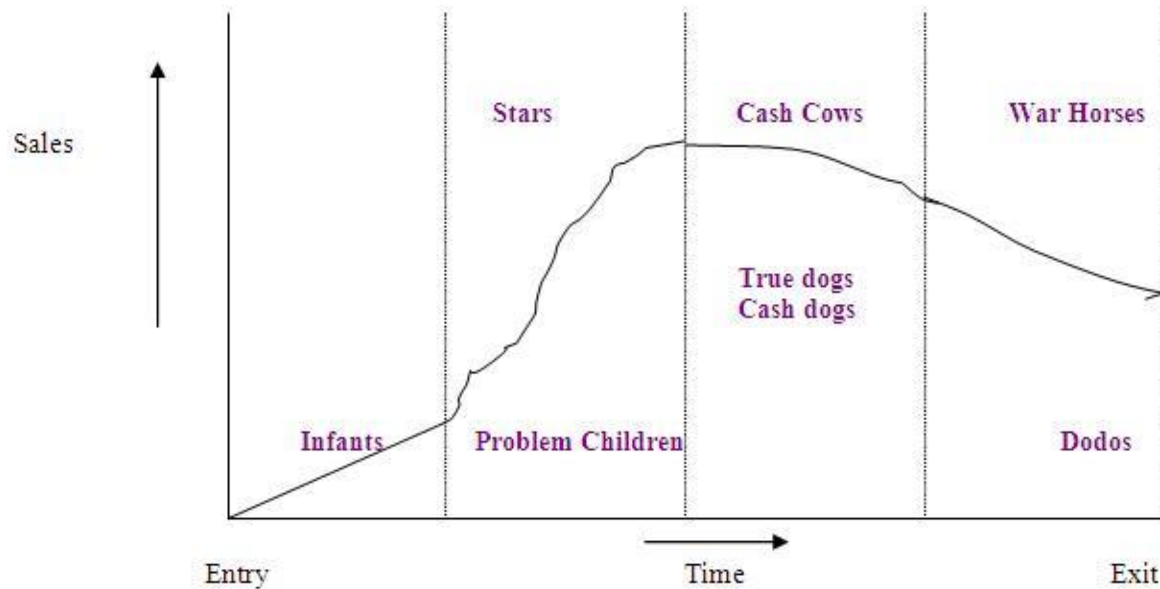
BCG/product life cycle matrix

This model was developed by Barksdale and Harris on the grounds that the BCG matrix ignores the position of the industry. Their matrix attempts to resolve this difficulty as indicated in following figure.



'Infants' are seen at the pioneering (introduction) stage. Research and development costs are being recouped and promotional costs are high because most communication effort is being directed towards informing the marketplace.

'Stars' enjoy high market share in a high growth market. These are costly in terms of communication costs at this growth stage, but this SBU has good potential for the future once the product becomes accepted and the SBU moves into the 'cash cow' category.

'Problem children' being in a low market share but high growth situation are costly to maintain and to become successful marketing action must be taken to move them to star or ulti mately to cash cow status.

'Cash cows' provide a steady revenue flow as they simply make money having a high market share, albeit in a low growth market.

'True dogs' have a low market share in a saturated market and provide a flat or even negative cash flow.

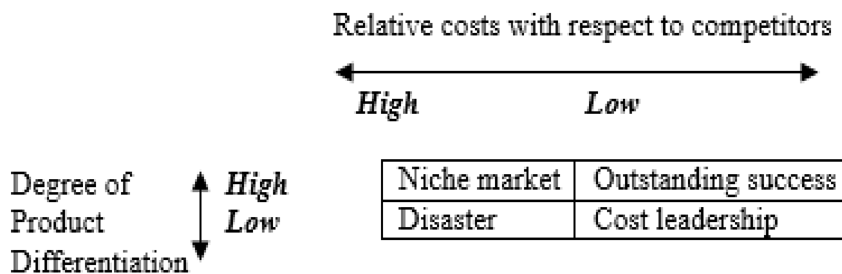
'Cash dogs' have a low market share in a saturated market, but produce a small positive cash flow.

'War horses' are seen in a declining market but are still support able because of their high market share, which contributes to a positive cash flow. The likelihood, too, is that competitors are leaving the market, so handing their market share back to the marketplace.

'Dodos' are precarious SBUs in that they are in a declining market and have a low market share and the likelihood is that their cash flow is negative. They should be deleted, but are probably still there because management clings to the belief that they might witness a revival.

Industry/Market Evolution Model

Michael Porter first recognized the generic strategies for success in a competitive market. He identified two key factors for attaining the competitive advantage that wins higher market share. These two factors are low costs in relation to other competitors and a high degree of product differentiation. These two aspects of competitive positioning form the axes of Porter's Competitive Positioning Matrix as shown in following figure.



As seen from the matrix, the most undesirable (and hence disastrous) situation would be when an organisation offers a product that is undistinguished against its rivals with relatively high cost in comparison to competitors. The unquestionable organisational success lies in attaining just opposite status i.e. low costs and high product distinctiveness. Some companies may survive with high costs with distinctive product offerings in a niche market or with undistinguished run-of-the-mill products having tight control over operating costs.

Porter's Generic Strategies

Michael Porter has described a category scheme consisting of three general types of strategies that are commonly used by businesses. These three generic strategies are defined along two dimensions: strategic scope and strategic strength. Strategic scope is a demand-side dimension (Porter was originally an economist before he specialised in strategy) and looks at the size and

composition of the market you intend to target. Strategic strength is a supply-side dimension and looks at the strength or core competency of the firm. In particular he identified two competencies that he felt were most important: product differentiation and product cost (efficiency).

He originally ranked each of the three dimensions (level of differentiation, relative product cost, and scope of target market) as either low, medium, or high, and juxtaposed them in a three dimensional matrix. That is, the category scheme was displayed as a 3 by 3 by 3 cube. But most of the 27 combinations were not viable.

In his 1980 classic Competitive Strategy: Techniques for Analysing Industries and Competitors, Porter simplifies the scheme by reducing it down to the three best strategies. They are cost leadership, differentiation, and market segmentation (or focus). Market segmentation is narrow in scope while both cost leadership and differentiation are relatively broad in market scope.

Empirical research on the profit impact of market share indicated that firms with a high market share were often quite profitable, but so were many firms with low market share. The least profitable firms were those with moderate market share. This was sometimes referred to as the hole in the middle problem. Porter's explanation of this is that firms with high market share were successful because they pursued a cost leadership strategy and firms with low market share were successful because they used market segmentation to focus on a small but profitable market niche. Firms in the middle were less profitable because they did not have a viable generic strategy.

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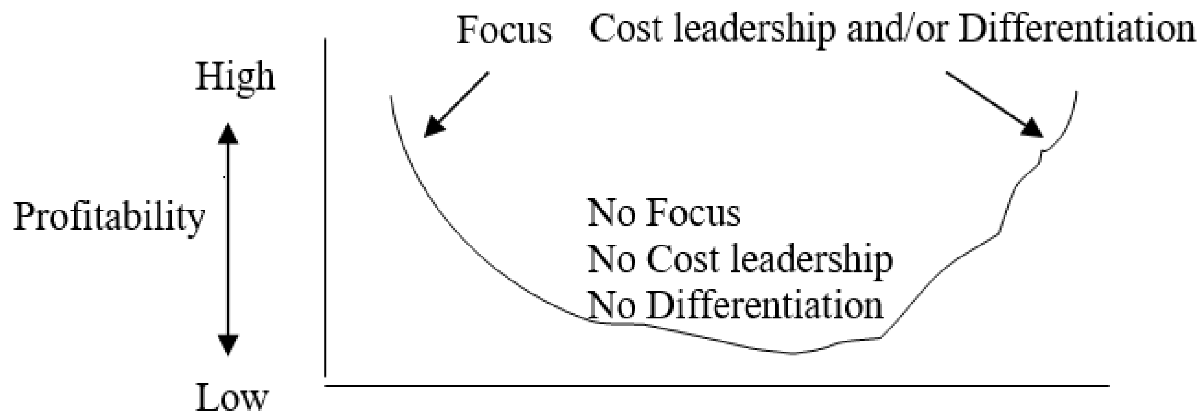
Combining multiple strategies is successful in only one case. Combining a market segmentation strategy with a product differentiation strategy is an effective way of matching your firm's product strategy (supply side) to the characteristics of your target market segments (demand side). But combinations like cost leadership with product differentiation are hard (but not impossible) to implement due to the potential for conflict between cost minimisation and the additional cost of value-added differentiation.

Since that time, some commentators have made a distinction between cost leadership, that is, low cost strategies, and best cost strategies. They claim that a low-cost strategy is rarely able to provide a sustainable competitive advantage. In most cases firms end up in price wars. Instead, they claim a best-cost strategy is preferred. This involves providing the best value for a relatively low price.

Porter also mentioned that a high market share is not necessarily a major financial criterion, which is shown in the following figure.



Here three situations are important.

Cost leadership: This simply means reducing prices to be lowest in the market. By pursuing this strategy, the organisation concentrates upon achieving the lowest costs of production and distribution so that it has the capability of setting its prices at a lower level than its competitors. This strategy emphasises efficiency. By producing high volumes of standardised products, the firm hopes to take advantage of economies of scale and experience curve effects. The product is often a basic no-frills product that is produced at a relatively low cost and made available to a very large customer base. Maintaining this strategy requires a continuous search for cost reductions in all aspects of the business. The associated distribution strategy is to obtain the most extensive distribution possible. Promotional strategy often involves trying to make a virtue out of low cost product features.

Whether it then chooses to do this depends on its objectives and perception of the market. Saunders provided the examples of IBM and Boeing, both of which are cost leaders who have chosen to use their lower costs not to reduce prices, but rather to generate higher returns that could subsequently be invested in marketing, R&D and manufacturing as a means of maintaining or strengthening their position.

To be successful, this strategy usually requires a considerable market share advantage or preferential access to raw materials, components, labour, or some other important input. Without one or more of these advantages, the strategy can easily be mimicked by competitors. Successful

implementation also benefits from:

- Process engineering skills
- Products designed for ease of manufacture
- Sustained access to inexpensive capital
- Close supervision of labour
- Tight cost control
- Incentives based on quantitative targets

Differentiation: This is the establishment of some unique features (also described as USP by Roger Reeves), which could be product or image related that competitors couldn't match. By pursuing this strategy, the organisation emphasises a particular element of the marketing-mix that is seen by customers to be important and as a result provides a meaningful basis for competitive advantage. The firm then wants to be quality leader (Mercedes Benz with cars), service leader (McDonald's), marketing leader (Japanese cars) or the technological leader (Dolby with noise suppression circuits for tape decks). Differentiation can also be achieved by means of the brand image and packaging especially in a mature market where the products are for the most part physically indistinguishable.

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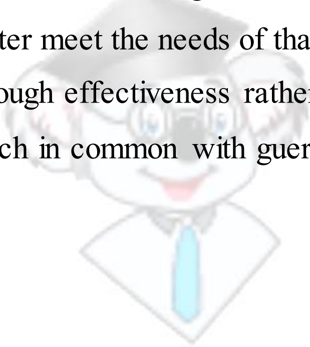
Differentiation involves creating a product that is perceived as unique. The unique features or benefits should provide superior value for the customer if this strategy is to be successful. Because customers see the product as unrivalled and unequalled, the price elasticity of demand tends to be reduced and customers tend to be more brand loyal. This can provide considerable insulation from competition. However there are usually additional costs associated with the differentiating product features and this could require a premium pricing strategy.

To maintain this strategy the firm should have:

- Strong research and development skills
- Strong product engineering skills
- Strong creativity skills

- Good cooperation with distribution channels
- Strong marketing skills
- Incentives based largely on subjective measures
- Be able to communicate the importance of the differentiating product characteristics
- Stress continuous improvement and innovation
- Attract highly skilled, creative people

Focus: This is where the company consolidates its efforts on a small product range in a singular market niche. In this strategy the firm concentrates on a select few target markets. It is also called a focus strategy or niche strategy. It is hoped that by focusing your marketing efforts on one or two narrow market segments and tailoring your marketing mix to these specialised markets, you can better meet the needs of that target market. The firm typically looks to gain a competitive advantage through effectiveness rather than efficiency. It is most suitable for relatively small firms and has much in common with guerrilla marketing warfare strategies.



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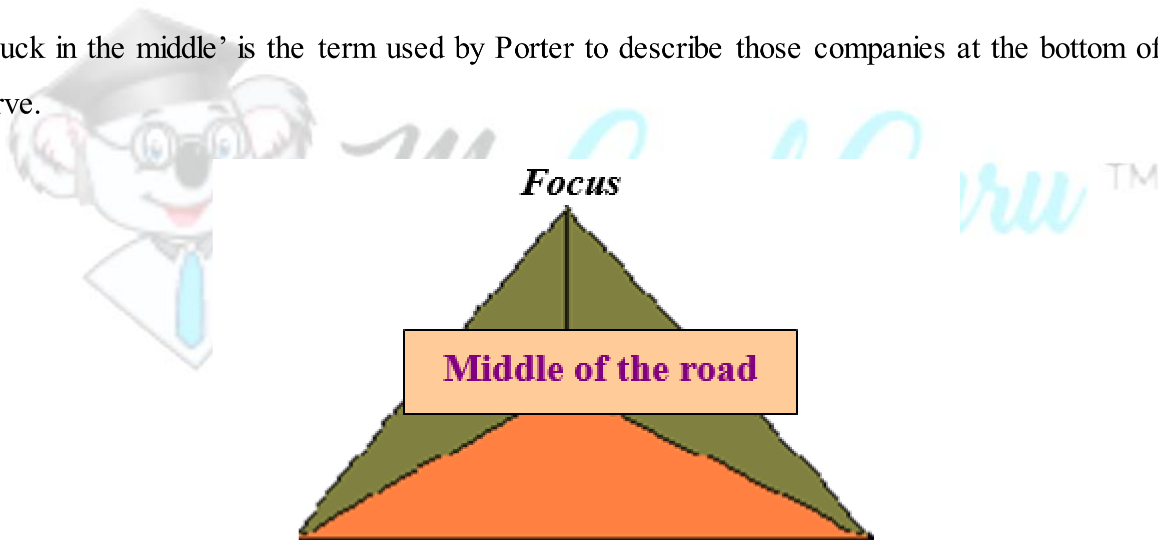
Porter's Model of competitive advantage

COMPETITIVE ADVANTAGE

STRATEGIC TARGET	Uniqueness perceived by customer	Low cost position
Industry-wide	Differentiation	Cost Leadership
Specific segment	Differentiation focus	Cost focus

'Stuck in the middle' is the term used by Porter to describe those companies at the bottom of the curve.



There is no single best strategy within a given industry and the task faced by the marketing strategists involves selecting the strategic approach that will best allow it to maximise its strengths vis-à-vis its competitors.

Type of strategy	Ways to achieve the strategy	Benefits	Possible problems
Cost leadership	Size and economies of scale Globalisation Relocating to low-cost parts of world Modification/simplification of designs Greater labour effectiveness Greater operating effectiveness Strategic alliance New sources of supply	Outperforming rivals Erecting entry barriers Resisting five competitive forces	Vulnerability to even lower cost operators Possible price wars Difficulty of sustaining in long-term
Focus	Concentration upon one or a small number of segments The creation of a strong and specialist	A more detailed understanding of particular segments Creation of entry barriers Reputation for specialisation Ability to concentrate efforts	Limited opportunities for sector growth Possibility of outgrowing market Decline of the sector Reputation for specialisation that ultimately inhibits growth and development into other sectors
Differentiation	The creation of strong brand identities The consistent pursuit of those factors which customers perceive to be important High performance in one or more of a spectrum of activities	Distancing from others in the market Creation of major competitive advantage Flexibility	Difficulties of sustaining the bases for differentiation Possible high costs Difficulty of achieving true and meaningful differentiation

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Porter's advanced Model

Strategic Position	Growth (Emerging industry)	Maturity (Transition to maturity)	Decline
Leader	Keep ahead of the field	Cost leadership Raise barriers to entry Deter competitors	Redefine scope Divest peripheral activities Encourage departures
Follower	Imitation at lower cost Joint ventures	Differentiation Focus	Differentiation Look for new opportunities

- **'Growth'** is exemplified in an emerging industry by purchasing conservatism over the attributes of new products and the potential for them becoming quickly dated in the style or functional senses.
- **'Transition to maturity'** usually means diminished profit margins as more competitors enter the market and there is a slowing down of sales. Purchasing confidence is higher through product familiarity, and the emphasis is upon features and non-price factors like image. Focus is important in terms of attempting to serve individual market segment needs.
- **'Decline'** suggests that the marketplace has become saturated and that products are uninteresting. Alternate products start to appear and this stage is when companies should seek to exit the marketplace and look for alternative markets and products.

Michael Porter's Value Chain Model

A value chain is a chain of activities. Products pass through all activities of the chain in order and at each activity the product gains some value. The chain of activities gives the products more added value than the sum of added values of all activities. It is important not to mix the concept of the value chain with the costs occurring throughout the activities. A diamond cutter can be used as an example of the difference. The cutting activity may have a low cost, but the activity adds too much of the value of the end product, since a rough diamond is a lot less valuable than a cut diamond.

The value chain categorizes the generic value-adding activities of an organization. The "primary activities" include: inbound logistics, operations (production), outbound logistics, marketing and sales, and services (maintenance). The "support activities" include: administrative infrastructure management, human resource management, information technology, and procurement. The costs

and value drivers are identified for each value activity. The value chain framework quickly made its way to the forefront of management thought as a powerful analysis tool for strategic planning. Its ultimate goal is to maximize value creation while minimizing costs.

Primary activities are directly concerned with the creation or delivery of a product or service. They can be grouped into following five main areas.

1) **Inbound Logistics** involve relationships with suppliers and include all the activities required to receive, store, and disseminate inputs.
2) **Operations** are all the activities required to transform inputs into outputs (products and services).
3) **Outbound Logistics** include all the activities required to collect, store, and distribute the output.
4) **Marketing and Sales** activities inform buyers about products and services, induce buyers to purchase them, and facilitate their purchase.
5) **Service** includes all the activities required to keep the product or service working effectively for the buyer after it is sold and delivered.

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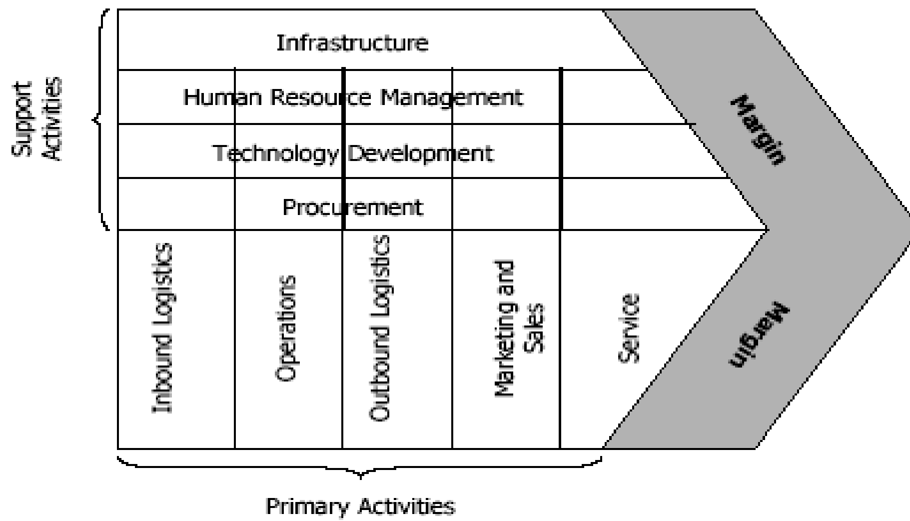
Each of these primary activities is linked to support activities, which help to improve their effectiveness or efficiency.

There are four main areas of support or secondary activities as discussed below:

1) **Procurement** - is the acquisition of inputs, or resources, for the firm.
2) **Human Resource management** - consists of all activities involved in recruiting, hiring, training, developing, compensating and (if necessary) dismissing or laying off personnel.
3) **Technological Development** - pertains to the equipment, hardware, software, procedures and technical knowledge brought to bear in the firm's transformation of inputs into outputs.
4) **Infrastructure** - serves the company's needs and ties its various parts together, it consists of functions or departments such as accounting, legal, finance, planning, public affairs, government relations, quality assurance and general management.

The basic model of Porter's Value Chain is as follows:



The concept has been extended beyond individual organizations. It can apply to whole supply chains and distribution networks. The delivery of a mix of products and services to the end customer will mobilize different economic factors, each managing its own value chain. The industry wide synchronized interactions of those local value chains create an extended value chain, sometimes global in extent. Porter terms this larger interconnected system of value chains the "value system." A value system includes the value chains of a firm's supplier (and their suppliers all the way back), the firm itself, the firm distribution channels, and the firm's buyers (and presumably extended to the buyers of their products, and so on).