An Effective Study on Strategic Portfolio Analysis

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Abstract: Strategic management involves the formulation and implementation of the major goals and initiatives taken by a company's top management on behalf of owners, based on consideration of resources and an assessment of the internal and external environments in which the organization competes. Strategic management provides overall direction to the enterprise and involves specifying the organization's objectives, developing policies and plans designed to achieve these objectives, and then allocating resources to implement the plans. Academics and practicing managers have developed numerous models and frameworks to assist in strategic decision making in the context of complex environments and competitive dynamics. Strategic management is not static in nature; the models often include a feedback loop to monitor execution and inform the next round of planning. Michael Porter identifies three principles underlying strategy: creating a "unique and valuable [market] position", making trade-offs by choosing "what not to do", and creating "fit" by aligning company activities with one another to support the chosen strategy. Dr. Vladimir Kvint defines strategy as "a system of finding, formulating, and developing a doctrine that will ensure long-term success if followed faithfully." Corporate strategy involves answering a key question from a portfolio perspective: "What business should we be in?" Business strategy involves answering the question: "How shall we compete in this business?" In management theory and practice, a further distinction is often made between strategic management and operational management. Operational management is concerned primarily with improving efficiency and controlling costs within the boundaries set by the organization's strategy.

Key points: strategy, portfolio, market growth rate, expansion, relative market share.

INTRODUCTION

Corporate portfolio analysis could be defined as a set of techniques that help strategists in taking strategic decisions with regard to individual products or businesses in a firm’s portfolio. It is primarily used for competitive analysis and corporate strategic planning in multi-product and multi-business firms. They may also be used in less diversified firms, if these consist of a main business and other minor complementary interests. In the strategic portfolio analysis (A) Boston Consulting Group (BCG) Matrix, (B) General Electronic (GE) Matrix (C) TOWS Matrix is very important tools in portfolio strategic analysis. The top management to analyse this portfolios on behalf of owners.

How to Apply BCG Matrix to Your Company

The BCG matrix was created by Bruce D. Henderson for the Boston Consulting Group in 1970. This chart was created with the purpose of helping companies analyze their different business units or product lines. The analysis helps these companies to allocate resources where they are most appropriate as well as to use the results in brand marketing, product management, strategic management, and portfolio analyses.

The chart is a graphical planning tool, where the company’s products and services can be plotted to help make key business decisions. These decisions include whether to keep a particular business unit, sell it or to invest more in it. The y-axis of the
The graph represents rate of market growth while the x-axis represents market share.

The matrix helps add input to the decision making process but does not take into account all possible factors that a company may face. The tool is not predictive and also doesn’t take into account any new or disruptive products that may enter and change the market, nor does it account for shifts in consumer demand.

UNDERSTANDING THE MATRIX

The chart or graph is divided into four categories. These are the cows, the dogs, the stars and the unknowns. A product line of a business unit is plotted based on its relative market share and rate of growth in the market and falls within one of these categories.

1) The Cash Cows

The product lines that fall within this category enjoy a large share of the market in a slow-growing industry. This means that they are able to generate revenues in greater amounts than the investment required to maintain their business. The product line may be considered boring and settled in a mature market, with the company holding it to continue to generate revenues. The company will attempt to milk these as much as possible with as little investment as possible.

2) The Dogs

The dogs are those product lines or business units that have a smaller market share in a mature and slow-growing industry. Usually, these product lines manage to earn what is put into them, breaking-even and maintaining the market share. Generally this unit is largely worthless to the company in terms of earning potential but may afford other benefits to the company such as the creation of jobs as well as synergies that assist other business units. These benefits may be enough for the company to keep this business unit active despite its less than exciting position. However, dogs can negatively affect how investors judge the management of a company and it is suggested that these product lines be sold off.

3) The Stars

As the name makes clear, stars are those business units that have a large market share in a fast-growing industry. These product lines have a clearly visible market or niche leading path and require large amounts of funding to ensure that they can fight of competitors and maintain their growth rate. Companies aim to turn stars into their next cash cows with the inevitable decline in the growth of the industry. This can happen potentially if they are able to maintain their position as a market leader. If this does not happen, then stars can turn into dogs.

4) The Unknowns

The unknowns (also called question marks or problem children) are those business units that have a smaller market share in a high-growth market. This is where most businesses will start from and at this point the business unit has the potential to grow market share and turn into a star or lose further marker share and turn into dogs when the growth of the market itself declines. Careful study and analysis is required for business units in this category to assess their potential and worth. If any potential is seen then further investment can be made into them.

The natural cycle for most products in that they begin their life as question marks and turn into stars as their position clarifies. When the market growth slows down, they turn into cash cows and at the end of the cycle, the cash cow turns into a dog. According to the Boston Consulting Group, a diversified company with a balanced portfolio is in the ideal position to use its strengths to capitalize on its growth opportunities and potential. A balanced portfolio is one which has:

- Stars to assure future success
- Cash cows to bring in funds for future growth
- Question marks that can be turned into the next stars with some attention and investment

The Axes

On either side of the grid is an indicator marked on the axis. The idea that prompted this grid as a while was the need to manage cash flows. The model assumes that one of the main indicators for cash generation is relative market share and the one for cash usage was the market growth rate.

- Relative Market Share – A higher market share means higher cash return. The reason behind the selection of this metric is based on its relationship with the experience curve. The belief is that when the company produces more products, it benefits from higher economies of scale and the experience curve which in turn result in higher profits. The market share is measured relative to its largest
competitor. Another reason for the selection is that this indicator carries more information than just cash flows as is the case in profits. It shows the brand’s position in relation to major competitors and a likely indication for the future.

- **Market Growth Rate** – A higher market growth rate means more earnings and often profits. On the other hand, it also means a higher consumption of cash as investment to stimulate future growth. This investment is made into those products which show a good potential for continued growth and success and are expected to provide a return on investment. This matrix assumes that a higher growth rate is an indicator of accompanying demands for investment. The market growth rate provides more information about the brand position than just the cash flow and is a good indicator of the strength of the market and its future potential as well as attractiveness to more competitors.

**History**

The BCG Matrix is named after the Boston Consulting Group, a global management consulting firm. The company has 81 offices in 45 countries and is one of the Big Three management consulting firms. The company was founded by Bruce D Henderson, an alumnus of Vanderbilt University and Harvard Business School. He was recruited by McKinsey and it is here that he founded the Boston Consulting Group. Henderson developed the famous BCG matrix in 1968. According to the BCG, Henderson told clients the following:

“The payoff for leadership [in market share] is very high indeed, if it is achieved early and maintained until growth slows. Investment in market share during the growth phase can be very attractive, if you have the cash. Growth in market is compounded by growth in share. Increases in share increase the profit margin. The return in investment is enormous. “

**Limitations**

There are some limitations to the use of this popular matrix as well. These limitations mean a decline in the once extensive use of this tool. These include:

- Market growth is one of many factors that determine industry attractiveness and relative market share is only one of many factors that determine competitive advantage. This matrix does not take into account any other factors that may have a bearing on both industry attractiveness and competitive advantage.
- There is an underlying assumption that the business units are operating in isolation in relation to each other. In reality, a dog may be helping another unit gain a competitive advantage for example.
- The definition of a market is taken in the broad sense. This fails to take into account different situations such as a business unit that is dominating a niche but is overall less dominant in the larger industry. The way a market is defined in such an instance may change its definition from a dog to a cash cow.

**HOW TO APPLY BCG MATRIX TO YOUR BUSINESS**

“To be successful, a company should have a portfolio of products with different growth rates and different market shares. The portfolio composition is a function of the balance between cash flows. High growth products require cash inputs to grow. Low growth products should generate excess cash. Both kinds are needed simultaneously.”

**Practical Use Tips**

The BCG matrix can be useful to companies if applied using the following general steps.

**Step 1 – Choose the Unit.** Strategic Business Units, individual brands, product lines or the firm as a whole are all areas that can be analyzed using the BCG matrix. The chosen unit drives the entire analysis and key definitions. The market, industry, competitors and position will all be based on the chosen unit.

**Step 2 – Define the Market.** Following the choice of the unit or area to be analyzed, the most important stage for the rest of the matrix is the definition of the market. An incorrectly defined market will lead to an incorrect classification of the unit. A Mercedes-Benz analyzed in a passenger vehicle market will be a dog with a small market share. However, analyzed within a luxury car market, it will be a cash cow.

**Step 3 – Calculate Relative Market Share.** At this stage, the relative market share for the chosen unit needs to be calculated. This can be done in terms of revenues or marker share. The formula used here us a division of the selected brand’s market share or revenues by the market share or revenues of the biggest competitor in the industry. The result in plotted on the x-axis.
Step 4 – Calculate Market Growth Rate. Online industry reports can be used to find the rate of growth for the industry. If this is not possible, then it can be estimated by looking at the average revenue growth of the leading firms in the industry. This measurement is a percentage and is plotted on the y-axis.

Step 5 – Draw Circles on the Matrix. Once all the measures are calculated, they can be put onto the matrix. This can be done by drawing a circle for each brand within a unit, or all the brands in a company. The size of each circle should correspond to business revenue generated by the brand.

CONCLUSION

Strategic management is a continuous process. There are three stages in this process: strategy formulation, strategy implementation, and evaluation and control. Strategy management is also viewed as series of steps. Therefore, the strategic-management process can be best be studied and applied using the model. A review of the major strategic management models indicates that they all include the following steps: performing an environmental analysis, establishing organizational direction, formulating organizational strategy, implementing organizational strategy, evaluating and controlling strategy. The strategic management process mostly involves top management, board of directors, and planning staff. In its final form, a strategic decision is moulded from the streams of inputs, decisions, and actions.

All organizations engage in the strategic management process. The success of an organization is generally dependent upon the strategic management and organizational abilities of the managers. Many research studies show both financial and nonfinancial benefits which can be derived from a strategic-management approach to decision making. Moreover, the concept of strategic management is still involving and will continue to undergo change. Therefore, understanding and following and complete process of strategic management can be helpful to practicing managers to gain organizations' objectives.

Reference

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