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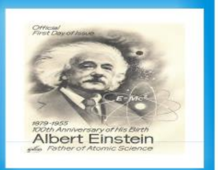

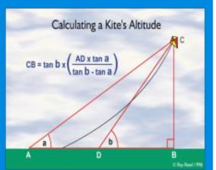

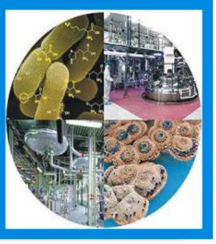

UGC NET - MANAGEMENT

SAMPLE THEORY

PAPER - II

- **Strategy Formulation**
- **Corporate Strategy**
- **ANSOFF'S Product/ Market Matrix**
- **The BCG Growth-Share Matrix Model**

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STRATEGY FORMULATION

THREE ASPECTS OF STRAT EGY FORMULATION

The following are the three aspects or levels of strategy formulation. The three sets of recommendations must be internally consistent and fit together in a mutually supportive manner that forms an integrated hierarchy of strategy, in the order given.

Corporate Level Strategy: In this aspect of strategy, we are concerned with broad decisions about the total organization's scope and direction. Basically, we consider what changes should be made in our growth objective and strategy for achieving it, the lines of business we are in, and how these lines of business fit together. It is useful to think of three components of corporate level strategy: (a) **growth or directional strategy** (what should be our growth objective, ranging from retrenchment through stability to varying degrees of growth - and how do we accomplish this), (b) **portfolio strategy** (what should be our portfolio of lines of business, which implicitly requires reconsidering how much concentration or diversification we should have), and (c) **parenting strategy** (how we allocate resources and manage capabilities and activities across the portfolio -- where do we put special emphasis, and how much do we integrate our various lines of business).

Competitive Strategy (often called Business Level Strategy): This involves deciding how the company will compete within each line of business (LOB) or strategic business unit (SBU).

Functional Strategy: These are more localized and shorter-horizon strategies dealing with how each functional area and unit will carry out its functional activities to be effective and maximize resource productivity.

CORPORATE LEVEL STRATEGY

(A) Concept and Nature of Corporate Strategy

(B) Components of Corporate Strategy

(C) Functions of Corporate Strategy

(D) Levels of Corporate Strategy

(E) Kinds of Corporate Strategy

(F) Schools of Thought on Corporate Strategy Formation

(G) Significance of Corporate Strategy

(H) Limitations of Corporate Strategy

CONC EPT AND NATURE OF CORPORAT E STRAT EGY

The word strategy is derived from the Greek word "*strategtia*" which was used first around 400 B.C. This connotes the art and science of directing military forces. In business parlance, there is no definite meaning assigned to strategy. A few definitions stated below may clarify the concept of corporate strategy:

KENNETH ANDREWS (1955), "The pattern of objectives, purpose, goals and the major policies and plans for achieving these goals stated in such a way so as to define what business the company is in or is to be and the kind of company it is or is to be" This definition refers to the business definition.

IGOR ANSOFF (1965) explained the concept of strategy as "the common thread among the organizations, activities and product markets, that defines the essential nature of business that the organization was or planned to be in future".

The definition stressed on the commonality of approach that exists in diverse organizational activities.

HENRY MINTZBERG (1987) explains that "strategies are not always the outcome of rational planning. …………. a pattern in a stream of decisions and actions. The definition makes a distinction between intended strategies and emergent strategies.

ANSOFF (1984) "Basically a strategy is a set of decision making rules for the guidance of organizational behavior. This definition has changed drastically what Ansoff had said earlier in 1965.

William Glueck defines the term strategy as "the unified, comprehensive and integrated plan that relates the strategic advantage of the firm to the challenges of the environment and is designed to ensure that basic objectives of the enterprise are achieved through implementation process" The definition lays stress on the following:

- It is a unified, comprehensive and integrated plan

- Challenges of the environment are seen in the context of strategic advantage
- Strategy ensures achievement of basic objectives through proper implementation process from the definitions discussed above, we may identify the following **elements:**
- It is a plan or course of action or a set of decision rules.
- It is derived from its policies, objectives and goals.
- It is related to pursue those activities which move an organization from its current position to a desired future state.
- It is concerned with the requisite resources to implement a plan. The term "Corporate Strategy" is gaining importance in the era of privatization, globalization and liberalization. A few aspects regarding the nature of strategy are as follows:
- Corporate strategy is related mostly to external environment.
- Corporate strategy is being formulated at the higher level of management. At operational level, operational strategies are also formulated.
- Corporate strategy integrates three distinct and closely related activities in strategy making. The activities are strategic planning, strategic implementation and strategic evaluation and control.
- Corporate strategy is related to long term.
- It requires systems and norms for its efficient adoption in any organization.
- It provides overall framework for guiding enterprise thinking and action.
- It is concerned with a unified direction and efficient allocation of organization resources.
- Corporate strategy provides an integrated approach for the organization and aids in meeting the challenges posed by environment.

COMPONENTS OF CORPORATE STRATEGY

The major components of corporate strategy are purpose and objectives, vector, competitive advantage, synergy, personal values and aspirations and social obligations. Ansoff has used the term "common thread" for the purpose. According to him, the common thread is a statement of relationship between present and future product market postures. In this section, the different components of corporate strategy are discussed.

Objectives

Corporate objectives should be stated in such a way so that they may provide a clear idea about the scope of the enterprise's business. Objectives give the direction for which action plan is formulated. Objectives are open-ended attributes denoting a future state. Objectives translate the purpose into goals. A few specific aspects about objectives are as follows:

The objectives should

- have time frame.
- be attainable.
- be challenging.
- be understandable.
- be measurable and controllable

For having clarity in objectives, the business domain is defined specifically in terms of a product class, technology, customer group, market need or some other combination.

Vector

Corporate strategy has one more important component i.e. Vector. Vector gives the directions within an industry and across industry boundaries which the firm proposes to pursue. If an organization has the objective to maximize sales, the series of decisions will be to enhance salesman's commission, release nationwide advertisement, introduce total quality management and introduce new product range. Vector signifies that a series of decisions are taken in the same direction to accomplish the objectives.

Competitive Advantage

Corporate strategy is relative by nature. In the formulation of corporate strategy, the management should isolate unique features of the organization. The steps to be taken must be competitively superior. While making plans, competitors may be ignored.

However, when we formulate corporate strategies, we cannot ignore competitors. If an organization does not look at competitive advantage, it cannot survive in a dynamic environment. This aspect builds internal strength of the organization and enhance the quality of corporate strategy.

Synergy

Synergy means measurement of the firm's capability to take advantage of a new product market move. If decisions are made in the same direction to accomplish the objectives there will be synergic impacts. The corporate strategy will give the synergy benefit.

FUNCTIONS OF CORPORAT E STRATEGY

Corporate strategy performs the following functions:

i) It provides a dual approach to problem solving. Firstly, it exploits the most effective means to overcome difficulties and face competition. Secondly, it assists in the deployment of scarce resources among critical activities.

ii) It focuses attention upon changes in the organizational set up, administration of organizational process affecting behavior and the development of effective leadership.

iii) It offers a technique to manage changes. The management is totally prepared to anticipate, respond and influence to look at changes. It also offers a different way of thinking.

iv) It furnishes the management with a perspective whereby, the latter gives equal importance to present and future opportunities.

v) It provides the management with a mechanism to cope with highly complex environment characterized by diversity of cultural, social, political and competitive forces.

LEVELS OF CORPORAT E STRATEGY

Corporate strategy may exist at three levels in an organization. They may be at corporate level, business level and operating level. In this section, a brief description of these three levels of strategy is given:

Corporate Level Strategy: - It is believed that strategic decision making is the responsibility of top management. At the corporate level, the board of directors and chief executive officers are involved in strategy making. Corporate planners and consultants may also be involved. Mostly, corporate level strategies are futuristic, innovative and pervasive in nature. Decision like spreading the range of business interests, acquisitions, diversification, structural redesigning, mergers, takeovers, liquidations come under corporate level strategies.

Business Level Strategy: - Strategic business unit (SBU) managers are involved at this level in taking strategic decisions. These strategies relate to a unit within an organization. At business level, the objectives are formulated for SBUs and resources are allocated among functional areas. These strategies operate under the defined scope of corporate level strategy. Business level strategy is more specific and action oriented. It relates mainly with "how" aspect. The corporate level strategy is related to "what" aspect of corporate strategy.

Operating Level Strategy: - This level of strategy is at the operating end of the organization. It is also known as functional level strategy. These decisions relate to training, investment in plant, advertising, sales promotion, total quality management, market segmentation etc. This decision is almost tactical. They deal with a relatively restricted plan providing objectives for specific function, allocation of resources among different operations within the functional area and coordination between them. The following table shows distinctive characteristics of the three levels of strategy:

Dimensions	Levels		
	Corporate	Business	Operating Functional
1. Time Horizon	Long	Medium	Short
2. Type of Decision	Philosphical	Mixed	Operational
3. Risk Involved	High	Medium	Low
4. Impact	Significant	Major	Insignificant
5. Profit Potential	High	Medium	Low
6. Flexibility	High	Medium	Low
7. Adaptability	Poor	Medium	Significant
8. Innovations	Innovative	Mixed	Routine
9. Levels of Decision Making	Highest	Middle	Lowest

Table 1: Strategic decisions at different levels of corporate strategy

The strategies at different levels are interrelated to each other. The interrelationship between corporate strategy and functional strategies is shown in below figure24.1. The figure 24.2 shows the relationship between corporate, business and functional strategies.

The example of first category can be that of Reliance Industries Ltd. It is a highly integrated company producing textile yarns and a variant of petro chemical products. The second figure may be related to Ashok Leyland Ltd., which is engaged in manufacturing and selling of heavy commercial vehicles. The SBU concept was considered in this case.

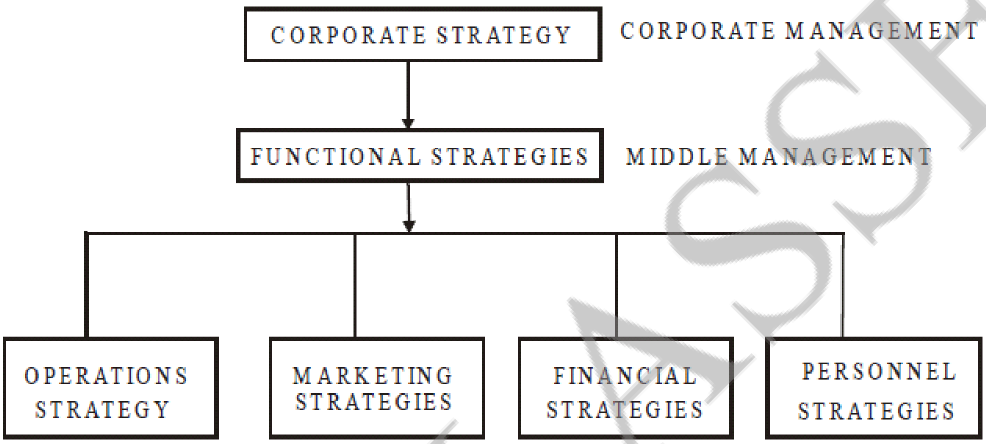

Figure 2 : Corporate and Functional Strategies in Single SBU Firms

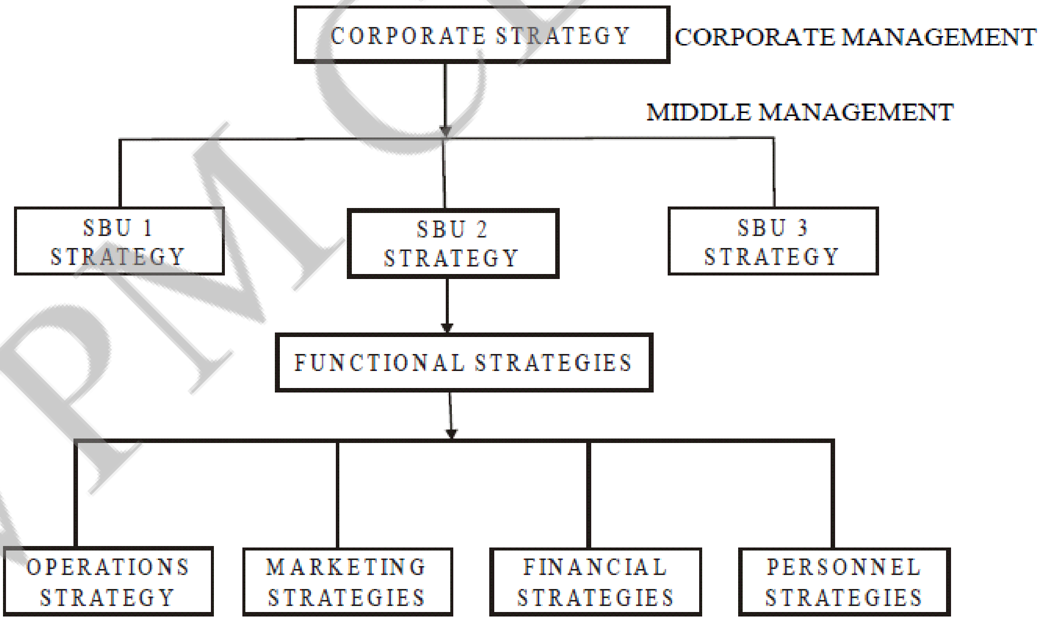

Figure 3: Corporate SBU and Functional Strategies in Multiple SBU firms

KINDS OF CORPORATE STRATEGY

There are four grand strategic alternatives. They are stability, expansion, retrenchment and any combination of these three. These strategic alternatives are also called as grand strategies. A brief description about them are as follows:

a) **Stability Strategy-** It is adopted by an organization when it attempts to improve functional performance. They are further classified as follows:

i) No change strategy

ii) Profit strategy

iii) Pause/Proceed with caution strategy

b) **Expansion Strategy: -** It is followed when an organization aims at high growth. They operate through

i) Concentration

ii) Integration

iii) Diversification

iv) Cooperation

v) Internationalization

Mergers, takeovers, Joint ventures and strategic alliances come under expansion through cooperation. International strategies are further classified into global strategy, transnational strategy, international strategy and multi-domestic strategy.

c) **Retrenchment Strategy: -** It is followed when an organization aims at a contraction of its activities. It is done through turnaround, divestment and liquidation in either of the following three modes:

i) Compulsory winding up

ii) Voluntary winding up

iii) Winding up under supervision of the court

d) **Combination Strategies: -** They are followed when an organization adopts a combination of stability, expansion and retrenchment either at the same time in different businesses or at different times in the same business. The well-known companies of the TTK group, based in Southern India, adopted a restructuring plan in the late 1980s involving following strategies.

i) Merger of TTK chemicals with TTK pharma.

ii) TT industries & Textiles Ltd. Planned for expansion through joint venture.

iii) TTK Ltd. diversified into the field of nonstick cooking utensils.

iv) TTK maps & publications expanded into the general publishing business after a turnaround. Business strategies are of three types: Cost leadership (lower cost/ broad target), differentiation (differentiation / broad target) and focus (lower cost or differentiation / narrow target).

SCHOOLS OF THOUGHT ON CORPORATE STRATEGY FORMATION

The subject of strategic management is in the midst of an evolutionary process. In this regard, several strands of thinking are emerging. They can be classified under the following groups:

- The Prescriptive Schools
- The Descriptive Schools
- The Integrative Schools

a) **The prescriptive schools: -** Under this category, three variations are found. The brief descriptions about them are as follows:

i) **The design school: -** (Selznick and Andrews) – Strategy is seen as something unique. The process of strategy formation is based on judgment and thinking.

ii) **The planning school: -** (Ansoff) – Under this school, the strategy is seen as a plan divided into sub-strategies and programs. The lead role in strategy formation is played by the planners.

iii) **The positioning school: -** (Schendel-Hatten & Porter) – The process of strategy formation is analytical, systematic and deliberate. Under this school, strategy is seen as a set of planned generic positions chosen by a firm on the basis of an analysis of the competition and the industry in which they operate.

b) **The Descriptive Schools:** - In this category, six schools of thought are existing. Their brief description is as follows:

i) **Entrepreneurial School** (Schumpeter & Cole): –The process of strategy formation is intuitive, visionary and largely deliberate. Strategy is seen as the outcome of a personal and unique perspective often aimed at the creation of a niche.

ii) **Cognitive School** (Simon and March): – This school perceives strategy formation as a mental process. The lead role is played by the thinker philosopher.

iii) **Learning School** (Weick, Quinn, Senge and Lindblom) – This school perceives strategy formation as an emergent process. The process is informal and messy and the lead role is played by the learner.

iv) **Power School** (Allison & Astley): – Under this school, strategy is seen as political and cooperative process or pattern. The process of strategy formation is messy, emergent and deliberate. This school perceives strategy formation as a negotiation process.

v) **Cultural School** (Rhenman and Normann): – Under this school, strategy is seen as a collective perspective. The process of strategy formation is ideological, constrained and deliberate.

vi) **Environmental School** (Hanan, Freeman and Pugh): – The lead role in strategy formation is played by the environment as an entity. This reactive process of strategy formation is passive and imposed and hence emergent.

c) **The Integrative School:** – The major contributions to the configuration school are by Chandler, Miles and Snow. Under this school, strategy is viewed in relation to a specific context and thus could be in a form that corresponds to any process visualized by above nine schools. The strategy formation process is integrative, episodic and sequential.

SIGNIFICANCE OF CORPORATE STRATEGY

In the present day competitive environment, no business organization can dream of survival without formulating appropriate corporate strategy. As the environment is continuously changing, the need for corporate strategic framework is more specific. The following areas clearly show the importance of corporate strategy:

i) Corporate strategy rationalizes allocation of scarce resources.

ii) Corporate strategy motivates employees examples to shape their work in the context of shared corporate goals.

iii) Strategy assists management to meet unanticipated future changes.

iv) Organizational effectiveness is ensured through implementing and evaluating the strategy.

v) Corporate strategy is a powerful tool to management to deal with the future which is uncertain and hazy in all respects.

vi) Corporate strategy improves the capability of management in coping with the volatile external environmental forces.

vii) Corporate strategy encourages the management to choose the best course of action to realize the objectives.

viii) Strategy planning system provides an objective basis for measuring performance.

LIMITATIONS OF CORPORAT EST RATEGY

The corporate strategy has the following specific limitations:

i) The process of strategy formulation is not an easy one. The process of forming corporate strategy is complex, cumbersome and complicated.

ii) Corporate strategies are useful for long range problems. They are not effective to overcome current exigencies.

iii) The corporate strategy formulation process calls for considerable time, money and effort. Developing appropriate corporate strategy is not a simple and economical proposition. For financially weak companies, cost becomes a great hindrance.

iv) As future is uncertain and cannot be predicted accurately, the strategic planning system based on hazy and uncertain estimates is not exact.

v) Implementation of corporate strategy is influenced by organizational factors, behavioral factors and motivational factors. The gap between formulation and implementation of corporate strategy does not give desired results to the organization.

Corporate strategy involves four kinds of initiatives:

- Making the necessary moves to establish positions in different businesses and achieve an appropriate amount and kind of diversification. A key part of corporate strategy is making decisions on how many, what types, and which specific lines of business the company should be in. This may involve deciding to increase or decrease the amount and breadth of diversification. It may involve closing out some LOB's (lines of business), adding others, and/or changing emphasis among LOB's.

- Initiating actions to boost the combined performance of the businesses the company has diversified into: This may involve vigorously pursuing rapid-growth strategies in the most promising LOB's, keeping the other core businesses healthy, initiating turnaround efforts in weak-performing LOB's with promise, and dropping LOB's that are no longer attractive or don't fit into the corporation's overall plans. It also may involve supplying financial, managerial, and other resources, or acquiring and/or merging other companies with an existing LOB.

- Pursuing ways to capture valuable cross-business strategic fits and turn them into competitive advantages -- especially transferring and sharing related technology, procurement leverage, operating facilities, distribution channels, and/or customers.
- Establishing investment priorities and moving more corporate resources into the most attractive LOB's.

It is useful to organize the corporate level strategy considerations and initiatives into a framework with the following three main strategy components: growth, portfolio, and parenting. These are discussed in the next three sections.

What should be Our Growth Objective and Strategies?

Growth objectives can range from drastic retrenchment through aggressive growth. Organizational leaders need to revisit and make decisions about the growth objectives and the fundamental strategies the organization will use to achieve them. There are forces that tend to push top decision-makers toward a growth stance even when a company is in trouble and should not be trying to grow, for example bonuses, stock options, fame, ego. Leaders need to resist such temptations and select a growth strategy stance that is appropriate for the organization and its situation. Stability and retrenchment strategies are underutilized.

Some of the major strategic alternatives for each of the primary growth stances (retrenchment, stability, and growth) are summarized in the following three sub-sections.

ANSOFF'S PRODUCT / MARKET MATRIX

INTRODUCTION

The Ansoff Growth matrix is a tool that helps businesses decide their product and market growth strategy.

Ansoff's product/market growth matrix suggests that a business' attempts to grow depending on whether it markets **new or existing** products in **new or existing markets.**

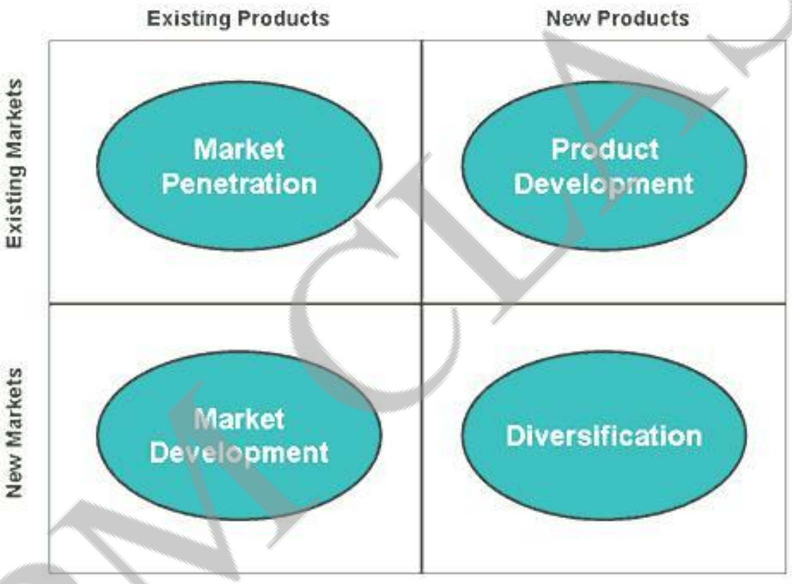

Figure 4

The output from the Ansoff product/market matrix is a series of suggested growth strategies that set the direction for the business strategy. These are described below:

Market penetration

Market penetration is the name given to a growth strategy where the business focuses on selling existing products into existing markets.

Market penetration seeks to achieve four main objectives:

- Maintain or increase the market share of current products – this can be achieved by a combination of competitive pricing strategies, advertising, sales promotion and perhaps more resources dedicated to personal selling
- Secure dominance of growth markets
- Restructure a mature market by driving out competitors; this would require a much more aggressive promotional campaign, supported by a pricing strategy designed to make the market unattractive for competitors
- Increase usage by existing customers – for example by introducing loyalty schemes A market penetration marketing strategy is very much about "business as usual". The business is focusing on markets and products it knows well. It is likely to have good information on competitors and on customer needs. It is unlikely, therefore, that this strategy will require much investment in new market research.

Market development

Market development is the name given to a growth strategy where the business seeks to sell its existing products into new markets.

There are many possible ways of approaching this strategy, including:

- New geographical markets; for example, exporting the product to a new country
- New product dimensions or packaging: for example
- New distribution channels
- Different pricing policies to attract different customers or create new market segments

Product development

Product development is the name given to a growth strategy where a business aims to introduce new products into existing markets. This strategy may require the development of new competencies and requires the business to develop modified products which can appeal to existing markets.

Diversification

Diversification is the name given to the growth strategy where a business markets new products in new markets.

This is an inherently more risk strategy because the business is moving into markets in which it has little or no experience.

For a business to adopt a diversification strategy, therefore, it must have a clear idea about what it expects to gain from the strategy and an honest assessment of the risks. **Diversification** is a form of corporate strategy for a company. It seeks to increase profitability through greater sales volume obtained from new products and new markets. Diversification can occur either at the business unit level or at the corporate level. At the business unit level, it is most likely to expand into a new segment of an industry that the business is already in. At the corporate level, it is generally very interesting entering a promising business outside of the scope of the existing business unit.

Ansoff pointed out that a diversification strategy stands apart from the other three strategies. The first three strategies are usually pursued with the same technical, financial, and merchandising resources used for the original product line, whereas diversification usually requires a company to acquire new skills, new techniques and new facilities.

The different types of diversification strategies

The strategies of diversification can include internal development of new products or markets, acquisition of a firm, alliance with a complementary company, licensing of new technologies, and distributing or importing a products line manufactured by another firm. Generally, the final strategy involves a combination of these options. This combination is determined in function of available opportunities and consistency with the objectives and the resources of the company.

There are three types of diversification: concentric, horizontal, and conglomerate.

Concentric diversification

This means that there is a technological similarity between the industries, which means that the firm is able to leverage its technical know -how to gain some advantage. For example, a company that manufactures industrial adhesives might decide to diversify into adhesives to be sold via retailers. The technology would be the same but the marketing effort would need to change.

It also seems to increase its market share to launch a new product that helps the particular company to earn profit. For instance, the addition of tomato ketchup and sauce to the existing "Maggi" brand processed items of Food Specialties Ltd. is an example of technological-related concentric diversification.

The company could seek new products that have technological or marketing synergies with existing product lines appealing to a new group of customers. This also helps the company to tap that part of the market which remains untapped, and which presents an opportunity to earn profits.

Horizontal diversification

The company adds new products or services that are often technologically or commercially unrelated to current products but that may appeal to current customers. In a competitive environment, this form of diversification is desirable if the present customers are loyal to the current products and if the new products have a good quality and are well promoted and priced. Moreover, the new products are marketed to the same economic environment as the existing products, which may lead to rigidity and instability. In other words, this strategy tends to increase the firm's dependence on certain market segments. For example, a company that was making notebooks earlier may also enter the pen market with its new product.

Conglomerate diversification (or lateral diversification)

The company markets new products or services that have no technological or commercial synergies with current products but that may appeal to new groups of customers. The conglomerate diversification has very little relationship with the firm's current business. Therefore, the main reasons of adopting such a strategy are first to improve the profitability and the flexibility of the company, and second to get a better reception in capital markets as the company gets bigger. Even if this strategy is very risky, it could also, if successful, provide increased growth and profitability.

Risks involved in diversification

Diversification is the riskiest of the four strategies presented in the Ansoff matrix and requires the most careful investigation. Going into an unknown market with an unfamiliar product offering means a lack of experience in the new skills and techniques required. Therefore, the company puts itself in a great uncertainty. Moreover, diversification might necessitate significant expanding of human and financial resources, which may detract focus, commitment, and sustained investments in the core industries. Therefore, a firm should choose this option only when the current product or current market orientation does not offer further opportunities for growth. In order to measure the chances of success, different tests can be done.

- The attractiveness test: the industry that has been chosen has to be either attractive or capable of being made attractive.
- The cost-of-entry test: the cost of entry must not capitalize all future profits.
- The better-off test: the new unit must either gain competitive advantage from its link with the corporation or vice versa.

Growth Strategies

All growth strategies can be classified into one of two fundamental categories: concentration within existing industries or diversification into other lines of business or industries. When a company's current industries are attractive, have good growth potential, and do not face serious threats, concentrating resources in the existing industries makes good sense. Diversification tends to have greater risks, but is an appropriate option when a company's current industries have little growth potential or are unattractive in other ways. When an industry consolidates and becomes mature, unless there are other markets to seek (for example other international markets), a company may have no choice for growth but diversification.

There are two basic concentration strategies, vertical integration and horizontal growth. Diversification strategies can be divided into related (or concentric) and unrelated (conglomerate) diversification. Each of the resulting four core categories of strategy alternatives can be achieved internally through investment and development, or externally through mergers, acquisitions, and/or strategic alliances -- thus producing eight major growth strategy categories. Comments about each of the four core categories are outlined below, followed by some key points about mergers, acquisitions, and strategic alliances.

1. **Vertical Integration:** This type of strategy can be a good one if the company has a strong competitive position in a growing, attractive industry. A company can grow by taking over functions earlier in the value chain that were previously provided by suppliers or other organizations ("backward integration"). This strategy can have advantages, e.g., in cost, stability and quality of components, and making operations more difficult for competitors. However, it also reduces flexibility, raises exit barriers for the company to leave that industry, and prevents the company from seeking the best and latest components from suppliers competing for their business.

   A company also can grow by taking over functions forward in the value chain previously provided by final manufacturers, distributors, or retailers ("forward integration"). This strategy provides more control over such things as final products/services and distribution, but may involve new critical success factors that the parent company may not be able to master and deliver. For example, being a world-class manufacturer does not make a company an effective retailer.

   Some writers claim that backward integration is usually more profitable than forward integration, although this does not have general support. In any case, many companies have moved toward less vertical integration (especially backward, but also forward) during the last decade or so, replacing significant amounts of previous vertical integration with outsourcing and various forms of strategic alliances.

2. **Horizontal Growth:** This strategy alternative category involves expanding the company's existing products into other locations and/or market segments, or increasing the range of products/services offered to current markets, or a combination of both. It amounts to expanding sideways at the point(s) in the value chain that the company is currently engaged in. One of the primary advantages of this alternative is being able to choose from a fairly continuous range of choices, from modest extensions of present products/markets to major expansions -- each with corresponding amounts of cost and risk.

3. **Related Diversification (aka Concentric Diversification):** In this alternative, a company expands into a related industry, one having synergy with the company's existing lines of business, creating a situation in which the existing and new lines of business share and gain special advantages from commonalities such as technology, customers, distribution, location, product or manufacturing similarities, and government access. This is often an appropriate corporate strategy when a company has a strong competitive position and distinctive competencies, but its existing industry is not very attractive.

4. **Unrelated Diversification (Conglomerate Diversification):** This fourth major category of corporate strategy alternatives for growth involves diversifying into a line of business unrelated to the current ones. The reasons to consider this alternative are primarily seeking more attractive opportunities for growth in which to invest available funds (in contrast to rather unattractive opportunities in existing industries), risk reduction, and/or preparing to exit an existing line of business (for example, one in the decline stage of the product life cycle). Further, this may be an appropriate strategy when, not only the present industry is unattractive, but the company lacks outstanding competencies that it could transfer to related products or industries. However, because it is difficult to manage and excel in unrelated business units, it can be difficult to realize the hoped-for value added.

Mergers, Acquisitions, and Strategic Alliances: Each of the four growth strategy categories just discussed can be carried out internally or externally, through mergers, acquisitions, and/or strategic alliances. Of course, there also can be a mixture of internal and external actions.

Various forms of strategic alliances, mergers, and acquisitions have emerged and are used extensively in many industries today. They are used particularly to bridge resource and technology gaps, and to obtain expertise and market positions more quickly than could be done through internal development. They are particularly necessary and potentially useful when a company wishes to enter a new industry, new markets, and/or new parts of the world.

Despite their extensive use, a large share of alliances, mergers, and acquisitions fall far short of expected benefits or are outright failures. For example, one study published in

Business Week in 1999 found that 61 percent of alliances were either outright failures or "limping along." Research on mergers and acquisitions includes a Mercer Management Consulting study of all mergers from 1990 to 1996 which found that nearly half "destroyed" shareholder value; an A. T. Kearney study of 115 multibillion-dollar, global mergers between 1993 and 1996 where 58 percent failed to create "substantial returns for shareholders" in the form of dividends and stock price appreciation; and a Pr ice-Waterhouse-Coopers study of 97 acquisitions over $500 million from 1994 to 1997 in which two-thirds of the buyer's stocks dropped on announcement of the transaction and a third of these were still lagging a year later.

Many reasons for the problematic record have been cited, including paying too much, unrealistic expectations, inadequate due diligence, and conflicting corporate cultures; however, the most powerful contributor to success or failure is inadequate attention to the merger integration process. Although the lawyers and investment bankers may consider a deal done when the papers are signed and they receive their fees, this should be merely an incident in a multi-year process of integration that began before the signing and continues far beyond.

Stability Strategies

There are a number of circumstances in which the most appropriate growth stance for a company is stability, rather than growth. Often, this may be used for a relatively short period, after which further growth is planned. Such circumstances usually involve a reasonable successful company, combined with circumstances that either permit a period of comfortable coasting or suggest a pause or caution. Three alternatives are outlined below, in which the actual strategy actions are similar, but differing primarily in the circumstances motivating the choice of a stability strategy and in the intentions for future strategic actions.

1. **Pause and Then Proceed:** This stability strategy alternative (essentially a timeout) may be appropriate in either of two situations: (a) the need for an opportunity to rest, digest, and consolidate after growth or some turbulent events - before continuing a growth strategy, or (b) an uncertain or hostile environment in which it is prudent to stay in a "holding pattern" until there is change in or more clarity about the future in the environment.

2. **No Change:** This alternative could be a cop-out, representing indecision or timidity in making a choice for change. Alternatively, it may be a comfortable, even long-term strategy in a mature, rather stable environment, e.g., a small business in a small town with few competitors.

3. **Grab Profits While You Can:** This is a non-recommended strategy to try to mask a deteriorating situation by artificially supporting profits or their appearance, or otherwise trying to act as though the problems will go away. It is an unstable, temporary strategy in a worsening situation, usually chosen either to try to delay letting stakeholders know how bad things are or to extract personal gain before things collapse. Recent terrible examples in the USA are Enron and WorldCom.

Retrenchment Strategies

Turnaround: This strategy, dealing with a company in serious trouble, attempts to resuscitate or revive the company through a combination of contraction (general, major cutbacks in size and costs) and consolidation (creating and stabilizing a smaller, leaner company). Although difficult, when done very effectively it can succeed in both retaining enough key employees and revitalizing the company.

Captive Company Strategy: This strategy involves giving up independence in exchange for some security by becoming another company's sole supplier, distributor, or a dependent subsidiary.

Sell Out: If a company in a weak position is unable or unlikely to succeed with a turnaround or captive company strategy, it has few choices other than to try to find a buyer and sell itself (or divest, if part of a diversified corporation).

Liquidation: When a company has been unsuccessful in or has none of the previous three strategic alternatives available, the only remaining alternative is liquidation, often involving a bankruptcy. There is a modest advantage of a voluntary liquidation over bankruptcy in that the board and top management make the decisions rather than turning them over to a court, which often ignores stockholders' interests.

What Should Be Our Portfolio Strategy?

This second component of corporate level strategy is concerned with making decisions about the portfolio of lines of business (LOB's) or strategic business units (SBU's), not the company's portfolio of individual products.

Portfolio matrix models can be useful in reexamining a company's present portfolio. The purpose of all portfolio matrix models is to help a company understand and consider changes in its portfolio of businesses, and also to think about allocation of resources among the different business elements. The two primary models are the BCG Growth-Share Matrix and the GE Business Screen (Porter, 1980, has a good summary of these). These models consider and display on a two-dimensional graph each major SBU in terms of some measure of its industry attractiveness and its relative competitive strength

THE BCG GROWTH-SHARE MATRIX MODEL

The BCG Growth-Share Matrix is a portfolio planning model developed by Bruce Henderson of the Boston Consulting Group in the early 1970's. It is based on the observation that a company's business units can be classified into four categories based on combinations of market growth and market share relative to the largest competitor, hence the name "growth-share". Market growth serves as a proxy for industry attractiveness, and relative market share serves as a proxy for competitive advantage. The growth-share matrix thus maps the business unit positions within these two important determinants of profitability: market share & market growth.

Market Share and Market Growth

Market share is the percentage of the total market that is being serviced by your company, measured either in revenue terms or unit volume terms. The higher your market share, the higher the proportion of the market you control.

The Boston Matrix assumes that if you enjoy a high market share you will be making money. (This assumption is based on the idea that you will have been in the market long enough to have learned how to be profitable, and will be enjoying scale economies that give you an advantage).

Market growth is used as a measure of a market's attractiveness. Markets experiencing high growth are ones where the total market is expanding, meaning that it's relatively easy for businesses to grow their profits, even if their market share remains stable

Relative market share

This indicates likely cash generation, because the higher the share the more cash will be generated. As a result of 'economies of scale' (a basic assumption of the BCG Matrix), it is assumed that these earnings will grow faster the higher the share. The exact measure is the brand's share relative to its largest competitor.

The reason for choosing relative market share, rather than just profits, is that it carries more information than just cash flow. It shows where the brand is positioned against its main competitors, and indicates where it might be likely to go in the future. It can also show what type of marketing activities might be expected to be effective.

Market growth rate

It is the rate with which market is growing. The reason for this is often because the growth is being 'bought' by the high investment, in the reasonable expectation that a high market share will eventually turn into a sound investment in future profits. The theory behind the matrix assumes, therefore, that a higher growth rate is indicative of accompanying demands on investment.

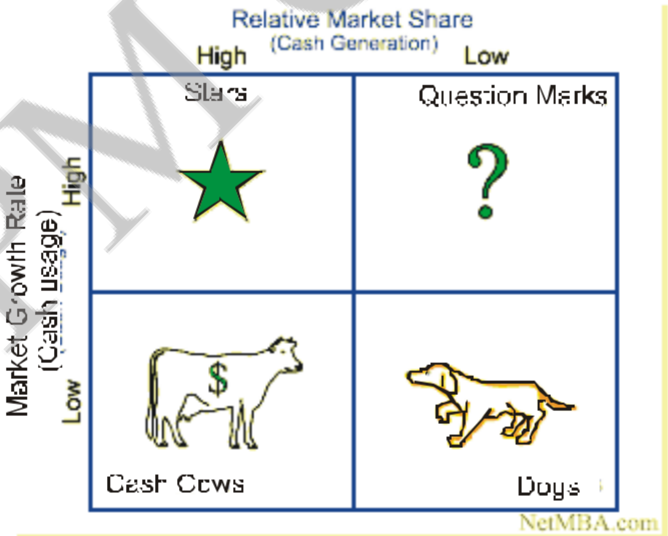

Figure 5: BCG Growth-Share Matrix

This framework assumes that an increase in relative market share will result in an increase in the generation of cash. This assumption often is true because of the experience curve; increased relative market share implies that the fir m is moving forward on the experience curve relative to its competitors, thus developing a cost advantage. A second assumption is that a growing market requires investment in assets to increase capacity and therefore results in the consumption of cash. Thus the position of a business on the growth-share matrix provides an indication of its cash generation and its cash consumption.

Henderson reasoned that the cash required by rapidly growing business units could be obtained from the firm's other business units that were at a more mature stage and generating significant cash. By investing to become the market share leader in a rapidly growing market, the business unit could move along the experience curve and develop a cost advantage. From this reasoning, the BCG Growth-Share Matrix was born.

The four categories are:

- **Dogs** - Dogs have low market share and a low growth rate and thus neither generate nor consume a large amount of cash. However, dogs are cash traps because of the money tied up in a business that has little potential. Such businesses are candidates for divestiture.
- **Question marks** - Question marks are growing rapidly and thus consume large amounts of cash, but because they have low market shares they do not generate much cash. The result is a large net cash consumption. A question mark (also known as a "problem child") has the potential to gain market share and become a star, and eventually a cash cow when the market growth slows. If the question mark does not succeed in becoming the market leader, then after perhaps years of cash consumption it will degenerate into a dog when the market growth declines. Question marks must be analyzed carefully in order to determine whether they are worth the investment required to grow market share.
- **Stars** - Stars generate large amounts of cash because of their strong relative market share, but also consume large amounts of cash because of their high growth rate; therefore, the cash in each direction approximately nets out. If a star can maintain its large market share, it will become a cash cow when the market growth rate declines. The portfolio of a diversified

company always should have stars that will become the next cash cows and ensure future cash generation.

- **Cash cows** - As leaders in a mature market, cash cows exhibit a return on assets that is greater than the market growth rate, and thus generate more cash than they consume. Such business units should be "milked", extracting the profits and investing as little cash as possible. Cash cows provide the cash required to turn question marks into market leaders, to cover the administrative costs of the company, to fund research and development, to service the corporate debt, and to pay dividends to shareholders. Because the cash cow generates a relatively stable cash flow, its value can be determined with reasonable accuracy by calculating the present value of its cash stream using a discounted cash flow analysis.

Under the growth-share matrix model, as an industry matures and its growth rate declines, a business unit will become either a cash cow or a dog, determined solely by whether it had become the market leader during the period of high growth.

While originally developed as a model for resource allocation among the various business units in a corporation, the growth-share matrix also can be used for resource allocation among products within a single business unit. Its simplicity is its strength - the relative positions of the firm's entire business portfolio can be displayed in a single diagram.

Limitations of BCG

- The growth-share matrix once was used widely, but has since faded from popularity as more comprehensive models have been developed. Some of its weaknesses are:
- Market growth rate is only one factor in industry attractiveness, and relative market share is only one factor in competitive advantage. The growth-share matrix overlooks many others factors in these two important determinants of profitability.
- The framework assumes that each business unit is independent of the others. In some cases, a business unit that is a "dog" may be helping other business units gain a competitive advantage.

- The matrix depends heavily upon the breadth of the definition of the market. A business unit may dominate its small niche, but have very low market share in the overall industry. In such a case, the definition of the market can make the difference between a dog and a cash cow. While its importance has diminished, the BCG matrix still can serve as a simple tool for viewing a corporation's business portfolio at a glance, and may serve as a starting point for discussing resource allocation among strategic business units.

The overall goal of this ranking was to help corporate analysts decide which of their business units to fund, and how much; and which units to sell. Managers were supposed to gain perspective from this analysis that allowed them to plan with confidence to use money generated by the *cash cows* to fund the *stars* and, possibly, the *question marks*. As the BCG stated in 1970:

Only a diversified company with a balanced portfolio can use its strengths to truly capitalize on its growth opportunities. The balanced portfolio has:

· stars whose high share and high growth assure the future;

· cash cows that supply funds for that future growth; and

· question marks to be converted into stars with the added funds.

Critical Evaluation

While theoretically useful, and widely used, several academic studies have called into question whether using the BCG matrix actually helps businesses succeed, and the model has since been removed from some major marketing textbooks. One study (Slater and Zwirlein, 1992) which looked at 129 firms found that those who follow portfolio planning models like the BCG matrix had lower shareholder returns.

The matrix ranks only market share and industry growth rate, and only implies actual profitability, the purpose of any business. (It is certainly possible that a particular *dog* can be profitable without cash infusions required, and therefore should be retained and not sold.) The matrix also overlooks other elements of industry. With this or any other such analytical tool, ranking business units has a subjective element involving guesswork about the future, particularly with respect to growth rates. Unless the rankings are approached with rigor and skepticism, optimistic evaluations can lead to a dot com mentality in which even the most dubious businesses are classified as “question marks” with good prospects; enthusiastic managers may claim that cash must be thrown at these businesses immediately in order to turn them into stars, before growth rates slow and it’s too late. Poor definition of a business’s market will lead to some *dogs* being misclassified as *cash cows*.

As originally practiced by the Boston Consulting Group, the matrix was undoubtedly a useful tool, in those few situations where it could be applied, for graphically illustrating cash flows. If used with this degree of sophistication its use would still be valid. However, later practitioners have tended to over-simplify its messages. In particular, the later application of the names (problem children, stars, cash cows and dogs) has tended to overshadow all else—and is often what most students, and practitioners, remember.

This is unfortunate, since such simplistic use contains at least two major problems:

‘Minority applicability’. The cash flow techniques are only applicable to a very limited number of markets (where growth is relatively high, and a definite pattern of product life-cycles can be observed, such as that of ethical pharmaceuticals). In the majority of markets, use may give misleading results.

‘Milking cash cows’. Perhaps the worst implication of the later developments is that the (brand leader) cash cows should be milked to fund new brands. This is not what research into the FMCG markets has shown to be the case. The brand leader’s position is the one, above all, to be defended, not least since brands in this position will probably outperform any number of newly launched brands. Such brand leaders will, of course, generate large cash flows; but they should not be `milked’ to such an extent that their position is jeopardized. In any case, the chance of the new brands achieving similar brand leadership may be slim—certainly far less than the popular perception of the Boston Matrix would imply.

Perhaps the most important danger is, however, that the apparent implication of its four-quadrant form is that there should be balance of products or services across all four quadrants; and that is, indeed, the main message that it is intended to convey. Thus, money must be diverted from ‘cash cows’ to fund the ‘stars’ of the future, since ‘cash cows’ will inevitably decline to become ‘dogs’. There is an almost mesmeric inevitability about the whole process. It focuses attention, and funding, on to the 'stars'. It presumes, and almost demands, that 'cash cow s' will turn into 'dogs'.

The reality is that it is only the 'cash cows' that are really important—all the other elements are supporting actors. It is a foolish vendor who diverts funds from a 'cash cow' when these are needed to extend the life of that 'product'. Although it is necessary to recognize a 'dog' when it appears (at least before it bites you) it would be foolish in the extreme to create one in order to balance up the picture. The vendor, who has most of his (or her) products in the 'cash cow' quadrant, should consider himself (or herself) fortunate indeed, and an excellent marketer, although he or she might also consider creating a few stars as an insurance policy against unexpected future developments and, perhaps, to add some extra growth. There is also a common misconception that 'dogs' are a waste of resources. In many markets 'dogs' can be considered loss-leaders that while not themselves profitable will lead to increased sales in other profitable areas.