POLITECNICO DI MILANO

Corporate strategy and portfolio analysis

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Corporate Strategy

The main goal of Corporate Strategy is to manage financial resources allocation to the portfolio of different Strategic Business Units the overall company is made of

The key issues to deal with are:

1. **To analyze and compare the competitive positioning of each business, and of the overall business portfolio**
2. **To suggest a generic strategic orientation to each business (that will be further specified at a Business Strategy level)**
3. **To define criteria and priorities for financial resource allocation to each business (cash generating vs. cash absorbing SBU), looking for an overall portfolio's financial equilibrium**

Diversification strategy

- **Diversification is a Corporate level strategy aimed at entering new business areas which the corporation is not currently serving (and create new SBUs to serve such new business areas)**

- **Diversification is hence a choice of "hierarchy", that is, internalizing a new business within the corporate portfolio**

- **Diversification is more favorable than other alternatives (e.g. brand franchising) when the following criteria are met:**

1. **Scope economies (i.e. scale economies applied to a wider range or family of activities performed) are present**

2. **Transaction costs (i.e. costs to bear to set up an agreement with the "market") are high**

About diversification strategies

The history: from the era of diversification (1950-80) to refocusing. Why?

- Emphasis on shareholders value
- Turbulence → Specialisation
- Sharing resources and capabilities as real source of advantage

When diversification creates value ?

- Attractiveness test (the industry must be attractive)
- The Cost-of-entry test
- The better-off test (is the combination more profitable?)

The meaning of relatedness in the "digital" era

- Industry boundaries are growingly "fuzzy"
- More and more business areas may be loosely related

Corporate competitive advantage

Two main typologies of business portfolios exist:

"Non correlated portfolios"

"Correlated portfolios"

in a correlated portfolio, the business areas show similarities in the customer needs satisfied, and the products and services sold are operationally related.
In a non-correlated portfolio, such correlation becomes blurred, and products and services offered are apparently unrelated.

Usually real-world cases of business portfolios do not strictly belong to one of these categories

Real portfolios are a mix of the two extreme solutions

Corporate competitive advantage - continue

General electric
material
utitlity/energy
health
GE for aviation
...

Non correlated portfolios

ADVANTAGES

- **"Bank effect"**

"bank effect", as cash-generating SBUs will be used as an internal bank to feed cash-absorbing SBUs within the corporate portfolio;

- **Better use of top human resources**
- **Risk diversification**
- **Sharing of infrastructural activities**

DISADVANTAGES

- **Very complex organisation**
- **Cultural heterogeneity** ناهمگونی
- **Few synergies**

Corporate competitive advantage - continue

Correlated portfolios

ADVANTAGES

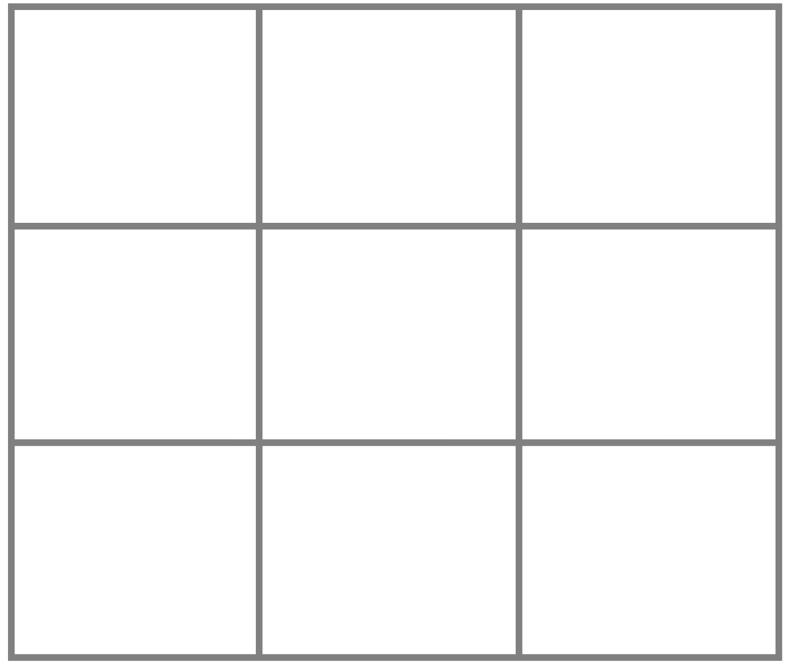
- **Sharing of resources (economies of scale, of scope, critical mass, …)**
- **Sharing of competences**
- **Similar markets**

DISADVANTAGES

- **High risk**
- **High managerial complexity**

Matrixes for portfolio analysis

BUSINESS AREA
ATTRACTIVENESS



COMPETITIVE POSITIONING
OF THE SBU

Basic idea: to represent a diversified company’s BA in a simple graphical model to support Corporate Strategy definition

Matrixes for portfolio analysis

Key assumption

Long-term profitability of a SBU depends on:

1. **Business Area attractiveness**

2. **SBU competitive positioning in the Business Area**

Matrixes for portfolio analysis

Main objectives

- **To analyse the competitive advantage coming from the managing of a SBU's portfolio**
- **To support the choice of a business portfolio (Corporate Strategy definition)** status quo to the desired space!
- **To provide some guidelines to SBUs for the definition of their own strategy**
- **To analyse the strategies of competitors**

Boston Consulting Group (BCG) Matrix

- **The growth-share matrix - developed by The Boston Consulting Group in 1968 - describes products in terms of just two factors: market growth rate and relative market share.**

- **Positions in the product portfolio chart typically correspond to a business's cash flow characteristics. Generally, participation in a high-growth market requires cash, and high relative market share generates cash.**

Boston Consulting Group (BCG) Matrix

Main objectives

- **To verify the "bank effect"**
- **To shape a business portfolio that is well balanced from a financial point of view**
- **To define a "virtuous circle" strategy**
- **To analyse the strategies of competitors**

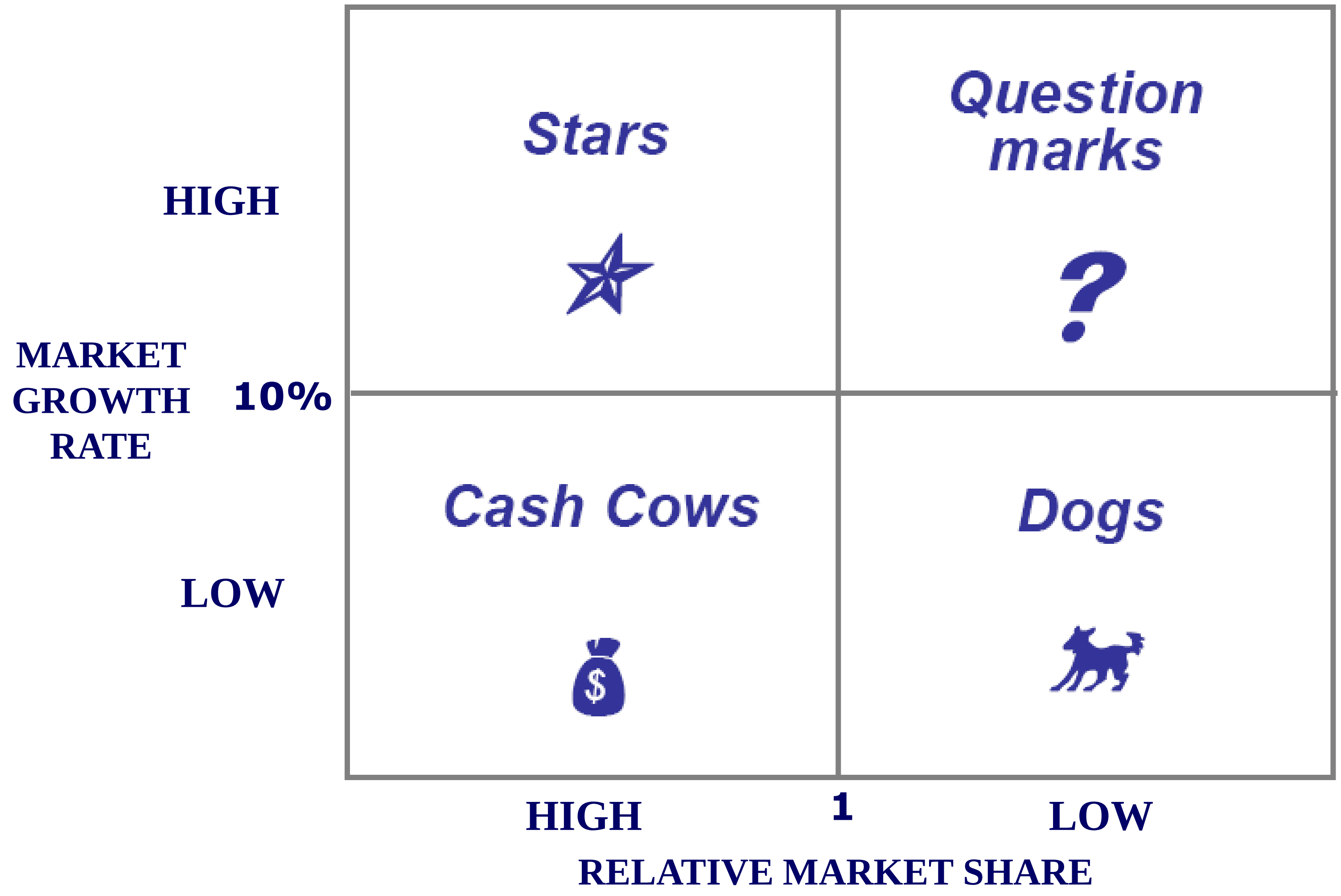
Boston Consulting Group (BCG) Matrix

Basic assumption

1. **Business Area attractiveness can be measured through "Market growth rate":**
   - **Price wars are less likely**
   - **Customer base expands, and offer can catch up with demand**

2. **SBU competitive positioning can be measured through "Relative market share":**
   - **SBU can benefit from cost advantages depending on size (for instance, economies of scale and experience, production capacity saturation, etc.)**

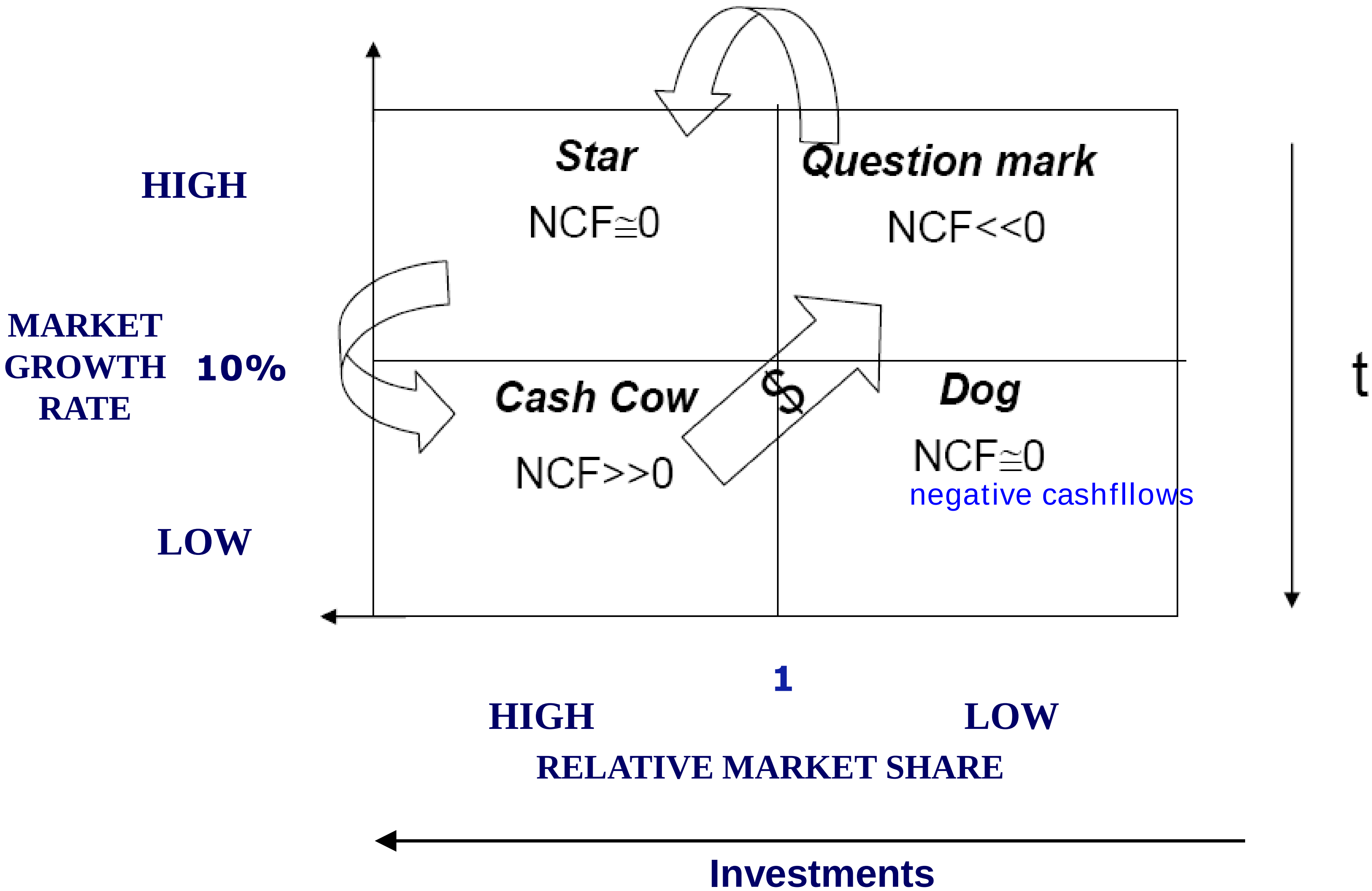
Boston Consulting Group (BCG) Matrix



Boston Consulting Group (BCG) Matrix

- **Stars** are high-growth, high-share products which may or may not be self-sufficient in cash flow.
- **Cash Cows** are products with high market share and slow growth, which characteristically generate large amounts of cash.
- **Question Marks** are products with high growth but low share. They require large amounts of cash to mantain market share, and still larger amounts to gain share.
- **Dogs** are product with low market share and slow growth, which neither generate nor require significant amounts of cash. Mantaining share usually requires the reinvestment of any profits as well as additional capital. These products are often called «cash traps».

Boston Consulting Group (BCG) Matrix



BCG Matrix: recommended strategies

- **Stars:** **Hold or Build Share**
- **Cash Cows:** **«Milk» for cash**
- **Question Marks:** **Build Share or Divest**
- **Dogs:** **Harvest or Divest**

if there were any positive sinergy creates the value

Divesting means selling or spinning off the business unit to another entity, while harvesting means reducing or stopping the investment in the business unit and extracting as much cash as possible from it.

BCG Matrix: the balanced portfolio

All products eventually become either cash-cows or dogs. The value of a product is completely dependent upon obtaining a leading share of its market before the growth slows.

The balanced portfolio has:

-**stars** whose high shares and high growth assure the future;

-**cash-cows** that supply funds for that future growth;

-**question marks** to be converted into stars.

Dogs need dedicated strategies.

Bruce Henderson, BCG Founder, 1970

GE-McKinsey Matrix

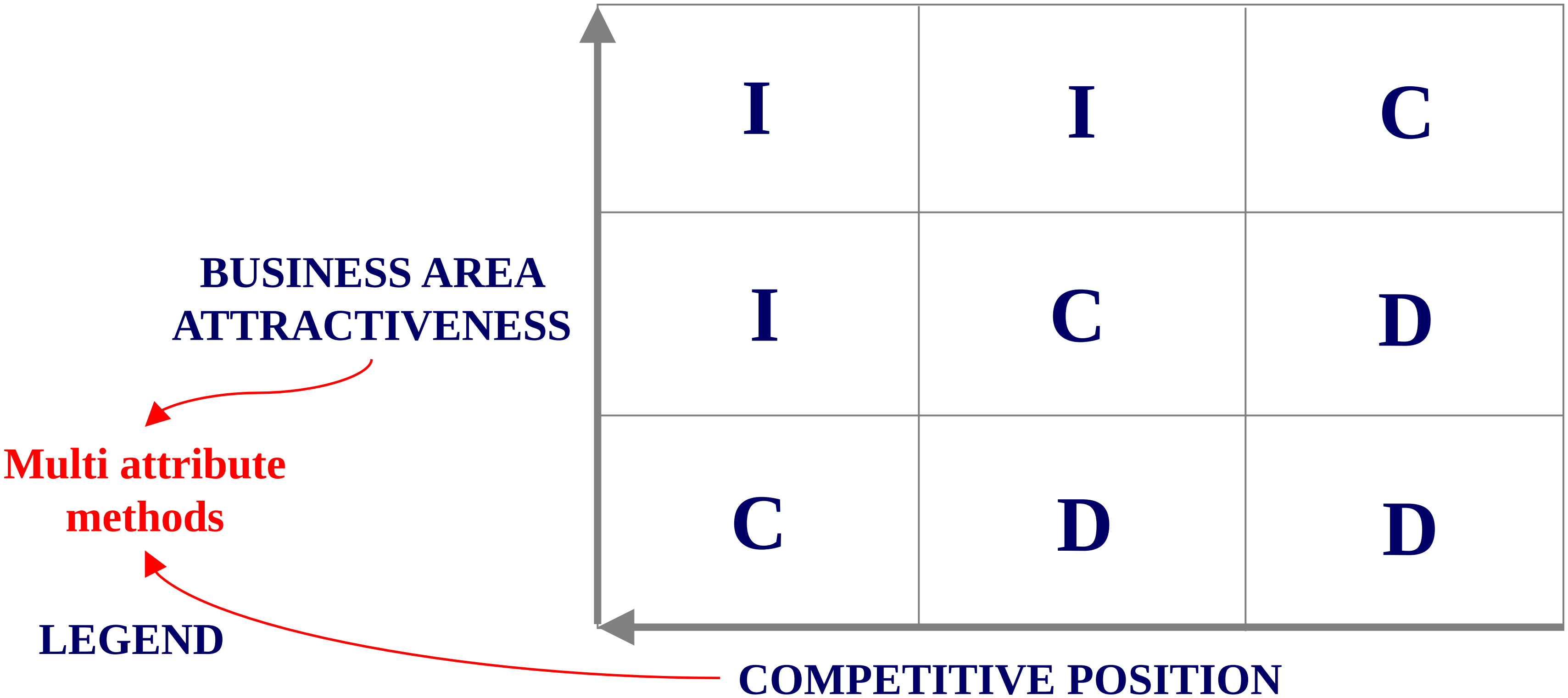
- The GE/McKinsey matrix was developed in 1971 by McKinsey at the request of GE. It uses two dimensions - **market segment attractiveness and business strength -** each of which is built up from a large number of variables.
- Systematically weighting those variables, each business (or product) is classified into one of nine cells in a 3 x 3 matrix.
- Like the BCG matrix, this approach aims to compare investment opportunities. The difference is that multiple measures are used to assess market attractiveness and competitive position.

GE-McKinsey Matrix

Main objectives

- **To allocate resources correctly**
- **To choose the businesses to invest in, to maintain and to divest**
- **To analyse the strategies of competitors**

GE-McKinsey Matrix - continue



LEGEND

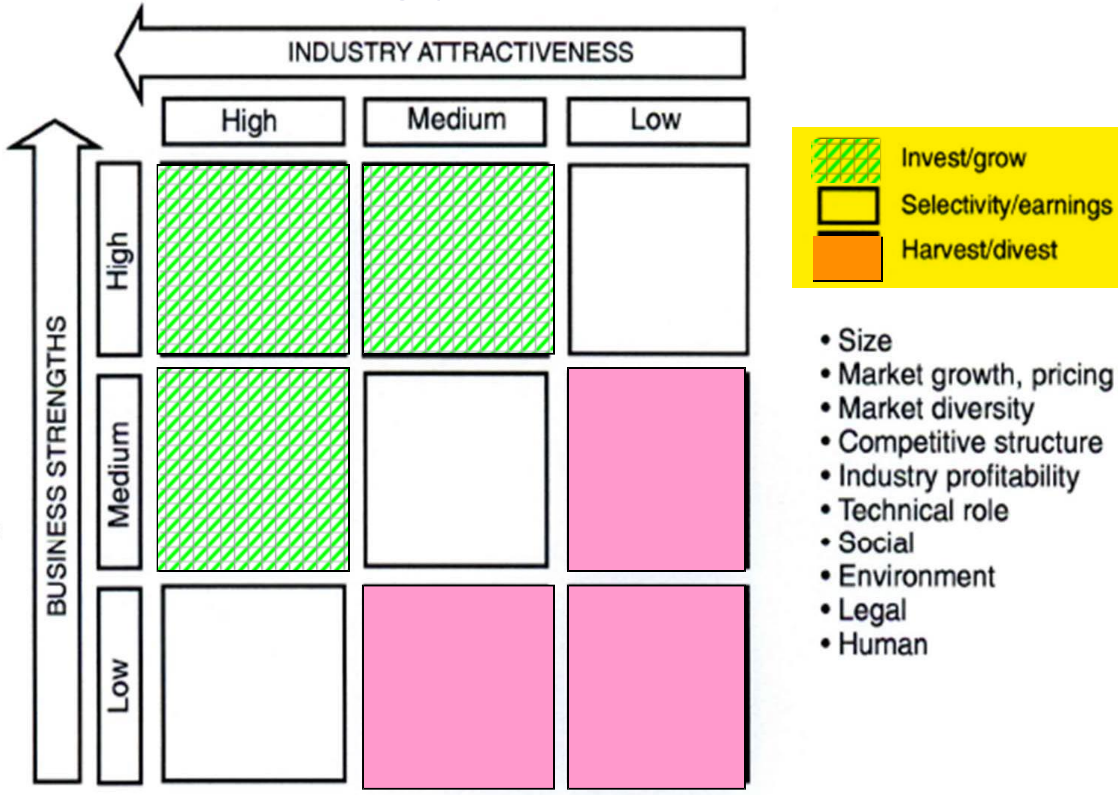
I = TO INVEST IN ORDER TO INCREASE THE MARKET SHARE

C = TO CONSERVE, BALANCING FINANCIAL SOURCES AND INVESTMENTS

D = TO DISINVEST IN ORDER TO ACHIVE CASH

GE-McKinsey Matrix: the nine-cells strategy scheme

- Size
- Growth
- Share
- Position
- Profitability
- Margins
- Technology position
- Strength/weaknesses
- Image
- Pollution
- People



- Size
- Market growth, pricing
- Market diversity
- Competitive structure
- Industry profitability
- Technical role
- Social
- Environment
- Legal
- Human

Source: McKinsey & Co.

Industry attractiveness

	Weighting factor		Rating (1-10)		Score
• Market size	%	x		=	
• Growth rate	%	x		=	
• Profit margin potentials	%	x		=	
• Competitive intensity	%	x		=	
• Cyclical or seasonal sales	%	x		=	
• Position on learning curve	%	x		=	
					100%

Business Strenghts

	Weighting factor	Rating (1-10)	Score
• Relative market share	% x	=	
• Price competitiveness	% x	=	
• Product or service quality perception	% x	=	
• Marketer's knowledge of customers and the market	% x	=	
• Sales effectiveness	% x	=	
• Geography coverage	% x	=	
	100%		

GE-McKinsey Matrix: recommended strategies

Market segment attractiveness

Business strengths	High	Medium	Low
High	1 **Premium invest/ Grow**	2 **Selective invest/ Grow**	4 **Protective selectivity/ Earnings**
Medium	3 **Challenge invest/ Grow**	5 **Prime selectivity/ Earnings**	7 **Restructure harvest/ Divest**
Low	6 **Opportunistic selectivity/ Earnings**	8 **Opportunistic harvest/ Divest**	9 **Harvest/ Divest**

Source: D. W. Craven, Strategic Marketing, 1991

Desirable: Invest/Grow strategy
In between: Selective strategy
Undesirable: Harvest/Divest strategy

if you have solid data this model is better
it's from past data
we need to define the BA accurately

GE-McKinsey Matrix: recommended strategies

1. **Premium Invest / Grow**. These businesses are a target for investment, they have strong business strengths, are in attractive markets and they should therefore have high returns on investment and competitive advantage. They should receive financial and managerial support to maintain their strong position and to continue contributing to long-term profitability.

2. **Selective Invest / Grow**. Businesses in this box have good business strength in an industry that is losing its attractiveness. They should be supported if necessary but they may be self-supporting in cash flow terms.

3. **Challenge Invest / Grow**. Businesses here are in very attractive industries but have average business strength. They should be invested in to improve their long-term competitive position.

GE-McKinsey Matrix: recommended strategies

4. **Protective Selectivity / Earnings**. Strong businesses in unattractive markets should be net cash generators and could provide funds for use throughout the rest of the portfolio. Investment should be aimed at keeping these businesses in a dominant position of strength but over-investment can be disastrous especially in a mature market.
5. **Prime Selectivity / Earnings**. Businesses with average business strengths and in average industries can improve their positions by creative segmentation to create profitable segments and by selective investment to support the segmentation strategy. The business needs to create superior returns by concentrating on building segment to differentiate themselves.
6. **Opportunistic Selectivity / Earnings**. These businesses are in very attractive markets but their business strength is weak. Investment must be aimed at improving the business strengths. These businesses will probably have to be funded by other businesses in the group as they are not self-funding. Only businesses that can improve their strengths should be retained if not they should be divested.

GE-McKinsey Matrix: recommended strategies

7. **Restructured Harvest / Divest**. They have average business strengths in an unattractive market and the strategy should be to harvest the business in a controlled way to prevent a defeat or the business could be used to upset a competitor.
8. **Opportunistic Harvest / Divest**. Businesses with weak business strengths in moderately attractive industries are candidates for a controlled exit or divestment. Attempts to gain market share by increasing business strengths could prove to be very expensive and must be done with caution
9. **Harvest / Divest**. These businesses have neither strengths nor an attractive industry and should be exited. Investments made should only be done to fund the exit.