Study Material

Class - M. Com
Subject Code – MC 4.1
Subject – Strategic Management
Topic – BCG Matrix

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Learning outcome from this study material

- Explanation of BCG Matrix as a managerial strategy
- Brands Classification into four quadrants
- Advantages and disadvantages of Matrix

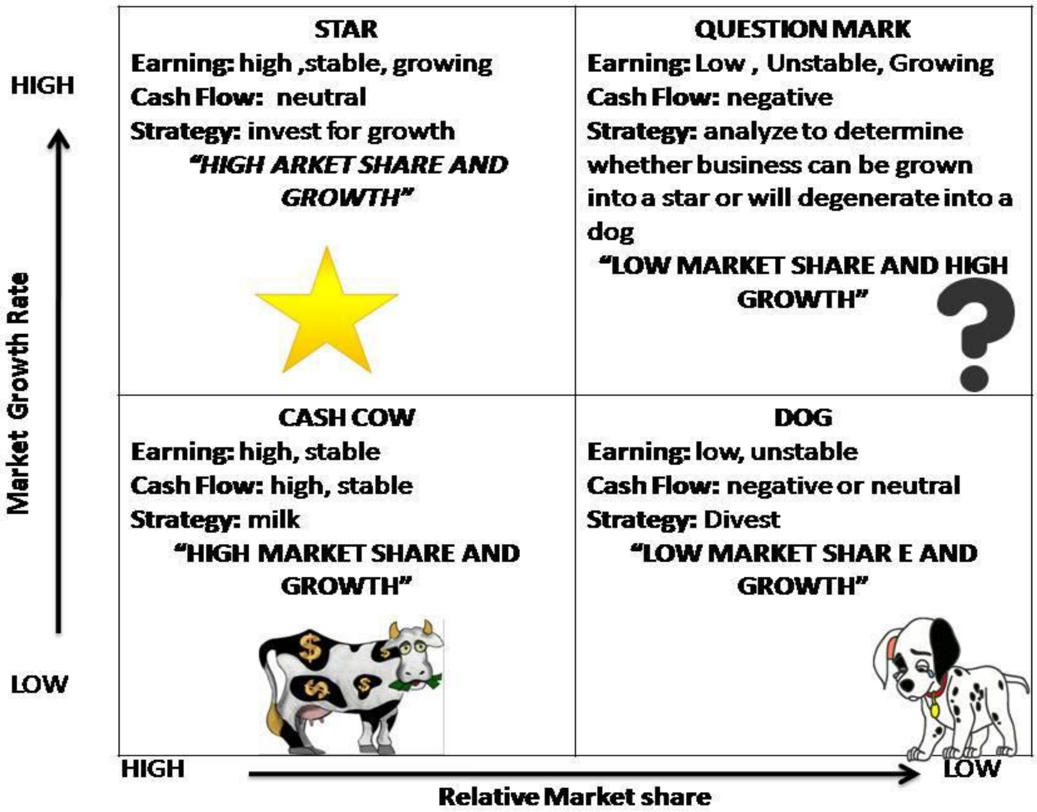
BCG MATRIX

BCG matrix is a framework created by Boston Consulting Group to evaluate the strategic position of the business brand portfolio and its potential. It classifies business portfolio into four categories based on industry attractiveness (growth rate of that industry) and competitive position (relative market share).

These two dimensions reveal likely profitability of the business portfolio in terms of cash needed to support that unit and cash generated by it. The general purpose of the analysis is to help understand, which brands the firm should invest in and which ones should be divested.

The Boston Consulting group's product portfolio matrix (BCG matrix) is designed to help with long-term strategic planning, to help a business consider growth opportunities by reviewing its portfolio of products to decide where to invest, to discontinue or develop products. It's also known as the Growth/Share Matrix.

The Matrix is divided into 4 quadrants based on an analysis of market growth and relative market share, as shown in the diagram below.



Relative market share. One of the dimensions used to evaluate business portfolio is relative market share. Higher corporate's market share results in higher cash returns. This is because a firm that produces more, benefits from higher economies of scale and experience curve, which results in higher profits. Nonetheless, it is worth to note that some firms may experience the same benefits with lower production outputs and lower market share.

Market growth rate. High market growth rate means higher earnings and sometimes profits but it also consumes lots of cash, which is used as investment to stimulate further growth. Therefore, business units that operate in rapid growth industries are cash users and are worth investing in only when they are expected to grow or maintain market share in the future.

There are four quadrants into which firms brands are classified:

Dogs. Dogs hold low market share compared to competitors and operate in a slowly growing market. In general, they are not worth investing in because they generate low or negative cash returns. But this is not always the truth. Some dogs may be profitable for long period of time, they may provide synergies for other brands or SBUs or simple act as a defence to counter competitors moves.

Therefore, it is always important to perform deeper analysis of each brand or SBU to make sure they are not worth investing in or have to be divested. Strategic choices: Retrenchment, divestiture, liquidation

Cash cows. Cash cows are the most profitable brands and should be "milked" to provide as much cash as possible. The cash gained from "cows" should be invested into stars to support their further growth. According to growth-share matrix, corporates should not invest into cash cows to induce growth but only to support them so they can maintain their current market share. Again, this is not always the truth. Cash cows are usually large corporations or SBUs that are capable of innovating new products or processes, which may become new stars. If there would be no support for cash cows, they would not be capable of such innovations.
Strategic choices: Product development, diversification, divestiture, retrenchment

Stars. Stars operate in high growth industries and maintain high market share. Stars are both cash generators and cash users. They are the primary units in which the company should invest its money, because stars are expected to become cash cows and generate positive cash flows. Yet, not all stars become cash flows. This is especially true in rapidly changing industries, where new innovative products can soon be outcompeted by new technological advancements, so a star instead of becoming a cash cow, becomes a dog. Strategic choices: Vertical integration, horizontal integration, market penetration, market development, product development

Question marks. Question marks are the brands that require much closer consideration. They hold low market share in fast growing markets consuming large amount of cash and incurring losses. It has potential to gain market share and become a star, which would later become cash cow. Question marks do not always succeed and even after large amount of investments they struggle to gain market share and eventually become dogs. Therefore, they require very close consideration to decide if they are worth investing in or not. Strategic choices: Market penetration, market development, product development, divestiture

BCG matrix quadrants are simplified versions of the reality and cannot be applied blindly. They can help as general investment guidelines but should not change strategic thinking. Business should rely on management judgement, business unit strengths and weaknesses and external environment factors to make more reasonable investment decisions.

Advantages and disadvantages

Benefits of the matrix:

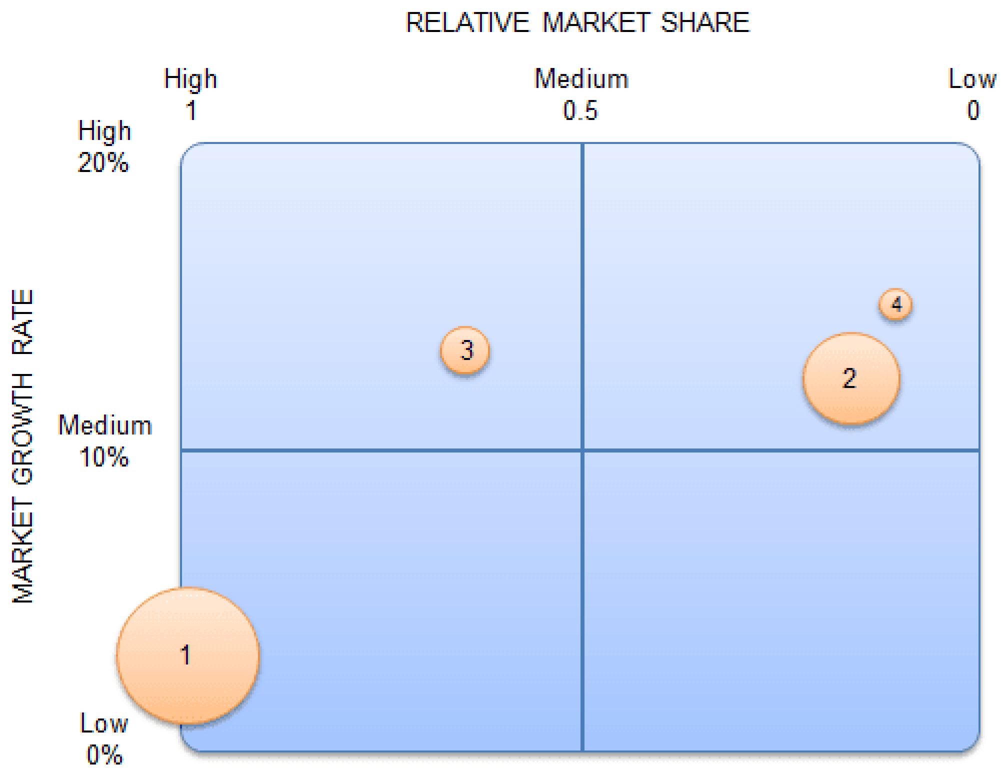
- Easy to perform;
- Helps to understand the strategic positions of business portfolio;
- It's a good starting point for further more thorough analysis.

Growth-share analysis has been heavily criticized for its oversimplification and lack of useful application. Following are the main limitations of the analysis:

- Business can only be classified to four quadrants. It can be confusing to classify an SBU that falls right in the middle.
- It does not define what 'market' is. Businesses can be classified as cash cows, while they are actually dogs, or vice versa.
- Does not include other external factors that may change the situation completely.
- Market share and industry growth are not the only factors of profitability. Besides, high market share does not necessarily mean high profits.
- It denies that synergies between different units exist. Dogs can be as important as cash cows to businesses if it helps to achieve competitive advantage for the rest of the company.

Examples Corporate "A" BCG Matrix

Brand	Revenues in Rupees	% of corporate revenues	Largest rival's market share	Your brand's market share	Relative market share	Market growth rate
Brand 1	500,000	54%	25%	25%	1	3%
Brand 2	350,000	38%	30%	5%	0.17	12%
Brand 3	50,000	6%	45%	30%	0.67	13%
Brand 4	20,000	2%	10%	1%	0.1	15%



This example was created to show how to deal with a relative market share higher than 100% and with negative market growth.
