

CONGLOMERATE, INC.

Your Role

You are in charge of corporate investments. You have only two opportunities that are feasible now. You must make a decision today. Corporate management has said that only one of these investments can be funded.

Recently, you attended a course given about the BCG method of corporate planning. You came away from that course with a summary paper (attached). You've made many investment decisions in the past and you are now wondering whether the BCG method might help you to analyze the current investments.

The Situation

Conglomerate, Inc. has stated its objective is "to maximize profits" and you agree with this. The company currently has three major products, Cup, Sunbars, and Digits.

- Cup has a very large market share (10 times the market share of its leading competitor), and it has a large sales volume. However, it is in a market that is growing at only two percent per year.¹ It produces about \$2,000,000 US in cash flow and profits are about \$1,600,000 after taxes.
- Sunbars has a modest current sales volume ($\frac{1}{4}$ that of Cup), a relative market share of 1.5 (versus its leading competitor), and it is in a market that is growing 20% a year. Cash flow from Sunbars is currently negligible. Sunbars produces an after-tax profit of \$500,000 per year. Future prospects for Sunbars are good.
- Finally, Digits, while also having a modest sales volume, is in a market that is not growing at all, and it has a small market share, about 5 of the leading competitor. Digits has barely adequate profits of \$50,000 per year and it has negligible cash flow.

Recently, an inventor has found a better way to make Digits. He has come to your company with a proposal. It calls for an investment of \$1,500,000. The forecasts are that, while this invention would not affect final demand, it would produce cost savings after taxes of about \$500,000 per year for the next ten years. After the initial outflow of \$1,500,000, the invention would yield a net cash flow of \$500,000 per year. Your sales forecasts for Digits show it holding steady for the next ten years. You are highly confident about both the cost and sales forecasts.

The Sunbars division also has an opportunity it feels would strengthen its position in the market. It proposes a new advertising campaign. Since Sunbars are sold by direct mail, initial small-scale mailings have given you an excellent idea of its success. The \$1,800,000 investment would generate after tax profits of \$400,000 the first year, \$300,000 the second, then \$100,000 per year for the next eight years. Cash flow would be approximately the same as profits.

After thorough investigation, you are convinced that these investments would not adversely affect the community, the employees, the customers, or the retailers. In other words, there are no negative side effects. The two investment possibilities have no impact on other products in this firm.

¹ Growth rates are in constant or real dollars (after adjusting for inflation).

Company Portfolio Evaluation

[Excerpt from *Marketing Management*, 5th edition, by Philip Kotler. Prentice Hall, 1984, pp. 51-54.]

After a company gets clear about its mission, objectives, and goals it needs to review its current portfolio or businesses and decide what to do with each business. A major task of strategic planning is to decide which businesses to build, maintain, phase down, and phase out.

As a first step, companies have to identify carefully the actual businesses they are in. A company that operates (say) twelve divisions is not necessarily in twelve businesses. A single division of a company may consist of several businesses if the division produces different products for different customer groups. On the other hand, two or more company divisions may be so interrelated that they form a single business. Companies therefore have to freshly identify their distinctive businesses. General Electric went through this grueling exercise some years ago and identified forty-nine different businesses they were in. They called these *strategic business units* (SBUs). A SBU ideally has the following characteristics:

- It is a single business or collection of related businesses.
- It has a distinct mission.
- It has its own competitors.
- It has a responsible manager.
- It consists of one or more program units and functional units.
- It can benefit from strategic planning.
- It can be planned independently of the other businesses.

Now each SBU must be evaluated for its strategic profit potential. Top management might have a vague sense that one SBU is a “yesterday has-been,” and another is a “tomorrow’s breadwinner,” and so on. But this impressionistic approach needs to be replaced by a more analytical classification of businesses. In the last decade, several portfolio evaluation frameworks have been proposed, of which the two best known are those of the Boston Consulting Group and General Electric.

Boston Consulting Group growth/share matrix

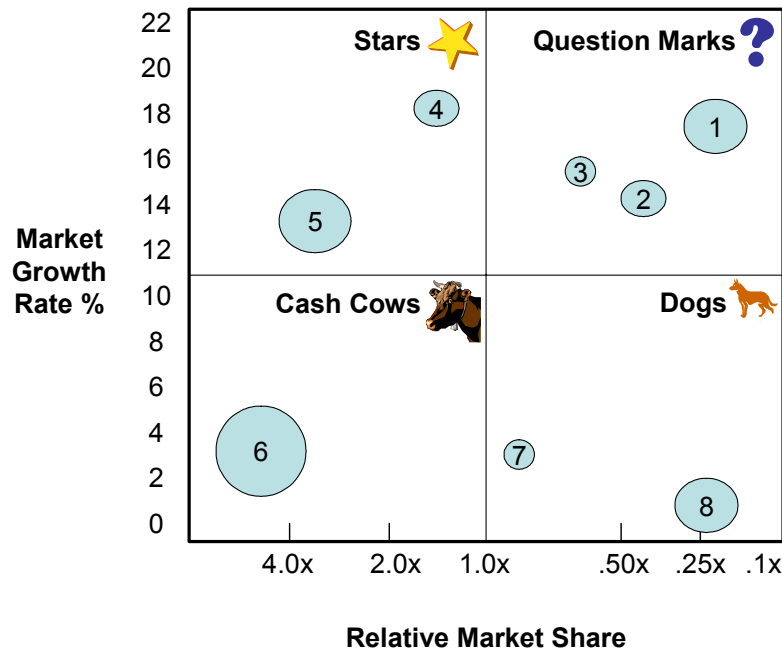
The Boston Consulting Group (BCG), a leading management consulting firm, developed and popularized an approach known as the *growth-share matrix* shown in Figure 1.² The eight circles represent the current sizes and positions of eight businesses making up a hypothetical company. The dollar-volume size of each business is proportional to the circle’s area: Thus the two largest businesses are 5 and 6. The location of each business indicates its market growth rate and relative market share.

Specifically, the market growth rate on the vertical axis indicates the annual growth rate of the market in which the business operates; in the figure it ranges from 0 percent to 20 percent, although a larger range could be shown. A market growth rate above 10 percent is considered high.

The relative market share on the horizontal axis indicates the SBU’s market share relative to the largest competitor. A relative market share of 0.1 means that the company’s SBU sales volume is only 10 percent of the leader’s sales volume; and 10 means that the company’s SBU is the leader and has ten times the sales of the next-strongest company in the market. Relative market share is divided into high and low share, using 1.0 as the dividing line. Relative market share is drawn in log scale, so that equal distances represent the same percentage increase.

² See Derek Abell, *Strategic Market Planning: Problems and Analytical Perspectives*. Englewood Cliffs, NJ: Prentice-Hall, 1979, Chapter 4.

Figure 1. The Boston Consulting Group's Growth-Share Matrix



The growth-share matrix is divided into four cells, each indicating a different type of business:

- Question Marks.** Question marks are company businesses that operate in high growth markets but have low relative market share. Most businesses start off as a question mark in that the company tries to enter a high growth market in which there is already a market leader. A question mark requires a lot of cash, since the company has to keep adding plant, equipment, and personnel to keep up with the fast-growing market, and, additionally, it wants to overtake the leader. The term *question mark* is well chosen because the company has to think hard about whether to keep pouring money into this business or get out. The company in Figure 1 operates three question-mark businesses, and this may be too many. The company might be better off investing more cash in one or two of these businesses, instead of spreading its cash thinly over all three businesses.
- Stars.** If a company is successful with a question-mark business, it becomes a star. A star is the market leader in a high-growth market. This does not necessarily mean that the star provides a lot of cash throw-off for the company. The company has to spend a great deal of money keeping up with the market's rate of growth and fighting off competitors' attacks. Stars are often cash-using rather than cash-generating; at the same time, they are usually profitable and become the company's future cash cows. In the illustration, the company has two stars, and this augurs well. The company would have to show concern if it had no current stars.
- Cash Cows.** When a market's annual growth rate falls to less than 20 percent, the former star becomes a cash cow if it still has the largest relative market share. A cash cow is so called because it produces a lot of cash for the company. The company does not have to finance a lot of expansion since the market's growth rate is low. And since the business is the market leader, it enjoys economies of scale and higher profit margins. The company uses its cash cow businesses to pay its bills and support the stars, question marks, and dogs, which tend to be cash hungry. In the illustration, however, the company has only one cash cow business and is therefore highly vulnerable. In the event this cash cow suddenly loses relative market share, the company has to pump enough money back into its cash cow in order to maintain market leadership. If it uses all the throw-off cash to support the other businesses, its strong cash cow may turn into a weak cash cow.

- *Dogs.* Dogs describe company businesses that have weak market shares in low-growth markets. They typically generate low profits or losses, although they may throw off some cash. The company in the illustration manages two dog businesses, and this may be two too many. The company should consider whether it is holding on to these dog businesses for good reasons (such as an expected turnaround in the market growth rate or a new chance at market leadership) or out of sentimental reasons. Dog businesses often take up more management time than they are worth and need to be phased down further or phased out.

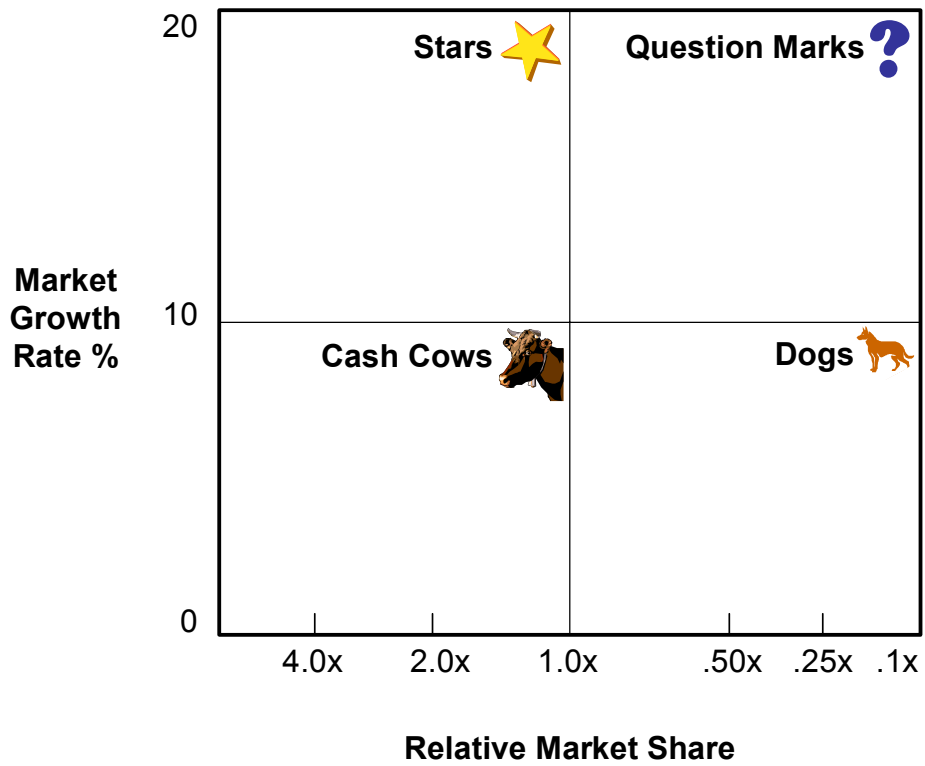
Having located its businesses in the growth-share matrix, the company will determine whether its business portfolio is healthy. An unbalanced portfolio would have too many dogs or question marks and/or too few stars and cash cows.

The company's next task is to determine what objective to assign to each SBU, and what support it will need. Four alternative objectives can be pursued:

- *Build.* Here the objective is to increase the SBU's market share, even foregoing short-term earnings to achieve this objective. "Building" is appropriate for question marks whose shares have to grow if they are to become stars.
- *Hold.* Here the objective is to preserve the SBU's market share. This objective is appropriate for strong cash cows if they are to continue to yield a large positive cash flow.
- *Harvest.* Here the objective is to increase the SBU's short-term cash flow regardless of the long-term effect. This strategy is appropriate for weak cash cows whose future is dim and from whom more cash flow is needed. Harvesting can also be used with question marks and dogs.
- *Divest.* Here the objective is to sell or liquidate the business because resources can be better used elsewhere. That is appropriate for dogs and question marks that are acting as a drag on the company's profit.

As time passes, SBUs change their position in the growth-share matrix. Successful SBUs have a life cycle. They start as question marks, move into stars, then into cash cows, and finally into dogs toward the end of their life cycle. For this reason, companies should look not only at the current positions of their businesses in the growth/share matrix (as in a snapshot) but at their changing positions (as in a motion picture). Each business should be reviewed with respect to where it was last year, the year before, and so on, as well as where it will probably go next year, the year after, and the years after that. If the expected trajectory of a given business is not satisfactory, the company will ask that business's manager to propose a new strategy and the likely resulting trajectory. Thus the share/growth matrix becomes a planning framework for the strategic planners at company headquarters. They use it to try to get each business to perform as well as possible, although some they put out to pasture.

BCG Matrix Worksheet



Decision

My decision is to:

- Invest in Sunbars
- Invest in Digits

Reason for my decision: