2.2. Market & Customers

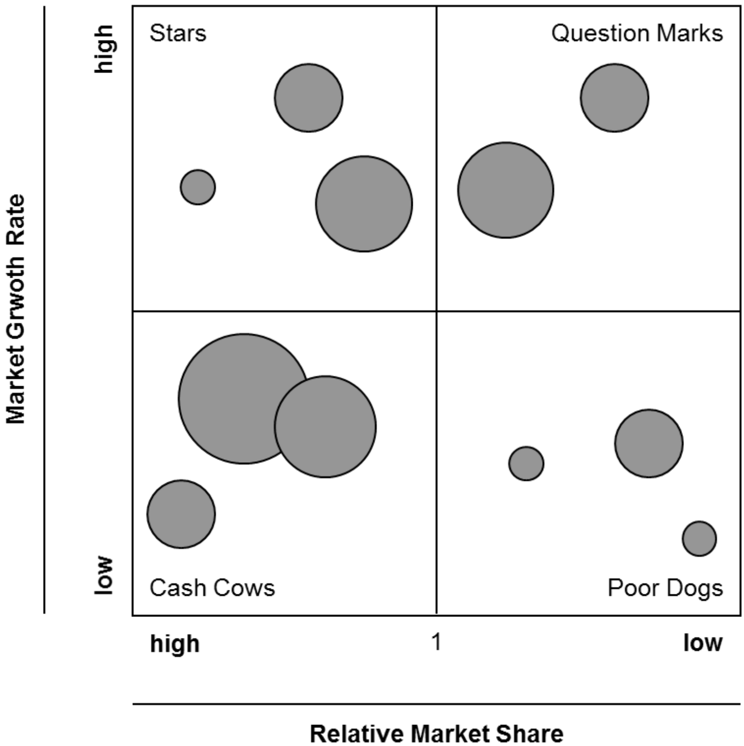
2.2.1. BCG Matrix (Growth-Share Matrix)

The BCG matrix is probably the most prominent portfolio concept, which was developed in the 1960's by The Boston Consulting Group. The matrix is based on the following assumptions:

- Because of the learning curve effect, a high relative market share goes along with a competitive advantage in terms of costs compared to the competition and vice versa. Consequently, the most powerful competitor will have a competitive advantage in terms of profitability and thus generate more cash flows.
- Being in a growing market goes along with increased capital requirements to finance the growth. This also goes along with the product life cycle concept, stating that a successful company should allocate its resources according to the life cycle phase to maintain a balance between growth and profitability.

The matrix shows the relative market share on the x-axis (please note: a relative market share of e.g. 1 means that the company has the same market share as the largest competitor; a relative market share of e.g. 1.5 means that the company has 50% more market share than its largest competitor), and the market growth rate on the y-axis. Within the matrix, strategic business units can be categorized by four main quadrants:

- Poor dogs
- Cash cows
- Stars
- Question marks



Categorizing the strategic business units helps to manage diversified companies, as from the position in the matrix implications on cash flows, contribution margins, capital requirements, relative market shares and growth rates can be derived. This information depicted in such a clearly arranged way helps management to balance the strategic business units and to best allocate resources, especially in respect to balancing business units which generate positive cash flows with those consuming cash flows. In addition to this, generic strategies can be derived from the four quadrants.

Next, let’s look at the four quadrants and their implications:

1) **Poor dogs**

Poor dogs have a low market share as well as a low growth rate. Therefore, they neither generate nor consume large cash flows. However, money is tied up in poor dogs as a business with no or little future potential. Thus, poor dogs are candidates for divestiture.

2) **Cash cows**

Cash cows are leaders in mature markets and have a return on assets that is greater than the market growth rate. Therefore, they generate more positive cash flows than they consume, and profits from business units in the cash cow quadrant should be harvested while investing as little cash as possible. From a cash flow perspective, cash cows provide the cash which is necessary to turn question marks into market leaders (while also covering administrative costs, research and development, corporate debt payments, shareholders dividends, etc.).

3) **Stars**

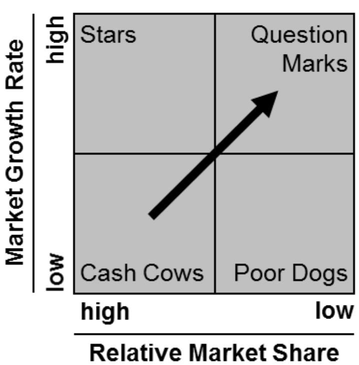
Business units in the stars quadrant generate large amounts of cash due to a high relative market share, but at the same time also consume large amounts of cash due to their high growth rate. Consequently, cash flow in total is expected to be neutral. If a star can sustain its high market share over time, it will become a cash cow once the market growth rate declines. From a portfolio point of view, a diversified company needs stars in the portfolio because in future those will be the business units that generate large amounts of cash, which will be needed to enable the funding and growth of future businesses.

4) Question marks

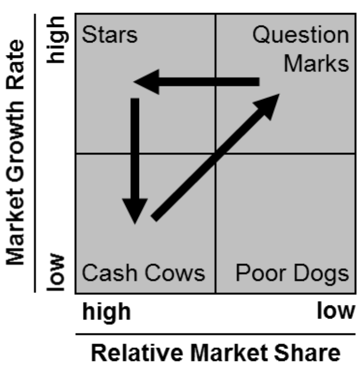
Question marks are businesses in a growing market, but only have a small relative market share and thus do not generate a lot of cash themselves. Therefore, they need a high amount of cash, which leads to a negative overall cash flow of question marks. However, question marks still have a potential for gaining more market share, which would ultimately make them stars in a growing market. Once the market growth is declining, those business units would become cash cows. If the question marks are not successful in increasing their market share, they are consuming a large amount of cash over time and will eventually become poor dogs. Consequently, question marks need to be analyzed thoroughly and kept track of to determine if further investment to grow market share is favorable or not.

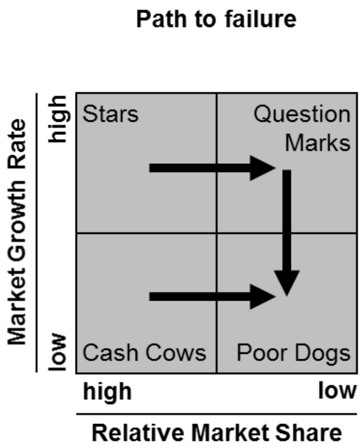
In the following charts, the cash flow implication of the BCG matrix is shown in the optimum situation, as well as successful and not successful paths.

Cash flow optimum



Path to success





In order to implement the BCG matrix, the following steps are necessary:

1) Definition of strategic business units

In the first step, the strategic business units need to be defined. If a company is diversified, it should be easy to identify strategic business units as the company is operating in different markets with different products. Otherwise it might be more difficult to define strategic business units – as a basic rule, the business units need to be independent in such a way that a management decision of one business unit does not directly influence another business unit.

2) Evaluation of market attractiveness

The main indicator for market attractiveness in the BCG matrix concept is the market growth rate, which is calculated by the market volume increase divided by the base period market volume.

In addition to determining the market growth rate, a separation between low and high growing businesses need to be made for the BCG matrix. This separation is a subjective measure and needs to be specified according to the specific markets in which the strategic business units are operating.

3) Evaluation of the strategic business unit position

The competitive strength of a business unit is measured by the relative market share. If the relative market share of a business unit is greater than 1, then it is by definition the market leader, having the largest market share of all players in the market. All business units having a market share smaller than 1 are therefore by definition not market leaders.

4) Evaluation of the strategic business unit performance

The third dimension of the BCG matrix shows the business unit's contribution to the overall company. Mostly, revenue is used for this performance measure, which is indicated by the size of the business unit's bubble in the chart.

5) Analysis according to the BCG matrix quadrants

According to the criteria for each of the 4 quadrants, the strategic business units can now be categorized. For each of the business units, the implications from the respective quadrant can be derived.

From an overall point of view, not only the single business units should be analyzed, but also the overall portfolio's balance of business units in the various quadrants. There should be a balance of cash flows on the one hand, and balanced investments into business units on the other hand.

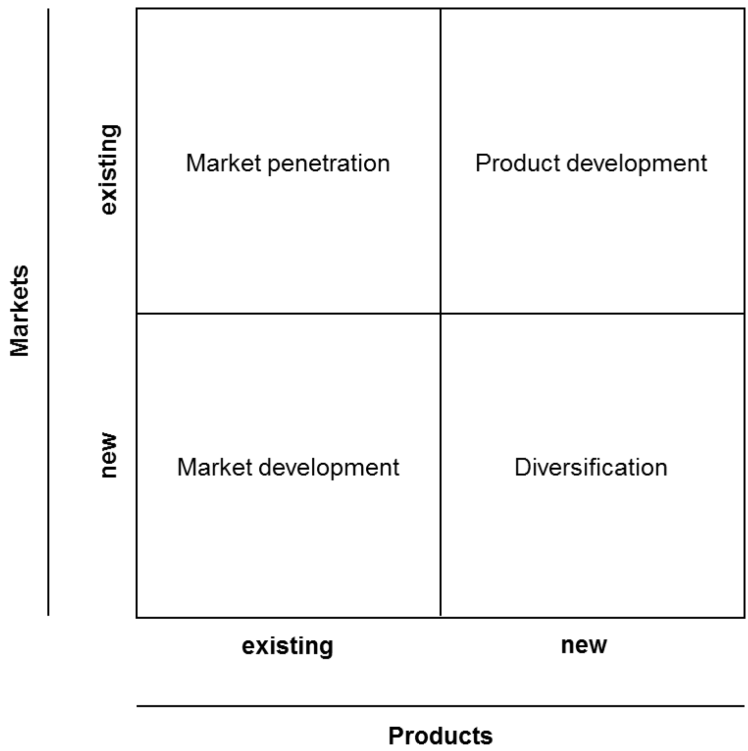
The implications of the four quadrants can be summarized as shown in the following table:

	Poor dogs	Cash cows	Question marks	Stars
Relative market share	Low	High	Low	High
Growth rate	Low	Low	High	High
Contribution margin	Low	High	Low/ negative	High
Capital requirement	Low	Low	High	High
Cash flow	Low/ negative	High	Low/ negative	Low/ neutral

2.2.2. Ansoff Matrix (Product-Market Matrix)

The Ansoff matrix is also known as the product-market matrix and helps to structure an organization’s options for further development of the products and services. The matrix has the two dimensions products and markets, of which four generic strategies can be derived:

- Market penetration
- Product development
- Market development
- Diversification



1) Market penetration

With market penetration, market share is increased by focusing on the existing market with existing products. The market can be further penetrated by the following ways.

- Extension of the current product use with existing customers, e.g. via product enhancements, product re-design, decrease of life-time, change of sales unit size, relaunch of existing products, etc.
- Enticement of customers from competition, e.g. via product enhancements focused on the competitor's customers' requirements, change of price politics, imitation of competitor's products, using new sales channels which competitors are using, etc.
- Acquisition of new customers, e.g. via product modifications, change of marketing mix to address those new customers, etc.

2) Product development

In this case, additional products or configurations are developed for launching them in existing markets. The development of new products can be split into real innovations (which are a real novelty for the market and/or the organization) and product developments which are further developments of existing products.

When the focus is on developing products which are new for the organization, but not for the market, organizations are often characterized by a high awareness for costs, low investments into research and development, as well as extensive capabilities in analyzing and copying products.

3) Market development

The market development can focus on completely new markets as well as new market segments which have not been covered before:

- New geographical markets (regional, national, international expansion)
- New market segments by enhancement of product functionalities which are corresponding to the new segment's customer requirements
- New customer groups by offering additional configurations of products addressing the new customer groups' requirements.

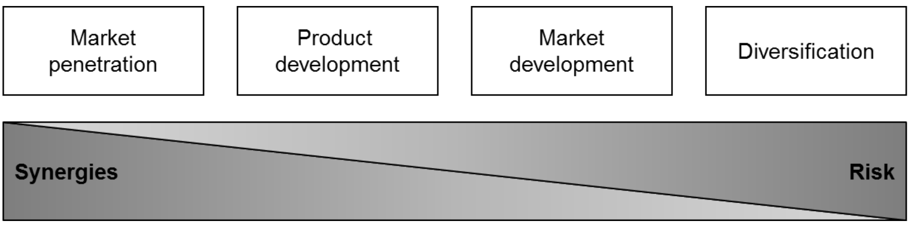
4) Diversification

When diversifying, the company focuses on new business outside of existing markets and products, thus developing new products for new markets. Diversification is a possible strategy in case of high market saturation when no additional sales in the existing markets are expected. Diversification can be further divided into

- **Horizontal diversification:** creating related products and services which can be based on existing core competencies and capabilities, leading to synergies with existing products and services. The main advantages are often the creation of synergies, reduction of risks, increasing company growth and balancing fluctuation of existing products.
- **Vertical diversification**: moving to previous or subsequent stages of the production cycle. Diversifying to previous stages usually means entering the business of the company's suppliers. Diversifying to subsequent stages means moving in the value chain towards the end customers, e.g. by not delivering single parts or components to other players but developing full systems to be sold to the end customers. Vertical diversification is often also referred to in conjunction with make-or-buy decisions, to determine whether it makes sense to manufacture a product oneself, or to buy it from another company. Advantages can be lower costs, securing access to raw materials or customers, and increasing control over the whole process including quality.

- **Lateral diversification** (conglomerates): offering new products which are not related to existing products of the company. Lateral diversification usually reduces risk (as the products are not related to each other and are therefore independent from each other in their development) and increases synergies of the organization.

Comparing the four generic strategies with each other, synergies are decreasing, and risks are increasing the further away the strategy is from existing products.



Four major steps are involved in implementing the Ansoff matrix.

1) As-is analysis

As a basis for deciding which of the four generic strategies will be viable, an as-is analysis should be performed. Typically, a SWOT analysis is made in order to have a clear picture of the organization's internal strengths and weaknesses, as well as external opportunities and threats.

2) Applying the generic strategies

In the second step, the generic strategies of the Ansoff matrix are applied to the organization. Each of the four generic strategies need to be customized according to the organization's individual initial situation. E.g. for applying the market development strategy, it must be defined which new markets and also how they could be reached.

3) Selecting the best-fitting growth strategy

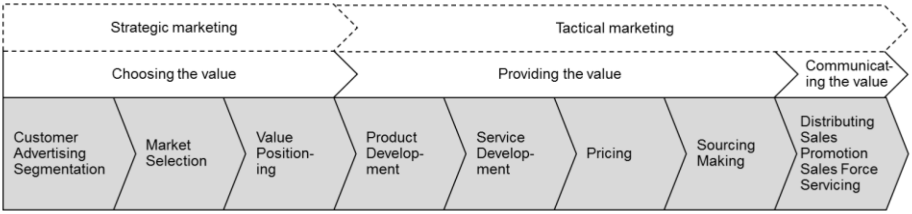
After the four generic strategies have been adopted to the organization's individual situation, a decision must be made which of those four strategies should be implemented. For doing so, a scoring model proved to be useful to decide between the options.

4) Detailed definition of the selected growth strategy

After selecting the growth strategy which will be pursued, it must be defined in more detail, specifically in terms of how it will be implemented. In addition, an appropriate communication strategy should be defined so that the strategic direction of the organization is properly communicated to the relevant persons.

2.2.3. 4 P's / 4 C's

Before looking at the 4 P’s in more detail, let’s first get a quick overview about strategic and tactical marketing. While strategic marketing focuses more on choosing the value, tactical marketing focuses on how to provide and communicate the value.



A successful business can identify and satisfy its customer needs better than the competition, and therefore does well in both strategic and tactical marketing. A company without customers won’t have a lot of value, so attracting and retaining customers is a major task. While customers are usually attracted by a superior product or service, they are retained by via satisfaction.

The 4 P’s represent the marketing mix, consisting of the key factors for positioning and marketing a product or service. The 4 P’s stand for

- Product
- Price
- Place
- Promotion

Marketing mix			
Product	**Price**	**Place**	**Promotion**
• Product variety	• List price	• Channels	• Sales promotion
• Quality	• Discounts	• Coverage	• Advertising
• Design	• Allowances	• Assortments	• Sales force
• Features	• Payment period	• Locations	• Public relations
• Brand name	• Credit terms	• Inventory	• Direct marketing
• Packaging		• Transport	
• Sizes			
• Warranties			
• Returns			

Product

Product refers to the product itself, but also the packaging of the product, service and warranties. The product with its features and benefits is the most obvious source for differentiation and competitive advantage.

Key questions are:

- Which customer needs are satisfied by the product?
- Which features does the product have to meet those customer needs?
- Which features does the product miss and which customer needs cannot be satisfied?
- Which features does the product have, which do not satisfy any customer needs and therefore do not add customer value?
- How and where will the customer use it?
- How does the product look like and how will customers experience it?
- In which configurations should the product be available?
- How is the product named?
- How is it branded?
- How is the product differentiated from competitive products?

Price

Price refers to the end customer's price, as well as pricing for different sales channels. If the price is a major competitive advantage, it is of strategic relevance for the whole organization.

Key questions are:

- What value does the product deliver to the customers?
- Which price points exist in the market to which customers are already used?
- How price sensitive are the customers?
- Which discounts and special promotions should be considered?
- How does the price compare to competitive and substitute products?

Place

Place refers to the distributions channels in which the product is available, as well as the physical placement of the product in each of the distribution channels.

Key questions are:

- Where are our customers buying their products?
- In which kind of stores are they buying? (E.g. in a supermarket, specialist boutique store, online store)
- How can the relevant distribution channels be accessed?
- Is it necessary to build a dedicated sales force for the product?

Where and how are competitors selling their products, and how can one's own offering be differentiated from the competition?

Promotion

Promotion contains advertising, sales promotion, discounts, etc. in order to increase customer awareness, entering new markets or specifically differentiate a product from its competition.

Key questions are:

- Where and when can the marketing messages be brought to the target market?
- By which means can the target market be reached? (E.g. TV, radio, billboards, magazines, press, online)
- When exactly should the product be promoted? (E.g. considering seasonality, competitive promotions, cross-promotions)
- How does the competition promote their products and how should the company react?

Related to the concept of 4 P's is the concept of 4 C's. While looking at the 4 P's marketing mix from the company's point of way, the 4 C's embrace the customers view. Each of the 4 P's has a corresponding item of the 4 C's.

4 P's		4 C's
Product	⟺	Customer
Price	⟺	Cost
Place	⟺	Convenience
Promotion	⟺	Communication

Customer

Instead of focusing on the product, the customer and the customer needs need to be in the center of attention and need to be analyzed.

Key questions are:

- Which customers are served (based on segmentation)?
- What are the specific customer requirements for those customers?
- What is the price elasticity for those customers?
- Which customer segments are served primarily and thus with a high importance, and which customer segments are served along the way?
- Which substitute products exist from the customer’s point of view, and how likely is a substitution?
- How profitable are those customers (per segment, per customer, per market, etc.)?

Cost

The price of the product is often only a part of the customer’s cost. For acquiring a specific product, a customer usually has additional costs like finding a point of sales, getting there physically, etc.

Key questions are:

- Which costs are associated with the purchase for the customer?
- What are the fixed and variable costs for the customer?
- Which switching costs exist for the customer when switching to the company’s product, and which switching costs exist when the customer wants to switch to another company’s product?

Convenience

Instead of looking at the distribution channel, the focus should be on making the product available to the customer in the most convenient way.

Key questions are:

- How convenient is it for the customer to get the product?
- Is it available at the right time at the right place with the right quantity and quality?

Communication

Promotion is often considered as manipulative and flows only into one way. Opposed to that, communication means building up a two-way communication to reach the customer.

Key questions are:

- How can communication be started with a potential customer?
- What are his preferred ways and times of communication?
- Which feedback do we get out from the customer communication and what can be learnt from this?