

Corporate Portfolio Analysis (1)

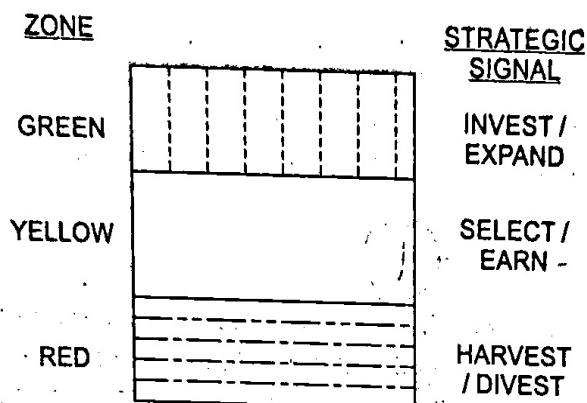
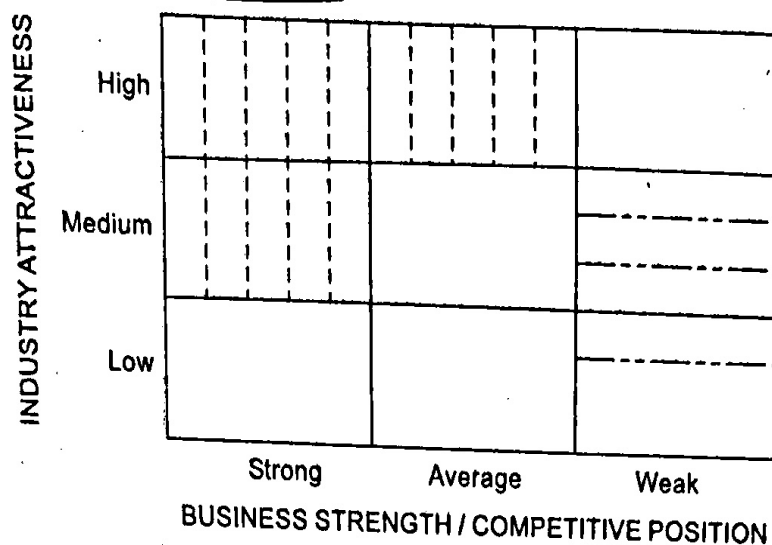
Corporate portfolio analysis (or simply, portfolio analysis) could be defined as a set of techniques that help strategists in taking strategic decisions with regard to individual products or businesses in a firm's portfolio. It is primarily used for competitive analysis and strategic planning in multi-product and multi business firms. They may also be used in less diversified firms, if these consist of a main business and other minor complementary interests. The main advantages in adopting a portfolio approach in a multi-product, multi-business firm is that resources could be targeted at the corporate level to those businesses that possess the greatest potential for creating competitive advantage. For instance, a diversified company may decide to divert resources from its cash-rich businesses to more prospective ones that hold promise of a faster growth, so that the company achieves its corporate level objectives in an optimal manner.

Corporate portfolio techniques evolved during the mid-1960s and several of these soon became quite popular. During the 1970s, there arose a tendency to discredit the techniques when it was realised that the assumptions underlying them did not always hold good.⁴ Currently, however, it is accepted that these techniques are useful, not as being purely prescriptive, but as an important and decisive part of a set of criteria—normative as well as descriptive—that assist strategists in exercising a strategic choice.

There are a number of techniques that could be considered as corporate portfolio analysis techniques. Among them we have the Boston Consulting Group (BCG) or product portfolio, General Electric's Nine-cell, Hofer's Product-Market Evolution, Directional Policy and the Strategic Position and Action Evaluation matrices. Not all of these techniques have retained their popularity and importance though. We will describe the General Electric's Nine-cell matrix as an illustration of the corporate portfolio matrices.

GE Nine-cell Matrix This corporate portfolio analysis technique is based on the pioneering efforts of the General Electric (GE) Company of the United States, supported by the consulting firm of McKinsey & Company. Exhibit 9.5 shows a typical GE nine-cell matrix.

Exhibit 9.5 General Electric nine-cell matrix



The vertical axis represents industry attractiveness, which is a weighted composite rating based on eight different factors. These factors are: market size and growth rate, industry profit margin, competitive intensity, seasonality, cyclicality, economies of scale, technology and social, environmental, legal and human impacts. The horizontal axis represents business strength competitive position, which is again a weighted composite rating based on seven factors. These factors are: relative market share, profit margins, ability to compete on price and quality, knowledge of customer and market, competitive strengths and weaknesses, technological capability and calibre of management.⁵ As can be seen from the list of the factors, good use can be made of the industry, competitor and SWOT analyses information for determining the weightage and rating to assign to each factor. The industry attractiveness and business unit strength are calculated by first identifying the criteria for each, determining the value of each parameter in the criteria and multiplying that value by a weighting factor. The result is a quantitative measure of industry attractiveness and the business unit's relative performance in that industry. The two composite values for industry attractiveness and business strength/competitive position are plotted for each business in a company's portfolio. The pie charts (or circles) not shown in the exhibit denote the proportional size of the industry and the dark segments represent the company's market share.

The nine cells of the GE matrix are grouped on the basis of low to high industry attractiveness and weak to strong business strength. Three zones, of three cells each, are made, denoting different combinations represented by green, yellow and red colours. For this reason, the GE matrix is also known as the stoplight strategy matrix. The different combinations can be seen in Exhibit 9.4. Based on the green zone, the signal is

'go ahead', to grow and build, indicating expansion strategies. Businesses in the green zone attract major investment. For the yellow zone, the signal is 'wait and see', indicating hold-and-maintain type of strategies, aimed at stability and consolidation. For the red zone, the signal is 'stop', indicating retrenchment strategies of divestment and liquidation or a rebuilding approach for adopting turnaround strategies.

The GE nine-cell matrix offers some distinct advantages. It incorporates a large variety of strategic variables like the market share and industry size. The GE matrix is also a powerful analytical tool to channel corporate resources to businesses that combine medium to high industry attractiveness with average to strong business strength/competitive position. On the other hand, the major drawback of the GE matrix is that it only provides broad strategic prescriptions rather than the specifics of business strategy.⁶

Overall, corporate portfolio analysis can help companies that are running diverse businesses, to develop feasible strategic alternatives and to allocate resources among them. Other benefits include a more perceptive understanding of the businesses, leading to better strategic decisions and availability of an interesting vocabulary and graphic aids for communication.⁷

Like all analytical techniques, portfolio analysis has its drawbacks. Problems arise in measuring parameters like the actual growth rate of a business. There are also organisational and motivational problems arising due to the adoption of the recommendations emerging out of portfolio analysis.⁸ Hill and Jones point out four major flaws of the portfolio techniques.⁹ First, an assessment of businesses in terms of just two dimensions of market share and industry growth can be misleading as a number of other factors need to be taken into account. Secondly, the relation between relative market share and cost savings is not directly proportional; companies with low market share and focussed on a market niche could have low operations cost. Third, a high market share in a low-growth industry does not necessarily result in a large cash flow. Lastly, none of the portfolio techniques treat the source of value creation from diversification strategies. SBUs cannot be just treated as independent units as they are linked to the corporate headquarters and share skills and competencies. Real value may be derived from managing successfully, a diversified portfolio of businesses, rather than just putting together the 'right' portfolio of businesses.

No organised evidence is available regarding the use and application of portfolio analysis techniques by Indian organisations. Research studies on corporate planning in Indian companies, though dealing with several issues, fail to take cognizance of the use of portfolio models. (See for example Reference 10.)¹⁰ However, these models do provide a powerful analytical tool and could be appropriately adapted to suit the Indian context. For instance, companies could take into account the governmental priorities and rate different businesses in their portfolio along the priority dimension (e.g. high, medium, or low). Whenever the businesses rate high in terms of governmental priorities, they may be considered as high potential businesses and vice versa. The priority dimension may be used along with the other dimensions of product/market evolution or competitive position. What is being suggested, however, lies in the realm of conjecture and empirical evidence is needed first to establish the suitability of the portfolio models in the Indian context.

Corporate Parenting Analysis ^② Campbell, Goold and Alexander suggest that two issues must be addressed by the diversified corporation: (a) What businesses should a diversified corporation own and why and (b) What organisational structure, management processes and philosophy will foster superior performance from the corporation's individual business units?¹¹ They proposed the concept of corporate parenting to consider the role of the corporate headquarters in managing a set of businesses in a portfolio. A diversified corporation or a multi-business company is often viewed as consisting of a corporate headquarter or centre with SBUs acting as satellites. The manner in which the centre manages and nurtures the individual businesses is termed as corporate parenting. The total corporation is viewed in terms of resources and capabilities that can be used to build individual businesses as well as create synergies across these businesses. In this manner, corporate parenting attempts to do away with one major drawback of the corporate portfolio techniques. While portfolio

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techniques consider the industry attractiveness of various industries and focuses on the cash contributions that each business could make to the overall portfolio of businesses, corporate parenting views the organisation in its totality as a diversified corporation and focuses on the value created from the relationship between the parent and its businesses.