Ansoff Matrix

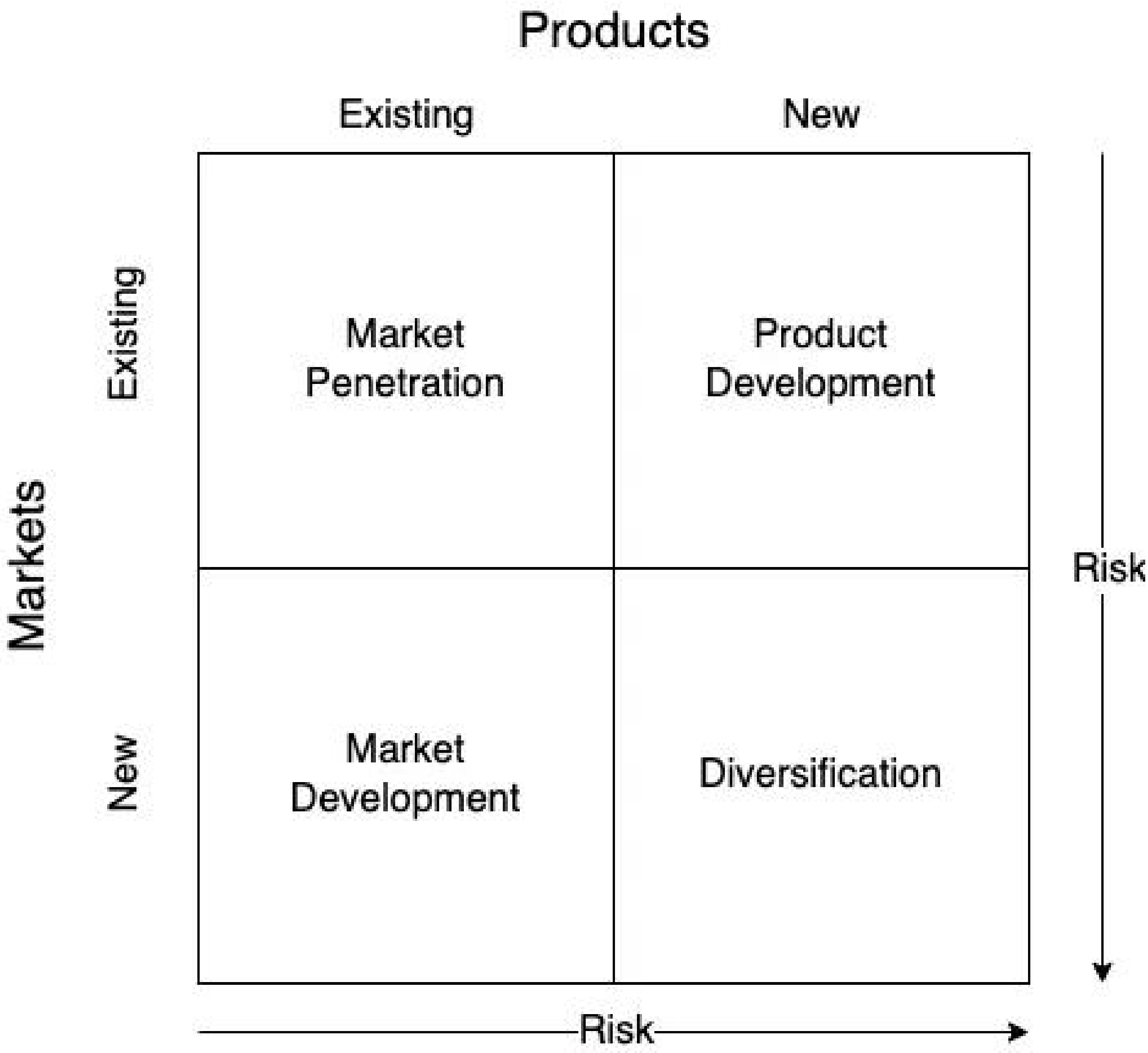
Idea In Short

For any decision to be taken at corporate level, you need the right strategic tools. Ansoff matrix is one of them. Ansoff matrix helps a firm decide their market growth as well as product growth strategies. The 2 questions which the Ansoff Matrix can answer are:

- How can we grow in the existing markets, and
- What amends can be made in the product portfolio to have better growth

The Ansoff Matrix, also called the Product/Market Expansion Grid, is a tool you could use to analyze & recommend strategies for growth. The matrix also reveals the risks associated with each strategy.

H. Igor Ansoff, mathematician & business manager, developed this matrix, which he published in Harvard Business Review 1in 1957. Subsequently, the Ansoff Matrix has helped many marketers & leaders understand the risks of growing their business. This matrix allows managers to quickly summarize the available growth strategies & evaluate the associated risks. The key idea is that each time you move into a new quadrant (horizontally or vertically), risk increases.



Ansoff Matrix Visualization

The four strategies are:

1. Market Penetration: It focuses on increasing sales of existing products to an existing market
2. product Development: It focuses on introducing new products to an existing market
3. Market Development: Its strategy focuses on entering a new market using existing products
4. Diversification: It focuses on entering a new market with the introduction of new products

Of the four strategies, market penetration is the least risky, while diversification is the riskiest.

Market Penetration

In this strategy, a firm aims to increase its market share through existing products in an established market. Market penetration is about selling more of the company's existing products to existing markets. To penetrate & grow its customer base in the existing market, the firm may:

- Decreasing prices to attract existing or new customers
- Improve its distribution network
- Invest more in marketing, esp. promotions
- Acquiring competitors operating in the same markets
- Increase it's production capacity

Brands, such as Coca-Cola, Pepsi & Heineken, spend a lot of marketing budgets to penetrate markets. In addition, they also try to leverage their distribution channels by making attractive deals with a large variety of distributors, such as supermarkets, restaurants, bars, etc. Similarly, telecommunication operators that cater to the same market employ a market penetration strategy by offering introductory prices, running promotion campaigns, increasing their distribution channels through supermarkets, bundling their subscription plans with hardware, etc.

Case - Coca Cola

Due to the incredible strength of Coca Cola's brand, the company has been able to utilize market penetration on an annual basis by creating an association between Coca Cola & Christmas, such as through the infamous Coca Cola Christmas advertisements, which helped boost sales during the festive period.

Product Development

In this strategy, a firm develops new products to cater to an existing market. This involves extensive research & development to expand the product range. A firm employs this strategy when it has a strong understanding of its current market. In addition, it should have the capable to provide innovative solutions to meet the market demands. For example, a firm could modify its existing products by adding features that deliver more customer value. Alternatively, it could launch new products alongside its existing products at the risk of cannibalizing the existing products. A classic example of product development is Apple launching a brand new product each year. Likewise, firms in the pharmaceutical industry, such as Pfizer, Merck, Bayer, etc. heavily invest in Research & Development to launch new & innovative drugs. Similarly, automotive OEMs are creating electric cars to meet the changing needs of their existing market as consumers are becoming more environmentally conscious. The product development strategy can be implemented in several ways:

- Investing in R&D to develop new products to cater to the existing market
- Acquiring a competitor's product that better meets the need of the existing market
- Joint venture with other firms to merge resources to develop new products
- Strategic partnerships with other firms to gain access to each partner's distribution channels or brand

Case - Coca Cola

Coca Cola launched Cherry Coke in 1985 – the company's first extension beyond its original recipe. This product was Coca Cola's strategic response to small-scale competitors who identified a profitable opportunity to add cherry-flavoured syrup to Coca Cola & resell it. The company has since gone on to successfully launch other flavoured variants including lime, lemon and vanilla.

Market Development

In this strategy, a firm enters a new market with its existing products. Expanding into new markets may mean expanding into new geographies, customer segments, regions, etc. This strategy is most successful if:

1. The firm owns proprietary technology that it can leverage into new markets
2. Consumers in the new market are profitable, and
3. Consumer behavior in the new markets does not deviate too far from the existing markets

Hence, this is about selling more of the company's existing products to new markets. It is about reaching new customer segments or expanding internationally by targeting new geographic areas. For example, IKEA has successfully implemented this strategy over the past few decades across several geographies to become one of the largest furniture retailers in the world. IKEA started off by expanding to markets relatively close in terms of culture as to its home country, Sweden, before targeting more challenging geographic areas such as China and the Middle-East. Similarly, sporting companies such as Nike and Adidas recently entered the Chinese market for expansion. The two firms are offering the same products to a new demographic. This strategy can be executed in several ways, such as:

- Catering to a different customer segment
- Entering into a new domestic market (expanding regionally)
- Entering into a foreign market (expanding internationally)

Case - Coca Cola

The launch of Coke Zero in 2005 was a classic example of this – its concept being identical to Diet Coke; the great taste of Coca Cola but with zero sugar and low calories. Diet Coke was launched more than 30 years ago, and whilst more females drink it every day than any other soft drink brand, it came to light that young men shied away from it due to its consequential perception of being a woman's drink. With its shiny black can and polar opposite advertising campaigns, Coke Zero has successfully generated a more masculine appeal.

Diversification

In this strategy, a firm enters a new market with a new product. Correspondingly, this strategy is the riskiest among the strategies in the Ansoff matrix. This is because executing this strategy requires, both market & product development activities. However, related diversification can mitigate the associated risk. Diversification strategies are about entering new markets with new products that are either related or completely unrelated to a company's existing offering. Diversification in turn can be classified into three types of diversification strategies:

- Concentric/horizontal diversification (or related diversification): Entering a new market with a new product that is somewhat related to a company's existing product offering
- Conglomerate diversification (or unrelated diversifcation): Entering a new market

with a new product that is completely unrelated to a company's existing offering

- Vertical diversification (or vertical integration): Moving backward or forward in the value chain by taking control over activities that used to be outsourced to 3rd parties, such as suppliers, OEMs or distributors

In general, firms can broadly explore two types of diversification:

1. Related diversification: There are potential synergies to be realized between the existing business and the new product/market. For example, a leather shoe producer that starts a line of leather wallets or accessories is pursuing a related diversification strategy
2. Unrelated diversification: There are no potential synergies to be realized between the existing business and the new product/market. For example, a leather shoe producer that starts manufacturing phones is pursuing an unrelated diversification strategy

Case - Coca Cola

In 2007, Coca-Cola spent $4.1 billion to acquire Glaceau, including its health drink brand Vitamin water. With a year-on-year decline in sales of carbonated soft drinks like Coca-Cola, the brand anticipated the drinks market to head towards a less-sugary future, so jumped on board the growing health drink sector.

Effectiveness

What is clear with Ansoff's Matrix is the incremental increase in risk offered by the five strategies. The incremental cost of each step beyond market penetration should be clearly evaluated against the uncertainty of operating in new markets and industries. Some consultants use a nine-box grid for a more sophisticated analysis. This puts modified products between existing & new ones. For example, a different flavor of your existing pasta sauce rather than launching a soup. Likewise, n expanded markets between existing and new ones. For example, opening another store in a nearby town, rather than expanding internationally. Hence, the Ansoff matrix is a robust framework that can help consultant make strategic recommendations that determine the course of a company. It is typically used when the most important products of a company reach the maturity stage of the product lifecycle.

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Summary

The Ansoff Matrix is a great framework to structure the options a company has in order to grow. Market Penetration is the least risky of all four and most common in day-to-day business. Diversification is the most risky since a company starts entering a completely new and unfamiliar market with a new and unfamiliar product. However, if a company manages to successfully enter several unrelated markets, it has the advantage of having a well-balanced product portfolio which actually decreases the total risk. In such a situation it is usefull to work with frameworks like the GE/Mckinsey Matrix or the BCG Growth-Share Matrix.