

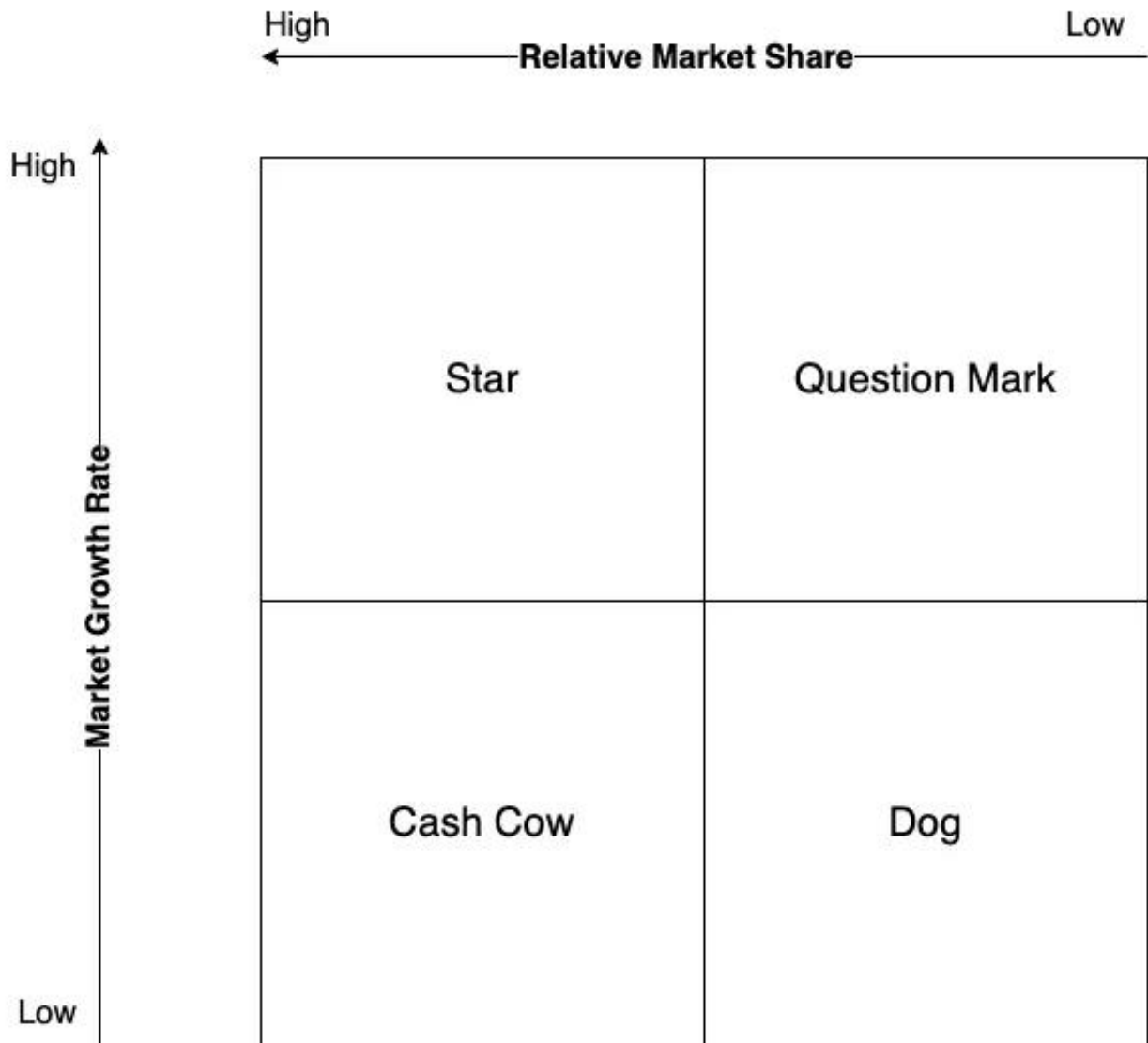
BCG Growth - Share Matrix

Idea In Short

In the BCG matrix, market growth and market share of the products (or service) of a company are compared to each other. This allows a company to determine whether they should invest in a product or whether they should de-invest, or even stop the product altogether.

The growth-Share matrix (also known as the Product Portfolio matrix) is a tool developed by Boston Consulting Group (BCG). The purpose of BCG Matrix is to make product investment decisions at a strategic level. The matrix is used in corporate strategy to analyze business units or product lines based on two variables: relative market share and the market growth rate. By combining these variables into a matrix, a company can pivot their products and determine where to allocate its resources, where to maximize its cash flows and where to divest. Depending on their market performance, products can be classified into one of the four categories (quadrants):

- Stars
- Question Marks
- Cash Cows, and
- Dogs



BCG Growth - Share Matrix Visualization

Relative Market Share

Bruce Henderson, the creator of the BCG Matrix used this variable to measure a company's competitiveness. The exact measure for relative market share is the company's share relative to its largest competitor. The framework assumes that an increase in relative market share will result in an increase in the cash flow. This is because the company benefits from scale economies and thus gains cost leadership over its competitors.

For example, if Philips has a 20% market share in the mobile phone industry and Samsung (its largest competitor) has 60%, the ratio would be 1:3 (0.33) implying that Samsung has a relatively weak position. If Samsung only had a share of 10%, the ratio would be 2:1 (2.0), implying that Philips is in a relatively strong position. The

cut-off point here is 1.0, meaning that a company should at least have a similar market share as its largest competitor in order to have a high relative market share.

Market Growth Rate

The second variable is the market growth rate. This variable measures market attractiveness. Most organizations usually strive for rapid growth markets. Such markets promise higher long-term returns on investments. However, companies should factor making significant investments to achieve high growth in these markets. These investments fund customer acquisition campaigns, increase production capacity, establish distribution networks, etc. What an industry considers high or low growth rate can vary among industries. However, investors consider 10% growth per annum a reasonable cut-off point when evaluating alternative investments.

For example, if Samsung operates in an industry where the market grows at 12% a year on average, then the investors would consider the market growth rate reasonably high.

Question Marks

Ventures or start-ups usually start off as question marks. Question Marks (or Problem Children) are businesses operating with a low market share in a high growth market. They have the potential to eventually gain market share and become Stars (market leaders). If managed well, Question Marks will rapidly grow and thus, consume a large amount of cash investments. If Question Marks do not succeed in becoming a market leader, they might degenerate into Dogs; this happens when market growth declines after years of cash consumption. Therefore, companies must carefully analyze Question Marks to determine whether they are worth the investment required to grow market share.

An example that can be considered as a 'Question mark' in the BCG Matrix is the tablet from Philips.

Stars

Stars are business units with a high market share (potentially market leaders) in a fast-growing industry. These products generate large amounts of cash due to their high relative market share. However, they also require large investments to fight competitors and maintain growth rate. Successfully diversified companies should always have some Stars in their portfolio to ensure future cash flows. Apart from the assurance that Stars give for the future, they are also very good for a company's branding.

An example of a product that can be classified as 'Star' in the BCG Matrix is the LED lamp from Philips.

Cash Cows

Eventually after years of operating in the industry, market growth might decline and revenues stagnate. At this stage, your Stars are likely to transform into Cash Cows. Companies expect to generate high profits and cash flows because of the large relative market share in a mature market. However, because of the lower growth rate, companies invest less in these products and business units. Cash cows typically generate cash in excess of the amount of cash needed to maintain the business. Hence, companies 'milk' the excess cash from the Cash Cows to support investments in other business units (Stars and Question Marks). Cash Cows ultimately bring balance and stability to a portfolio.

An example of a product that can be classified as a 'Cash Cow' is the Philips energy-saving lamp.

Dogs

Business units in a slow-growth or declining market with a small relative market share are considered Dogs. These units typically break even i.e. neither create nor consume large amounts of cash. Furthermore, these products generate cash barely enough to maintain the business's market share. Therefore, these products are not very interesting to investors. However, since there is still money involved in these products or business units, Dogs are likely to be divested or liquidated. Usually, the products and business units are used to enable or alongside units with more potential.

An example that can be considered as a 'Dog' in the BCG Matrix is the plasma TV from Philips.

BCG Matrix and the Product Life Cycle

The BCG matrix has a strong connection with the Product Life Cycle. The Question Marks represent products or Strategic Business Units (SBUs) that are in the introduction phase. This is when new products are being launched in the market. Stars are SBUs or products in their growth phase. This is when sales are increasing at their fastest rate. Cash Cows are in the maturity phase: when sales are near their highest, but the rate of growth is slowing down due to saturation in the market. And Dogs are in the decline phase: the final stage of the cycle, when sales begin to fall.



BCG Product Lifecycle

Summary

Taking these factors together, you can draw the ideal path to follow in the BCG Matrix, from start-up to market leader. Fund Question Marks and Stars with investments generated by Cash Cows. Divest or liquidate Dogs with little potential to free up cash and use it elsewhere. In the end, you will need a balanced portfolio of Question Marks, Stars and Cash Cows to assure future positive cash flows.

