10 Diversification Strategies

10-1 Product Portfolio Management (PPM)

〈Assumption〉

Two factors to influence cash flow

Cash flow = Fund Inflow – Fund Outflow

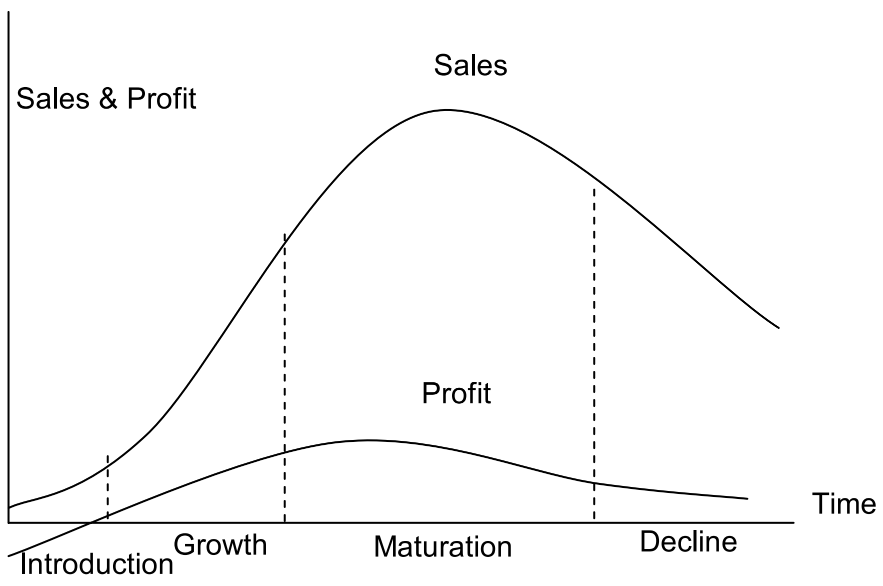
○Product Life Cycle (environmental force) → Fund Outflow

- ○Introductory Period → Growth Period → Maturation Period →Decline Period
- ○Proxy Variable = Market Growth Rate
- ○The higher a market growth rate, the greater a fund outflow.

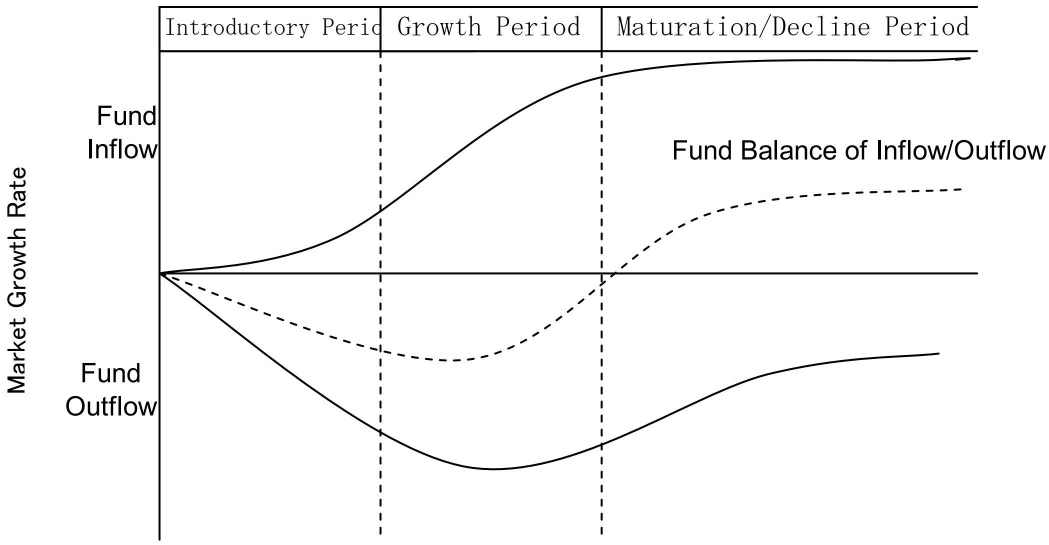
○Experience Curve Effect (position in competition) → Fund Inflow

- ○High Market Share → Low Cost → High Profit
- ○Proxy Variable = Relative Market Share
- ○(= Own Firm's Share ÷ Largest Competitor's Share)
- ○The higher a relative market share, the greater a fund inflow.

Product Life Cycle



Product Life Cycle and Funds

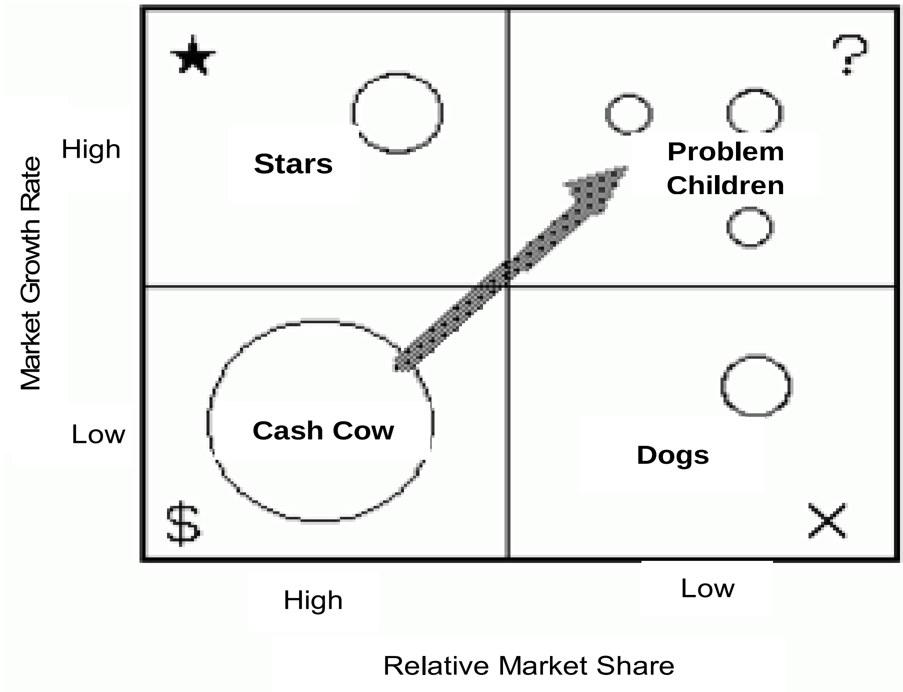


Note: Fund Inflow = After-Tax Profit + Depreciation
Fund Outflow = Development Investment + Capital Expenditure + Operating Fund

Product Portfolio Matrix

(BCG Growth-Share Matrix)

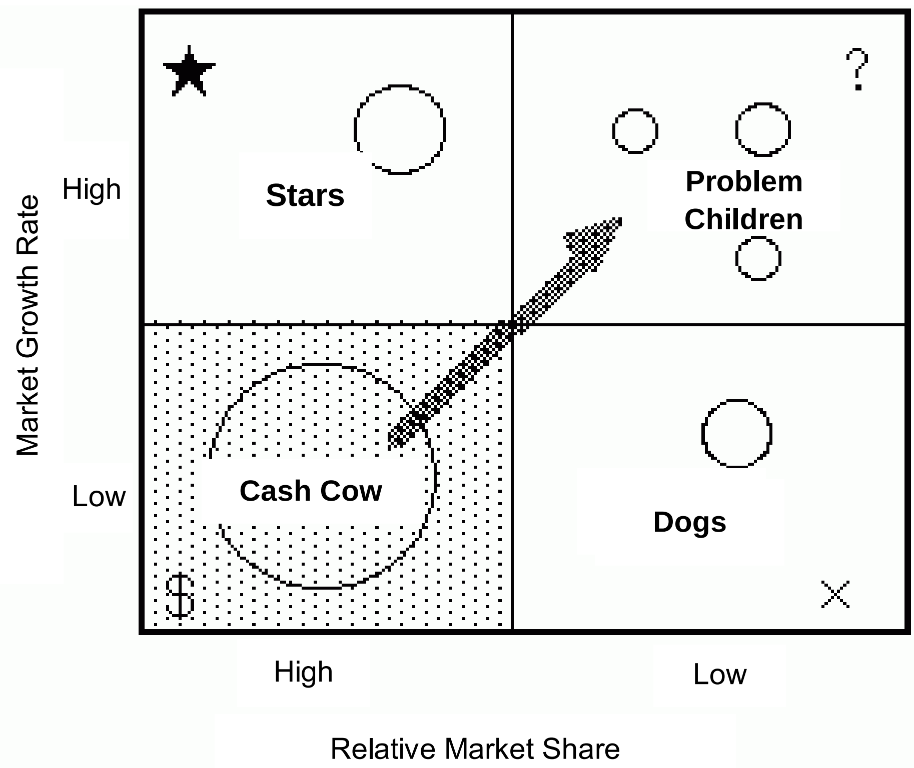
The diagram in which the vertical axis represents the market growth rate and the horizontal axis the relative market share, where each business is positioned and its individual ratio of sales-size is represented by the dimension of the circle.



＊Note that, on the horizontal axis, the market share is higher to the left.

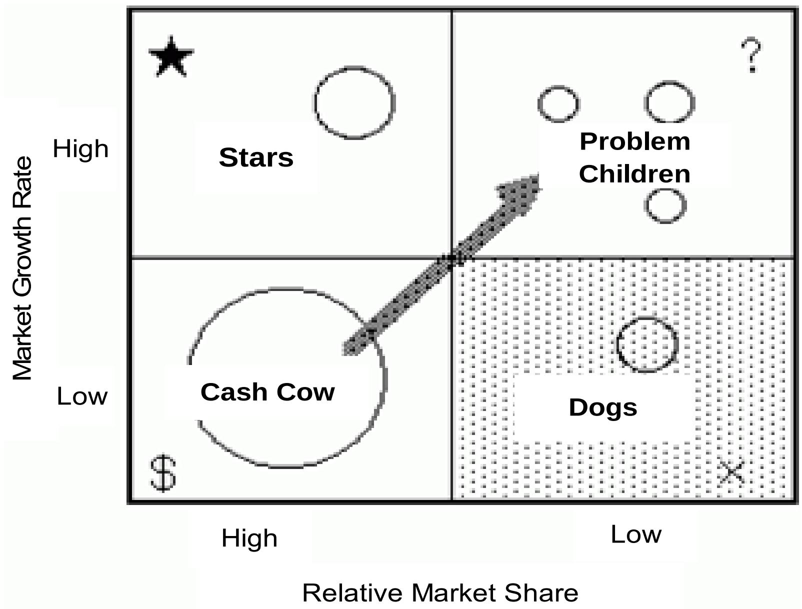
〈Denomination and Characteristics of Each Cell〉

Cash Cow



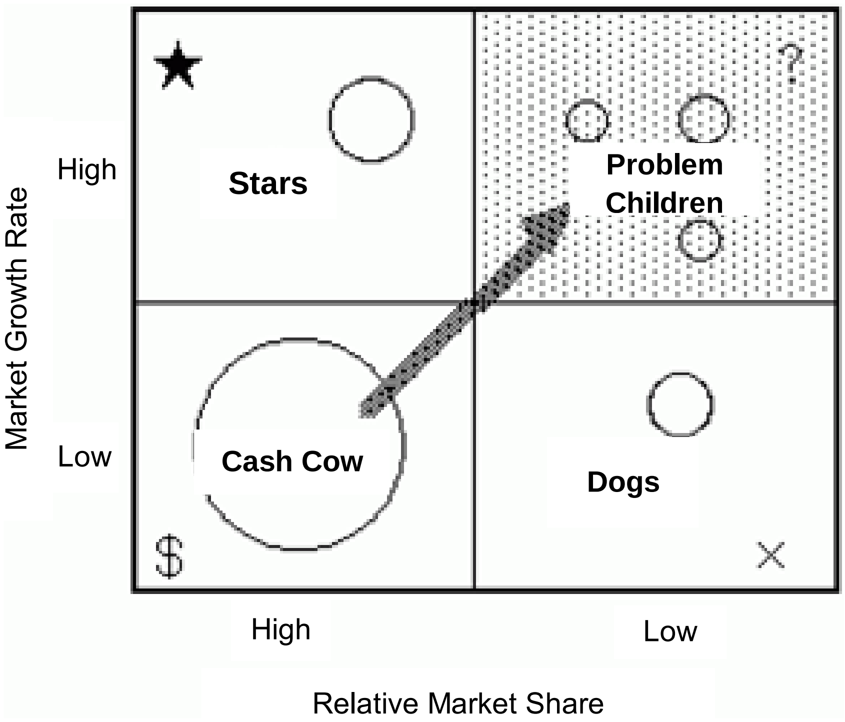
The product which lays down a fund that by far surpasses the amount which can be effectively reinvested into that product per se. This category of products provides the fund to help bring up other products.

Dogs



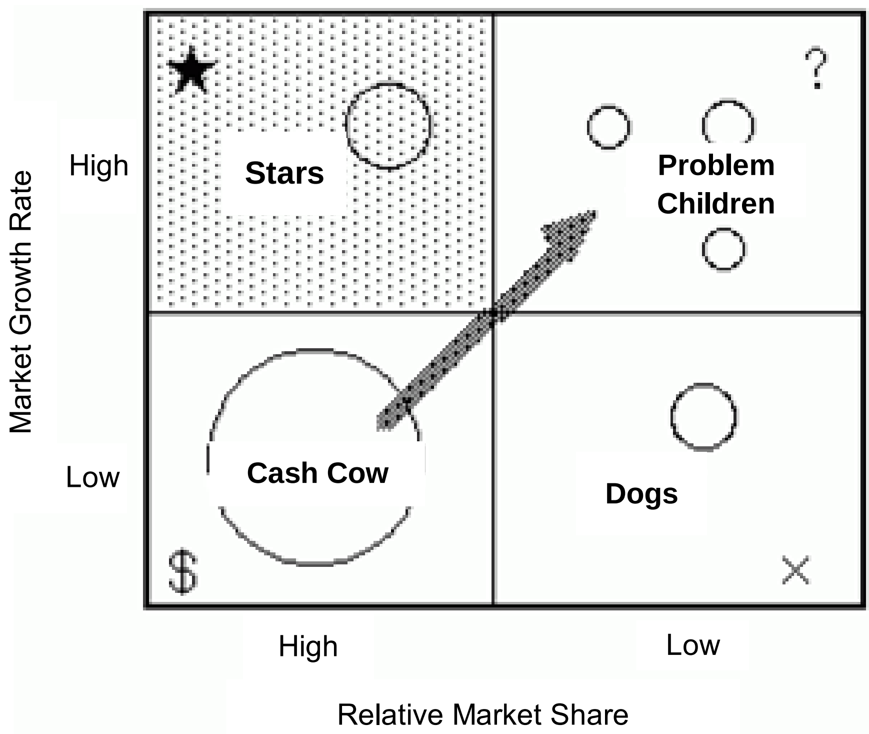
The product with a small share in a slow-growing market. With a low profit ratio, this product cannot be considered to become source of funds in the future.

Problem Children



The product with a small share in a fast-growing market. A large amount of fund is required just to maintain its market share, and even a larger amount becomes necessary to expand its share.

Stars



The product with both high growth and high share of the market. Though a requisite fund is large, so is an inflow fund. In the future, if the growth rate subsides, this at once turns into a great source of fund.

〈Strategic Suggestions〉

Changes in the market growth rate represented on the vertical axis are not at companies' discretion. That is, provided all products are inevitable to trace a life cycle of growth, maturation and decline, with respect to the same axis, they shift from top to bottom in accordance with the passage of time.

On the other hand, the market share rises and falls depending on strategies of own firm's and competitors'. Thus, a diversified company's strength emanates by adopting the following fund allocation:

- ●Cash Cow maintains its share and maximizes (wrings out) the profit. No more than what's required should be spent on Cash Cow. The basic stance is to invest that fund in Problem Children.
- ●In case there are too many Problem Children, they should be narrowed down to just a small number into which the profit obtained with Cash Cow gets intensively funneled so as to nurture these to Stars in the future (expansion/pullout).
- ●The share of Starts needs to be maintained so that they will grow into Cash Cow in the future.
- ●For Dogs, there is one choice out of a pullout, extraction, or concentration.

〈Credit of PPM〉

- ●Correction of ROI-focused management: Albeit with the same profit ratio, a business strategy varies depending on the industry's growth rate or own firm's competitive position.
- ●With an effective allocation of resources among different businesses, a long-term growth by diversification becomes possible PPM constitutes a rough indication of its resource allocation.

〈Problems and Limitations of PPM〉

- ●Definition of market: Depending on what spectrum of a product market is set up as one analysis unit, a market growth rate and a relative market share turn out different.
- ●Market growth rate: It's often difficult to have a market growth rate correctly stand in for a product life cycle (i.e., How many years backward? Quantity or money amount?). And, there are some life cycles which do not exhibit a normal curve.

- ●Relative market share: In an industry where the experience curve effect is extremely small, a high share does not necessarily equal a high profit. In case one attains a high share by the differentiation with a high cost, its profit is not necessarily higher than others'. Also, there are instances that the experience curve discontinuously transforms itself ((being refracted) because of a technological changeover.
- ●Middle-level position: It is too simple to decide on the strategic suggestions with the only four cells while there are businesses positioned in the medium on both the vertical and horizontal axes.
- ●Synergy effect: Apart from the case that each business unit is completely independent, PPM does not take into consideration relevance among businesses. For example, IC to Seiko is not only a Problem Child, but also is an important part of its current Cash Cow. Pulling out of such a common-parts business may potentially weaken its Cash Cow. Also, there are instances for a growth of certain business to promote other business's growth.
- ●PPM is not capable to make a selection of the future business that lies ahead in diversification.
- ●For overcoming a portion of the above-described problems, there is Business Screen by GE/McKinsey which is comprised of the nine cells.

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