

Strategy Toolkit

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Strategy Toolkit

Introduced by Mind Tools CEO, James Manktelow



Welcome to our Strategy Toolkit!

Strategy is the art of working out how to win in business and life.

It involves understanding your environment, crafting a unique and valuable

competitive position, and using your resources in such a way that you make best use of the opportunities open to you.

This e-book contains many of the classic strategy tools taught on MBA courses in top business schools – all in one convenient PDF.

Enjoy finding out about them – and putting them into practice!

A handwritten signature of James Manktelow in black ink. The signature is written in a cursive style and is positioned to the right of the introductory text.

James Manktelow, CEO,
MindTools.com

SWOT Analysis

Discover new opportunities. Manage and eliminate threats.

SWOT Analysis is a powerful technique for understanding your Strengths and Weaknesses, and for looking at the Opportunities and Threats you face.

Used in a business context, it helps you carve a sustainable niche in your market. Used in a personal context, it helps you develop your career in a way that takes best advantage of your talents, abilities and opportunities.

Business SWOT Analysis

What makes SWOT particularly powerful is that, with a little thought, it can help you uncover opportunities that you are well placed to exploit. And by understanding the weaknesses of your business, you can manage and eliminate threats that would otherwise catch you unawares.

More than this, by looking at yourself and your competitors using the SWOT framework, you can start to craft a strategy that helps you distinguish yourself from your competitors, so that you can compete successfully in your market.

How to Use the Tool

Start by [downloading](#) a copy of our free SWOT Analysis Template.

To carry out a SWOT Analysis, answer the following questions:

Strengths:

- What advantages does your company have?
- What do you do better than anyone else?
- What unique or lowest-cost resources do you have access to?
- What do people in your market see as your strengths?
- What factors mean that you 'get the sale'?

Consider this from an internal perspective, and from the point of view of your customers and

people in your market. Be realistic: It's far too easy to fall prey to 'not invented here syndrome'. (If you are having any difficulty with this, try writing down a list of your characteristics. Some of these will hopefully be strengths!)

In looking at your strengths, think about them in relation to your competitors – for example, if all your competitors provide high quality products, then a high quality production process is not a strength in the market, it is a necessity.

Weaknesses:

- What could you improve?
- What should you avoid?
- What are people in your market likely to see as weaknesses?
- What factors lose you sales?

Again, consider this from an internal and external basis: Do other people seem to perceive weaknesses that you do not see? Are your competitors doing any better than you? It is best to be realistic now, and face any unpleasant truths as soon as possible.

Opportunities:

- Where are the good opportunities facing you?
- What are the interesting trends you are aware of?

Useful opportunities can come from such things as:

- Changes in technology and markets on both a broad and narrow scale.
- Changes in government policy related to your field.
- Changes in social patterns, population profiles, lifestyle changes, etc.
- Local events.

A useful approach for looking at opportunities is to look at your strengths and ask yourself whether these open up any opportunities.

Alternatively, look at your weaknesses and ask yourself whether you could create opportunities by eliminating them.

Threats:

- What obstacles do you face?
- What is your competition doing that you should be worried about?
- Are the required specifications for your job, products or services changing?
- Is changing technology threatening your position?
- Do you have bad debt or cash-flow problems?
- Could any of your weaknesses seriously threaten your business?

Carrying out this analysis will often be illuminating – both in terms of pointing out what needs to be done, and in putting problems into perspective.

Tip:

SWOT can be used in two ways – as a simple icebreaker helping people get together and ‘kick off’ strategy formulation, or in a more sophisticated way as a serious strategy tool. If you’re using it as a serious tool, make sure you’re rigorous in the way you apply it:

- Only accept precise, verifiable statements (‘Cost advantage of US\$10/ton in sourcing raw material x’, rather than ‘Good value for money’).
- Ruthlessly prune long lists of factors, and prioritize factors so that you spend your time thinking about the most significant factors.
- Make sure that options generated are carried through to later stages in the strategy formation process.
- Apply it at the right level – for example, at product or product line level, rather than at the much vaguer whole company level.
- Supplement it with other option-generation tools – none is likely to be completely comprehensive.

Strengths and **weaknesses** are often internal to your organization. **Opportunities** and **threats** often relate to external factors. For this reason the SWOT Analysis is sometimes called Internal-External Analysis and the SWOT Matrix is sometimes called an IE Matrix Analysis Tool.

You can also apply SWOT Analysis to your competitors. As you do this, you’ll start to see how and where you should compete against them.

Example

A start-up small consultancy business might draw up the following SWOT matrix:

Strengths:

- We can respond very quickly as we have no red tape, no need for higher management approval, etc.
- We can give really good customer care, as the current small amount of work means we have plenty of time to devote to customers.
- Our lead consultant has strong reputation within the market.
- We can change direction quickly if our approach isn’t working.
- We have little overhead, so can offer good value to customers.

Weaknesses:

- Our company has no market presence or reputation.
- We have a small staff with a shallow skills base in many areas.
- We are vulnerable to vital staff being sick, leaving, etc.
- Our cash flow will be unreliable in the early stages.

Opportunities:

- Our business sector is expanding, with many future opportunities for success.
- Our local council wants to encourage local businesses with work where possible.
- Our competitors may be slow to adopt new technologies.

Threats:

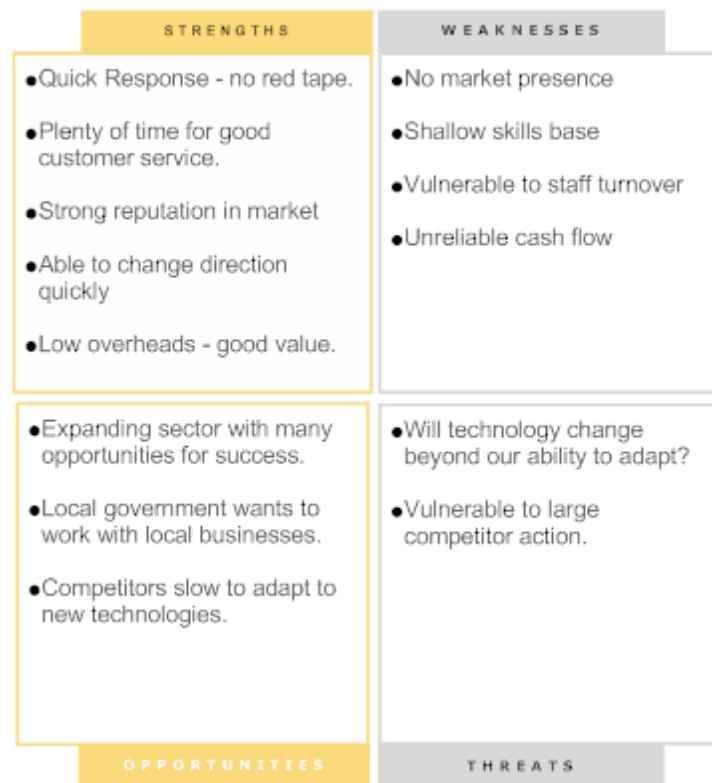
- Will developments in technology change this market beyond our ability to adapt?
- A small change in focus of a large competitor might wipe out any market position we achieve.

The consultancy may therefore decide to specialize in rapid response, good value

services to local businesses. Marketing would be in selected local publications, to get the greatest possible market presence for a set advertising budget. The consultancy should keep up-to-date with changes in technology where possible.

You can see this analysis in diagram format in figure 1 below.

Figure 1: Small Consultancy SWOT Analysis

**Key Points**

SWOT Analysis is a simple but powerful framework for analyzing your company's Strengths and Weaknesses, and the

Opportunities and Threats you face. This helps you to focus on your strengths, minimize threats, and take the greatest possible advantage of opportunities available to you.

PEST Analysis**Understanding 'big picture' forces of change**

Related variants: PESTLE, PESTEL, PESTLIED, STEEPLE and SLEPT Analysis

PEST Analysis is a simple, useful and widely-used tool that helps you understand the 'big picture' of your **P**olitical, **E**conomic, **S**ocio-Cultural and **T**echnological environment. As

such, it is used by business leaders worldwide to build their vision of the future.

It is important for these reasons:

- By making effective use of PEST Analysis, you ensure that what you are doing is aligned positively with the powerful forces of change that are affecting our world. By taking advantage of change, you are much more likely to be successful than if your activities oppose it.
- Good use of PEST Analysis helps you avoid taking action that is doomed to failure from the outset, for reasons beyond your control.
- PEST is useful when you start operating in a new country or region. Use of PEST helps you break free of unconscious assumptions, and helps you quickly adapt to the realities of the new environment.

How to Use the Tool

PEST is a simple mnemonic standing for Political, Economic, Socio-Cultural and Technological.

To use this tool, follow this three stage process:

1. [Brainstorm](#) the relevant factors that apply to you.
2. Identify the information that applies to these factors.
3. Draw conclusions from this information.

Download our free worksheet [here](#), to record your analysis.

Tip:

The important point is to move from the second step to the third step: it is sterile just to describe factors without thinking through what they mean. However, be careful not to assume that your analysis is perfect: use it as a starting point, and test your conclusions against the reality you experience.

The following factors may help as a starting point for brainstorming (but make sure you include other factors that may be appropriate to your situation):

Political:

- Government type and stability.
- Freedom of press, rule of law and levels of bureaucracy and corruption.
- Regulation and de-regulation trends.
- Social and employment legislation.
- Tax policy, and trade and tariff controls.
- Environmental and consumer-protection legislation.
- Likely changes in the political environment.

Economic:

- Stage of business cycle.
- Current and project economic growth, inflation and interest rates.
- Unemployment and labor supply.
- Labor costs.
- Levels of disposable income and income distribution.
- Impact of globalization.
- Likely impact of technological or other change on the economy.
- Likely changes in the economic environment.

Socio-Cultural:

- Population growth rate and age profile.
- Population health, education and social mobility, and attitudes to these.
- Population employment patterns, job market freedom and attitudes to work.
- Press attitudes, public opinion, social attitudes and social taboos
- Lifestyle choices and attitudes to these.
- Socio-Cultural changes.

Technological Environment:

- Impact of emerging technologies.
- Impact of Internet, reduction in communications costs and increased remote working.
- Research and Development activity.
- Impact of technology transfer.

These are shown in Figure 1 on the next page:

Figure 1: PEST Analysis

PEST Analysis Framework

**Other forms of PEST – PESTLE, PESTLIED, STEEPLE and SLEPT:**

Some people prefer to use different flavors of PEST Analysis, using other factors for different situations. The variants are:

PESTLE/PESTEL: Political, Economic, Sociological, Technological, Legal, Environmental;

PESTLIED: Political, Economic, Social, Technological, Legal, International, Environmental, Demographic;

STEEPLE: Social/Demographic, Technological, Economic, Environmental, Political, Legal, Ethical; and

SLEPT: Social, Legal, Economic, Political, Technological

Choose the flavor that most suits you!

Example

We're going to avoid giving an example here, because of the huge potential for causing offense: few societies seem perfect to outsiders, and there are few things as irritating as having an outsider criticize one's own country...

However, a broad principle is that things that make activity more difficult for people or organizations raise the cost of doing business: business is either stopped altogether, or costs more as people spend time and money circumventing difficulties. The higher the cost of doing business in a region, the more project profitability is squeezed or eliminated. And given that businesspeople normally have at least some level of intelligence, businesses and projects that could otherwise operate are never

launched – meaning that less economic activity takes place. (The lower the amount of economic activity, the poorer and less capable societies tend to be.)

Another broad principle is wherever there is rapid or major change in an area, there are likely to be new opportunities and threats that arise. Smart people and companies will take advantage of the opportunities and manage the threats.

And do remember that few situations are perfect: it is up to us to make the most of the situation in which we find ourselves.

Key Points

PEST Analysis is a useful tool for understanding the 'big picture' of the

environment in which you are operating, and the opportunities and threats that lie within it. By understanding your environment, you can take advantage of the opportunities and minimize the threats.

PEST is a mnemonic standing for Political, Economic, Social and Technological. These headings are used firstly to brainstorm the characteristics of a country or region and, from this, draw conclusions as to the significant forces of change operating within it.

This provides the context within which more detailed planning can take place to take full advantage of the opportunities that present themselves.

The Ansoff Matrix

Understanding the risks of different options

Also known as the Product/Market Expansion Grid

For a whole variety of reasons, there are times when as an individual or in business you want or need to expand or change your field or market. In business, you might need to achieve economies of scale, make more money for investors, or gain national or even global recognition of their brand. As an individual, you may want to change company, or even career.

Having decided that you want to grow your business or career, you'll have hundreds of ideas about things you could do. For your business, this means new products, new markets, new channels, or new marketing campaigns. For your career, it means new skills, new roles, and even new industries.

That's great! But which ones should you choose? And why?

Using a strategic approach, such as the Ansoff Model or Matrix, helps you evaluate your options and choose the one that suits your situation best, and gives you the best return on

the potentially considerable investment that you'll need to make.

Understanding the Tool

The Ansoff Matrix was first published in the Harvard Business Review in 1957, and has given generations of marketers and small business leaders a quick and simple way to develop a strategic approach to growth.

Sometimes called the Product/Market Expansion Grid, it shows four growth options for business formed by matching up existing and new products and services with existing and new markets, as shown in Figure 1 on the next page.

The Matrix essentially shows the risk that a particular strategy will expose you to, the idea being that each time you move into a new quadrant (horizontally or vertically) you increase risk.

Figure 1: The Ansoff Matrix - Business

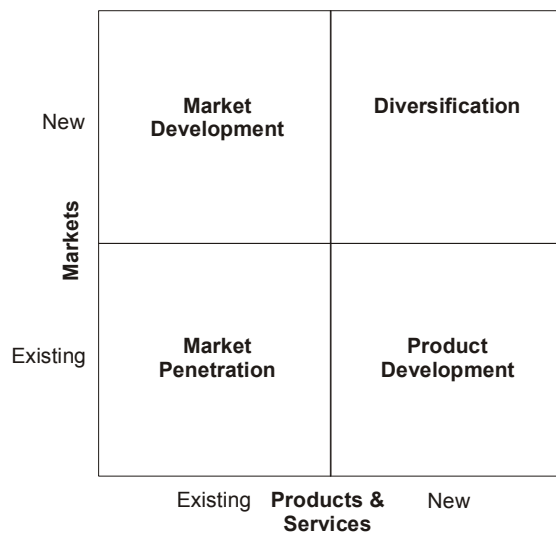
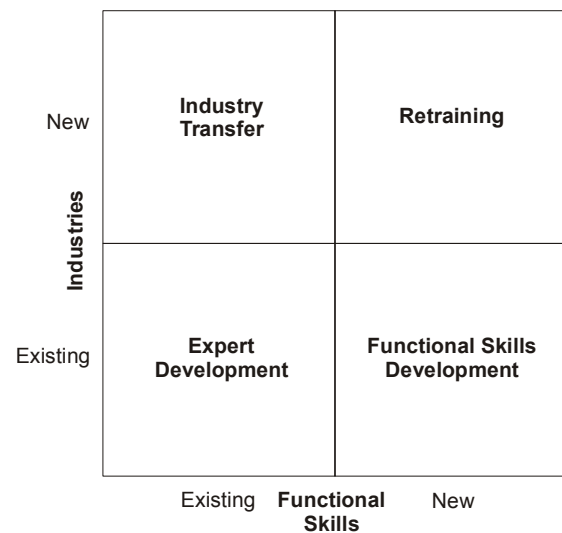


Figure 2: The Ansoff Matrix - Career



The Corporate Ansoff Matrix

Looking at it from a business perspective, staying with your existing product in your existing market is a low risk option: You know the product works, and the market holds few surprises for you.

However, you expose yourself to a whole new level of risk either moving into a new market with an existing product, or developing a new product for an existing market. The market may turn out to have radically different needs and dynamics than you thought, or the new product may just not work or sell.

And by moving two quadrants and targeting a new market with a new product, you increase your risk to yet another level!

Personal Ansoff

Looking at it from a personal perspective, just staying where you are is (usually!) a low risk option.

Switching to a new role in the same company, or changing to a similar job with a company in the same industry is a higher risk option. And switching to a new role in a new industry has an even higher level of risk.

This is shown in figure 2.

Tip 1:

Interpret this according to your circumstances. For example, an accountant may find it easy to switch from one industry to another. But a salesman doing this might lose contacts that would take a while to rebuild.

Tip 2:

Don't be too scared by risk – if you manage risk correctly (for example, by researching carefully, making contingency plans, arranging insurance, and suchlike) and 'calculate' it well, then it can be well worth taking quite large risks.

How to Use the Tool

Use of the tool is straightforward:

1. Start by downloading either our free [Corporate Ansoff](#) or [Personal Ansoff worksheet](#). Then plot the approaches you're considering on the matrix. The table on the next page shows how you might classify different approaches.

<p>Market Development</p> <p>Here, you're targeting new markets, or new areas of the market. You're trying to sell more of the same things to different people. Here you might:</p> <ul style="list-style-type: none"> • Target different geographical markets at home or abroad. • Use different sales channels, such as online or direct sales if you are currently selling through the trade. • Target different groups of people, perhaps different age groups, genders or demographic profiles from your normal customers. 	<p>Diversification</p> <p>This strategy is risky: There's often little scope for using existing expertise or achieving economies of scale, because you are trying to sell completely different products or services to different customers.</p> <p>Its main advantage is that, should one business suffer from adverse circumstances, the other is unlikely to be affected.</p>
<p>Market Penetration</p> <p>With this approach, you're trying to sell more of the same things to the same people. Here you might:</p> <ul style="list-style-type: none"> • Advertise, to encourage more people within your existing market to choose your product, or to use more of it. • Introduce a loyalty scheme. • Launch price or other special offer promotions. • Increase your sales force activities. • Buy a competitor company (particularly in mature markets). 	<p>Product Development</p> <p>Here, you're selling more things to the same people. Here you might:</p> <ul style="list-style-type: none"> • Extend your product by producing different variants, or packaging existing products it in new ways. • Develop related products or services (for example, a domestic plumbing company might add a tiling service – after all, if they're plumbing in a new kitchen, most likely tiling will be needed!). • In a service industry, increase your time to market, customer service levels, or quality.

2. Manage risk appropriately. For example, if you're switching from one quadrant to another, make sure that:

- You research the move carefully.
- You build the capabilities needed to succeed in the new quadrant.
- You've got plenty of resources to cover a possible thin period while you're developing and learning how to sell the new product, or are learning what makes the new market tick.
- You have firstly thought through what you have to do if things don't work out, and that failure won't 'break' you.

Taking Ansoff Further

Some marketers use a nine-box grid for a more sophisticated analysis. This adds 'modified' products between existing and new ones (for example, a different flavor of your existing pasta sauce rather than launching a soup), and 'expanded' markets between existing and new ones (for example, opening another store in a nearby town, rather than going into online sales).

This is useful as it shows the difference between product extension and true product development, and also between market expansion and venturing into genuinely new markets (see Figure 3). However, be careful of the three 'options' in blue, as they involve trying to do two things at once without the one benefit

of a true diversification strategy (escaping a downturn in one product market).

Figure 3: The 9-Box Grid

Markets	New	Market Development	Partial Diversification	Diversification
	Expanded	Market Expansion	Limited Diversification	Partial Diversification
	Existing	Market Penetration	Product Extension	Product Development
		Existing	Modified	New
		Products & Services		

The Boston Matrix

Focusing effort to give the greatest returns

Also called the BCG Matrix, the Growth-Share Matrix and Portfolio Analysis

If you enjoy visual representations and vivid descriptions of your business then you'll love the Boston Matrix!

Also called the BCG Matrix, it provides a useful way of looking at the opportunities open to you, and helps you analyze which segments of your business are performing well – and which ones aren't. That way, you can decide on the most appropriate investment strategy for your business in the future, and where best to allocate your resources.

Understanding the Model

Market Share and Market Growth

To understand the Boston Matrix you need to understand how market share and market growth interrelate.

Market share is the percentage of the total market that is being serviced by your company, measured either in revenue terms or unit volume terms. The higher your market share, the higher proportion of the market you control.

The Boston Matrix assumes that if you enjoy a high market share you will normally be making

money (this assumption is based on the idea that you will have been in the market long enough to have learned how to be profitable, and will be enjoying scale economies that give you an advantage).

The question it asks is, "Should you be investing your resources into that product line just because it is making you money?" The answer is, "not necessarily."

This is where market growth comes into play. Market growth is used as a measure of a market's attractiveness. Markets experiencing high growth are ones where the total market is expanding, which should provide the opportunity for businesses to make more money, even if their market share remains stable.

By contrast, competition in low growth markets is often bitter, and while you might have high market share now, what will the situation look like in a few months or a few years? This makes low growth markets less attractive.

Note:

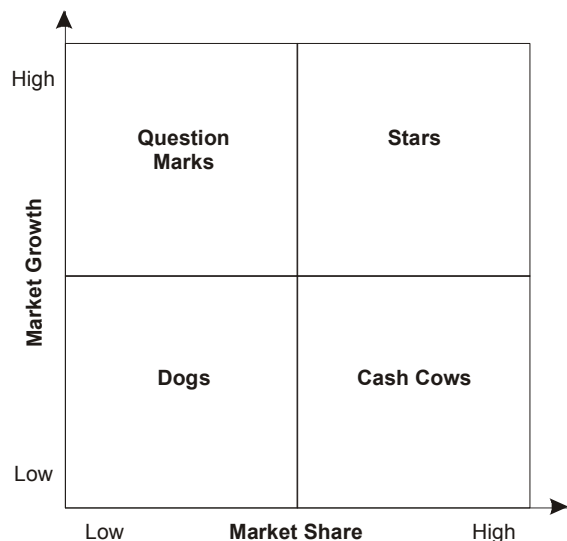
The origin of the Boston Matrix lies with the Boston Consulting Group in the early 1970s. It was devised as a clear and simple method for helping corporations decide which parts of their business they should allocate their available cash to. Today, this is as important as ever because of the limited availability of credit.

However, the Boston Matrix is also a good tool for thinking about where to apply other finite resources: people, time and equipment.

The Matrix Itself

The Boston Matrix categorizes opportunities into four groups, shown on axes of Market Growth and Market Share:

Figure 1: The Boston Matrix



These groups are explained below:

Dogs: Low Market Share / Low Market Growth

In these areas, your market presence is weak, so it's going to take a lot of hard work to get noticed. Also, you won't enjoy the scale economies of the larger players, so it's going to be difficult to make a profit.

Cash Cows: High Market Share / Low Market Growth

Here, you're well-established, so it's easier to

get attention and exploit new opportunities. However it's only worth expending a certain amount of effort, because the market isn't growing and your opportunities are limited.

Stars: High Market Share / High Market Growth

Here you're well established, and growth is exciting! There should be some strong opportunities here, and you should work hard to realize them.

Question Marks (Problem Child): Low Market Share / High Market Growth

These are the opportunities no one knows what to do with. They aren't generating much revenue right now because you don't have a large market share. But, they are in high growth markets so the potential to make money is there.

Question Marks might become Stars and eventual Cash Cows, but they could just as easily absorb effort with little return. These opportunities need serious thought as to whether increased investment is warranted.

How to Use the Tool

To use the Boston Matrix to look at your opportunities, first download our free [worksheet](#), and then use the following steps:

Step One: Plot your opportunities in terms of their relative market presence, and market growth on the blank matrix provided on the [worksheet](#).

Step Two: Classify them into one of the four categories. If a product seems to fall right on one of the lines, take a real hard look at the

Tip:

Be careful about these lines – there's nothing magical about them or their position. There may be very little real difference between a Problem Child with a market share of 49%, and a Star with a market share of 51%. It's also not necessarily true that the line should run through the 50% position. As ever, use your common sense.

situation and rely on past performance to help you decide which side you will place it.

Step Three: Determine what you will do with each product/product line. There are typically four different strategies to apply:

- *Build Market Share:* Make further investments (for example, to maintain Star status, or turn a Question Mark into a Star)
- *Hold:* Maintain the status quo (do nothing)
- *Harvest:* Reduce the investment (enjoy positive cash flow and maximize profits from a Star or Cash Cow)
- *Divest:* For example, get rid of the Dogs, and use the capital to invest in Stars and some Question Marks.

Tip 1:

From a personal perspective, you can evaluate the opportunities open to you by substituting the dimension of Market Share with one of Professional Skills. Plot the options open to you on the personal version of the BCG Matrix, and take action appropriately.

Tip 2:

A similar (and equally powerful) tool is the Action Priority Matrix, which helps you pick projects which legitimately give you the quickest and highest value returns. By using the BCG Matrix and Action Priority Matrix together, you get the best of both worlds!

Key Points

The Boston Matrix is an effective tool for quickly assessing the options open to you, both on a corporate and personal basis.

With its easily understood classification into Dogs, Cash Cows, Question Marks, and Stars, it helps you quickly and simply screen the opportunities open to you – and identify where best to invest the money, time, and effort you have available.

The GE-McKinsey Matrix

Determining investment priorities

If you had endless amounts of money and time, there would probably be no need to figure out how best to allocate your resources. But, in reality, we all have to prioritize our investments – particularly in difficult economic conditions.

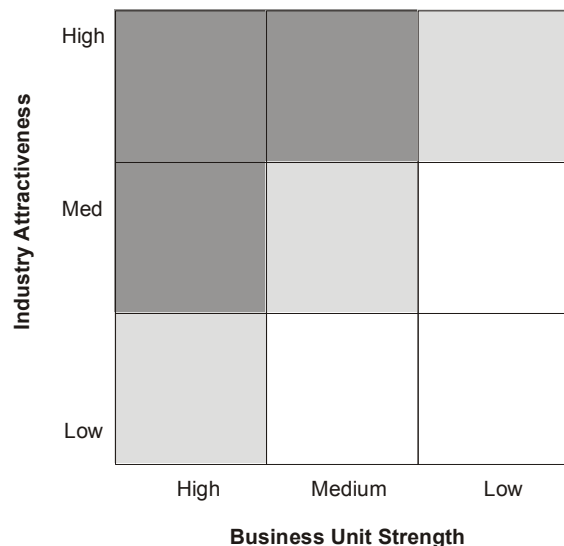
When faced with this challenge in your organization, how do you decide which product groups to continue, which market segments to focus on, or which business units to sell? To make that decision, you must first understand your business portfolio – and you start by determining the benchmarks to define your portfolio.

In the 1970s, the Boston Consulting Group (BCG) developed the [growth-share matrix](#), which uses market growth and market share as

a way of looking at the opportunities open to you, so that you can choose the ones that will give you the best results. In the BCG 2 x 2 matrix, the more of each dimension your product line has, the more attractive it is – and, therefore, the more you should invest in it.

General Electric (GE) liked the visual part of BCG's matrix, but not the dimensions. GE therefore asked its consulting firm, McKinsey & Company, to create a model that better suited GE's needs. The result was the 3 x 3 GE Matrix (also called the McKinsey Matrix, the Business Strength Matrix, or the Nine-Box Matrix).

Figure 1: A Blank GE/McKinsey Matrix



The original GE Matrix showed industry attractiveness on the x-axis, and business unit strength on the y-axis. Over time, it has become more common to do the opposite, which is what you see above.

The GE matrix uses the dimensions of industry attractiveness and business unit strength. Both of these include a wide variety of factors that the organization itself chooses. The GE matrix is considered more sophisticated than the BCG matrix because it has more flexibility and a wider scope.

By plotting the positions of various business units, product lines, or products, a company can 'see' how best to allocate its resources. You may find this quick summary approach particularly effective for developing, evaluating, and communicating strategic decisions.

Using the GE Matrix

Step 1: Determine Industry Attractiveness (vertical axis)

There are several factors that define an industry, and they're often used to help you determine whether or not you want to enter a particular market in the first place. Here are

some examples of attractiveness factors that may or may not be appropriate for your business:

- Market growth (from BCG's matrix).
- Market size.
- [PEST factors](#) – political, economic, sociocultural, and technological elements.
- [Porter's Five Forces](#) factors – supplier power, buyer power, strength of competition, threat of substitution, and barriers to entry.
- Workforce availability.
- Fluctuations/changes in demand.
- Profit margins.
- Legal and/or regulatory pressures.

Follow these steps to determine industry attractiveness:

- Brainstorm the factors you'll use to determine how attractive your various markets are. This is a subjective process, and different organizations will come up with different results. Just be aware that you'll need to apply all of these factors to all of the business units or product lines that you're evaluating. This helps you compare the overall attractiveness of each unit or product that you're considering.
- Assign a weight to each factor. Your weights must add up to 1.0 when you're finished.

Then, rate each business unit on each industry attractiveness factor. Use this scale of 1–9:

- 1 = Extremely unattractive.
- 5 = Industry average.
- 9 = Extremely attractive.

Multiply the rating by the weight to calculate a score for each factor for each business unit. Add these scores together, and use them to plot the matrix.

Attractiveness Factor	Weight	Business Unit 1		Business Unit 2		Business Unit 3	
		Rating	Weighted Rating	Rating	Weighted Rating	Rating	Weighted Rating
Market size	0.10	3	0.30	7	0.70	8	0.80
Market growth	0.30	4	1.20	7	2.10	5	1.50
Profit margins	0.25	2	0.50	8	2.00	4	1.00
Volatility	0.15	5	0.75	6	0.90	7	1.05
Strength of competition	0.20	3	0.60	7	1.40	5	1.00
TOTALS	1.00		3.35		7.10		5.35

Step 2: Determine Business Strength (horizontal axis)

'Business strength' brings together a combination of factors that determine how strong a particular business unit or product is, compared with others in its industry. Again, you can use a variety of factors to gauge your business strength, including the following:

- Market share (from BCG's matrix).
- Production capacity.
- Production flexibility.
- Product differentiation.
- Company reputation.
- Managerial competence.
- Customer loyalty.

(A [SWOT analysis](#) is a useful framework for determining and evaluating business strengths.)

The business strength dimension of the matrix focuses on elements that an individual company controls. However, bear in mind that operating in an attractive market may not be profitable, if your organization lacks the ability to supply customers effectively with what they want.

The steps for determining business strength are the same as for industry attractiveness:

- Brainstorm the factors you'll use to determine how strong your business unit or product market is. Remember, you'll apply all of these factors to all business units or product lines.
- Assign a weight to each factor. Your weights must add up to 1.0 when you're finished.
- Rate each business unit on each business strength factor. Use this scale of 1–9:

1 = Extremely weak.

5 = Industry average.

9 = Extremely strong/represents best practice.

Multiply the rating by the weight to calculate a score for each factor for each business unit. Add these scores together, and use them to plot the matrix.

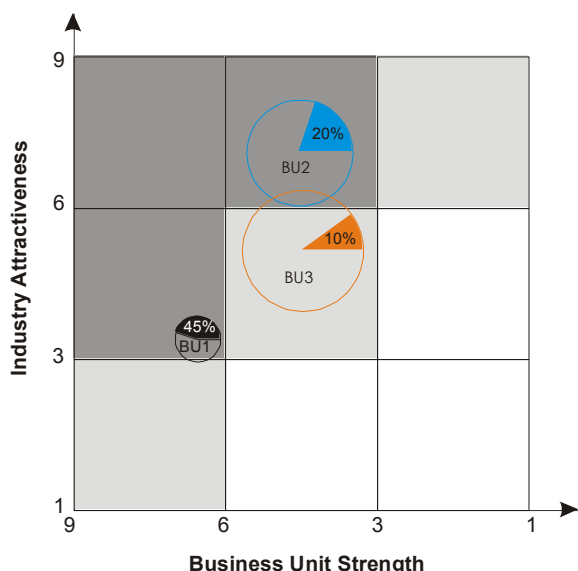
Strength Factor	Weight	Business Unit 1		Business Unit 2		Business Unit 3	
		Rating	Weighted Rating	Rating	Weighted Rating	Rating	Weighted Rating
Market share	0.30	6 (45%)	1.70	4 (20%)	1.20	3 (10%)	0.90
Manufacturing capacity	0.15	5	0.75	3	0.45	4	0.60
Quality	0.25	7	1.75	7	1.75	5	1.25
Workforce skill	0.10	7	0.70	8	0.80	4	0.40
Marketing ability	0.20	8	1.60	3	0.60	8	1.60
TOTALS			6.60		4.80		4.75

Step 3: Plot the Information

Plot your business units, or product groups, onto the matrix (see the example in Figure 2). Use a circle for each business unit, following these guidelines:

- Business unit strength and industry attractiveness are shown by the circle's position on the matrix.
- Market size is represented by the size of the circle.
- Market share is represented by a pie chart within the circle.

Figure 2: Example GE/McKinsey Matrix



Sometimes a matrix includes an arrow leading from the circle. This indicates the direction in which the business unit is expected to move, relative to competitors and the industry as a whole.

The resulting matrix is easy to read, and it identifies which parts of your company are doing well, and which ones are doing poorly.

Interpreting the Matrix

Finally, the GE matrix describes a set of strategies related to the positions of the business units. There are three general strategies:

1. **Grow** – Strategic Business Units (SBUs) in the top left corner (dark gray squares) have a relatively strong position in an attractive industry. This indicates that it's a good idea to invest in these. Look for growth opportunities, and build on current strengths to improve your position in the market.
2. **Hold** – SBUs in the middle (light gray squares) are average. Some might have a good position in a slower industry, or they might have a weak position in a good market. There's something positive

that you can develop within these business units. Reasonable strategies that you can consider here are to invest more resources, defend your current position, or attempt to find a niche.

3. **Harvest/Exit** – SBUs in the bottom right corner (white squares) are in an unattractive industry, a weak position, or both. There are no promising scenarios, so it's probably best to look at exit strategies. It's not a good idea to invest any further in these business units. Instead, use your resources for units in other parts of the matrix.

Remember that many more criteria are relevant to a complete analysis of a business unit, not just the ones in the GE matrix. The matrix provides a great visual summary of relative positions, and it's a good starting point to investigate the strategic direction that best fits each business unit or product line.

Porter's Five Forces

Assessing the balance of power in a business situation

The Porter's 5 Forces tool is a simple but powerful tool for understanding where power lies in a business situation. This is useful, because it helps you understand both the strength of your current competitive position, and the strength of a position you're looking to move into.

With a clear understanding of where power lies, you can take fair advantage of a situation of [strength](#), improve a situation of [weakness](#), and avoid taking wrong steps. This makes it an important part of your planning toolkit.

Conventionally, the tool is used to identify whether new products, services or businesses have the potential to be profitable. However it can be very illuminating when used to understand the balance of power in other situations too.

Key Points

Use the GE-McKinsey matrix to assign investment priorities in various parts of your organization. By analyzing a business unit based on its market strength and the attractiveness of its industry, you can quickly see how well positioned it is for growth and potential. If business units have a favorable position in both or one of these dimensions, it's probably worth continuing to invest in them. Business units in the lower part of the matrix are likely to contribute little benefit to your organization.

The GE matrix gives you an excellent overview of your strategic business units, or other segments of your company. From there, you can start a detailed investigation of the exact strategy to pursue – so that you can maximize your market position, and best allocate your resources.

How to Use the Tool

Five Forces Analysis assumes that there are five important forces that determine competitive power in a situation. These are:

1. **Supplier Power:** Here you assess how easy it is for suppliers to drive up prices. This is driven by the number of suppliers of each key input, the uniqueness of their product or service, their strength and control over you, the cost of switching from one to another, and so on. The fewer the supplier choices you have, and the more you need suppliers' help, the more powerful your suppliers are.
2. **Buyer Power:** Here you ask yourself how easy it is for buyers to drive prices down. Again, this is driven by the number of buyers, the importance of each individual buyer to your business,

the cost to them of switching from your products and services to those of someone else, and so on. If you deal with few, powerful buyers, they are often able to dictate terms to you.

3. **Competitive Rivalry:** What is important here is the number and capability of your competitors – if you have many competitors, and they offer equally attractive products and services, then you'll most likely have little power in the situation. If suppliers and buyers don't get a good deal from you, they'll go elsewhere. On the other hand, if no-one else can do what you do, then you can often have tremendous strength.
4. **Threat of Substitution:** This is affected by the ability of your customers to find a different way of doing what you do – for example, if you supply a unique software product that automates an important process, people may substitute by doing the process

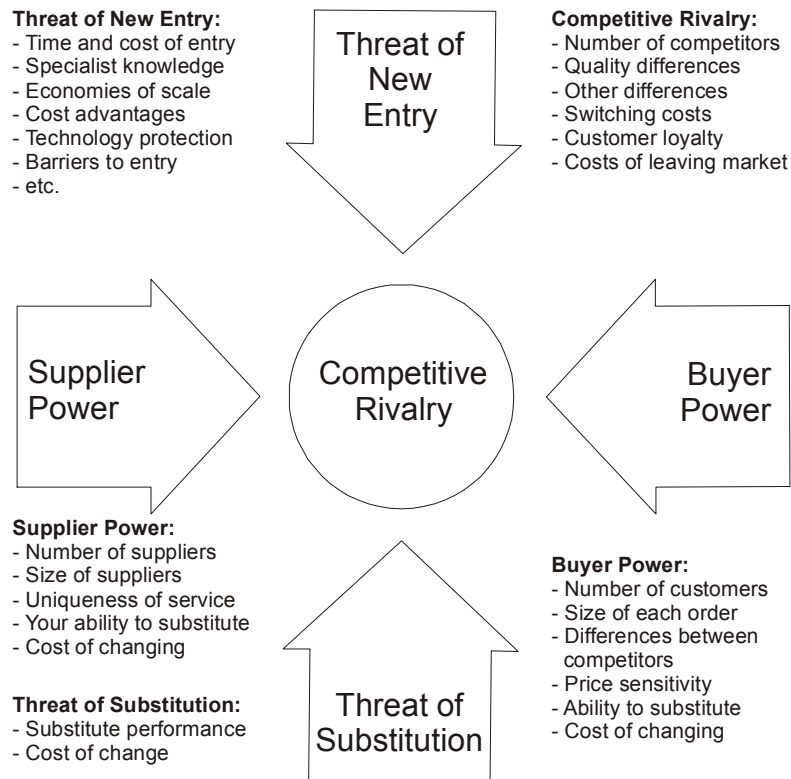
manually or by outsourcing it. If substitution is easy and substitution is viable, then this weakens your power.

5. **Threat of New Entry:** Power is also affected by the ability of people to enter your market. If it costs little in time or money to enter your market and compete effectively, if there are few economies of scale in place, or if you have little protection for your key technologies, then new competitors can quickly enter your market and weaken your position. If you have strong and durable barriers to entry, then you can preserve a favorable position and take fair advantage of it.

These forces can be neatly brought together in a diagram like the one below:

To use the tool to understand your situation, look at each of these forces one-by-one and write your observations on our free worksheet which you can download [here](#).

Porter's Five Forces



Brainstorm the relevant factors for your market or situation, and then check against the factors listed for the force in the diagram above.

Then download our free worksheet, mark the key factors on the diagram, and summarize the size and scale of the force on the diagram. An easy way of doing this is to use, for example, a single '+' sign for a force moderately in your favor, or '--' for a force strongly against you (you can see this in the example below).

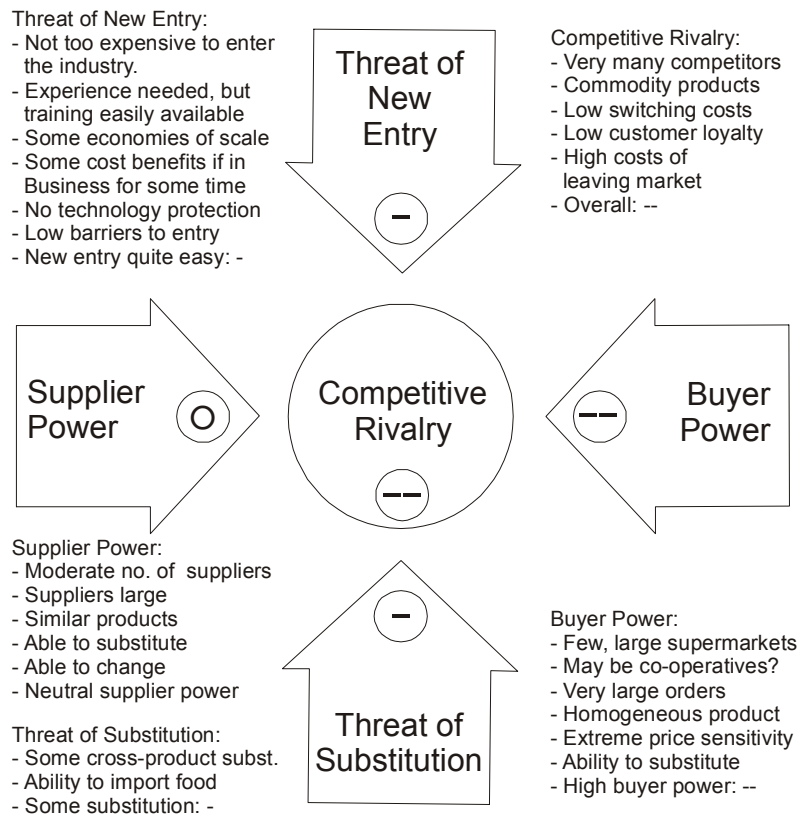
Then look at the situation you find using this analysis and think through how it affects you. Bear in mind that few situations are perfect; however use environmental scanning as a framework for thinking through what you could change to increase your power with respect to each force.

This tool was created by Harvard Business School professor, Michael Porter, to analyze the attractiveness and likely-profitability of an industry. Since publication, it has become one of the most important business strategy tools. The classic article which introduces it is 'How Competitive Forces Shape Strategy' in Harvard Business Review 57, March – April 1979, pages 86-93.

Example

Martin Johnson is deciding whether to switch career and become a farmer – he's always loved the countryside, and wants to switch to a career where he's his own boss. He creates the following Five Forces Analysis as he thinks the situation through:

Porter's Five Forces - Buying a Farm



This worries him:

- The **threat of new entry** is quite high: if anyone looks as if they're making a sustained profit, new competitors can come into the industry easily, reducing profits.
- **Competitive rivalry** is extremely high: if someone raises prices, they'll be quickly undercut. Intense competition puts strong downward pressure on prices.
- **Buyer Power** is strong, again implying strong downward pressure on prices.
- There is some **threat of substitution**.

Unless he is able to find some way of changing this situation, this looks like a very tough industry to survive in. Maybe he'll need to specialize in a sector of the market that's protected from some of these forces, or find a related business that's in a stronger position.

Key Points

Porter's Five Forces Analysis is an important tool for assessing the potential for profitability in an industry. With a little adaptation, it is also useful as a way of assessing the balance of power in more general situations.

It works by looking at the strength of five important forces that affect competition:

- **Supplier Power:** The power of suppliers to drive up the prices of your inputs;
- **Buyer Power:** The power of your customers to drive down your prices;
- **Competitive Rivalry:** The strength of competition in the industry;
- **The Threat of Substitution:** The extent to which different products and services can be used in place of your own; and
- **The Threat of New Entry:** The ease with which new competitors can enter the

market if they see that you are making good profits (and then drive your prices down).

By thinking through how each force affects you, and by identifying the strength and direction of each force, you can quickly assess the strength

of the position and your ability to make a sustained profit in the industry.

You can then look at how you can affect each of the forces to move the balance of power more in your favor.

Porter's Generic Strategies

Choosing your route to competitive advantage

Which do you prefer when you fly: a cheap, no-frills airline, or a more expensive operator with fantastic service levels and maximum comfort? And would you ever consider going with a small company which focuses on just a few routes?

The choice is up to you, of course. But the point we're making here is that when you come to book a flight, there are some very different options available.

Why is this so? The answer is that each of these airlines has chosen a different way of achieving competitive advantage in a crowded marketplace.

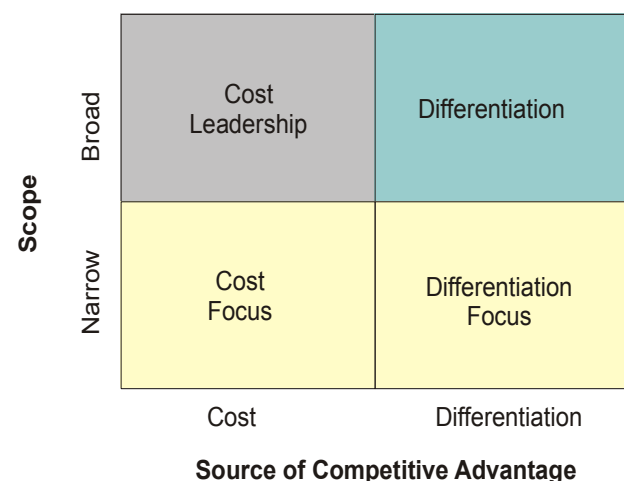
The no-frills operators have opted to cut costs to a minimum and pass their savings on to customers in lower prices. This helps them grab market share and ensure their planes are as full as possible, further driving down cost. The luxury airlines, on the other hand, focus their efforts on making their service as wonderful as possible, and the higher prices they can command as a result more than make up for their higher costs.

Meanwhile, smaller airlines try to make the most of their detailed knowledge of just a few routes to provide better or cheaper services than their larger, international rivals.

These three approaches are examples of "generic strategies", because they can be applied to products or services in all industries, and to organizations of all sizes. They were first set out by Michael Porter in 1985 in his book *Competitive Advantage: Creating and Sustaining Superior Performance*. Porter called

the generic strategies "Cost Leadership" (no frills), "Differentiation" (creating uniquely desirable products and services) and "Focus" (offering a specialized service in a niche market). He then subdivided the Focus strategy into two parts: "Cost Focus" and "Differentiation Focus". These are shown in Figure 1 below.

Figure 1: Porter's Generic Strategies



The terms "Cost Focus" and "Differentiation Focus" can be a little confusing, as they could be interpreted as meaning "A focus on cost" or "A focus on differentiation". Remember that Cost Focus means emphasizing cost-minimization **within a focused market**, and Differentiation Focus means pursuing strategic differentiation **within a focused market**.

The Cost Leadership Strategy

Porter's generic strategies are ways of gaining competitive advantage - in other words, developing the "edge" that gets you the sale and takes it away from your competitors. There are two main ways of achieving this within a Cost Leadership strategy:

- Increasing profits by reducing costs, while charging industry-average prices.

Remember that Cost Leadership is about minimizing the cost **to the organization** of delivering products and services. The cost or price paid **by the customer** is a separate issue!

- Increasing market share through charging lower prices, while still making a reasonable profit on each sale because you've reduced costs.

The Cost Leadership strategy is exactly that - it involves being the leader in terms of cost in your industry or market. Simply being amongst the lowest-cost producers is not good enough, as you leave yourself wide open to attack by other low cost producers who may undercut your prices and therefore block your attempts to increase market share.

You therefore need to be confident that you can achieve and maintain the number one position before choosing the Cost Leadership route. Companies that are successful in achieving Cost Leadership usually have:

- Access to the capital needed to invest in technology that will bring costs down.
- Very efficient logistics.
- A low cost base (labor, materials, facilities), and a way of sustainably cutting costs below those of other competitors.

The greatest risk in pursuing a Cost Leadership strategy is that these sources of cost reduction are not unique to you, and that other competitors copy your cost reduction strategies. This is why it's important to continuously find ways of reducing every cost. One successful way of doing this is by adopting the Japanese

Kaizen philosophy of "continuous improvement".

The Differentiation Strategy

Differentiation involves making your products or services different from and more attractive than those of your competitors. How you do this depends on the exact nature of your industry and of the products and services themselves, but will typically involve features, functionality, durability, support and also brand image that your customers value.

To make a success of a generic Differentiation strategy, organizations need:

- Good research, development and innovation.
- The ability to deliver high-quality products or services.
- Effective sales and marketing, so that the market understands the benefits offered by the differentiated offerings.

Large organizations pursuing a differentiation strategy need to stay agile with their new product development processes. Otherwise, they risk attack on several fronts by competitors pursuing Focus Differentiation strategies in different market segments.

The Focus Strategy

Companies that use Focus strategies well concentrate on particular niche markets and, by understanding the dynamics of that market and the unique needs of customers in it, develop uniquely low cost or well-specified products for the market. Because they serve customers in their market uniquely well, they tend to build strong brand loyalty amongst their customers. This makes their particular market segment less attractive to competitors.

As with broad market strategies, it is still essential to decide whether you will pursue Cost Leadership or Differentiation once you have selected a Focus strategy as your main approach: Focus is not normally enough on its own.

But whether you use Cost Focus or Differentiation Focus, the key to making a

success of a generic Focus strategy is to ensure that you are adding something extra as a result of serving only that market niche. It's simply not enough to focus on only one market segment because your organization is too small to serve a broader market (if you do, you risk competing against better-resourced broad market companies' offerings.)

The "something extra" that you add can contribute to reducing costs (perhaps through your knowledge of specialist suppliers) or to increasing differentiation (though your deep understanding of customers' needs).

Generic strategies apply to not-for-profit organizations too. A not-for-profit can use a Cost Leadership strategy to minimize the cost of getting donations and achieving more for their income, while one with pursuing a Differentiation strategy will be committed to the very best outcomes, even if the volume of work they do as a result is lower. Local charities are great examples of organizations using Focus strategies to get donations and contribute to their communities.

Choosing the Right Generic Strategy

Your choice of which generic strategy to pursue underpins every other strategic decision you make, so it's worth spending time to get it right.

But you **do** need to make a decision: Porter specifically warns against trying to "hedge your bets" by following more than one strategy. One of the most important reasons why this is wise advice is that the things you need to do to make each type of strategy work appeal to different types of people. Cost Leadership requires a very detailed internal focus on processes. Differentiation, on the other hand, demands an outward-facing, highly creative approach.

So, when you come to choose which of the three generic strategies is for you, it's vital that you take your organization's competencies and strengths into account.

Use the following steps to help you choose.

Step 1: For each generic strategy, carry out a [SWOT analysis](#) of your strengths and weaknesses, and the opportunities and threats you would face, if you adopted that strategy.

Having done this, it may be clear that your organization is unlikely to be able to make a success of some of the generic strategies.

Step 2: Use [Five Forces Analysis](#) to understand the nature of the industry you are in.

Step 3: Compare the SWOT analyses of the viable strategic options with the results of your Five Forces analysis. For each strategic option, ask yourself how you could use that strategy to:

- Reduce or manage supplier power.
- Reduce or manage buyer/customer power.
- Come out on top of the competitive rivalry.
- Reduce or eliminate the threat of substitution.
- Reduce or eliminate the threat of new entry.

Select the generic strategy that gives you the strongest set of options.

Porter's Generic Strategies offer a great starting point for strategic decision making. Once you've made your basic choice, though, there are still many strategic options available. [Bowman's Strategy Clock](#) helps you think at the next level of details, in that it splits Porter's options into eight sub-strategies.

Key Points

According to Porter's Generic Strategies model, there are three basic strategic options available to organizations for gaining competitive advantage. These are: Cost Leadership, Differentiation and Focus.

Organizations that achieve Cost Leadership can benefit either by gaining market share through lowering prices (whilst maintaining profitability,) or by maintaining average prices and therefore increasing profits. All of this is achieved by reducing costs to a level below those of the organization's competitors.

Companies that pursue a Differentiation strategy win market share by offering unique features that are valued by their customers. Focus strategies involve achieving Cost Leadership or Differentiation within niche markets in ways that are not available to more broadly-focused players.

Apply This to Your Life

Ask yourself what your organization's generic strategy is. How does this affect the choices you make in your job?

If you're in an organization committed to achieving Cost Leadership, can you reduce costs by hiring less expensive staff and training them up, or reducing turnover? Can you reduce training costs by devising in-house schemes for sharing skills and knowledge amongst team members? Can you reduce expenses by using technology such as video conferencing over the Internet?

If your organization is pursuing to Differentiation, can you improve customer service? [Customer Experience Mapping](#) may help here. Can you help to foster a culture of continuous improvement and innovation in your team?

And if you're working for a company that has chosen a Focus strategy, what knowledge or expertise can you use or develop to add value for your customers that isn't available to broad market competitors?

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