

# Space matrix strategic management method

[Business](#), [Management](#)



The SPACE matrix is a management tool used to analyze a company. It is used to determine what type of a strategy a company should undertake. The Strategic Position & ACTION Evaluation matrix or short a SPACE matrix is a strategic management tool that focuses on strategy formulation especially as related to the competitive position of an organization. The SPACE matrix can be used as a basis for other analyses, such as the SWOT analysis, BCG matrix model, industry analysis, or assessing strategic alternatives (IE matrix).

What is the SPACE matrix strategic management method? To explain how the SPACE matrix works, it is best to reverse-engineer it. First, let's take a look at what the outcome of a SPACE matrix analysis can be, take a look at the picture below. The SPACE matrix is broken down to four quadrants where each quadrant suggests a different type or a nature of a strategy: Aggressive Conservative Defensive Competitive This is what a completed SPACE matrix looks like: This particular SPACE matrix tells us that our company should pursue an aggressive strategy.

Our company has a strong competitive position in the market with rapid growth. It needs to use its internal strengths to develop a market penetration and market development strategy. This can include product development, integration with other companies, acquisition of competitors, and so on. Now, how do we get to the possible outcomes shown in the SPACE matrix? The SPACE Matrix analysis functions upon two internal and two external strategic dimensions in order to determine the organization's strategic posture in the industry.

The SPACE matrix is based on four areas of analysis. Internal strategic dimensions: Financial strength (FS) Competitive advantage (CA) External strategic dimensions: Environmental stability (ES) Industry strength (IS) There are many SPACE matrix factors under the internal strategic dimension. These factors analyze a business internal strategic position. The financial strength factors often come from company accounting. These SPACE matrix factors can include for example return on investment, leverage, turnover, liquidity, working capital, cash flow, and others.

Competitive advantage factors include for example the speed of innovation by the company, market niche position, customer loyalty, product quality, market share, product life cycle, and others. Every business is also affected by the environment in which it operates. SPACE matrix factors related to business external strategic dimension are for example overall economic condition, GDP growth, inflation, price elasticity, technology, barriers to entry, competitive pressures, industry growth potential, and others.

These factors can be well analyzed using the Michael Porter's Five Forces model. The SPACE matrix calculates the importance of each of these dimensions and places them on a Cartesian graph with X and Y coordinates. The following are a few model technical assumptions: - By definition, the CA and IS values in the SPACE matrix are plotted on the X axis. - CA values can range from -1 to -6. - IS values can take +1 to +6. - The FS and ES dimensions of the model are plotted on the Y axis. - ES values can be between -1 and -6. - FS values range from +1 to +6. How do I construct a SPACE matrix?

The SPACE matrix is constructed by plotting calculated values for the competitive advantage (CA) and industry strength (IS) dimensions on the X axis. The Y axis is based on the environmental stability (ES) and financial strength (FS) dimensions. The SPACE matrix can be created using the following seven steps: Step 1: Choose a set of variables to be used to gauge the competitive advantage (CA), industry strength (IS), environmental stability (ES), and financial strength (FS). Step 2: Rate individual factors using rating system specific to each dimension.

Rate competitive advantage (CA) and environmental stability (ES) using rating scale from -6 (worst) to -1 (best). Rate industry strength (IS) and financial strength (FS) using rating scale from +1 (worst) to +6 (best). Step 3: Find the average scores for competitive advantage (CA), industry strength (IS), environmental stability (ES), and financial strength (FS). Step 4: Plot values from step 3 for each dimension on the SPACE matrix on the appropriate axis. Step 5: Add the average score for the competitive advantage (CA) and industry strength (IS) dimensions.

This will be your final point on axis X on the SPACE matrix. Step 6: Add the average score for the SPACE matrix environmental stability (ES) and financial strength (FS) dimensions to find your final point on the axis Y. Step 7: Find intersection of your X and Y points. Draw a line from the center of the SPACE matrix to your point. This line reveals the type of strategy the company should pursue. SPACE matrix example The following table shows what values were used to create the SPACE matrix displayed above. Each factor within each strategic dimension is rated using appropriate rating scale.

Then averages are calculated. Adding individual strategic dimension averages provides values that are plotted on the axis X and Y. Where do I go next? The SPACE matrix can help to find a strategy. But, what if we have 2-3 strategies and need to decide which one is the best one? The Quantitative Strategic Planning Matrix (QSPM) model can help to answer this question. Should you have any questions about the SPACE matrix, you might want to submit them at our management discussion forum. Quantitative Strategic Planning Matrix (QSPM)

Quantitative Strategic Planning Matrix (QSPM) is a high-level strategic management approach for evaluating possible strategies. Quantitative Strategic Planning Matrix or a QSPM provides an analytical method for comparing feasible alternative actions. The QSPM method falls within so-called stage 3 of the strategy formulation analytical framework. When company executives think about what to do, and which way to go, they usually have a prioritized list of strategies. If they like one strategy over another one, they move it up on the list. This process is very much intuitive and subjective.

The QSPM method introduces some numbers into this approach making it a little more "expert" technique. What is a Quantitative Strategic Planning Matrix or a QSPM? The Quantitative Strategic Planning Matrix or a QSPM approach attempts to objectively select the best strategy using input from other management techniques and some easy computations. In other words, the QSPM method uses inputs from stage 1 analyses, matches them with results from stage 2 analyses, and then decides objectively among alternative strategies. Stage 1 strategic management tools...

The first step in the overall strategic management analysis is used to identify key strategic factors. This can be done using, for example, the EFE matrix and IFE matrix. Stage 2 strategic management tools... After we identify and analyze key strategic factors as inputs for QSPM, we can formulate the type of the strategy we would like to pursue. This can be done using the stage 2 strategic management tools, for example the SWOT analysis (or TOWS), SPACE matrix analysis, BCG matrix model, or the IE matrix model. Stage 3 strategic management tools... The stage 1 strategic management methods provided us with key strategic factors.

Based on their analysis, we formulated possible strategies in stage 2. Now, the task is to compare in QSPM alternative strategies and decide which one is the most suitable for our goals. The stage 2 strategic tools provide the needed information for setting up the Quantitative Strategic Planning Matrix - QSPM. The QSPM method allows us to evaluate alternative strategies objectively. Conceptually, the QSPM in stage 3 determines the relative attractiveness of various strategies based on the extent to which key external and internal critical success factors are capitalized upon or improved.

The relative attractiveness of each strategy is computed by determining the cumulative impact of each external and internal critical success factor. What does a QSPM look like and what does it tell me? First, let us take a look at a sample Quantitative Strategic Planning Matrix QSPM, see the picture below. This QSPM compares two alternatives. Based on strategies in the stage 1 (IFE, EFE) and stage 2 (BCG, SPACE, IE), company executives determined

that this company XYZ needs to pursue an aggressive strategy aimed at development of new products and further penetration of the market.

They also identified that this strategy can be executed in two ways. One strategy is acquiring a competing company. The other strategy is to expand internally. They are now asking which option is the better one. (Attractiveness Score: 1 = not acceptable; 2 = possibly acceptable; 3 = probably acceptable; 4 = most acceptable; 0 = not relevant) Doing some easy calculations in the Quantitative Strategic Planning Matrix QSPM, we came to a conclusion that acquiring a competing company is a better option. This is given by the Sum Total Attractiveness Score figure.

The acquisition strategy yields higher score than the internal expansion strategy. The acquisition strategy has a score of 4.04 in the QSPM shown above whereas the internal expansion strategy has a smaller score of 2.70. How do I construct a QSPM? You can see a sample Quantitative Strategic Planning Matrix QSPM above. The left column of a QSPM consists of key external and internal factors (identified in stage 1). The left column of a QSPM lists factors obtained directly from the EFE matrix and IFE matrix.

The top row consists of feasible alternative strategies (provided in stage 2) derived from the SWOT analysis, SPACE matrix, BCG matrix, and IE matrix. The first column with numbers includes weights assigned to factors. Now let us take a look at detailed steps needed to construct a QSPM. STEP 1... Provide a list of internal factors -- strengths and weaknesses. Then generate a list of the firm's key external factors -- opportunities and threats. These will be included in the left column of the QSPM. You can take these factors from the EFE matrix and the IFE matrix. Step 2...

Having the factors ready, identify strategy alternatives that will be further evaluated. These strategies are displayed at the top of the table. Strategies evaluated in the QSPM should be mutually exclusive if possible. Step 3... Each key external and internal factor should have some weight in the overall scheme. You can take these weights from the IFE and EFE matrices again. You can find these numbers in our example in the column following the column with factors. Step 4... Attractiveness Scores (AS) in the QSPM indicate how each factor is important or attractive to each alternative strategy.

Attractiveness Scores are determined by examining each key external and internal factor separately, one at a time, and asking the following question: Does this factor make a difference in our decision about which strategy to pursue? If the answer to this question is yes, then the strategies should be compared relative to that key factor. The range for Attractiveness Scores is 1 = not attractive, 2 = somewhat attractive, 3 = reasonably attractive, and 4 = highly attractive. If the answer to the above question is no, then the respective key factor has no effect on our decision.

If the key factor does not affect the choice being made at all, then the Attractiveness Score would be 0. Step 5... Calculate the Total Attractiveness Scores (TAS) in the QSPM. Total Attractiveness Scores are defined as the product of multiplying the weights (step 3) by the Attractiveness Scores (step 4) in each row. The Total Attractiveness Scores indicate the relative attractiveness of each key factor and related individual strategy. The higher the Total Attractiveness Score, the more attractive the strategic alternative or critical factor. Step 6...



Calculate the Sum Total Attractiveness Score by adding all Total Attractiveness Scores in each strategy column of the QSPM. The QSPM Sum Total Attractiveness Scores reveal which strategy is most attractive. Higher scores point at a more attractive strategy, considering all the relevant external and internal critical factors that could affect the strategic decision. Can I compare more than two strategies using a QSPM? Yes, in general, any number of alternative strategies can be included in the QSPM analysis. We included only two alternatives in our example just to keep it simple.

It is important to note that strategies subject to comparison should be mutually exclusive if possible. BCG Matrix Model The BCG matrix or also called BCG model relates to marketing. The BCG model is a well-known portfolio management tool used in product life cycle theory. BCG matrix is often used to prioritize which products within company product mix get more funding and attention. The BCG matrix model is a portfolio planning model developed by Bruce Henderson of the Boston Consulting Group in the early 1970's.

The BCG model is based on classification of products (and implicitly also company business units) into four categories based on combinations of market growth and market share relative to the largest competitor. When should I use the BCG matrix model? Each product has its product life cycle, and each stage in product's life-cycle represents a different profile of risk and return. In general, a company should maintain a balanced portfolio of products. Having a balanced product portfolio includes both high-growth products as well as low-growth products.

A high-growth product is for example a new one that we are trying to get to some market. It takes some effort and resources to market it, to build distribution channels, and to build sales infrastructure, but it is a product that is expected to bring the gold in the future. An example of this product would be an iPod. A low-growth product is for example an established product known by the market. Characteristics of this product do not change much, customers know what they are getting, and the price does not change much either. This product has only limited budget for marketing.

This is the milking cow that brings in the constant flow of cash. An example of this product would be a regular Colgate toothpaste. But the question is, how do we exactly find out what phase our product is in, and how do we classify what we sell? Furthermore, we also ask, where does each of our products fit into our product mix? Should we promote one product more than the other one? The BCG matrix can help with this. The BCG matrix reaches further behind product mix. Knowing what we are selling helps managers to make decisions about what priorities to assign to not only products but also company departments and business units.

What is the BCG matrix and how does the BCG model work? Placing products in the BCG matrix results in 4 categories in a portfolio of a company: BCG STARS (high growth, high market share) - Stars are defined by having high market share in a growing market. - Stars are the leaders in the business but still need a lot of support for promotion a placement. - If market share is kept, Stars are likely to grow into cash cows. BCG QUESTION MARKS (high growth, low market share) - These products are in growing markets but have low market share. - Question marks are essentially new products where

buyers have yet to discover them. The marketing strategy is to get markets to adopt these products. - Question marks have high demands and low returns due to low market share. - These products need to increase their market share quickly or they become dogs. - The best way to handle Question marks is to either invest heavily in them to gain market share or to sell them. BCG CASH COWS (low growth, high market share) - Cash cows are in a position of high market share in a mature market. - If competitive advantage has been achieved, cash cows have high profit margins and generate a lot of cash flow. Because of the low growth, promotion and placement investments are low. - Investments into supporting infrastructure can improve efficiency and increase cash flow more. - Cash cows are the products that businesses strive for. BCG DOGS (low growth, low market share) - Dogs are in low growth markets and have low market share. - Dogs should be avoided and minimized. - Expensive turn-around plans usually do not help. And now, let's put all this into a picture: Are there any problems with the BCG matrix model? Some limitations of the BCG matrix model include:

The first problem can be how we define market and how we get data about market share A high market share does not necessarily lead to profitability at all times The model employs only two dimensions – market share and product or service growth rate Low share or niche businesses can be profitable too (some Dogs can be more profitable than cash Cows) The model does not reflect growth rates of the overall market The model neglects the effects of synergy between business units Market growth is not the only indicator for attractiveness of a market There are probably even

more aspects that need to be considered in a particular use of the BCG model. Internal-External (IE) Matrix The Internal-External (IE) matrix is another strategic management tool used to analyze working conditions and strategic position of a business. The Internal External Matrix or short IE matrix is based on an analysis of internal and external business factors which are combined into one suggestive model. The IE matrix is a continuation of the EFE matrix and IFE matrix models. How does the Internal-External IE matrix work? The IE matrix belongs to the group of strategic portfolio management tools. In a similar manner like the BCG matrix, the IE matrix positions an organization into a nine cell matrix.

The IE matrix is based on the following two criteria: Score from the EFE matrix -- this score is plotted on the y-axis Score from the IFE matrix -- plotted on the x-axis The IE matrix works in a way that you plot the total weighted score from the EFE matrix on the y axis and draw a horizontal line across the plane. Then you take the score calculated in the IFE matrix, plot it on the x axis, and draw a vertical line across the plane. The point where your horizontal line meets your vertical line is the determinant of your strategy. This point shows the strategy that your company should follow. On the x axis of the IE Matrix, an IFE total weighted score of 1. 0 to 1. 9 represents a weak internal position. A score of 2. 0 to 2. 99 is considered average. A score of 3. 0 to 4. 0 is strong. On the y axis, an EFE total weighted score of 1. 0 to 1. 99 is considered low. A score of 2. 0 to 2. 99 is medium. A score of 3. 0 to 4. 0 is high. IE matrix example... Let us take a look at an example. We calculated IFE matrix for an anonymous company on the IFE matrix page. The total weighted score calculated on this page is 2. 79 which points at a company

with an above-average internal strength. We also calculated the EFE matrix for the same company on the EFE matrix page. The total weighted score calculated for the EFE matrix is 2.6 which suggests a slightly less than average ability to respond to external factors. Now we plot these values on axes in the IE matrix. This IE matrix tells us that our company should hold and maintain its position. The company should pursue strategies focused on increasing market penetration and product development (more about this below). What does the IE matrix tell me? Your horizontal and vertical lines meet in one of the nine cells in the IE matrix. You should follow a strategy depending on in which cell those lines intersect. The IE matrix can be divided into three major regions that have different strategy implications. Cells I, II, and III suggest the grow and build strategy.

This means intensive and aggressive tactical strategies. Your strategies should focus on market penetration, market development, and product development. From the operational perspective, a backward integration, forward integration, and horizontal integration should also be considered. Cells IV, V, and VI suggest the hold and maintain strategy. In this case, your tactical strategies should focus on market penetration and product development. Cells VII, VIII, and IX are characterized with the harvest or exit strategy. If costs for rejuvenating the business are low, then it should be attempted to revitalize the business. In other cases, aggressive cost management is a way to play the end game.

What is the difference between the IE matrix and BCG matrix? First, the IE matrix measures different values on its axes. The BCG matrix measures market growth and market share. The IE matrix measures a calculated value

that captures a group of external and internal factors. This means that the IE matrix requires more information about the business than the BCG matrix. While values for each axis in the BCG matrix are single-factor, values for each axis in the IE matrix are multi-factor figures. Because the IE matrix is broader in its definition, strategists often develop both the BCG Matrix and the IE Matrix when assessing their conditions and formulating strategies. Is the IE matrix forward-looking?

By default, both the BCG matrix and the IE matrix are constructed using factors related to current conditions. However, strategists often develop two sets of matrices -- a BCG Matrix and an IE Matrix for the current state and another set to reflect expectations of the future. IFE Matrix (Internal Factor Evaluation) Internal Factor Evaluation (IFE) matrix is a strategic management tool for auditing or evaluating major strengths and weaknesses in functional areas of a business. IFE matrix also provides a basis for identifying and evaluating relationships among those areas. The Internal Factor Evaluation matrix or short IFE matrix is used in strategy formulation.

The IFE Matrix together with the EFE matrix is a strategy-formulation tool that can be utilized to evaluate how a company is performing in regards to identified internal strengths and weaknesses of a company. The IFE matrix method conceptually relates to the Balanced Scorecard method in some aspects. How can I create the IFE matrix? The IFE matrix can be created using the following five steps: Key internal factors... Conduct internal audit and identify both strengths and weaknesses in all your business areas. It is suggested you identify 10 to 20 internal factors, but the more you can provide for the IFE matrix, the better. The number of factors has no effect on

the range of total weighted scores (discussed below) because the weights always sum to 1.00, but it helps to diminish estimate errors resulting from subjective ratings. First, list strengths and then weaknesses. It is wise to be as specific and objective as possible. You can for example use percentages, ratios, and comparative numbers. Weights... Having identified strengths and weaknesses, the core of the IFE matrix, assign a weight that ranges from 0.00 to 1.00 to each factor. The weight assigned to a given factor indicates the relative importance of the factor. Zero means not important. One indicates very important. If you work with more than 10 factors in your IFE matrix, it can be easier to assign weights using the 0 to 100 scale instead of 0.00 to 1.00.

Regardless of whether a key factor is an internal strength or weakness, factors with the greatest importance in your organizational performance should be assigned the highest weights. After you assign weight to individual factors, make sure the sum of all weights equals 1.00 (or 100 if using the 0 to 100 scale weights). The weight assigned to a given factor indicates the relative importance of the factor to being successful in the firm's industry. Weights are industry based. Rating... Assign a 1 to X rating to each factor. Your rating scale can be per your preference. Practitioners usually use rating on the scale from 1 to 4. Rating captures whether the factor represents a major weakness (rating = 1), a minor weakness (rating = 2), a minor strength (rating = 3), or a major strength (rating = 4).

If you use the rating scale 1 to 4, then strengths must receive a 4 or 3 rating and weaknesses must receive a 1 or 2 rating. Note, the weights determined in the previous step are industry based. Ratings are company

based. Multiply... Now we can get to the IFE matrix math. Multiply each factor's weight by its rating. This will give you a weighted score for each factor. Sum... The last step in constructing the IFE matrix is to sum the weighted scores for each factor. This provides the total weighted score for your business. Example of IFE matrix The following table provides an example of an IFE matrix. Weights times ratings equal weighted score. What values does the IFE matrix take?

Regardless of how many factors are included in an IFE Matrix, the total weighted score can range from a low of 1.0 to a high of 4.0 (assuming you used the 1 to 4 rating scale). The average score you can possibly get is 2.5. Side note... Why is the average 2.5 and not 2.0? Let's explain using an example. You have 4 factors, each has weight 0.25. Factors have the following rating: 1, 4, 1, 4. This will result in individual weighted scores 0.25, 1.0, 0.25, and 1.0 for factors 1 through 4. If you add them up, you will get total IFE matrix weighted score 2.5 which is also the average in this case. Total weighted scores well below 2.5 point to internally weak business. Scores significantly above 2.5 indicate a strong internal position.

What if a key internal factor is both a strength and a weakness in IFE matrix? When a key internal factor is both a strength and a weakness, then include the factor twice in the IFE Matrix. The same factor is treated as two independent factors in this case. Assign weight and also rating to both factors. What are the benefits of the IFE matrix? To explain the benefits, we have to start with talking about one disadvantage. IFE matrix or method is very much subjective; after all other methods such as the TOWS or SWOT matrix are subjective as well. IFE is trying to ease some of the subjectivity by



introducing numbers into the concept. Intuitive judgments are required in populating the IFE matrix with factors.

But, having to assign weights and ratings to individual factors brings a bit of empirical nature into the model. How does the IFE matrix differ from the SWOT matrix method? More is better... One difference is already obvious. It is the weights and ratings. This difference leads to another one. While it is suggested that the SWOT matrix is populated with only a handful of factors, the opposite is the case with the IFE matrix. Populating each quadrant of the SWOT matrix with a large number of factors can lead to the point where we are over-analyzing the object of our analysis. This does not happen with IFE matrix. Including many factors into the IFE matrix leads to each factor having only a small weight.

Therefore, if we are subjective and assign unrealistic rating to some factor, it will not matter very much because that particular factor has only a small weight (= small importance) in the whole matrix. It is important to note that a thorough understanding of individual factors included in the IFE matrix is still more important than the actual numbers. EFE Matrix (External Factor Evaluation) External Factor Evaluation (EFE) matrix method is a strategic-management tool often used for assessment of current business conditions. The EFE matrix is a good tool to visualize and prioritize the opportunities and threats that a business is facing. The EFE matrix is very similar to the IFE matrix.

The major difference between the EFE matrix and the IFE matrix is the type of factors that are included in the model. While the IFE matrix deals with internal factors, the EFE matrix is concerned solely with external factors.

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External factors assessed in the EFE matrix are the ones that are subjected to the will of social, economic, political, legal, and other external forces. How do I create the EFE matrix? Developing an EFE matrix is an intuitive process which works conceptually very much the same way like creating the IFE matrix. The EFE matrix process uses the same five steps as the IFE matrix. List factors: The first step is to gather a list of external factors.

Divide factors into two groups: opportunities and threats. Assign weights: Assign a weight to each factor. The value of each weight should be between 0 and 1 (or alternatively between 10 and 100 if you use the 10 to 100 scale). Zero means the factor is not important. One or hundred means that the factor is the most influential and critical one. The total value of all weights together should equal 1 or 100. Rate factors: Assign a rating to each factor. Rating should be between 1 and 4. Rating indicates how effective the firm's current strategies respond to the factor. 1 = the response is poor. 2 = the response is below average. 3 = above average. 4 = superior. Weights are industry-specific.

Ratings are company-specific. Multiply weights by ratings: Multiply each factor weight with its rating. This will calculate the weighted score for each factor. Total all weighted scores: Add all weighted scores for each factor. This will calculate the total weighted score for the company. You can find more details about this approach as well as about possible values that the EFE matrix can take on the IFE matrix page. EFE matrix example Total weighted score of 2.46 indicates that the business has slightly less than average ability to respond to external factors. (See the page on IFE matrix for an explanation of what category the 2.46 figure falls to. What should I include

in the EFE matrix? Now that we know how to construct or create the EFE matrix, let's focus on factors. External factors can be grouped into the following groups: Social, cultural, demographic, and environmental variables: Economic variables Political, government, business trends, and legal variables Below you can find examples of some factors that capture aspects external to your business. These factors may not all apply to your business, but you can use this listing as a starting point. Social, cultural, demographic, and environmental factors... - Aging population - Percentage of one race to other races - Per-capita income Number and type of special interest groups - Widening gap between rich & poor - Number of marriages and/or divorces - Ethnic or racial minorities -Education- Trends in housing, shopping, careers, business - Number of births and/or deaths -Immigration& emigration rates Economic factors... - Growth of the economy - Level of savings, investments, and capital spending - Inflation - Foreign exchange rates - Stock market trends - Level of disposable income - Import and export factors and barriers - Product life cycle (see the Product life cycle page) - Government spending - Industry properties - Economies of scale - Barriers to market entry Product differentiation - Level of competitiveness (see the Michael Porter's Five Forces model) Political, government, business trends ; legal factors... - Globalizationtrends - Government regulations and policies - Worldwide trend toward similar consumption patterns - Internet andcommunicationtechnologies (e-commerce) - Protection of rights (patents, trade marks, antitrust legislation) - Level of government subsidies - International trade regulations - Taxation -Terrorism- Elections and

political situation home and abroad Product Life Cycle Product Life Cycle (PLC) is a term used to describe individual stages in the life of a product.

Product life cycle is an important aspect of conducting business which affects strategic planning. Product life cycle can be divided into several stages characterized by the revenue generated by the product. What is the fundamental idea behind product life cycle? Product life cycle is very similar to a life. A living being is first born (introduction). Then it grows through its youth (growth) to become an adult (maturity). When it gets old, it declines both mentally and physically (decline), after which it eventually dies. An analogy to this process can be observed in production as well. First, a product is being developed. After we know what it is that we are selling and what the customer wants, we introduce it to the market.

As our product becomes known by consumers, it grows until it establishes a solid position in the market. At this point, our product is mature. After a period of time, the product is overtaken by development and the introduction of superior competitors. Then it goes into decline and is eventually withdrawn. All these phases together are called product life cycle. What is the official definition of a product life cycle? Business strategy and performance is affected to a great degree by life cycle stages of a product or service. Business priorities, budgeting, funding, production, distribution, marketing -- all these production aspects change depending on how long a product or a service has been in the market.

The product life cycle method identifies the four (five) distinct stages affecting sales of a product, from the product's inception until its retirement.

**INTRODUCTION** In the Introduction stage of the product life cycle, a product

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or a service is introduced to the market. This stage involves focused and intense marketing effort designed to establish a clear identity and promote maximum awareness. Consumers are testing the product in this phase.

**GROWTH** After a product is introduced in the market, consumers become more interested in it. This is called the Growth stage of the product life cycle. Sales are increasing and competitors are emerging as well. Products become more profitable and companies form alliances, joint ventures, and takeovers.

Customers are accustomed to the product and are starting to purchase it repetitively. Marketing efforts and costs are still significant. Advertising costs are high. Market share tends to stabilize.

**MATURITY** The market has reached saturation. Some producers at a later stage of the Maturity stage of the product life cycle begin to leave the market due to poor profit margins. Sales dynamics is beginning to decrease. Sales volume reaches a steady state supported by loyal customers. Producers attempt to differentiate their products. Brands, trademarks, and image are key tools in this production life cycle stage. Price wars and intense competition are common.

**DECLINE**

Continuous decline in sales signals entry into the Decline stage of the production life cycle. Competition is taking over your market share at this point. Economic and production conditions are becoming unfavorable.

Introduction of innovative products or a change in consumer tastes is common reason for a decline. There is intense price-cutting and many more products are withdrawn from the market. Profits can be improved by reducing marketing and cutting other costs.

Why is it important to know the product life cycle? Any for-profit business is constantly seeking ways to grow

future cash flows by maximizing revenue from the sale of products and services.

Positive cash flow allows a company to invest in development of new products and services, to expand production capabilities, to improve its workforce, and so on. It is most companies' goal to acquire key market share and become a leader in its respective industry. A consistent and sustainable cash flow from product that is well established and stabilized is the key to any long-term investment. And knowing the product life cycle can help with this. Does every product follow the same product life cycle curve? No. It would be very easy if every product went through the same fate or product life cycle. Most products in developed markets fail in the introduction phase. Their product life cycle is very short, and they do not even make it to the maturity stage.

We can also find products with cyclical maturity phases. A product enters the decline phase of the product life cycle where it is promoted to regain customers again. If costs of getting the product back to the top of the market are small, and the product is well positioned or even protected from major competitors, then we talk about a cash cow. This concept is further explained in the BCG matrix model. What are the trends in product life cycle? Short... One most observable trend is that product life cycles are becoming shorter and shorter. This is given mostly by ever-increasing competition (see Michael Porter's Five Forces model for more on competition).

While a manufacturer of pots and utensils faced competition only from another manufacturer in the same city hundreds of years ago, a pot manufacturer these days faces competition from many companies on the <https://assignbuster.com/space-matrix-strategic-management-method/>

other side of the globe in addition to other local manufacturers. Everyone is trying to come to the market with innovations. Revitalization... Many products in mature industries are revitalized by product differentiation and market segmentation. It is not uncommon that companies try to find new niches and market segments when they see their product is about to enter the Decline phase. Companies are becoming very flexible in their ability to reassess product life cycle costs and revenues. Longer operating life... Even though product life cycles shrink, the operating life of many products is becoming longer.

While a 10 years old car would be considered a wreck in 60's, today's cars are relatively very durable and their life time is extending. Companies have to take product operating life into account and adjust their planning accordingly. Companies are attempting to optimize product life cycle revenue and profits through warranties and upgrades to existing products. Five Forces Model by Michael Porter Five Forces model of Michael Porter is a very elaborate concept for evaluating company's competitive position. Michael Porter provided a framework that models an industry and therefore implicitly also businesses as being influenced by five forces. Michael Porter's Five Forces model is often used in strategic planning.

Porter's competitive five forces model is probably one of the most commonly used business strategy tools and has proven its usefulness in numerous situations. When exploring strategic management models, you also might want to check out the BCG matrix, SWOT analysis, IFE matrix, and SPACE matrix models. Why would I need to use Porter's Five Forces model? In general, any CEO or a strategic business manager is trying to steer his or her

business in a direction where the business will develop an edge over rival firms. Michael Porter's model of Five Forces can be used to better understand the industry context in which the firm operates. Porter's Five Forces model is a strategy tool that is used to analyze attractiveness of an industry structure. What is good about Porter's Five Forces model?

Porter has the ability to represent complex concepts in relatively easily accessible formats. His book about the Five Forces model is written in a very easy and understandable language. Even though his model is backed up by some complex model, the model itself is simple and easily comprehensible at all levels. Porter's Five Forces model provides suggested points under each main heading, by which you can develop a broad and sophisticated analysis of competitive position. This can be then used when creating strategy, plans, or making investment decisions about your business or organization. Does Porter's Five Forces model really work? Theoreticians have different view on this.

While some agree that Porter's Five Forces model is the ultimate explanation of how world works, others disagree. It depends in what time frame we judge the state of the facts. Even Michael Porter himself acknowledges that time is of essence when it comes to how his forces interact with each other. Numerous economic studies have shown that different industries can sustain different levels of profitability. This can be attributed to differences in industry structures. What is the basic idea behind Porter's Five Forces model? Porter's Five Forces model is made up by identification of 5 fundamental competitive forces: Barriers to entry Threat of substitutes Bargaining power of buyers Bargaining power of suppliers



Rivalry among the existing players Some later economists also consider government as the sixth force in this model. When putting all these points together in a graphical representation, we get Porter's Five Forces model which looks like this: Force 1: Barriers to entry Barriers to entry measure how easy or difficult it is for new entrants to enter into the industry. This can involve for example: Cost advantages (economies of scale, economies of scope) Access to production inputs and financing, Government policies and taxation Production cycle and learning curve Capital requirements Access to distribution channels Patents, branding, and image also fall into this category.

Force 2: Threat of substitutes Every top decision maker has to ask: How easy can our product or service be substituted? The following needs to be analyzed: How much does it cost the customer to switch to competing products or services? How likely are customers to switch? What is the price-performance trade-off of substitutes? If a product can be easily substituted, then it is a threat to the company because it can compete with price only. Now the question is how strong the position of buyers is. For example, can your customers work together to order large volumes to squeeze your profit margins? The following is a list of other examples: Buyer volume and concentration

What information buyers have Can buyers corner you in negotiations about price How loyal are customers to your brand Price sensitivity Threat of backward integration How well differentiated your product is Availability of substitutes Having a customer that has the leverage to dictate your prices is not a good position. Force 4: Bargaining power of suppliers This relates to

what your suppliers can do in relationship with you. How strong is the position of sellers? Are there many or only few potential suppliers? Is there a monopoly? Do you take inputs from a single supplier or from a group? (concentration) How much do you take from each of your suppliers?

Can you easily switch from one supplier to another one? (switching costs) If you switch to another supplier, will it affect the cost and differentiation of your product? Are there other suppliers with the same inputs available? (substitute inputs) The threat of forward integration is also an important factor here. Force 5: Rivalry among the existing players Finally, we have to analyze the level of competition between existing players in the industry. Is one player very dominant or all equal in strength/size? Are there exit barriers? How fast does the industry grow? Does the industry operate at surplus or shortage? How is the industry concentrated?

How do customers identify themselves with your brand? Is the product differentiated? How well are rivals diversified? Rivalry is the fifth factor in the Five Forces model but probably the one with the most attention. What are the assumptions behind the Five Forces model? From the risk-return perspective, Five Forces model indirectly implies that risk-adjusted rates of return should be constant across firms and industries. How can I analyze my business from inside? Porter's Five Forces model views the business from outside. It focuses on assessing competitive position within industry. If you wanted to analyze your firm from within, you might want to consider the SWOT model.

The SWOT model has some aspects of external view as well but complements Porter's Five Forces model in the internal view. Another model <https://assignbuster.com/space-matrix-strategic-management-method/>

that you might want to consider is the Balanced Scorecard and IFE/EFE matrix. Balanced Scorecard Balanced Scorecard is a performance management framework used by strategic decision makers to make the right decisions about their business. Balanced scorecard not only a set of strategic goals; it is also a method for monitoring progress toward organization's strategic goals. The balanced scorecard method is a management technique designed to provide a view of an organization from both internal and external perspective.

Before we get to the details, let us draw your attention to some other strategic management models, such as SWOT analysis, IFE matrix, EFE matrix, BCG matrix, and SPACE matrix. Strategic management professionals often work also with the quite analytical model called QSPM model. Understanding the Product Life Cycle and Porter's Five-Forces model is also very important. What is balanced scorecard and how does it work? Balanced scorecard views organization from four perspectives: Customer perspective, Internal-business processes, Learning and growth, Financials. The first step in the balance scorecard framework is to analyze these four perspectives. However, balanced scorecard does not end there, it goes further. Balanced scorecard also develops metrics and methods for collecting data to calculate them.

After data is collected and metrics calculated, each of the four perspectives can be analyzed relative to each other. Balanced scorecard provides feedback around both the internal business processes and external outcomes in order to continuously improve strategic performance and results. Perspective 1: Customer Customers are the ones who pay the bills;

therefore, it is important to keep them satisfied so that they not only come back but also spread the word and bring new customers too. Every business should be constantly asking the question: " How well are we meeting the needs of our customers, and how can we make them more satisfied? " Balanced scorecard brings this question into action items.

Balanced scorecard includes the question, methods for how we measure results, and an analysis of how our results meet our goals. This is an example of how the Customer perspective can be handled in the balance scorecard framework: Metric: Overall satisfaction ratings measured via surveys and polls. Target: At least 4. 00 out of 5. 0 from each of the major customer groups: youth, adult, elderly. Method: Our business regularly conducts customer surveys. A final question in each survey asks the respondent to rate his or her overall satisfaction. Data for this metric is compiled monthly. Perspective 2: Internal-business process After defining our customer and knowing how to make him happy, we also need to focus on our processes that get us to the customer.

We ask the question: " How do our internal processes function to efficiently deliver products and services, and how can we improve our efficiency? " Balanced scorecard can translate this into concrete targets, metrics, and methods. Below you can find an example of how balance scorecard addresses the Internal-business process perspective: Metric: Servicing customer calls in our call center. Target 1: Answer each incoming phone call from a customer within one minute. Target 2: Decrease the number of dropped calls to less than 2%. Method: This metric will measure the elapsed time from the moment when incoming phone call reaches our network to the

time it is picked up by an operator. An automated phone auditing IT system will be implemented to track phone statistics.

Perspective 3: Learning and growth Innovation and learning is the key ingredient needed for being ahead of the competition. Employees need to keep educating themselves and the company needs to provide them the right tools and motivation. Strategic planners need to ask the question: " How well are we positioned to ensure that goals are met in the future? " And again, balance scorecard can help translating this question into action steps. Below is an example of how balanced scorecard can handle the Learning and growth perspective. Metric: Staff development. Target: Each employee has to take training ABC by the end of March next year and succeed at least 80% score on a test.

Method: The company will offer training ABC that will be followed by a test.

Perspective 4: Finance Everything is about the bottom line. A business needs to align its priorities with activities that bring in revenue, and it has to be done in an efficient way. Decision makers need to ask the question: " How well are our finances managed to achieve our mission? " And this can be translated into detailed action steps, measures, and goals in the balanced scorecard framework as well. Here is an example: Metric: The Sales department expenditures as a proportion of company expenditures. Target 1: The Sales department expenditures will be less than 20% of the total company expenditures.

Target 2: The Sales department expenditures will grow at the same or lower rate than revenues from sales. Method: Total expenditures of company and revenues from sales figures will be obtained from the corporate accounting

system. Expenditures for the Sales department will be obtained from intradepartmental book-keeping system. These two figures will be used to calculate the percent. Why is the balanced scorecard method good? The good aspect of the balanced scorecard method is that it is tactical and concrete. While strategic planning documents often tend to be passive, they only say what should be accomplished but do not say how and do not say how it will be measured, balanced scorecard attempts to be active.

The balanced scorecard method transforms an organization's strategic plans and goals from mere statements into execution plans and "orders". This can be done at a very granular level if needed. Balanced scorecard provides a framework that not only provides performance measurements, but it also helps planners identify what should be done and how it should be measured. Balanced scorecard enables executives to truly execute their strategies. How is balanced scorecard implemented in real business? Major units throughout organizations often establish their own scorecard which is then integrated with the scorecards of other units to achieve the scorecard of the overall organization.

The balanced scorecard method today is often implemented as a full strategic planning and management system where data is fed directly from accounting and company IT systems into the model to calculate metrics and compare them with strategic goals and plans. What is the history of the Balanced Scorecard method? The balanced scorecard method was first published by Dr. Robert Kaplan and David Norton. They introduced the balance scorecard framework as a performance measurement framework that added strategic non-financial performance measures to traditional

financial metrics to give managers and executives a more balanced view of organizational performance.