

Strategic Management The Competitive Edge

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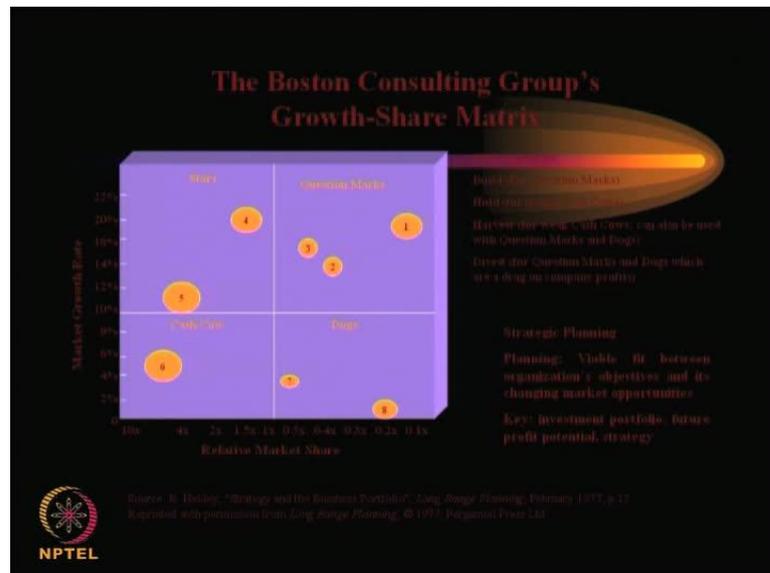
Module No. # 04

Lecture No. # 22

Corporate Strategy- 2

Welcome to this class! In the last class, we discussed about balancing of portfolios for an organization. **For a business, we need first and then for the organization next.** How should we balance the portfolios? When we discussed this portfolio balancing, three things came out to be important: first is the net cash flow, the second is the state of development and third is the risk involved.

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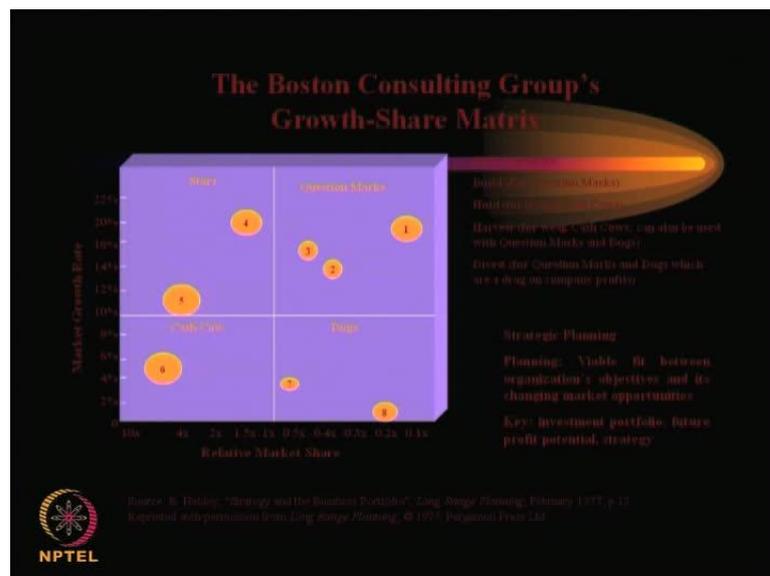
Net cash flow. All these portfolios, we are balancing this portfolio with respect to the investments made or proposed to be made or already made. So, this is the way we look at

it. Suppose, we have already made an investment, what is the type of cash flow realization that is taking place from that investment in that particular business unit?

Now, that brings you to the question: a business unit may be having a number of products and number of product lines also, then what are we really looking at? We are looking at the net cash flow with respect to each product and each product line. What do you mean by that? A product line may be consisting of several products. Suppose, let us say a product line has got some six products. We find out about these six products, what is the type of net cash flow, which is coming in.

Some product might be doing very well in the market. So, it may be raking in a higher net cash flow. Some product may not be doing that well in the market, so you may not be having a very high cash flow receipt.

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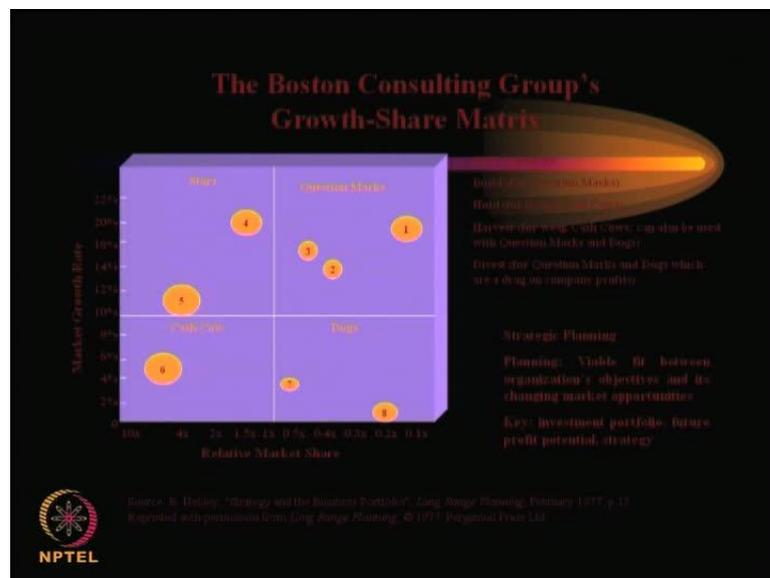
This is the way you look at it. Now, you sum it up over the product lines of the business unit. A business unit may be having some more than one product line. Then what happens? You find out the sum of these net cash flows, the sigma of that how it is coming.

Then, when you put this analysis in the perspective, you will know which product requires more attention in that particular business unit, which product and consequently

which product line also. So, to that product and product line, you have to pay more attention. This is the way you start looking at the net cash flow analysis.

The state of development comes in almost simultaneously. Sometimes when you find that your cash flows are not really very high - that is the net cash flow from a product, you start going to the state of development. At what state is this product? Is it in the embryonic stage, or is it in the growth state? Or is it in a maturity stage? Or it is towards the decline stage?

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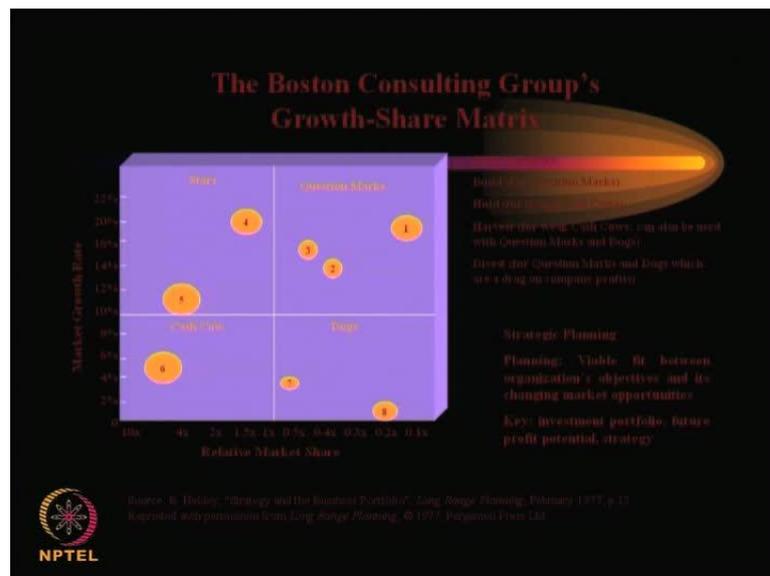
Why is it calling for higher investment or why the receipts are less? These are linked again. In order to take a decision on this one and two, there is a certain amount of risk that is involved. Suppose you say this product is in the introduction stage, it requires support. In order to support this project, we should fund. The question comes - How much funding? How long? That is related to the market, because suppose there is a competitor coming into the product market very soon, then the product will face very tough competition. When the product faces very tough competition, then the risk of investment also becomes extremely important. This is what I just mentioned also in the last class.

With respect to almost all the software major companies in India, there is a risk analysis division, which keeps on tracking the risk that is involved in the investment of the

companies. So, whether it is project A, project B, project C, whatever it is, they start advising the company on the risks that is involved in the project with respect to execution of the project and with respect to what might be the tangible, intangible results, all those types of things. The company's top management will naturally be guided by this risk analysis division of the company. Some of these risk analysis divisions are headed by Vice Presidents of the company also.

They advise the company on whether it is right to invest in a particular portfolio, in a particular project, all those types of things. This is where the portfolio balancing becomes extremely important. In order to help the strategic manager in this task, he can rely on some matrices, portfolio matrices.

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That is what I just mentioned in the last class. I said we will look at a few matrices. One of the common matrices which the Strategic Manager relies upon, he tries to draw upon Boston Consulting Groups growth share matrix. This is commonly referred to as the BCG matrix. For the first time, this BCG matrix was put out in this journal of long range planning in February 1977. How does it look like? This is how it looks like.

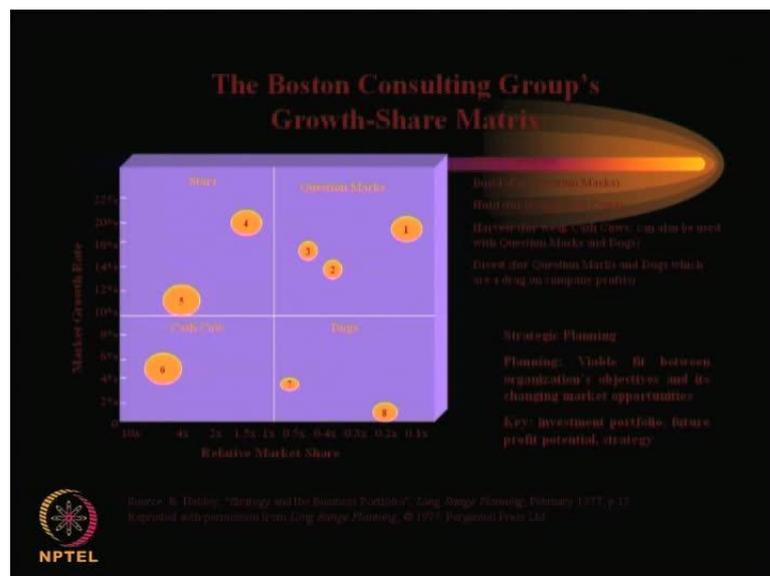
As you can see, it is a semi log graph. What do you mean by semi log graph? One side of the graph is normal; another side is having logarithmic values. That is why it is called semi log graph. If you look at this graph, the y-axis is normal. The y-axis represents the

With respect to all of these, how does it look like? If you really see each of these matrices, you are seeing different sizes of circles; one circle bigger, one circle smaller. How do you really draw these circles? This is given to you in this page number 123 of my book, Building the BCG matrix. How do you build this BCG matrix?

Reading from that, the first step would be to classify the various activities of the company into different business segments or SBUs. So, the first step is put the companies under the different SBU modes. How many SBUs are there for the company? You decide. The second, the growth rate of the market is determined for each of these SBUs and is plotted on a linear scale. The second happens to be your y-axis. The third, the assets employed by each of the business unit are compiled to determine the relative size of the business in relation to the company. Kindly note that.

Suppose, you might have invested only Rs.5, the asset of the company is Rs.100. How much have we invested in that? Only Rs.5. That is a compilation that is next done. The relative market share for different market segments are estimated and are plotted on a log scale - that is the x axis. How do you determine the position of each business unit? That is given to you in point number five.

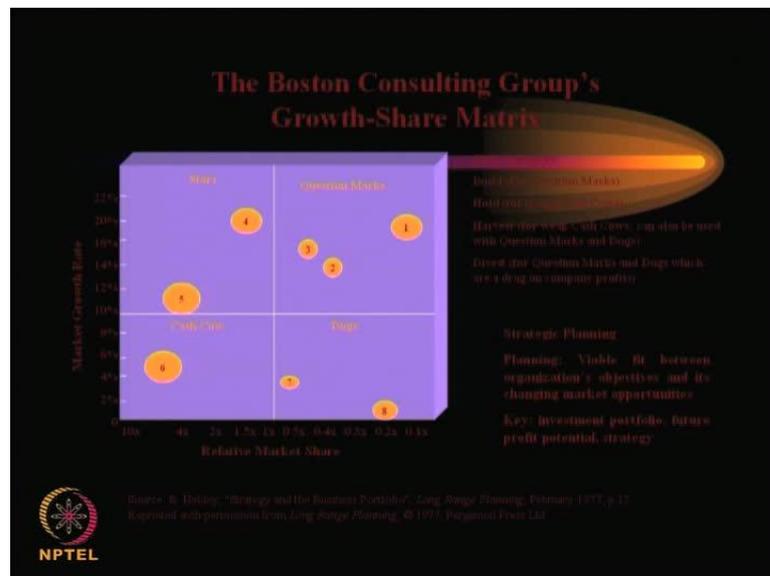
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The position of each business unit is plotted on a matrix of business growth rate and relative market share. The size of the business is represented by a circle with a diameter corresponding to the assets invested in the business.

Suppose, 100 is the total investment in the business, 5 is in your particular business unit, 5 represents the diameter of the circle. The radius of the circle is given by r equal to root of small p into r square, where capital r is a numeral proportional to the sales of the company and small p is the sales of the business unit, as a percentage of the total sales of the company. Both these figures - you should be having from the company side in order to draw this small circle. **This circle of the business unit - this is how you go about it.**

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What does this question mark mean? These question marks are like wild cats - problem child sometimes. You invest in some business, suppose it becomes a problem child. What do you do? You want to get rid of it before it becomes highly problematical. So, before it becomes too problematic, you may say - let me get rid of the whole thing.

So, from these question marks, you may see some of these business units disappearing or going towards dogs. This route can go towards dogs right from question marks only. But you do not want to invest in a business without prior homework, that is, doing without good homework and doing a prior analysis.

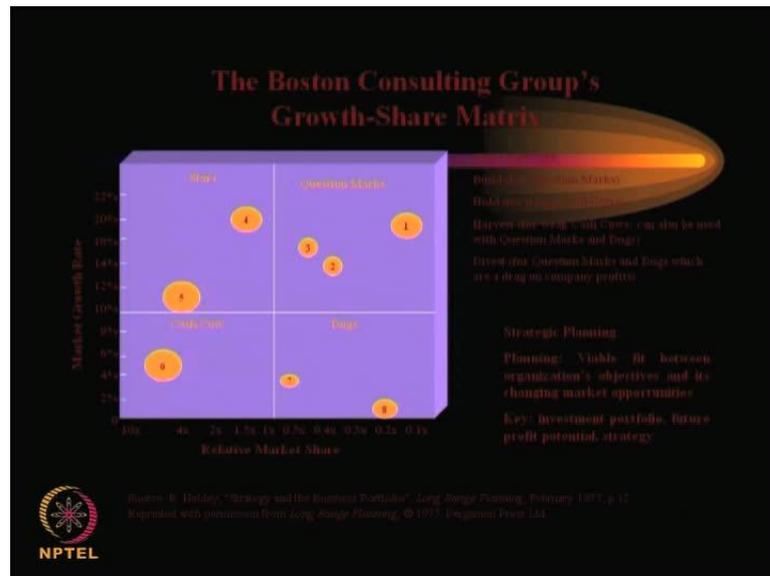
So, you do not want your business unit to go into dogs right from question marks. The objective of the strategic planner would be to convert that business to star, to the extent that is possible. That is, you would like to move that particular business from the question marks to star that is good for the company; because the stars are the leaders for the company, they tend to give more visibility and also bring higher sales to the company. In order to retain that star position, it may require some investment but that investment may also be justified, because you may retain that star position for a longer period in the marketplace. So, a risk manager may justify it by saying – yes, we can go ahead with the investment in this particular star. In other words, a strategic manager's aim would be to convert as many question marks as possible into stars.

These question marks sometimes referred to as problem child; sometimes referred to as wild cats, sometimes when it becomes highly problematical, may go into dogs, all these types of things which I just mentioned.

What about stars? They are the market leaders. They bring that visibility to the company. More the number of stars, better it is for the company. What do you mean by better it is for the company? Better for the company's health.

Suppose, a company has a number of stars, it means that it has so many business units which are leaders in themselves. The objective of the strategic manager, as I mentioned, would be to convert as many question marks as possible to stars. So, that is good for the company's health. More the number of stars, the company is in better lime light.

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Now, the next question that comes is- they also justify as I mentioned to you, the investment, if it is required to keep them longer in the stars. That is the risk analysis group of a company can also justify that investment.

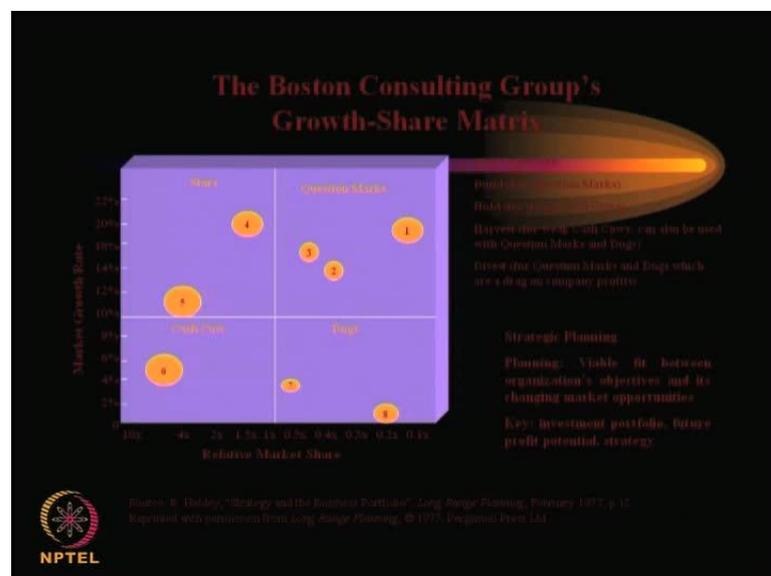
Now, what about the cash cows? These are the businesses of the business unit, which have gone through the phases of question marks and stars and they have moved to cash cows. A business when it starts, it will be in question marks. The objective of the strategic planner or the strategic manager in conjunction with the marketing manager would be to move it to stars. After retaining it as long as possible in that stars, this particular business comes to the cash cows. When it comes to the cash cows, what is the characteristic of this cash cow?

Here, the company can milk this business without too much of investment that is it has established a name for itself in the marketplace, the product is known; the company has also established itself in the marketplace. So, all these will contribute to the company getting returns from this particular investment on a regular basis without too much of investment. In other words, the risk that is involved is minimum with respect to a cash cow.

If you look at this particular graph, you have this business unit number six, where you are really towards the left end of this graph, and the company gets a constant return; that

is, it keeps on getting returns on this investment without having too much to invest. Now, suppose this 6 came to the center, then what is going to happen? What is this? Cash cow is slowly moving towards the dogs; that is it is going towards the decline stage. That is the time, when as a strategic manager, you should see what is a salvage value that you can get through that particular business. It is going to get into the decline stage. When it is getting into the decline stage, it is essential for you to salvage as much as value as possible.

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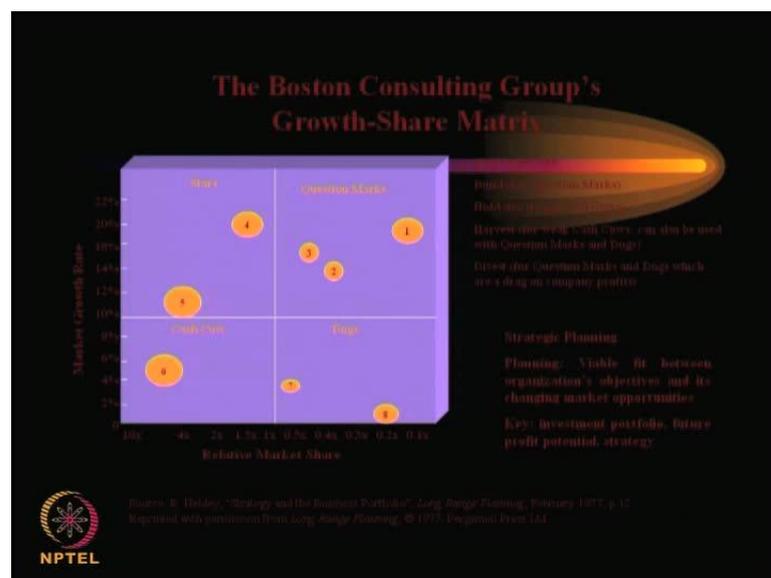
This is the essence of this particular BCG group matrix. If you look at it, this particular matrix on the right side of this, I have given some strategies. What is it? I have said a strategic planner would like to build for question marks.

He would like to hold on for strong cash cows like the one which you are seeing here. He would like to harvest for a weak cash cow. It can also be used for question marks and dogs then divest for question marks and dogs, which are a drag on the company's profit.

As I told you, sometimes these question marks are problem child or wild cats. At that point of time, it is possible that you may like to divest from the question mark stage itself, that is - try to salvage as much as value as possible. This is the type of thing which you might like to do.

As a strategic planner in this type of business unit, what will be your focus? In the planning side, your focus will be to establish a viable fit between the organization's objectives and the changing market opportunities. That is the objective of the whole process. In order to do that, what will you do? The key that you will employ as a strategic planner is your investment portfolio, the future profit potential and consequently the strategy to be adopted.

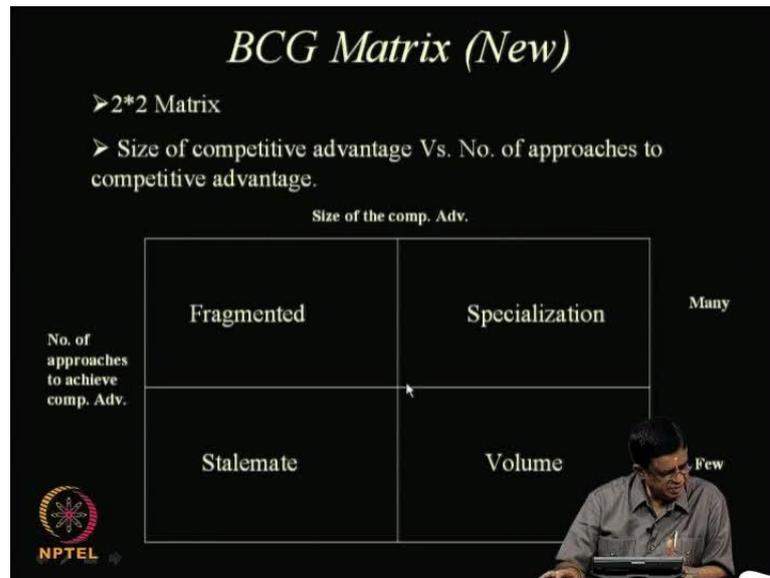
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So, the investment portfolio, the future profit potential and the strategy to be adopted hold the key for the strategic planning success of this business unit. This is where this BCG matrix can be helpful for a strategic planner. Now, this is one of the earliest matrices that were brought out by this company, BCG, Boston Consulting Group.

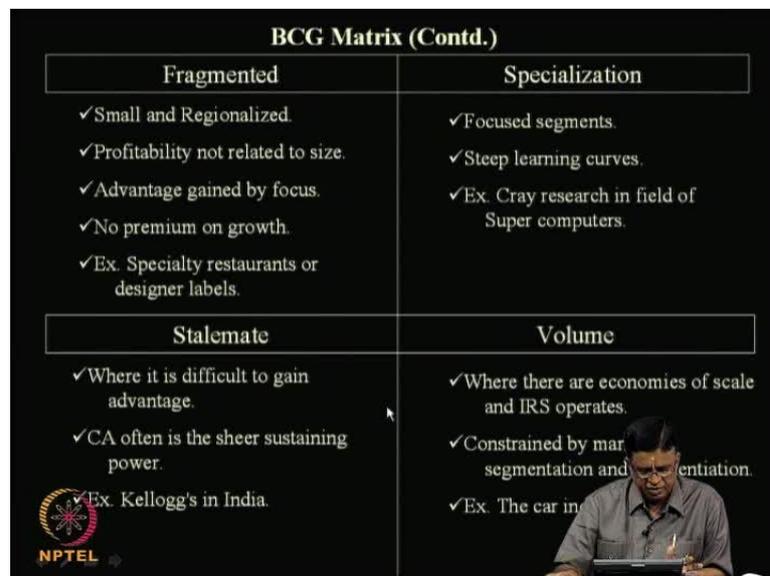
As in every field, lot of developments has taken place; even in this field of evaluation of portfolios as well. So, this BCG group itself started developing in the sense, undergoing modification. The BCG matrix itself now comes out with what is called a new BCG matrix. This new BCG matrix was unveiled in the year 1989. Again, it is a 2 by 2 matrix.

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What does it give? It looks at the competitive advantage - that is the size of the competitive advantage and the number of approaches to achieve that competitive advantage.

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If you see in this, the four quadrants are - first is specialization, second fragmented, third is stalemate, and fourth is volume. The number of approaches to achieve competitive advantages can go from few to many. This could be the size of the advantage.

In the next slide which I put out to you - What is meant by fragmented? What is meant by specialization? What is meant by stalemate? What is meant by volume?

What is fragmented? Fragmented means small and regionalized. You are not in every market; you are in a particular niche market of your own. So, the segment is something with which you are very familiar. For example, the well known automotive brand of TVS - any product which it launches, it would like to first launch it in the south because the name of TVS in the south is almost synonymous with quality, efficiency and you name it. When you say this product is from the house of TVS, automatically, the South Indian market, looks up to it and says - let us give this product a trial coming from the house of TVS.

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BCG Matrix (Contd.)	
Fragmented	Specialization
<ul style="list-style-type: none"> ✓ Small and Regionalized. ✓ Profitability not related to size. ✓ Advantage gained by focus. ✓ No premium on growth. ✓ Ex. Specialty restaurants or designer labels. 	<ul style="list-style-type: none"> ✓ Focused segments. ✓ Steep learning curves. ✓ Ex. Cray research in field of Super computers.
Stalemate	Volume
<ul style="list-style-type: none"> ✓ Where it is difficult to gain advantage. ✓ CA often is the sheer sustaining power. ✓ Ex. Kellogg's in India. 	<ul style="list-style-type: none"> ✓ Where there are economies of scale and IRS operates. ✓ Constrained by market segmentation and differentiation. ✓ Ex. The car in

So, TVS would like to take advantage of that regional niche, which it has created over so many years and then move to the other markets in the country. It may start from South then introduce it in the West, North like that.

So, fragmented stands for small and regionalized, profitability not related to size, then advantage is gained by focus, and there is no premium on growth. I have taken here the example of specialty restaurants or designer labels. If you see some of these specialty restaurants - let us say in Bangalore, you have this restaurant called MTR. It specializes in a few dishes and he does not go beyond those dishes.

Go to that restaurant at any point of time, you have only those dishes. If you want some other dish, it is not there. For him, he does not want to grow too much - no premium on growth. He keeps that. This is a way a fragmented market works.

Then, what about the specialization markets, contrasted to the fragmented markets? The specialization markets are focused segments; that is what I have said of the TVS.

They are in the auto business. They are focused segments. They are steep learning curves. For example, what I am giving you here is that of Cray Research in the field of Supercomputers. Cray Research always goes deep in the field of Supercomputers. They have done very good work in this.

What about stalemate? Where it is difficult to gain advantage? That is, that market where it is difficult to gain advantage. So, competitive advantage often in such types of market is the sheer sustaining power. I have given an example here of Kelloggs in India, that is corn flakes.

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<ul style="list-style-type: none"> ✓ Small and Regionalized. ✓ Profitability not related to size. ✓ Advantage gained by focus. ✓ No premium on growth. ✓ Ex. Specialty restaurants or designer labels. 	<ul style="list-style-type: none"> ✓ Focused segments. ✓ Steep learning curves. ✓ Ex. Cray research in field of Super computers.
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Why did I take this example? There are so many small scale units in India, which bring out tasty corn flakes, but do not have a great brand name. They may not pack it very neatly as Kelloggs. They may also pack it in a good plastic and sell it in different places, but not like the packaging resorted to by Kelloggs.

If you look at a big name like Kelloggs for its corn flakes that is his product, where is the competition coming from? The real competition is coming from all these small players because they are able to putout tasty corn flakes at probably a much lower rate or price than Kelloggs. This is what you can see in most of these places, where you have the corn flakes of a lesser known player and Kelloggs side by side. So, you can just make a comparison of the price, you will find that the price of this particular corn flake much lower compared to Kelloggs.

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How does Kelloggs get competitive advantage in this type of a scenario? Kelloggs will get competitive advantage in this type of a scenario, because of its status, the brand status that it has achieved in different global markets. It has achieved as a global player having vast resources at its command. So, it can sustain for a longer time in the market without having to bother too much about profits. What does it mean?

To put it simply, let us, say 10 packs of the small player's corn flakes go, 1 pack of Kelloggs goes- let us say that is sold in a particular shop. Kelloggs will not get too much worked upon; it will wait, because it has the wherewithal to wait, which the smaller player may not have. Suppose this smaller player instead of that 10 it becomes 5 for him, - let us say assume that scenario. Then, it becomes difficult for him to survive, because he was expecting a minimum ten business. This intrusion of Kellogg may be through incentives or through different methods. He might have just pulled some of the

customers of the small player towards his side. He may offer a toy for using this Kelloggs or he may offer a game, all those types of things free for the child for using this Kelloggs product.

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So, all this might pull the customer to the Kelloggs side. Then what is going to happen? The person who is going to suffer is the smaller player. This is what it means - the competitive advantage often is the sheer sustaining power. How does he get the sustaining power? He gets the sustaining power because he has got the resources and the brand at his command.

What about volume? Volume - where there are come economies of scale and IRS operates. What is IRS? Increasing Returns to Scale, **that is suppose, let us say** I produce more. When I produce more, what is going to happen? I expect the sales to be more. When I get the sales to be more it is very probable that I may get higher returns. But what is the constraint here?

You may be constraint by market segmentation and differentiation. That is, you should be able to differentiate your product from the competitor's product. You should be able to market your product in a segment where the competitor is not able to make a heavy dent into your market segment. All this is best amplified by the present car industry in India. Look at the present car industry in India.

It is a severe competition. Name it, all types of cars. You want the luxury car, it is there. So, the luxury market segment is there. You do not want the luxury car, you want a good car; that segment is also there. Now, you want a car. It is neither falling in the luxury car nor falling in the good car, all these types of market. You want a car. It can be a small car, it hardly matters. Now for that small car market, you find there are so many players virtually sweating it out.

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You have the Maruthi 800s. Now, the latest intrusion into this Maruthi 800s marketplace is the Nano. The result is suppose, you are a buyer, who wanted to buy the Maruthi 800, the market offers you a choice, why do not you look at this Nano and find out whether this Nano meets your needs or requirements and take a call, whether you want to buy a Maruthi 800 or go in for Nano. When you say Maruthi 800 is in the Indian market for nearly 26 long years, why not I try Nano, which is there for the last one year or less in the marketplace.

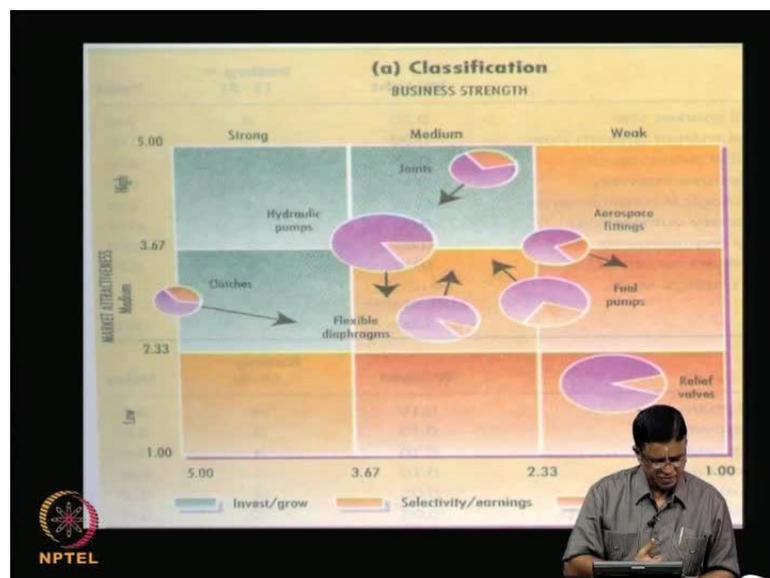
What is the buyer's psyche? The buyers psyche is to identify himself with the latest models of the car. So, Nano for him may represent one of the late entrants or the recent entrants into this type of market segment. Now, what is going to happen?

In this type of business like the Nano car business, how does the company like Tata make profits? How does it make profits? It is by economy subscale. The more number of

units of the car sold, it is possible that the company may be able to have a better **this thing in this**. So, this is the way BCG matrix has transformed itself into this in the present day circumstances. This is the way strategies are getting changed in the present day scenario. This is explained to you in my book. I have also explained here.

Let us, look at one more matrix, this is what is called the GE Matrix. Why is it called the GE Matrix? Because it was put out by the company General Electric. What does it have?

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If you see on the x-axis, it has got business strength; on the y-axis, it has got market attractiveness. How is it going? It is going from 1 to 5, on the business strength and again it is going from 1 to 5 on the market attractiveness. This is the way the whole screen as we see the GE Matrix screen or the GE Business screen is going.

If you compare this to the BCG Matrix, it has got more data compared to the BCG Matrix. If you look at this data, it includes market growth rate, profitability and pricing practices. The business trend includes data on market share, profitability and size.

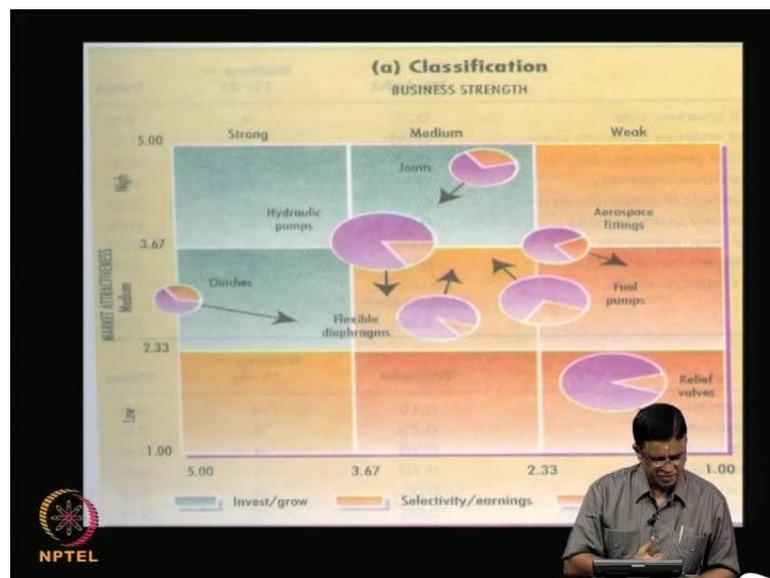
Now, how are this individual product line or business units are plotted as circles? The area of each circle is related to industry sales. The pi within the circles depicts the market share of the product line or business unit.

Repeating again, the area of each circle represents the industry sales. The pi within the circles depicts the market share of the product or business unit. How do you draw this GE Business screen?

You have to follow certain steps. Step number 1 - criteria using factors to determine the industry attractiveness for each product line or business unit has to be selected. It can be on a scale of one very attractive, to a scale of 5 very unattractive to a scale of 5 very attractive.

This industry attractiveness can be something like size of market, rate of growth of sales and cyclic nature of business - the nature of competition including vulnerability to foreign competition, then susceptibility to technological obsolescence and new products, entry conditions and social factors and then the profitability.

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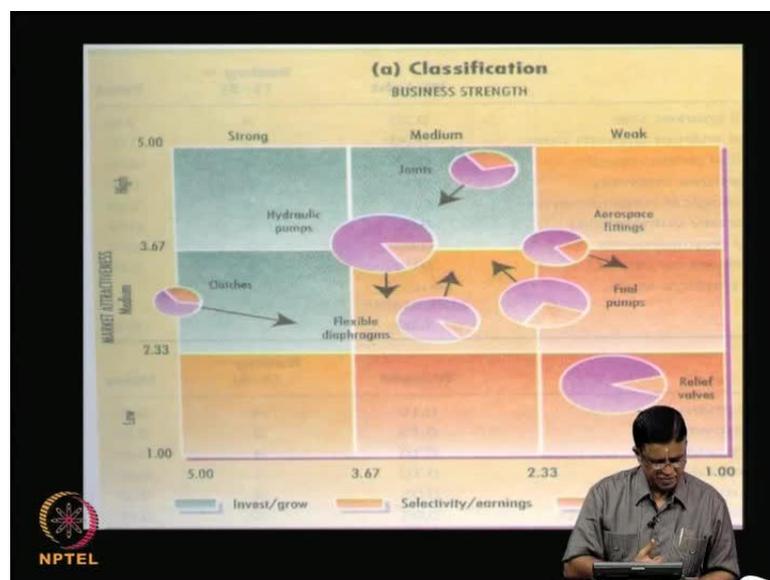


What about the Step 2 - the key factors for success for each product line or business unit have to be selected and the business strength or competitive position, should be rated on a scale 1 very weak to 5 very strong. What are the factors? Typical factors can be market share and capacity, growth rate, location and distribution, management skill, workforce harmony, technical excellence including product and process engineering, then the company image.

If you see the total of the weights, whether it is with respect to the market attractiveness or the industry attractiveness and the competitive position, both should add up to 100. The rating you can go from 1 to 5 or 1 to 10 also many times so that you can get a better figure. When you do that, you will get to have a score for the company.

Now, after doing this second stage what you are going to do in step 3? Each product line or the current position of the business unit can be plotted as shown in this figure. You can plot this particular thing as shown in this figure.

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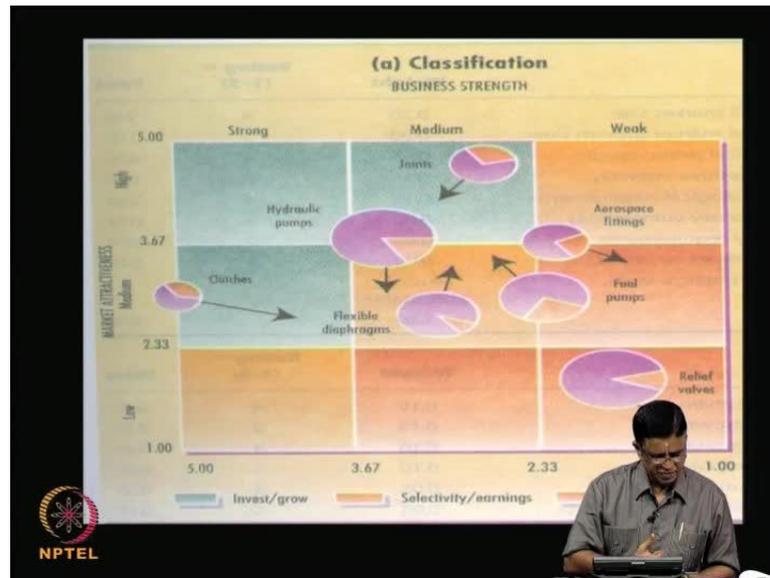


Then, when you plot this, how do you get to draw the inference? The company's future portfolio can be plotted assuming that the present corporate and business strategy remain, that is, you are not going to drastically change. Then, this gives the gap between the projected and desired portfolio and it can help in reviewing the company's current mission, objectives, strategies, and policies. This is the way this business screen can be made use of.

So, what is the type of strategies that you are looking at? If you see, when you are going towards this stage, that is 1 to 2.33, when you are in this type of a circle, you are looking at harvesting or divesting. When you are looking at this type of business units, you are looking at selectivity or earnings, that is you do not want to diversify them immediately, you want to retain them. When you are looking at some of these types of units with these

great things here, you may say that these are the units where I would like to invest or grow - that is this joints or this clutches. They are the ones which are going to hold. Similarly, hydraulics pumps to a certain extent can be made to come out as a star and all those types of things. So, you can be a strong player in this market.

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The business screen that is a GE Business screen has got certain shortcomings. What are the shortcomings? So many factors can become complicated, cumbersome. Why it is so?

It is because you are numerically estimating all this. This numerical estimate sometimes may be question for objectivity. Have you been really objective in giving this? Though, when I say it, we are very objective, it might be subjective. In this type of inference, there is a possibility that you may tend towards that.

Suppose, it is a new product or a new business, the position of this new product or new business cannot be effectively depicted on this business screen. This is a type of thing which you are likely to have, but however with all that it can be a good source of terrific insights to the strategic planner.

It can give with reference to different business units, more factors as compared to the BCG matrix - where does each business stand and can point out to him the different strategies also. Look at these circles. Take this one particular circle here, the joint circle; you are really seeing this is slightly moving down. Then, you are seeing these hydraulic

pumps going down like this - probably towards the cash cows. All these gives lot of pointers to the strategy planner. So, it can give terrific pointers to the strategic planner and say how the business is moving and what are the types of strategies, he should draw upon.

This is also a very important matrix. This matrix is used by many people to build upon the BCG matrix. That is, they make use of the BCG Matrix first and then make use of this matrix to build upon this.

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MARKET ATTRACTIVENESS	High	Protect Position <ul style="list-style-type: none"> Invest to grow at maximum digestible rate Concentrate effort on maintaining strength 	Invest to build <ul style="list-style-type: none"> Challenge for leadership Build selectively on strengths Reinforce vulnerable areas 	Build selectively <ul style="list-style-type: none"> Specialize around limited strengths Seeks ways to overcome weaknesses Withdraw if indications of sustainable growth are lacking
	Medium	Build Selectively <ul style="list-style-type: none"> Invest heavily in most attractive segments Build up ability to counter competition Emphasize profitability by raising productivity 	Selectivity manage for earnings <ul style="list-style-type: none"> Protect existing program Concentrate investments in segments where profitability is good And risk is relatively low 	Limited expansion or harvest <ul style="list-style-type: none"> Look for ways to expand without high risk; otherwise, minimize investment and rationalize operations
	Low	Protect and refocus <ul style="list-style-type: none"> Manage for current earnings Concentrate on attractive segments Defend strengths 	Manage for earnings <ul style="list-style-type: none"> Protect position in most profitable segments Upgrade product line Minimize investment 	Divest <ul style="list-style-type: none"> Sell at time that will maximize cash value Cut fixed costs and avoid investment meanwhile
		Strong	Medium	Weak
		BUSINESS STRENGTH		

NPTEL

In the next class, I will try to give the strategies with respect to each of the cells. In which this GE business screen, where the business might find itself. We will stop here.

Thank you!