BUSINESS PORTFOLIO ANALYSIS – HOFER METHOD

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Abstract: The business portfolio analysis represents an analytical approach by means of which managers have the possibility to view the corporation as a set of strategic business units that must be managed in a profitable way. Also, by taking into account features specific to the area in which the company operates, by taking into account the competitive advantage and the modalities of earmarking financial resources thereof, the business portfolio analysis provides managers the opportunity to approach companies from a different point of view and to pay increased attention to all activities that need to be undertaken.

The present paper aims at presenting from a conceptual standpoint the Hofer method of business portfolio analysis, its strategic consequences and the characteristic advantages and disadvantages. Moreover, the paper will emphasize the importance and part that the business portfolio analysis holds within a company.

Key words: business portfolio, strategic business units, strategic planning

A fundamental question that managers must answer each time is: In what direction must the company go? The strategy implemented by a company must be elaborated so that it considers all market opportunities and neutralizes current threats or foreseen threats. At the same time the company must value its strong points, by referring to the competition. On the basis of these features specific to an ideal strategy and by considering current options that companies may resort to, one may assert that the salient features of the strategy selection process are its difficulty and complexity.

Over time, a series of methods have been created with a view to support the strategy assessment and selection process. Of these, the methods corresponding to business portfolio analysis stands out. The analysis methods of the business portfolio analysis are used in order to identify and examine the various strategic alternatives that must be approached at corporate level.

The business portfolio planning offers three potential benefits. The first resides in the fact that it encourages the promotion of competitive analysis at the level of strategic business units, by means of comparative assessments thereof, resulting in a series of viable strategies focused on benefits yielded by corporate diversity. The second benefit supports the selective earmarking of financial resources by means of identification of strategic issues and by means of adoption of a standardized and objective negotiation process thereof. Thus, the force mix inside a company will be much better directed. The third benefit derives from the opinion of several experts who assert that this manner of approaching the business portfolio that focuses on a host of analysis methods that help reduce risks, increases concentration and involvement, as far as identification and implementation of strategies at corporate level is concerned.

Correlated to visual approach that is based on a series of graphic representations, the business portfolio analysis corresponding to a company is consolidated by the comparative assessment procedure of market shares, rates of market increase, market attractiveness, competitive position and life cycle of products/markets, specific to each strategic business unit. This business portfolio analysis must become routine activity undertaken by the company, through its carrying out on a regular basis, so that decisions of earmarking of financial resources may be monitored, updated and modified with a view to accomplishing corporate objectives, correlated to the process of generation thereof carried out in an efficient way by each strategic business unit[196].

After identifying business portfolio strategies, the next step is taken; it involves the outlining of strategies specific to the level of strategic business units. The basic decisions, that involve the earmarking of corporate resources together with the general approach, by means of which a strategic business unit will be managed, does not complete the strategic analysis process and the selection of the viable strategic alternative. Consequently, each strategic business unit must examine and select a certain type of strategy that in the end should lead to the meeting of long-term strategic objectives[197].

A significant contribution in the field of strategic business portfolio analysis specific to a company belongs to Charles W. Hofer. Over time, he undertook a series of research studies showing that the stage of the life cycle of a product represents a factor that influences to a greater or smaller extent the success of a strategy. Also, he was unsatisfied with the G.E. method, developed by the McKinsey & Company consultancy company and by the General Electric company, which did not stated clearly the position of strategic business units which have recently penetrated the market and which presented a high development potential in the future. Consequently, he proposed a new assessment matrix of business portfolio of the company, organised into 15 quadrants. The specialty literature mentions in under the name of “Hofer Matrix” or "Product/Market Evolution Matrix” and is quite similar to the Arthur D. Little matrix. Picture 1 displays the present matrix where strategic business units are graphically represented according to two basic indicators: competitive position on the market and the stage corresponding to the product/market evolution.

As in the case of the other approaches, Hofer matrix implies the division of the company into strategic business units. The next step resides in assessing the competitive position of business units, by using techniques similar to those used by the McKinsey matrix. The position occupied by each strategic business unit is graphically represented by using the two axes of the matrix. Thus, on the vertical axis (Ox) the competitive position of strategic business units is set and on the vertical axis (Oy) the stage of the life cycle specific to the market where these operate is set.

Further on, strategic business units are outlined, from a graphical point of view, under the form of circles. The size of each circle is proportional to the size of the market where the strategic business unit carries out its activity (measured on the basis of total income resulted on the mentioned markets), while the hatched areas, inside the circle, represent the market shares held by the strategic business units.

The power of the Hofer matrix resides in the fact that it may outline the distribution of strategic business units during stages specific to life cycle of the market (industry). Similar to the McKinsey matrix, the present matrix offers the company the possibility to make a diagnosis regarding the portfolio, in order to establish if it exhibits a balanced or unbalanced structure. A balanced portfolio should be composed of strategic business units of the type corresponding to ”Stars” and to ”Cash Cows” and to a few ”Question Marks”, which have recently penetrated the market or which are about to become ”Stars”. Of course, in practice, most of the companies will have portfolios whole salient feature will be the unbalance.

Strategic consequences

The strategic consequences of this analysis focus on the various stages of life cycle when strategic business units are not covered. Thus, similar to the other methods of business portfolio analysis, the Hofer matrix also suggests that each position held by a strategic business unit indicates the selection of a strategic alternative[198]. According to picture 1, suggested strategies are as follows:

Picture 1 – Hofer Matrix

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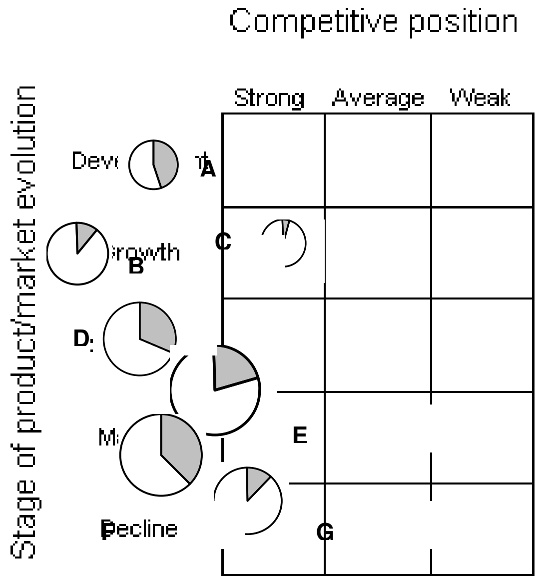
[196] Armstrong, J. Scott; Brodie, Roderick J. - Effects of Portfolio Planning Methods on Decision Making: Experimental Results, International Journal of Research in Marketing, 11, 1994, 73-84, North-Holland, p. 2

[197] Wensley, Robin - Making better decisions: The challenge of marketing strategy techniques - A comment on "Effects of portfolio planning methods on decision making: Experimental results" by Armstrong and Brodie, International Journal of Research in Marketing. Amsterdam: Jan 1994. Vol. 11, Iss. 1, p. 86

[198] Byars, Lloyd L. - Strategic management: formulation and implementation: concepts and cases, 3rd Edition, Harper Collins, New York, 1991, p.133



Source: Wheelen, Thomas L.; Hunger, J. David - Strategic management and business policy: concepts and cases, 10th Edition, Pearson/Prentice Hall, Upper Saddle River, 2006, p.304

1. Strategic business unit ”A” seems to be a potential ”Star”. It holds a large market share, it is in the stage of life cycle development and has a strong competitive position on the market. As such, unit ”A” represents a potential candidate in the competition for corporate resource competition.
2. Unit ”B” is very similar to unit ”A”. Nevertheless, investments in unit ”B” must take into account the fact that although it has a strong market position, its market share is quite small. Consequently, the cause for which market share has such a small value must be identified. Furthermore, a strategy that may contribute to the increase of market share must be developed, thus accounting for the future necessary investment.
3. Unit ”C” has a small market share, its salient feature resides in the fact that it holds a competitively weak position and it entered a small market whose development is underway. A strategy that may increase the market share and develop the competitive position must be elaborated so that the future investments be accounted for. For the unit ”C” a strategy residing in the elimination from the market must be applied, so that the investment for the first two units may be favourised.
4. Unit ”D” is characterised by a strong competitive position on the market and it holds a large market share. In this case, it is recommended that investments be made with a view to maintaining the current position on the market. On the lung run, it will become a “Cash Cow”.
5. Unit ”E” together with unit ”F” are included into the “Cash Cow” category and they should be capitalized on because of great cash flows that they generate.
6. Unit ”G” is included into the “Dogs” category and the management thereof is recommended, with a view to generating short-term cash flows in as much as it is possible. Nevertheless, on the long term the strategy of limitation or liquidation on the market must be selected.

Taking into account that the structure of business portfolio varies from company to company and that they may take multiple forms of graphic expression, Hofer suggested that the majority of business portfolio strategies specific to companies represent variations of one of the three characteristic situations of an ideal portfolio[199]. The three situations specific to a portfolio having an ideal structure are as follows:

[199] Pearce, John A., II; Robinson, Richard B., Jr. - Strategic management: strategy formulation and implementation , 2nd Edition, Irwin , Homewood, 1985, p. 253

a) Developing portfolio
b) Profitable portfolio
c) Balanced portfolio

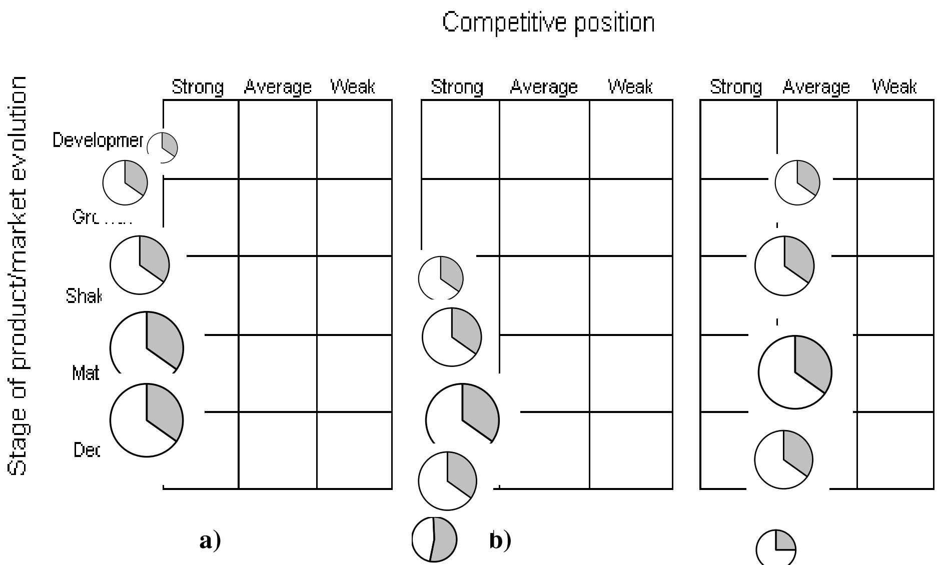
Picture 2 exhibits the three ideal situations and by means thereof several distinct objectives are outlined, objectives that a company may set with a view to meeting them by means of strategic earmarking of financial resources.

Strengths and weaknesses of the Hofer method

The main strengths of the matrix resides in the fact that it provides an image regarding the manner of distribution of the businesses undertaken by a company during specific stages of a life cycle. The company may predict how the present portfolio will develop in the future and it may also act in real time in order to guarantee that his portfolio is in a balanced condition.

Another advantage of the present matrix is that it manages to divert the management's attention from the corporate level and focus on potential strategies specific to the strategic business unit. According to specialty literature, the market life cycle represents one of the main factors that contribute to the adoption of strategic decisions at the level of the strategic business unit. Therefore, following the use of the Hofer matrix, the corporate management may identify strategic procedures that must be integrated and implemented at the level of strategic business units.

Picture 2 – Three ideal types of business portfolios



Source: Byars, Lloyd L. - *Strategic management: formulation and implementation: concepts and cases*, 3rd Edition, Harper Collins, New York, 1991, p.134

The disadvantage of the matrix resides in the fact that it does not focus on all the relevant factors that influence the level of attractiveness of a market. According to the McKinsey matrix, the present model illustrates as well the fact that the stage of the market life cycle is very important, but this element must not be deemed as being the only and the main influence factor of the level of market attractiveness. Therefore, there are other significant factors that may exert influence over the company's portfolio, without being dependent on the stage in which the market evolution is found.

Taking into consideration the above mentioned, we must emphasize the fact that the restriction of the portfolio analysis to a single method, is not a very wise decision. Each method presents a series of advantages and disadvantages and each of them tries to offer, at one time, a diagnostic of the business portfolio specific to a company[200].

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[200] Haspeslagh, Philippe - Portfolio Planning: Uses and Limits, Harvard Business Review. Boston: Jan/Feb 1982. Vol. 60, Iss. 1; p. 60

The methods of analysis of the business portfolio facilitate the debate and outline of the competitive positions of the company and also contribute to the generation of a series of questions related to the way in which the allotment of its actual resources contribute to the achievement of success and vitality on long term. At the same time, these methods, besides the fact that they help the managers to control the allotment of resources and suggest realistic objectives for every strategic business unit, also offer the possibility to use the strategic units as indispensable resources in the process of achievement of the objectives established at a corporate level[201].

In conclusion, it is recommended the combined use of a large variety of methods of analysis of the business portfolio, by the managers from a corporate level, because, in this way they will understand much better the whole market mix included in the custody account analysis, the strategic position held by every strategic business unit, within a market, the performance potential of the portfolio as well as the financial aspects related to the process of allotment of resources, for the business units within the portfolio. It should also be mentioned that the methods of analysis of the business portfolio are not instruments, which offer accurate answers, in spite of the appearances created by the stage of analysis, in which the strategic business units are represented graphically and with austerity. Nevertheless, their main virtue is simplicity, since these underlie the need to further research.

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