Ansoff's Matrix as a Tool for identifying Strategic Growth Options

Article by Réidin* Ní Aonghusa on behalf of the *CPA Examinations Team for Strategic Level Strategy & Leadership, February 2024.

Introduction

This article will describe the Ansoff product/market growth matrix and explain how it can be used as a framework for generating directions for organizational growth. This model considers a range of options for growth, based on an organization offering existing or new products into current or new markets – where markets may be defined as customers, and products as items sold to customers The most appropriate option depend on the current market situation of a given company and many other factors which are outlined below.

Ansoff's matrix is a useful framework for looking at possible strategies to reduce the gap between where the company may be without a change in strategy and where the company aspires to be.

When using Ansoff's matrix the risks inherent in each option must also be considered. This article will also consider some of the limitations of Ansoff analysis as a strategic model and how it has developed since first proposed by Ansoff in 1957.

Main aspects of Ansoff Analysis

The Ansoff matrix describes four possible product/market combinations: Market penetration, product development, market development and diversification (Ansoff 1957, 1989). The four strategies generated by the matrix are expanded below.

Market Penetration – The concept of increasing sales of existing products into an existing market

Market Development – Focuses on selling existing products to new markets.

Product Development – Focuses on introducing new products to an existing market.

Diversification – The concept of entering a new market with new products.

Figure 1 – Ansoff's Matrix

Figure 1 shows Ansoff's Matrix and demonstrates the increasing level of risk as the organisation moves away from its original product/market mix. The reason for this increased risk is explored below.

Market penetration

Market penetration occurs when a company increases sales to it's market with its current products - the market penetration strategy begins with the existing customers of the organisation. This strategy is used by companies in order to increase sales without drifting from the original product-market strategy (Ansoff, 1957). The main advantage of this approach is that it builds on existing strategic capabilities and does not require the company to venture into "unchartered" territory. This strategy can be important for businesses because retaining existing customers is cheaper than attracting new ones, which is why many organisations engage in relationship marketing activities to retain their high lifetime value customers.

Companies often penetrate markets in one of three ways:

* Attract customers from competitors.
* Increase volume and frequency of purchase by existing customers.
* Convert non-users to users.

This approach can lead to increasing power over buyers and suppliers by increasing market share as well as achieving economies of scale.

Product development

Another strategic option for an organisation is to develop new products. Product development occurs when a company develops new products catering to the same market. This refers to significant new product developments and not minor changes in an existing product of the firm. This strategy may offer the opportunity to use excess production capacity, counter competitive entry, maintain the company's reputation as a product innovator, exploit new technology or to protect overall market share. The product development strategy moves the firm into markets and towards customers that are currently not being catered for.

Market development

When a company follows the market development strategy, it moves beyond its immediate customer base towards attracting new customers for its existing products. This may for example involve selling existing products in new international markets. This may entail exploration of new segments of a market, new uses for the company's products and services, or new geographical areas in order to entice new customers. For example, Arm & Hammer was able to attract new customers when existing consumers identified new uses of their baking soda. This was a product originally produced for baking, but has many other potential uses eg as a household cleaner and as an ingredient in toothpaste.

Diversification

When a company pursues a diversification strategy it moves out of its current products and markets into new areas. It is important to note that diversification may be into related and unrelated areas. Related diversification may be in the form of backward, forward, and horizontal integration. Backward integration takes place when the company extends its activities towards its inputs such as suppliers of raw materials etc. in the same business. Forward integration differs from backward integration, in that the company extends its activities towards its outputs such as distribution etc. in the same business. Horizontal integration takes place when a company moves into businesses that are related to its existing activities.

Diversification is generally a high-risk strategy as it involves taking a step into a territory where the parameters are unknown to the company. The risks of diversification can be minimised by moving into related markets (Ansoff, 1989).

Application of Ansoff's Matrix

The appropriate option for an organization will depend on the business environment, competitive activity, the status of the industry and many other factors. This model should be used in conjunction with other strategic models such as Porters's Five Forces, BCG Matrix etc.

Market penetration, for example, may be a successful strategy only when the overall market is growing. In a growing market, companies are often able to increase sales to existing and some new customers without increasing their relative market share. Note that companies with low market share in a growing market can make gains by attacking a competitor head on. However, it is more difficult to benefit from a market penetration strategy in a declining market.

It is also important to note that each strategic option brings with it some fundamental risks, which can be reduced through careful planning and implementation. Generally, market penetration strategies are regarded as low risk as the business parameters of product and market remain the same to a great extent and it builds on existing expertise and customer relationships.

A product development strategy should be part of the natural growth of a company to replace existing (declining) products or to simply expand the product portfolio. A product development strategy can in some cases be risky, as there is a high rate of failure for new products. This strategy requires investment in research and development as well as in marketing.

A market development strategy will also involve certain risks. When entering new international markets, for example, it is important to understand the customers' needs and different cultural aspects which may impact on demand for products and services and influence the marketing strategy. A PESTEL analysis will be appropriate to understand any legal, cultural and economic issues that will impact the market.

It is also important to understand that the organizational lifecycle may determine the appropriate strategy. Perry (1987) identified product development and market development as appropriate growth strategies (Watts et al, 1998) for small and medium enterprises (SMEs).

The diversification strategy is deemed as a high-risk strategy, but many larger organisations have successfully pursued this strategy due to business foresight and effective control mechanisms.

Limitations of Ansoff Analysis

While Ansoff analysis helps in mapping the strategic options for companies, it is important to note that like all models, it has some limitations. By itself, the matrix can tell one part of the strategy story but it is imperative to look at other strategic models like SWOT, Five Forces and PESTEL in order to view how the strategy of an organisation is formulating and might change in the course of its future. Therefore, the steps to be taken while conducting a strategic analysis of an organisation include SWOT analysis, PESTEL and Ansoff matrix as fundamental models of analyses, which should be used in conjunction and not in isolation, to view the complete strategic scenario. Also, recommendations made on the basis of only one of the models will lack depth of analysis.

Example from Past Papers

The April 2021 Strategy and Leadership examination included (Question 1) a Case Study of TFL International Ltd. The firm, founded in 1983 has been very successful and is now one of the largest transport and logistics firms in Ireland. The information below was provided regarding the services, assets and competence of TFL. The full question (and solution) can be found here:

TFLI provides a range of transportation, warehousing and ancillary services for clients 365 days of the year. The firm operates on all major routes within Ireland, Ireland to mainland Europe and Ireland to the UK. It uses the ro-ro ferry routes from Rosslare and Dublin ports to link to the UK and to mainland Europe and uses both direct sailings to France (Cherbourg and Roscoff) and the UK "landbridge" to access the mainland. The firm has rolling reservations for its trucks on over 25 sailings a week out of and into Ireland. TFLI provides tractors and trailers; or just tractors where clients use their own trailers. The firm also offers groupage services to SMEs for part loads. TFLI owns 340 tractors and 980 trailers. The tractors have a median age of four years. The majority of the trailers are designed to carry containers, are temperature-controlled trailers or are "curtainsiders". The firm also has a small number of step frame trailers and flat trailers.

TFLI has a large warehouse and logistics centre located at its head office and main facility in Wexford. The warehouse is 10,000m^2 approximately and includes 12 loading bays and temperature-controlled storage rooms. TFLI also leases a warehouse near Liverpool in England and another one near Cherbourg in France. Both of these are about half the size of the warehouse in Wexford.

The new IT system integrates customer relationship management, sales processing, accounting along with truck monitoring and load tracking. All of this 'live' information allows the firm to manage the truck fleet very efficiently, for example, ensuring that trucks are fully loaded on over 90% of trips. It also enables every client to login into their account and see where their consignment is at any point in time. This service has received a lot of positive feedback, especially from larger clients. The second project involved obtaining recognised quality accreditations, and TFLI now has ISO:14001 certification and ISO:9001 certification.

TFL is facing a number of issues:

The combined impact of Brexit and the Covid-19 pandemic has had a significant impact on demand; however, this has mostly affected TFLI's non-contract-based revenues. The large clients that represent most of TFLI's revenue base were generally well prepared for the practical and documentary implications of Brexit. TFLI has had the most difficulty with smaller and once-off customers, some of which did not even have an Economic Operator's Registration and Identification (EORI) number.

In part (b) of this question candidates were asked to "assess the key issues facing TFL International Ltd and evaluate the business's options in dealing with such issues".

The solution provided used Ansoff's Matrix to generate some strategic options for TFL:

<u>Market Penetration</u> (e.g. growing within their current market), by reviewing the approach to marketing and promotion of TFLI's services.

The transport sector in Ireland is very fragmented with lots of competitors, including many small firms. The current crises in the industry may lead to a shakeup and the possibility of industry consolidation, as it is likely that some smaller competitors will be unable to remain in business. This may give TFLI the opportunity to consolidate their position in the market and to further penetrate the market using their existing resources and competitive strategy. As referred to elsewhere, TFLI perhaps needs to review the implementation of its competitive strategy, and perhaps its marketing and promotion, but there is certainly the possibility of gaining market share in the current context.*

∗ In the April 2021 examination students were informed in advance of the relevant industry for the case study question and were expected to research the industry in advance and to be aware of this type of information. Going forward, all relevant information will be included in the content of the Case Study.

<u>Market Development</u> – e.g. offering some of their existing services to new markets outside of Ireland/UK and EU. This could be regarded as risky as TFLI has no experience of the US or Chinese markets.

TFLI already provides a range of services including transportation in Ireland, to the UK, and to mainland Europe. It also provides a range of trailers depending on the requirements of the client and the nature of the goods to be transported. There is a possibility for the firm to increase the range of services it offers, for example, by organising international transportation outside of the UK and the EU. TFLI could operate as a freightforwarder or as a NVOCC for firms wishing to export to, for example, the United States or China.

<u>Product Development</u> – developing new products for their existing (Irish Markets). This builds on their existing capability, brand and knowledge of the Irish market. It also takes advantage of the macroenvironment of the Irish market (increased online purchasing).

An alternative expansion possibility for TFLI is (related) diversification into parcel delivery in the Irish market. The firm already has expertise in organising transportation and logistics and already employs a large number of drivers. Obviously, it will take some time and the development of an attractive marketing proposition to persuade firms to move from their current delivery service provider to one *provided by TFLI. However, this is currently an attractive market due to the increased level of online purchasing which leads to increased levels of deliveries, in particular to domestic residences.*

Development of Ansoff

Ansoff originally had a matrix with four separate boxes, but in practice strategic directions involve more continuous axes. Johnson, Whittington. Scholes, Angwin and Regner propose an adapted Ansoff Matrix as shown in Figure 2 below:

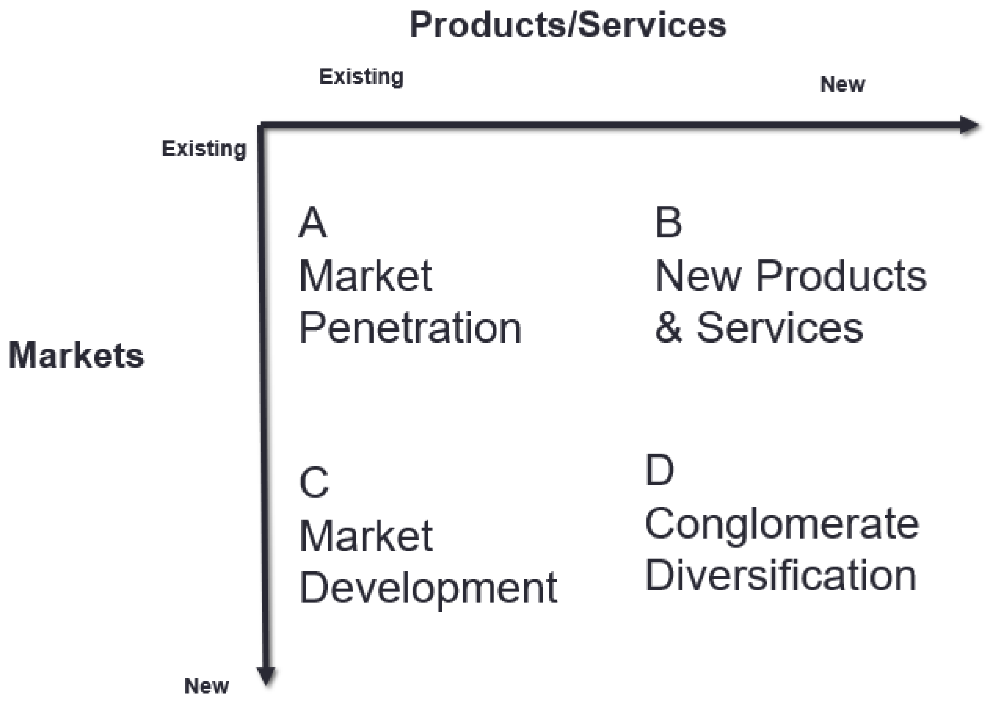

Figure 2 – Ansoff's Matrix (adapted)

Typically, an organisation will start by selling a specific product or product range in a specific market (Zone A). According to Ansoff, an organisation, when seeking to grow, may choose between *penetrating* further within its existing sphere of business or increasing its diversity into new markets or new products. The extent to which the organization will choose to diversify will tend to increase the associated risks. Generally, the closer the firm stays to its original products and markets the lower the risks will be, however this may lead to limiting the growth of the organisation.

In this adapted model Market Development (Zone C) and Product Development (Zone B) are both viewed as forms of related diversification with Zone D showing a high degree of diversification (Conglomerate Diversification)

Conclusion

Ansoff matrix is one of the most well-known frameworks for deciding upon growth strategies of an organisation. Strategic options relating to which products or services an organisation may offer in which markets are critical to the success of companies.

There are risks associated with all of the four strategic options entailed in the Ansoff matrix. Market penetration is generally considered as a low-risk strategy while diversification, and in particular conglomerate diversification, is deemed as a high-risk growth strategy as it involves moving simultaneously into new products and new markets.

Lastly, Ansoff matrix as a strategic model has certain limitations. The use of SWOT and PESTEL analysis is recommended, along with Ansoff analysis, to be able to capture a holistic view of the strategic scenario of an organisation