VALUE CHAIN ANALYSIS

Key Points

- The value chain helps an organization identify how it creates value for customers and locate where its sources of competitive advantage lie.
- Value chain models can be created in both qualitative and quantitative forms.
- Many organizations do not consciously make decisions to optimize the sources of advantage resident in their value chain and in so doing, risk losing competitive advantage.

Main Thoughts

Most mangers know that their organization's value chain represents the sequence of activities necessary to create a product or service, produce or deliver it, market and sell it to customers, distribute or provide it to those customers while ensuring necessary post sales service is completed. They also know that internal firm infrastructure activities such as human capital development or procurement support the main stages in the value chain. What managers sometimes aren't as knowledgeable of is the fact that the value chain within a firm or industry is actually comprised of a very specific model of performance that depicts the discrete stages of organizational value creation. Further, they don't always use the model to compare and contract activities across firms for the purpose of determining where competitive advantages lie.

Developed in the early 1980s by Harvard Business School Professor Michael Porter in his book *Competitive Advantage*, the value chain consists of two main components: primary activities and secondary activities. A generic, firm specific value chain is shown in figure 1.

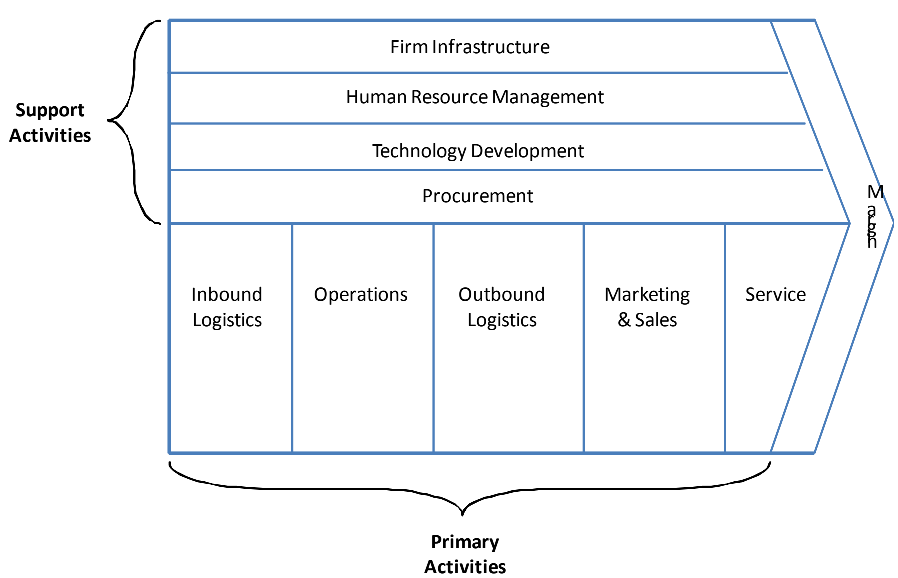

Figure 1: Porter Value Chain, 1985

Support Activities: These consist of activities that do not directly produce goods or services. Infrastructure activities such as administration, human resource management, information technology management, purchasing and procurement, and research and development are included in the support area of the model.

Primary Activities: These activities are the direct, value creating activities of the firm. Bringing raw materials into an organization, manufacturing a product or service, distributing it as well as marketing, selling and servicing the product are considered primary activities.

The model can and should be reconfigured to account for activities specific to the industry in which the firm competes. For example, in a service industry—such as professional services—inbound logistics might be replaced with methodology development or client acquisition. Regardless of industry however, the value chain is a powerful framework for analyzing both industry and firm specific activities.

For Example

The following is an example of the value chain for copier manufacturer.

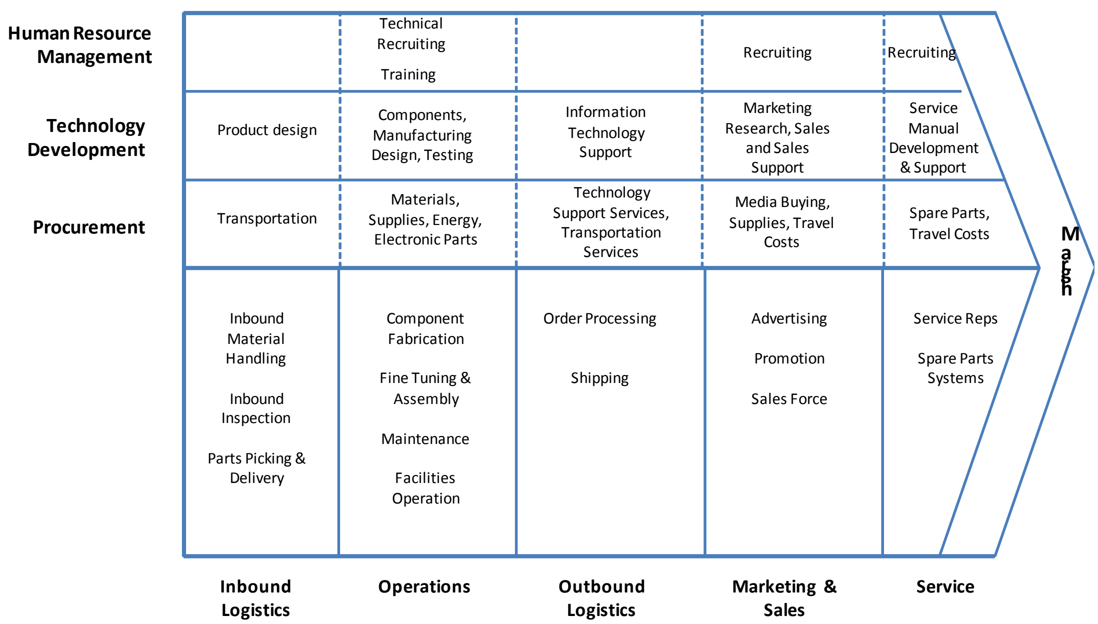

Figure 2: Value Chain for a Copier Manufacturer (adapted from Porter, 1985)

CPP Insight

Although the value chain has been in the public domain for over 20 years, it's not often used expressly as part of the strategy development process. This could be because managers aren't always sure how to go about developing one or are suspicious of the insight the analysis actually provides. To creating one, the most basic way is to simply catalog the activities an organization performs as is the case in Figure 2. This provides an initial way of understanding what an organization does and more specifically, where it might differentiate within the value chain to achieve advantage over competitors. The base version can then be contrasted to competitor value chains, which can be created as separate analysis as well. As the value chain template is incrementally built up over time, total costs can be identified for each activity. Then, depending costs can be identified on a per unit basis—which is the ultimate goal of the analysis. Again, this can be done for competitors as well. When complete, a solid understanding of relative cost position will have been gained from which effective strategies can then be created.

For More Information

Texts:
Porter, Michael E., 1985. *Competitive Advantage: Creating and Sustaining Superior Performance.* Free Press, New York.

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