The Value Chain

ANALYSIS TEMPLATE

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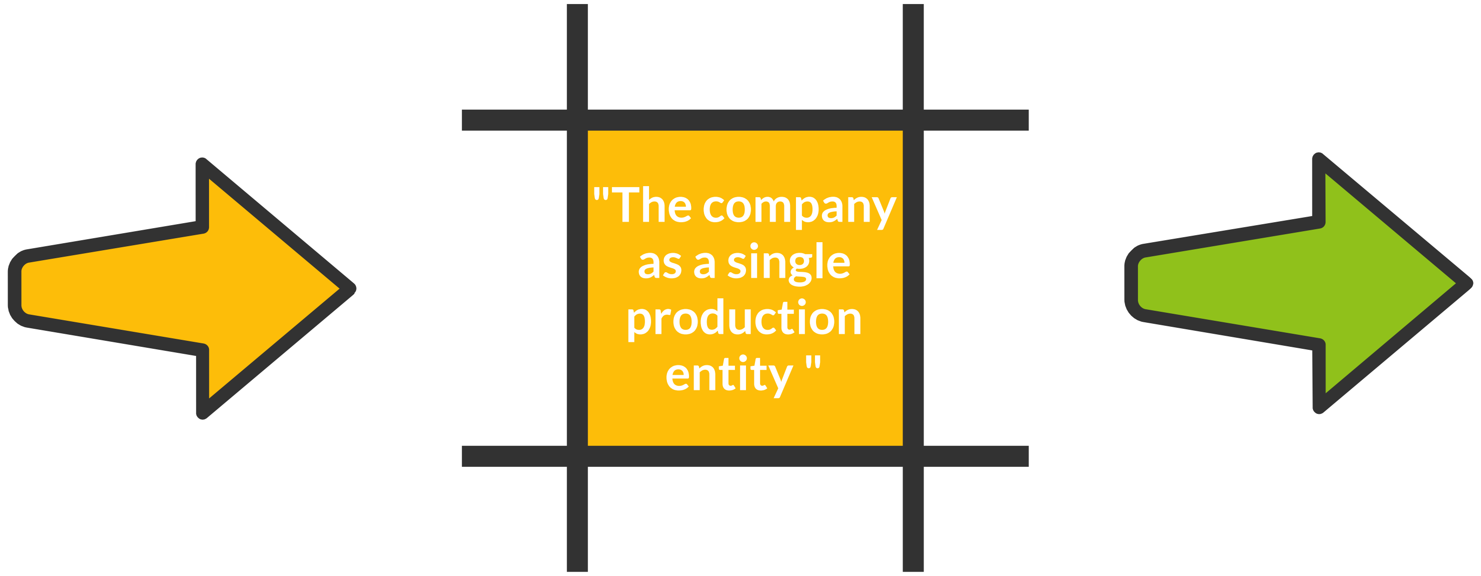
The value chain analysis template

An activity based view of the firm

Prepared by Stefano Messori, this document is intended as an accompaniment to the Value Chain MS Excel spreadsheet. The spreadsheet, which is available for free download (now also available an unlocked version), was developed on the basis of Michael E. Porter's framework and the aim is to introduce you to the role the value chain plays in developing and maintaining your company's competitive advantage. Outlined in this document are the instructions for the use of the spreadsheet and the foundation to better pursue your company's competitive advantage.

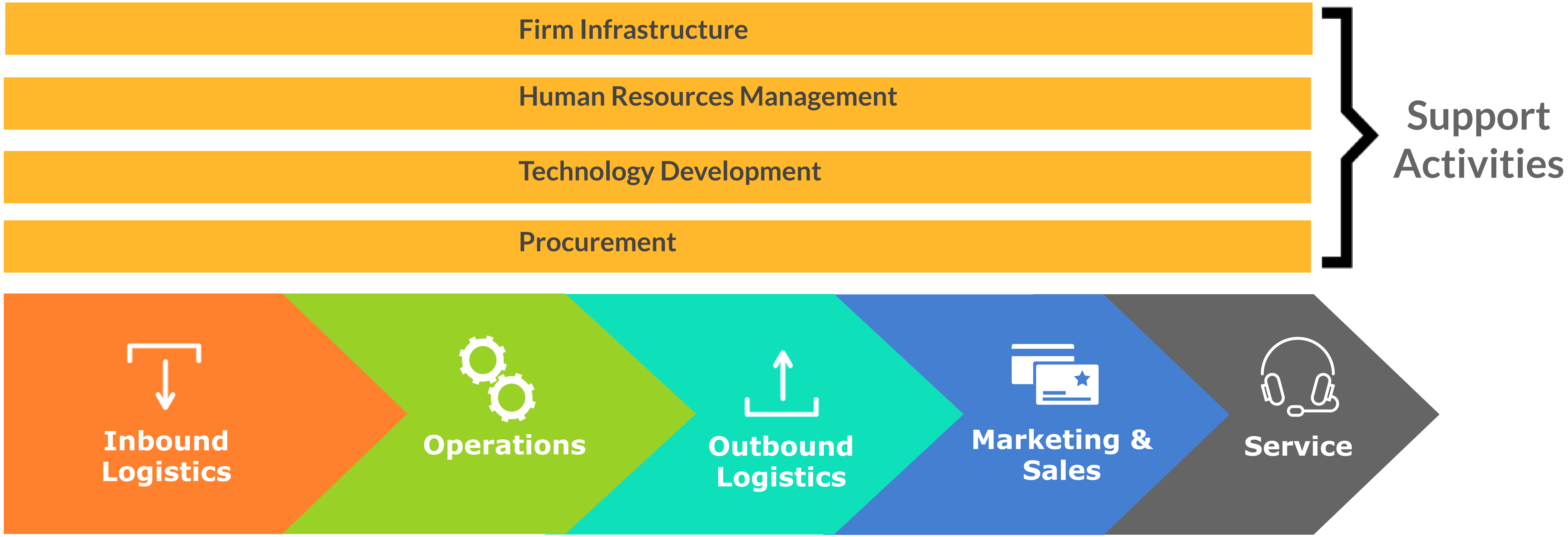
"An activity-based view of the firm"

The classical view of the firm as a single, self-contained entity that defines how inputs are converted into outputs is outdated.



The Value Chain
Model

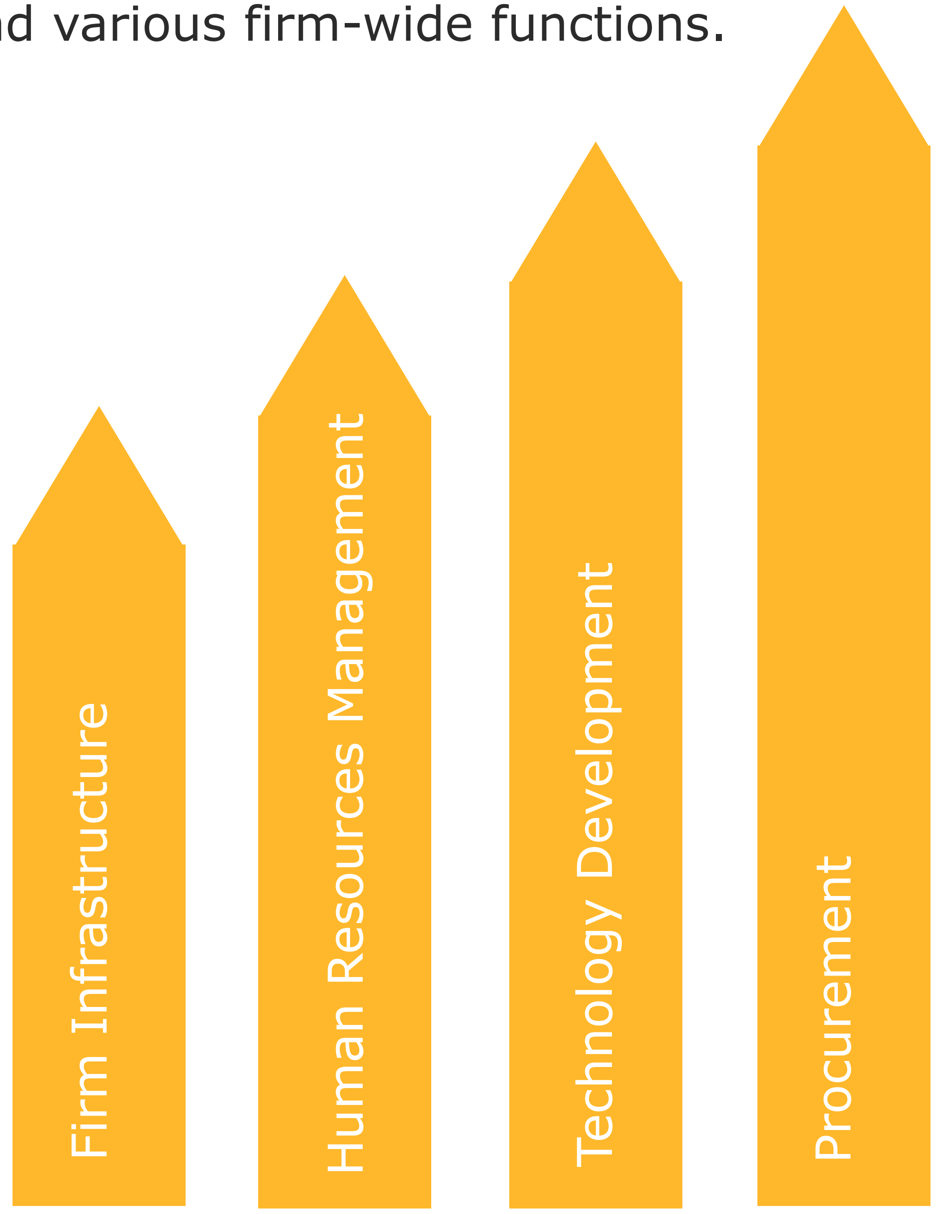
In a world where competition is based on value, your company needs to think more deeply about how this value is generated. It is necessary to partition your company on the basis of the pertinent strategic activities carried out within the company. The value chain is a theory whereby **the firm is understood to be a collection of discrete but related activities,** and helps illustrate how each of these activities creates value (for the target customer), and what determines their cost.



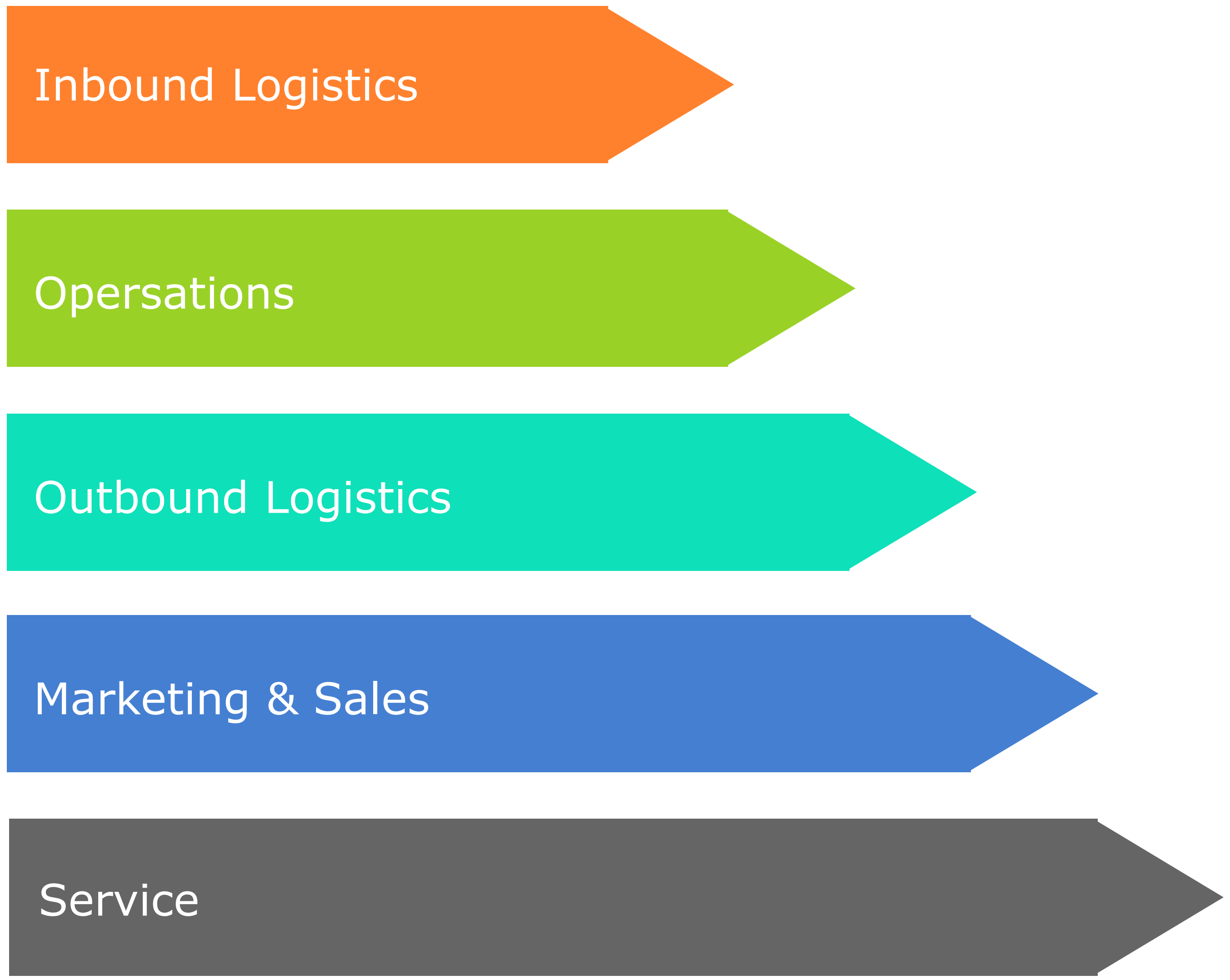
Two types of activity

Primary & support activities

Support activities:
activities supporting the primary activities by providing inputs, technology, human resources and various firm-wide functions.



Primary activities:
relating to the physical creation of the product, sales, and after-sales services.



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Support Activities

activities supporting the primary activities by providing inputs, technology, human resources and various firm-wide functions.

Procurement

the purchasing of the inputs used in the firm's value chain, not the purchased inputs themselves.

Human resources management

activities pertaining to the recruitment, hiring, training, development and compensation of all types of personnel.

Technology development

every activity incorporates technology, be it know-how, procedures or the technology inherent in process equipment.

Firm infrastructure

includes general management, planning, finance, accounting, legal and government affairs, and quality management. Infrastructure supports the entire chain and not individual activities.

Primary Activities

relating to the physical creation of the product, sales and after-sales services.

Inbound logistics

activities associated with receiving, storing and distributing inputs, such as material handling, warehousing, inventory control, vehicle scheduling and returns to suppliers.

Operations

activities associated with transforming inputs into the final product, such as machining, packaging, assembly, equipment maintenance, testing, printing and facility operations.

Outbound logistics:

activities associated with collecting, storing and physically distributing the product to buyers, such as warehousing of finished goods, material handling, delivery vehicle operation, order processing, and scheduling.

Marketing and sales:

activities associated with inducing buyers to purchase the product and providing a means whereby they can do so, such as advertising, promotion, sales, providing quotations, channel selection, channel relations and pricing.

Service

activities associated with providing services to maintain or enhance the value of the product, such as installation, repair, training, parts supply and product adjustment.

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Defining the activities in the value chain

Each generic category of activity in the value chain (inbound logistics, marketing, etc.) must be subdivided into discrete activities characterised by different technologies and economies. The product flow or order flow can be useful in doing so.

Activities should be isolated and separated if they:

1. have different economies,
2. have a high potential differentiation impact,
3. represent a significant or growing proportion of your company's costs.

You should assign the different activities to categories that best represent their contribution to your firm's competitive advantage.

Firm Infrastructure

Human Resources Management

Technology Development

Procurement

Inbound logistics

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activities associated with providing services to maintain or enhance the value of the product, such as installation, repair, training, parts supply and product adjustment.

Selecting the appropriate category in which to put an activity is an essential step in this process. The ability to redefine the roles of traditional activities can provide your company with a substantial competitive advantage.

Linkages within the value chain

Connecting competitive advantage

Having classified the different activities occurring within your organisation according to the categories making up the value chain, the next step is to determine how these activities interact with each other. It is necessary to view your *company as a system of interdependent activities*, related by linkages within its value chain. Linkages are *relationships between the way in which one activity is performed and the cost or performance of activity.*

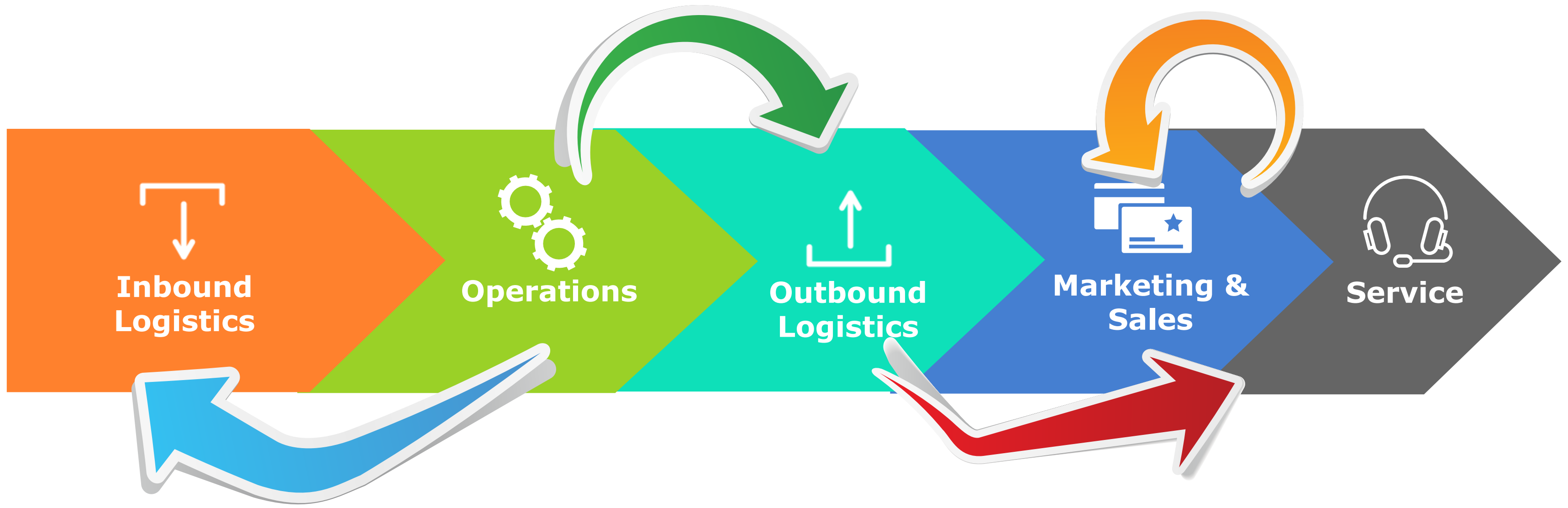
Competitive advantage in your company derives from the linkages between activities, just as much as from the individual activities themselves. For this reason the different activities your company performs must possess three characteristics:

Consistency – all activities must be in line with your overall strategy, ensuring an accumulative effect with regard to your competitive advantage, rather than serving to erode it;

Reinforcing – activities reinforce one another when they are not only consistent but when they are performed in such a way that it makes it cheaper and/or easier for your organisation to perform the next activity;

Optimisation – activities are optimising when they influence not just a single other activity but all of the other activities in your value chain.

Competitive advantage does not reside in only a few core activities of your company, but grows from the connections between all of the activities carried out. This is just one reason why a list of strengths and weakness is not enough to explain or to help maintain the competitive advantage of a company.



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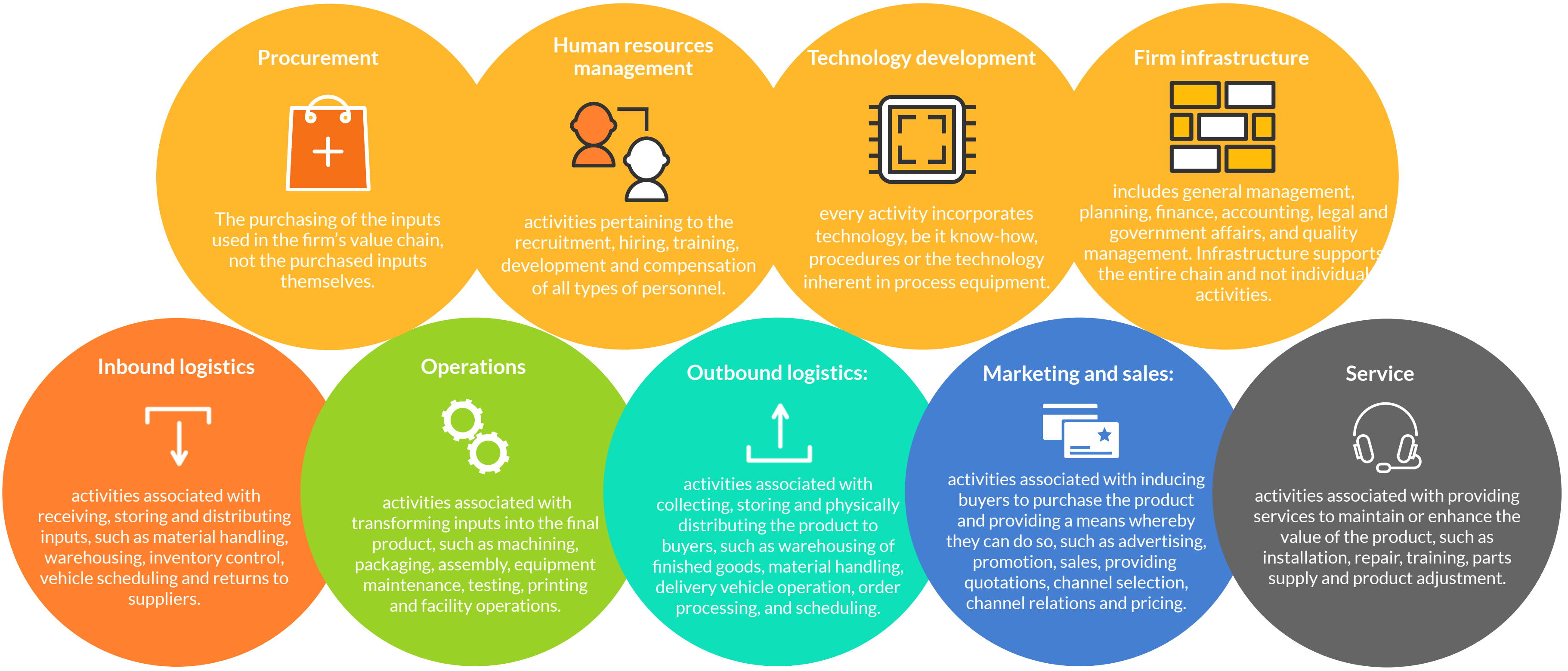


Linkages imply that your firm's costs or differentiation are not merely the result of efforts to reduce costs or to improve performance in each value activity individually.

Your company can develop linkages between activities by considering how:

1. to *connect individual activities on a deeper level*;
2. primary activities can be improved through *greater efforts invested in secondary activities*, and vice versa;
3. the activities performed within a firm reduce the need to *demonstrate, explain or service a product in the field.*

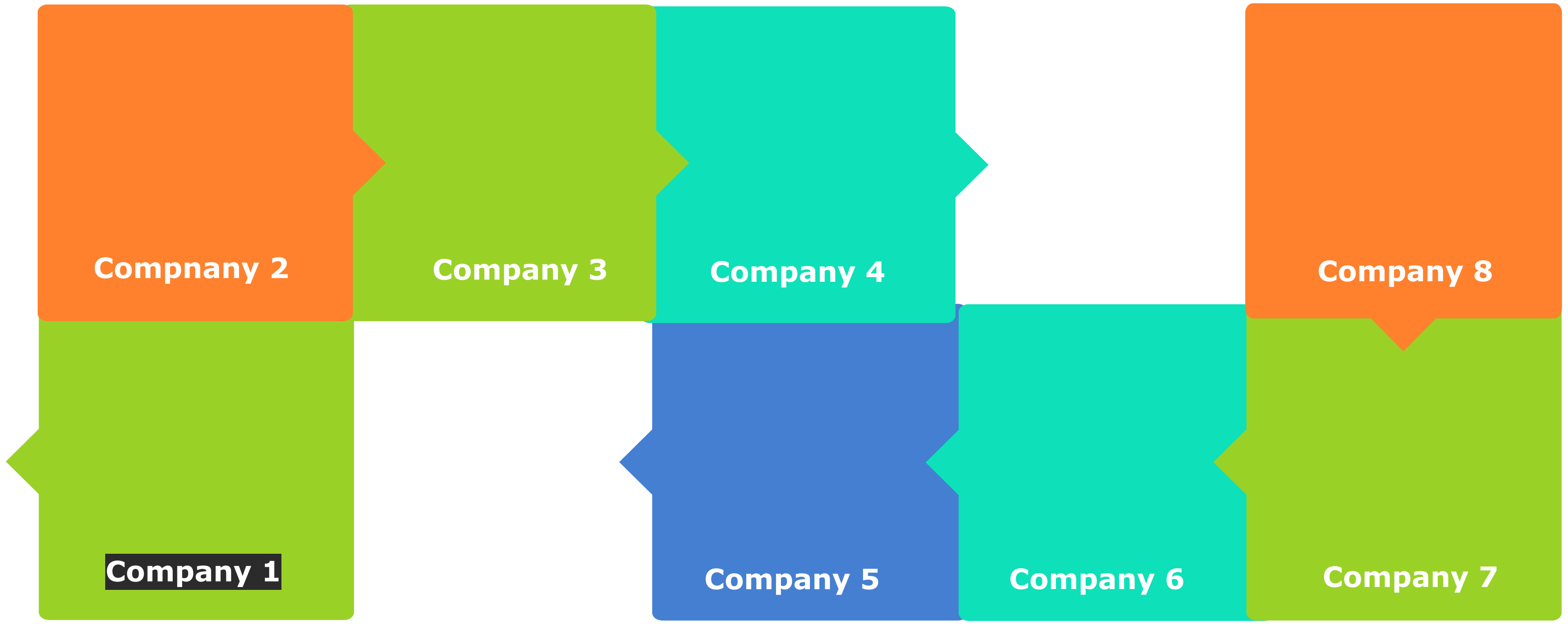
Although linkages within the value chain are crucial to your competitive advantage, they are often subtle and go unrecognised. Information systems are frequently vital to gaining competitive advantages from linkages. Exploiting linkages usually requires information or information flows that allow optimisation or coordination to take place.

Given the difficulty inherent in recognising and managing linkages, the ability to do so often yields a sustainable source of competitive advantage.

External linkages and the value system

Connecting competitive advantage

If you zoom out from your company's value chain and look at the larger picture, you will realise that your firm's value chain is embedded in a larger stream of activities, namely the value system. The value system comprises supplier value chains that create and deliver the inputs used in a firm's chain (upstream value), channel value chains (channel value) and, finally, buyer value chains (downstream value).



Gaining and maintaining a competitive advantage depends not only on **understanding your firm's value chain and its internal linkages,** but how your firm fits into the overall value system by **creating and nurturing external linkages with the other actors present in your industry.**

It is clear that the **quality of your product** still plays a central role in your company's success, but it is not the be all and end all. You need to move toward a broader view on value, by considering how **your company's value chain relates to your buyer's chain.**

Differentiation, then, derives fundamentally from creating value for your buyer through your firm's impact on its value chain. **Your company generates value when it creates a competitive advantage for the buyer, whether by lowering the buyer's costs or raising the buyer's performance.**

In most companies **external linkages,** like linkages within a firm's value chain, are **frequently overlooked**. This is one of many explanations for the existence of price-based competition in so many industries, whereby price seems to be the only dimension in the buyer's decision-making process.

Defining the company scope

Impact

Defining the limits in which your company is competing is an essential part of defining your competitive advantage, because it shapes the configuration and economics of the value chain.

There are four dimensions of scope that affect the value chain:

1. Segment scope – the product varieties produced and the buyers served.

2. Vertical scope – the extent to which you perform activities internally, rather than through independent firms.

3. Geographic scope – the range of regions, countries or groups of countries in which your firm competes on the basis of a coordinated strategy.

Industry scope – the range of related industries in which your firm competes on the basis of a coordinated strategy.

You can choose to embrace a broad scope or a narrow scope in the way your company operates.

A wide scope means that your company gains an advantage by performing activities internally. In so doing your firm can exploit relationships between its value chains, serving different segments, geographic areas or related industries.

A narrow scope means a more focused approach through which you can tailor your company's value chain to service the needs of a particular target segment, geographic area or industry, achieving lower costs or providing a unique service for your target.

Defining relevant business unit boundaries within your organisation

Deciding your company's competitive scope is an essential part of the process of defining strategically distinct business units within your organisation.

You can identify different business units in your company by:

1) **weighing the benefits** of integration and de-integration,

2) **comparing the strength of the relationships that derive from serving related segments**, geographic areas or industries with the differences in the value chains best suited to serving them separately.

Conclusions

On the Value Chain

Many companies fail to achieve their potential in terms of the creation of a sustainable competitive advantage because their existing organisational structure fails to group similar activities taking place within the organisation, and to coordinate them.

The value chain provides a systematic way to divide your firm into its discrete activities, and so can be used to examine **how the activities taking place in your firm are and might potentially be grouped.**

Your firm should draw unit boundaries in tune with its sources of competitive advantage, and provide for the appropriate types of coordination by relating its organisational structure to the value chain, and the linkages within it and with suppliers or channels.

"An organisational structure that corresponds to your value chain will improve your firm's ability to create and maintain a competitive advantage."

Stefano Messori
Design Strategist & Corporate Trainer

The Value Chain Analysis Template

Interested in Strategic Design?

Schedule an online conversation with me!

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