VALUE CHAIN ANALYSIS USING PORTER'S MODEL

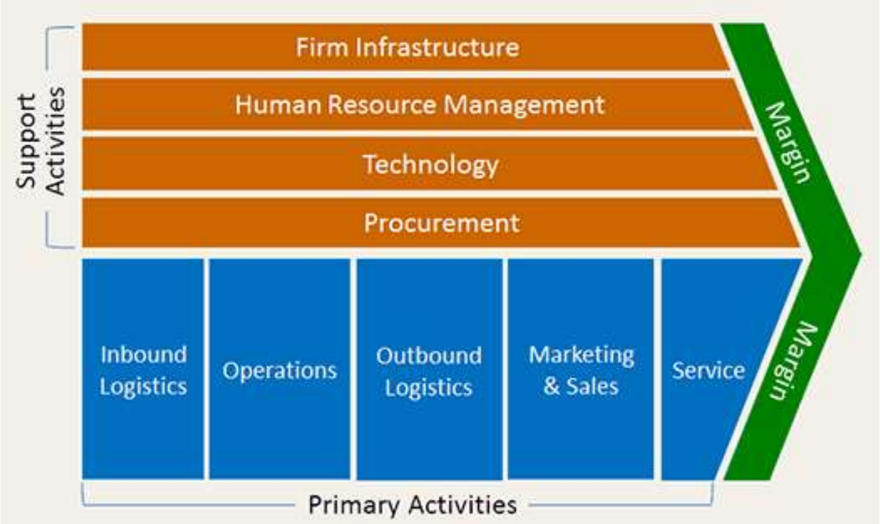
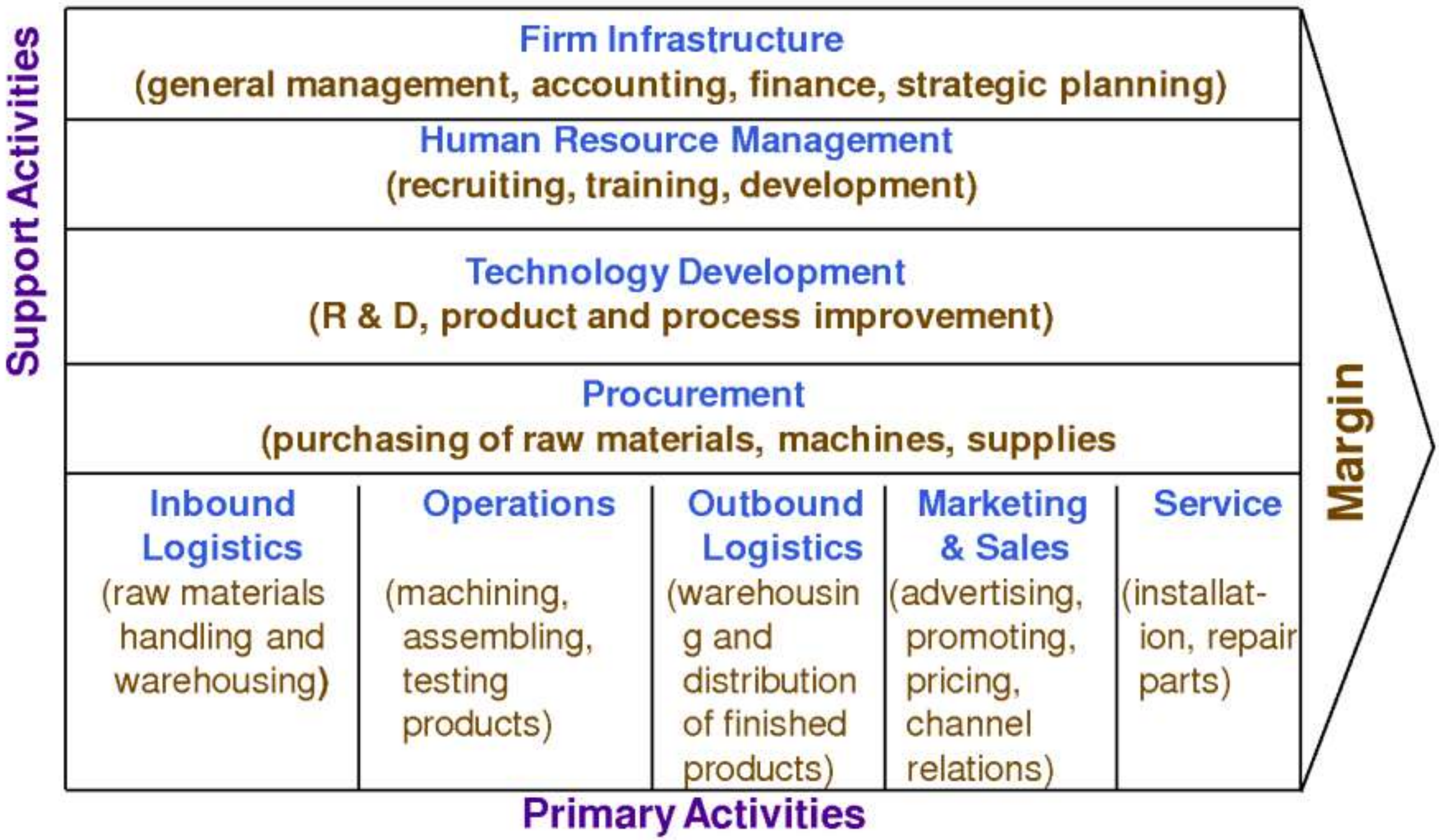


Figure 1 - Generic value chain

SHEETAL WAGH

- **A value chain is a set of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market.**
- **It is a set of activities that an organization carries out to create value for its customers.**
- **The concept comes from business management and was first described and popularized by Michael Porter in his 1985 best-seller, Competitive Advantage: Creating and Sustaining Superior Performance.**
- **The idea of the value chain is based on the process view of organizations, the idea of seeing a manufacturing (or service) organization as a system, made up of subsystems each with inputs, transformation processes and outputs.**
- **Inputs, transformation processes, and outputs involve the acquisition and consumption of resources – money, labour, materials, equipment, buildings, land, administration and management.**
- **How value chain activities are carried out determines costs and affects profits.**

Value Chain Analysis for Manufacturing Firms



❖ Primary Activities

Primary activities relate directly to the physical creation, sale, maintenance and support of a product or service. They consist of the following:

1) Inbound logistics – These are all the processes related to receiving, storing, and distributing inputs internally. Your supplier relationships are a key factor in creating value here.

2) Operations – These are the transformation activities that change inputs into outputs that are sold to customers. Here, your operational systems create value.

3) Outbound logistics – These activities deliver your product or service to your customer. These are things like collection, storage, and distribution systems, and they may be internal or external to your organization.

4) Marketing and sales – These are the processes you use to persuade clients to purchase from you instead of your competitors. The benefits you offer, and how well you communicate them, are sources of value here.

5) Service – These are the activities related to maintaining the value of your product or service to your customers, once it's been purchased.

❖ Support Activities

These activities support the primary functions above. In our diagram, the dotted lines show that each support, or secondary, activity can play a role in each primary activity. For example, procurement supports operations with certain activities, but it also supports marketing and sales with other activities.

1) **Procurement (purchasing) – This is what the organization does to get the resources it needs to operate. This includes finding vendors and negotiating best prices.**

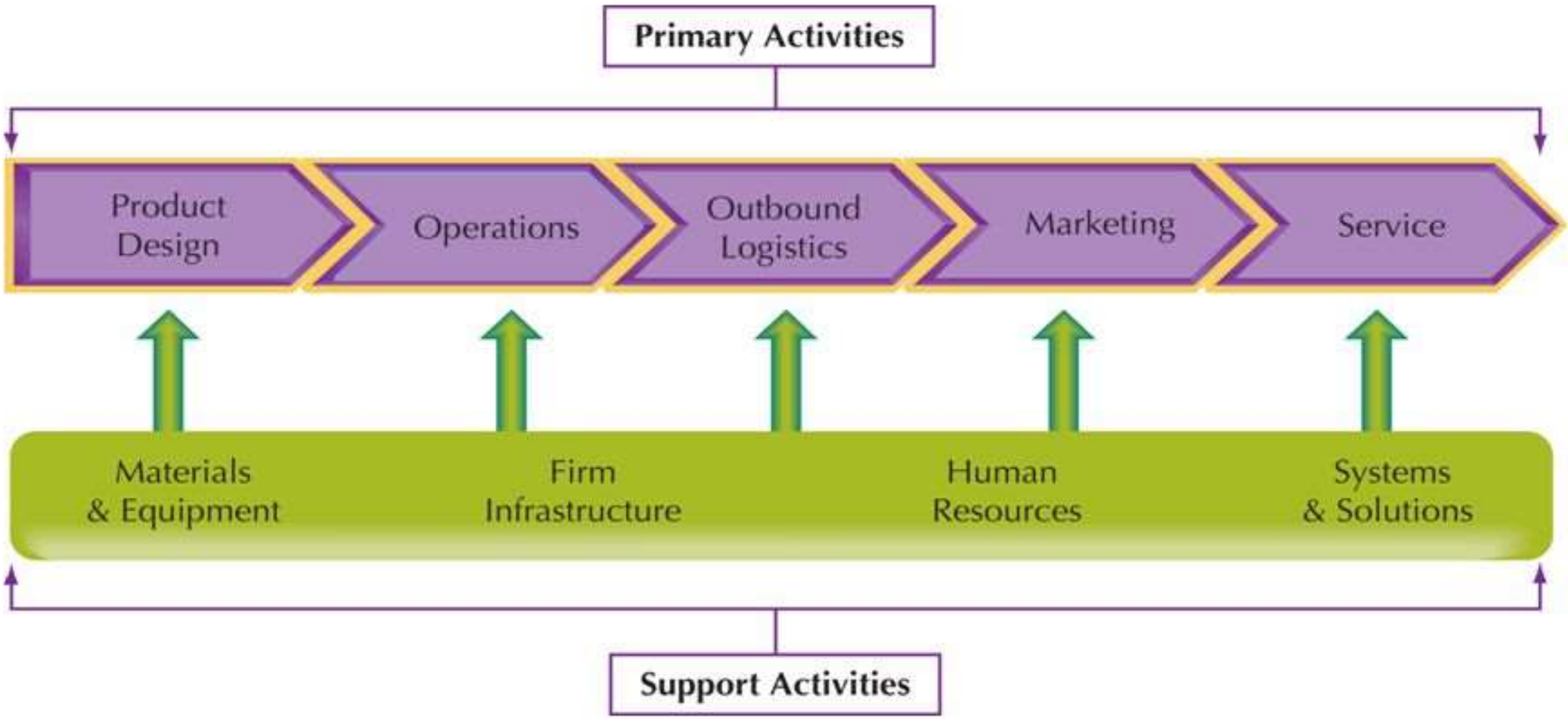
2) **Human resource management – This is how well a company recruits, hires, trains, motivates, rewards, and retains its workers. People are a significant source of value, so businesses can create a clear advantage with good HR practices.**

3) **Technological development – These activities relate to managing and processing information, as well as protecting a company's knowledge base. Minimizing information technology costs, staying current with technological advances, and maintaining technical excellence are sources of value creation.**

4) **Infrastructure – These are a company's support systems, and the functions that allow it to maintain daily operations. Accounting, legal, administrative, and general management are examples of necessary infrastructure that businesses can use to their advantage.**

The Firm as a Value Chain

Primary and Support Activities



❖ Using Porter's Value Chain

To identify and understand your company's value chain, follow these steps.

Step 1 – Identify sub activities for each primary activity

For each primary activity, determine which specific sub activities create value. There are three different types of sub activities:

Direct activities create value by themselves. For example, in a book publisher's marketing and sales activity, direct sub activities include making sales calls to bookstores, advertising, and selling online.

Indirect activities allow direct activities to run smoothly. For the book publisher's sales and marketing activity, indirect sub activities include managing the sales force and keeping customer records.

Quality assurance activities ensure that direct and indirect activities meet the necessary standards. For the book publisher's sales and marketing activity, this might include proofreading and editing advertisements.

Step 2 – Identify sub activities for each support activity

For each of the Human Resource Management, Technology Development and Procurement support activities, determine the sub activities that create value within each primary activity. For example, consider how human resource management adds value to inbound logistics, operations, outbound logistics, and so on. As in Step 1, look for direct, indirect, and quality assurance sub activities.

Then identify the various value-creating sub activities in your company's infrastructure. These will generally be cross-functional in nature, rather than specific to each primary activity. Again, look for direct, indirect, and quality assurance activities.

Step 3 – Identify links

Find the connections between all of the value activities you've identified. This will take time, but the links are key to increasing competitive advantage from the value chain framework. For example, there's a link between developing the sales force (an HR investment) and sales volumes. There's another link between order turnaround times, and service phone calls from frustrated customers waiting for deliveries.

Step 4 – Look for opportunities to increase value

Review each of the sub activities and links that you've identified, and think about how you can change or enhance it to maximize the value you offer to customers (customers of support activities can internal as well as external).

Significance of Value Chain

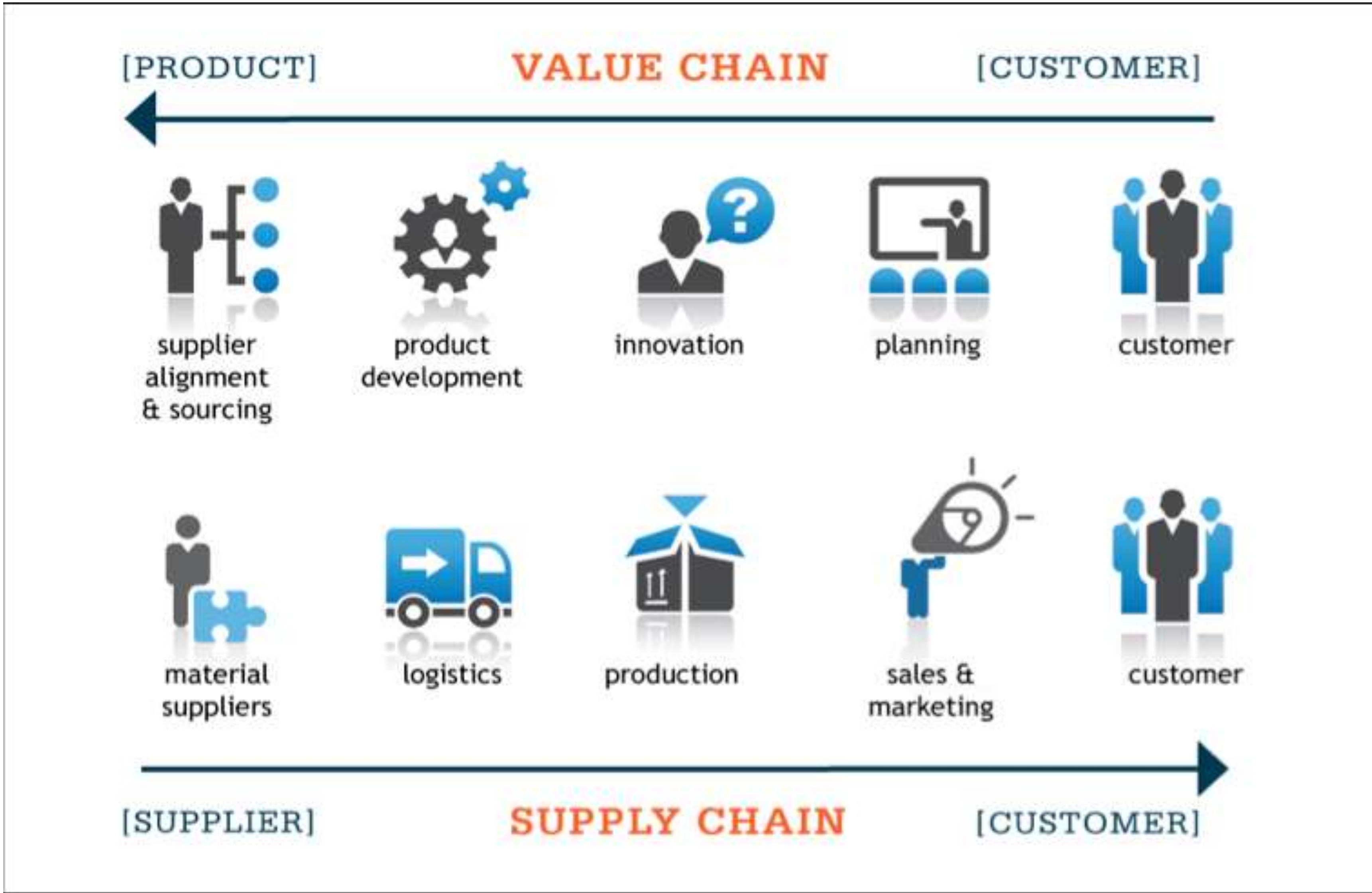
The value chain framework quickly made its way to the forefront of management thought as a powerful analysis tool for strategic planning. The simpler concept of value streams, a cross-functional process which was developed over the next decade,[13] had some success in the early 1990s.

The value-chain concept has been extended beyond individual firms. It can apply to whole supply chains and distribution networks. The delivery of a mix of products and services to the end customer will mobilize different economic factors, each managing its own value chain. The industry wide synchronized interactions of those local value chains create an extended value chain, sometimes global in extent. Porter terms this larger interconnected system of value chains the "value system". A value system includes the value chains of a firm's supplier (and their suppliers all the way back), the firm itself, the firm distribution channels, and the firm's buyers (and presumably extended to the buyers of their products, and so on).

Capturing the value generated along the chain is the new approach taken by many management strategists. For example, a manufacturer might require its parts suppliers to be located nearby its assembly plant to minimize the cost of transportation. By exploiting the upstream and downstream information flowing along the value chain, the firms may try to bypass the intermediaries creating new business models, or in other ways create improvements in its value system.

Value chain analysis has also been successfully used in large petrochemical plant maintenance organizations to show how work selection, work planning, work scheduling and finally work execution can (when considered as elements of chains) help drive lean approaches to maintenance. The Maintenance Value Chain approach is particularly successful when used as a tool for helping change management as it is seen as more user-friendly than other business process tools.

A value chain approach could also offer a meaningful alternative to evaluate private or public companies when there is a lack of publicly known data from direct competition, where the subject company is compared with, for example, a known downstream industry to have a good feel of its value by building useful correlations with its downstream companies.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THANK YOU