ESCOLA POLITÈCNICA SUPERIOR
UNIVERSITAT DE LLEIDA

CHAPTER 3:

THE PORTER'S VALUE CHAIN MODEL

Master's Degree in Informatics Engineering

POLYTECHNIC SCHOOL

University of Lleida

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SECTION 3.1:

Value Chain

Introduction:

- The value chain is composed for all the activities that a company carries out to generate a product (or a service), place it in the market in a way that is valuable and desired by its customers.
- These activities can (and should) be generators of "value" and "margins" that contribute to the "value" and "margin" of the entire process or product.
- The ”Value Chain" is, therefore, a concept or theoretical model that allows to systematize the description of the elements which forms of the activities of a business organization and the value that each one contributes.

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Introduction:

- An example, very primarily, of activity chain of a company would be it in the following schematic example of a manufacturing process.

Supply raw materials	Storage raw materials	Manufacturing Process 1	Manufacturing Process 2	. . .	Manufacturing Process N	Storage final products	Marketing & sales	Distribution	Customer Service

- What would we lack to analyze at this point?

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Value:

- Michael Porter points out that "value" is "what people are willing to pay for what your business offers."
- The value is a reflection of the price that is charged for the product and its sales volume. A company is profitable if the value that generates, exceeds the costs of creating its products.
- The goal of a generic strategy is to generate buyers, a value that exceeds, as much as possible, their costs.
- <u>The value, and not the cost, must be used when analyzing the competitive position</u>, so the companies may present a higher price if they achieve a significant "differentiation".

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Margin:

- It is the difference between the total value that the customer is willing to pay for the product (or service) and the total costs that the company is facing to generate it or produce it.
- In another words, the cost for the company to perform different activities that are generating value.

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Model:

- Michael Porter proposed using the value chain as an analysis tool in strategic planning to create "competitive advantage". This concept was described by him, in 1985, on his book: "Competitive Advantage: Creating and Sustaining Superior Performance".
- The model of the value chain proposed by Porter is essentially a tool or methodology of analysis of business activity through which we analyze and split up a company in its constituent parts or processes.
- Based on this analysis, we can identify sources of competitive advantage in those activities that generate value and also identify those activities that do not generate it.

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Model:

- Finally the value, the margin and the competitive advantage are the total of all the processes. Therefore, the value chain of a company is composed for all its activities that generate added value and the margins that these provide.
- The **competitive advantage** is achieved when the company develops and integrates the activities of its value chain in a less costly or better-differentiated way than its rivals. It is about:
    - Maximize value creation for the client
    - Minimize costs
    - So, will allow you to increase your margin.
    - And get greater profitability (margin between the income and the costs).

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Summary:

- Essentially, the value chain is a methodology of analysis of the business activity through which we split up a company in its constituent parts, looking to identify sources of competitive advantage in those activities that generate value.
- Called "chain" because each of the activities are interrelated with others and each adds “**value**” or "**strength**" to the product.
- It is a matter of disaggregating the activity of the company in its basic activities that allow us to identify the strengths and weaknesses in each point or activity and, especially, the points where we can generate "competitive advantage".

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According to the Porter’s Model, the value chain can be dividing with the following parts or activities:

- **Primary Activities**: Are those that refer to the physical creation of the product, its sale and the customer service. They can also be subdivided into other activities.
  - Inbound logistics
  - Operations (or manufacturing)
  - Outbound logistics
  - Marketing & sales
  - Customer services

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- Inbound logistics: All the operations of reception, storage and internal distribution of the raw materials and external products that we will use in the production of our products.
- Operations: All processes for the manufacture or obtaining of our products (or final services) that we will supply to our customers.
- Outbound logistics: The storage of our products and the distribution of them to our customers.
- Marketing & sales: All the activities for which our products or services are disclosed, and all activities and performances are carried out to make the sale of them.
- Customer services: All the activities aimed at maintaining the value of the products and services, applying the guarantees and maintaining the degree of customer satisfaction with the products and services.

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- **Secondary Activities**: For the normal development of primary activities, it is also necessary to carry out a whole set of activities, which are not part of the productive process, but which are necessary for the operation of the company.
- We can distinguish four secondary activities (also called support activities):
  - Firm infrastructure
  - Human Resources Management
  - Technology Development
  - Procurement

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- Firm Infrastructure: All the activities that support the operation of the company, such as the areas of management, planning and administration, accounting, finance, legal support, etc.
- HRM: Manage the research, recruitment, training and motivation of the staff as well as the management of their payrolls and social benefits.
- Technology Development: All the activities related to the implementation, research and development of technologies necessary to carry out the rest of the activities.
- Procurement: Manages the acquisition of machinery, raw materials, goods or services as well as other elements necessary for the operation of the company.

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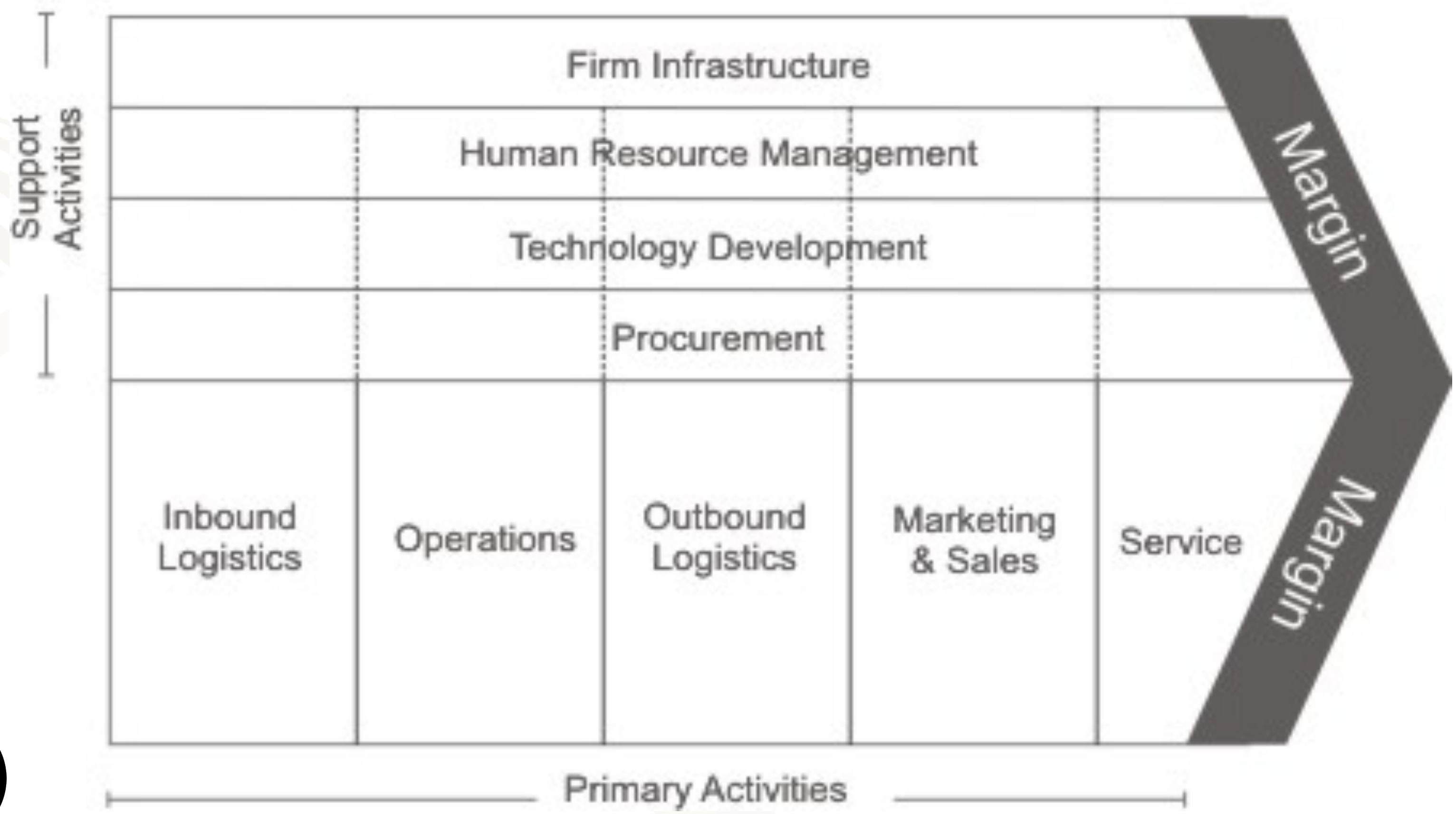
Porter’s Value Chain Chart



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Which is the aim?

- Increase the <u>competitive advantage</u> by increasing the <u>margin</u>.
- This will be achieved by <u>reducing costs</u> or <u>adding value</u> to the chain.

So, in a first phase, it’s needed to perform the following analysis and procedure:

- Characterization of all activities.
- Analyze whether they ADD value or DO NOT add value and in what degree they do it.
- Analyze its impact on the final cost.
- Analyze how it interacts with the rest of internal and external activities.

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ADD VALUE?

- Study what changes can be implemented to increase their value, increase the competitive advantage and / or reduce costs (important role of technologies and factor to be included in the Technology Plan ...).
- Select among all the points and actions that could provide value, which will be more efficient to increase the competitive advantage in accordance with the strategic plan of the company.
- Establish measurement systems to continuously verify the efficiency of the proposed improvements.

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DO NOT ADD VALUE?

- Delete
- Transform
- Outsource

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- An additional benefit of the analysis of the value chain is that it allows us to determine the "Core Business" of the company; understand the core business as the basic, distinctive, essential or main activity for the company. So, it's necessary a good study.

- The identification of this core business, allows focusing on activities that really can contribute value and create a competitive advantage, can take as a logical decision, to the outsourcing of the activities necessary for the operation of the company. Or, also, for the manufacturing process which are not generators of competitive advantage or value.

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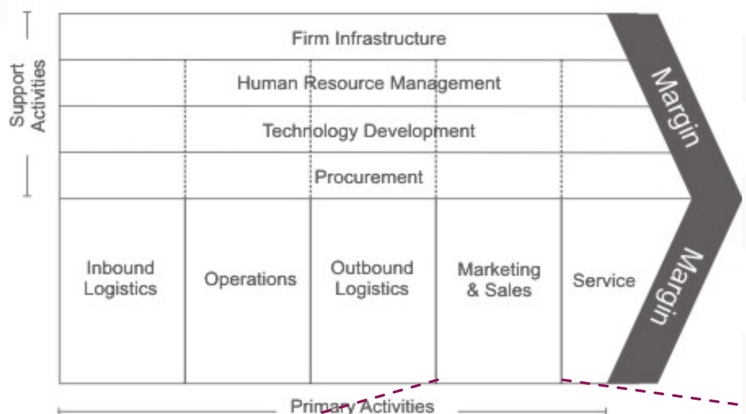
Disaggregation of activities

- In order to improve the analysis, we can subdivide or disaggregate each activity into other discrete activities that make up it and that it can allow us a more detailed and more efficient analysis, as indicated in the example of the following figure:



Marketing	Promotion	Publicity	Handbooks	Sales force

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Interaction of our value chain with the rest of the system

- Porter goes beyond the concept of the value chain and extends it not only to the company itself but also extends it to the whole system in which the company is immersed. In his book he says:
  - The competitive advantage can not be understood by looking at a company as a whole. It is derived from the many discrete activities that make a signature in the design, production, marketing, delivery and support of your product. Each of these activities can contribute to the relative cost site of a company and create a basis for differentiation.

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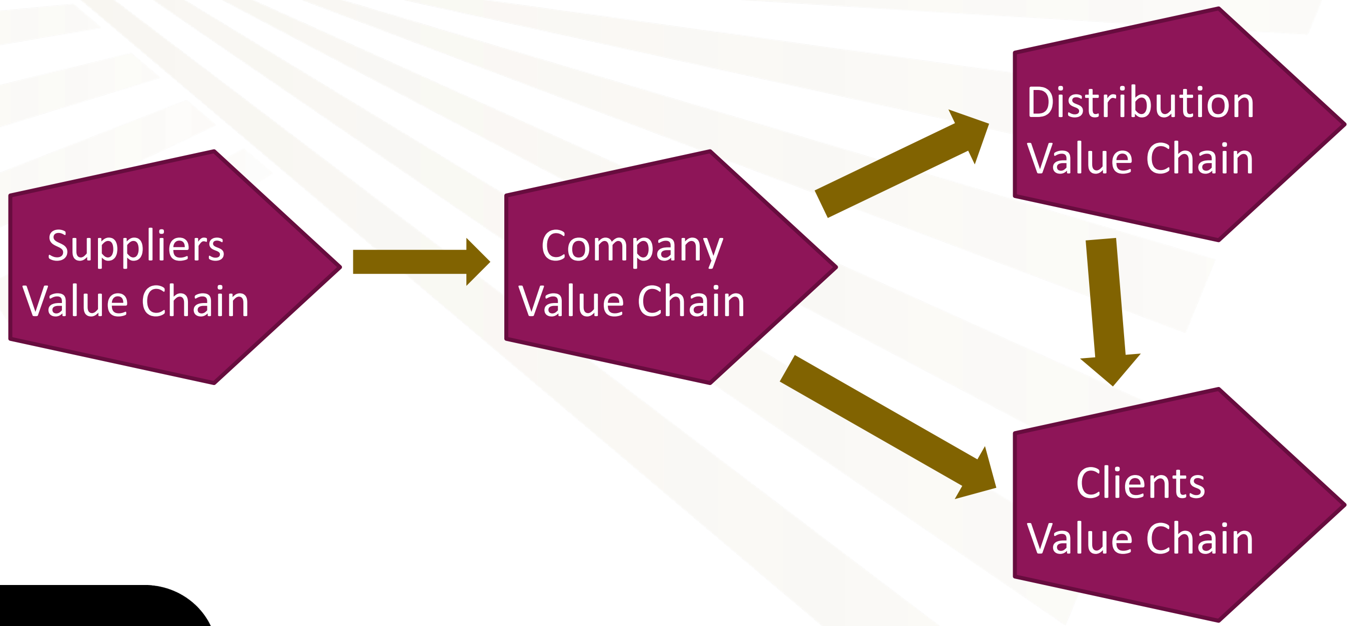
Interaction of our value chain with the rest of the system



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Based on this concept of interaction within the system, we can consider three generic value chains:

- Supplier Value Chain: Those that provide the supplies to our company or chain of values. They directly affect our costs and the quality and differentiation of our product.
- Distribution Value Chain: All the channels, mechanisms and intermediaries that perform in the delivery of our products and services to our customers. It affects the costs and margins as well as the value perceived by the customer and to his satisfaction.
- Clients (or Buyers) Value Chain: They are the best source of differentiation and those who perceive the value of the product or service better. They are the main focus of the company.

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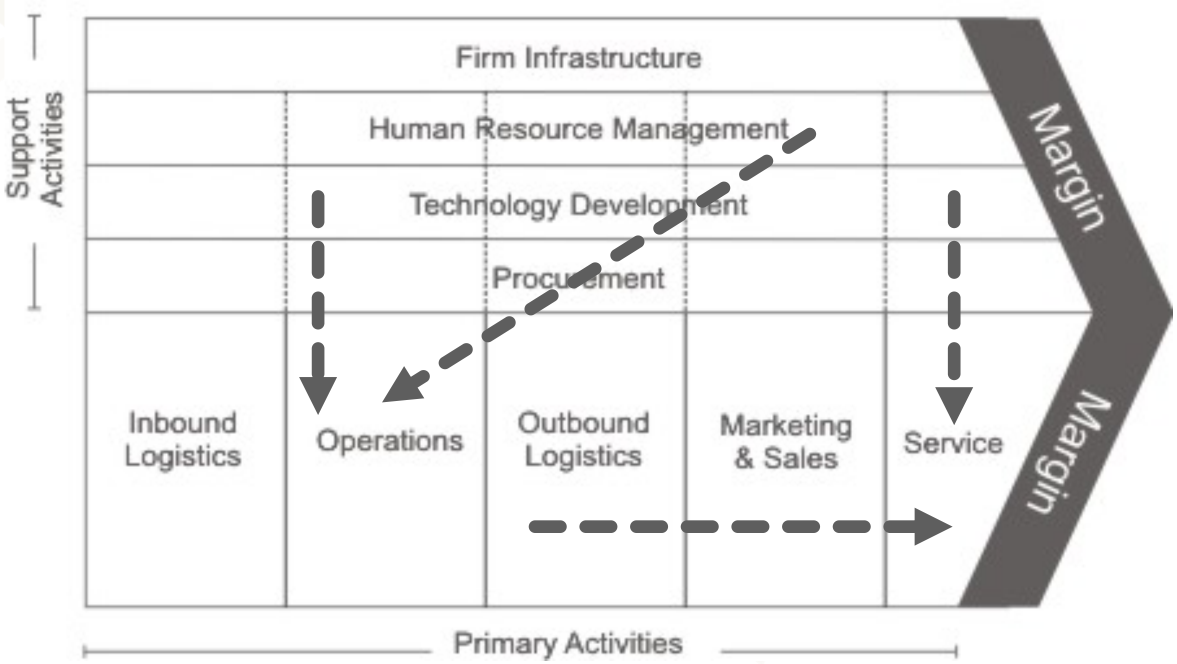
Interrelation of activities:

- The interrelation between the activities of our own company must also be contemplated, because together contemplated they can generate synergies and help in the generation of value.



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Interrelation of activities:

- For example, improvements in the development of technologies can progress and optimize manufacturing by reducing costs or adding value, or maintenance services.
- Improvements in trainings or motivation of Human Resources can also increase the quality and value of the product.
- Optimizations in the outbounds logistics can improve post sale service, etc.

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Interrelation of activities:

- This improvement of the competitive advantage based on the interrelation of the activities can be achieved in two ways:
  - Optimization: Modify an activity to improve another.
  - Coordination: Synchronize better different activities in order to improve overall efficiency and competitive advantage.

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Summary:

- The value chain must be a reflection of the strategic plan.
- Identify the sub-activities of each primary activities.
- Identify the sub-activities of each secondary (or support) activities.
- Determine the interrelations and their links.
- Evaluate the complete system: optimize or coordinate.
- Find opportunities to increase value, reduce costs, add competitive advantage.
- Prioritize, select and uses the benchmarking, to compare.
- Support yourself in previous analyzes: PEST/SWOT/Five Force.
- Focus on the client.