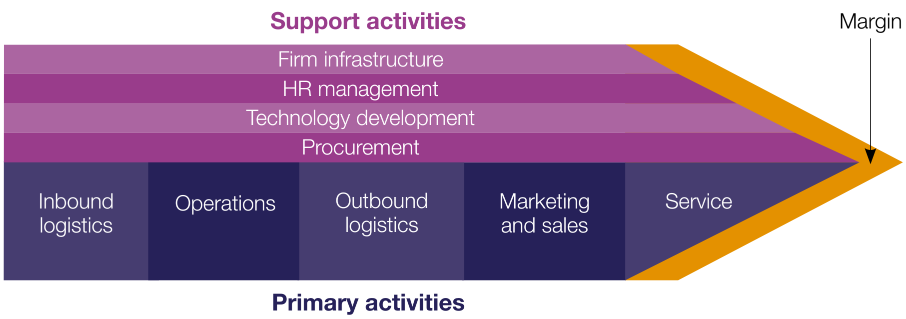
MANAGEMENT ACCOUNTING – BUSINESS STRATEGY

Porter's value chain has a modified version that's more applicable when analysing service organisations. **The examiner for paper P6** explains.

The value chain was designed by Michael Porter in 1985 as a systematic way to examine how competitive advantage develops and to identify where value is added in an organisation. You should be familiar with the original model (*see figure 1*) and the activities described within it.

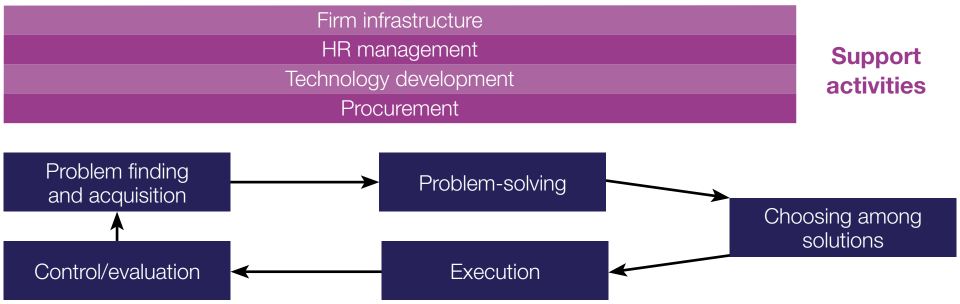
1 Porter's value chain



The value chain is based on the process view of organisations, in which the manufacturing (or service) company is seen as a system made up of many sub-systems, each with inputs, transformation processes and outputs involving the procurement and consumption of resources. How well the value chain activities are performed determines costs and affects profits.

The concept of the value chain underlies activity-based management and, ultimately, the balanced scorecard. But there are criticisms of the model. Its most notable weakness is that it cannot be applied easily to service organisations. In 1998, Charles Stabell and Øystein Fjeldstad addressed this problem by developing an alternative representation of a value chain for professional services firms (*see figure 2*).

2 Stabell's and Fjelstad's value shop



Stabell and Fjeldstad consider a professional service organisation to be a "value shop" – a workshop, not a retail outlet. As such, it mobilises resources to solve specific problems. This involves an iterative process that entails repeating a generic set of activities until a satisfactory solution is reached. The shop model applies to many organisations – eg, architects, consultancies and legal firms – and to those whose main purpose is to identify and exploit specific opportunities, such as developing a drug, finding oil or designing a new product.

Although the support activities are the same as in Porter's model, the primary activities are described differently. From this we can see that the management agenda in a value shop focuses on areas such as the assessment of problems and opportunities; the mobilisation of resources; project management, the delivery of solutions; the measurement of outcomes; and learning.

Such an organisation will:

- Apply multiple disciplines and specialities. Different skills and expertise are often required at various stages of the problem-solving process.
- Develop responses to deal with unique cases. The value-creation process is organised to deal with unique situations (although standardised solutions are often used).
- Make the best use of knowledge and expertise. Value shops are labour-intensive, usually demanding a scale of operation that broadly applies specialised expertise and knowledge across numerous problems or opportunities.
- Demonstrate a high degree of co-ordination across different activities, disciplines and sources of expertise.
- Perform cyclical and iterative activities. For example, a medical consultant moves back and forth between hypotheses and new data collection in order to develop, confirm or reject a number of theories before reaching a final diagnosis.
- Rely on referrals based on reputation and relationship. Value shops often need to call on expertise from other organisations or disciplines – for example, when a general practitioner sends a patient to a specialist, or when an IT vendor subcontracts to an expert.

As you read more broadly in preparation for your exams, look at a number of organisations and decide whether they are better analysed using Porter's original value chain model or the later modification developed by Stabell and Fjeldstad.