

The missing link

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Candidates can often recite the basic definitions of the activities in Michael Porter's value chain model, but applying them in an exam situation is another thing entirely

A common misconception among students is that value chain analysis is used mainly to identify areas where costs can be reduced. It is true that a value analysis will identify cost drivers, but it is also used to identify those activities that create value.

Michael Porter's use of the value chain is concerned not simply with organising activities efficiently, but with determining how an organisation's activities can be used to underpin its competitive advantage. Dell, for example, builds computers to order instead of holding finished stock. This reduces its investment in finished goods stock (outbound logistics), but the company requires flexibility and efficiency in its inbound logistics and operations activities to ensure that it remains competitive.

Although a firm's objective is to organise activities in a way that underpins competitive advantage, Porter also states that, to achieve competitive advantage, what it offers should be unique, sustainable and relevant. The differentiating factor needs to be valued by the customer. Here lies the important point: the value chain is about adding value to the end user. The value chain is therefore concerned with value – either real or perceived – for the customer, and it can be viewed as a model in which the company chooses how best to configure its activities to serve its customers more effectively than its competitors.

Exam hint: has the organisation identified what the customer values? Does it know what its competitive advantage is? Is it clear about being cost-led or differentiated? Has it conducted a competitor analysis to ascertain the strength of its competitive advantage?

By comparing two organisations from the computer retail sector we can observe the strategic choices that organisations make. Dell chooses to use the internet and tele-sales as the main channels for its marketing and sales activity, and uses distributors to fulfil its outbound logistics. PC World uses shops as well as the internet. Both firms

employ sales staff, but PC World, consistent with its decision to use retail outlets, has identified that its target customers value the personal touch, so it has chosen to employ trained staff (HR management activity) who can deal with them face to face. Its TV advertising (marketing and sales activity) emphasises this expert personal service as a benefit (differentiating factor) of shopping at PC World.

Compare this approach with that of a retailer such as Ikea, which believes that its target customers do not place a high value on personal customer service and has therefore decided against employing large numbers of sales staff. This allows it to keep employment costs down, supporting its low-cost strategy and its position in the market. Note that competitive advantage and what the customer values are the factors that have driven the decision.

As can be seen, each organisation will seek to configure its activities to satisfy its target customers. This means that not all organisations will perform all activities to the same extent. As an extreme example, compare the Ford Motor Company with eBay, a provider of person-to-person on-line auction facilities. You can well imagine that Ford's value chain is configured differently, and emphasises different value-creating activities, from that of eBay.

Exam hint: has the organisation configured its value chain appropriately? Is it performing any activities that do not create value? Is the organisation using the support activities effectively?

The value chain can be used to identify the critical activities that an organisation must ensure are performed effectively if it is to survive in its market. For example, Flying Flowers, a company that supplies flowers from Jersey through the post to 17 different countries, must ensure that the merchandise arrives in good condition if it is to provide an effective service. It could be argued that any company selling goods via the internet must ensure that it can deliver

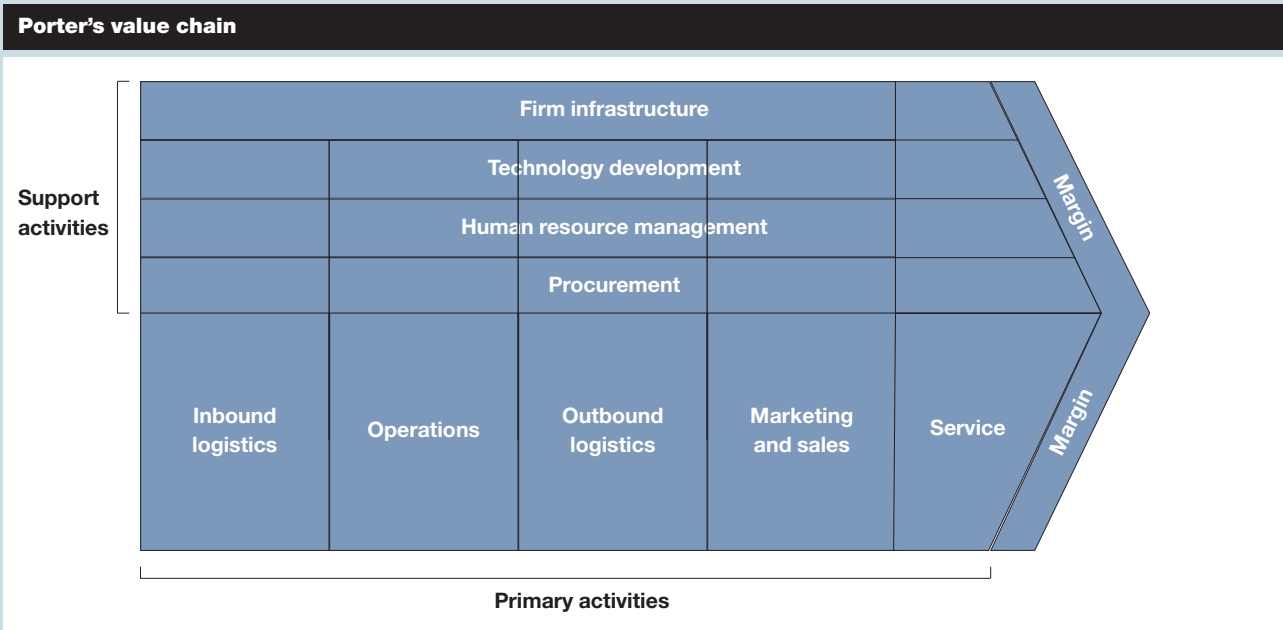
its products to market in good condition, but for Flying Flowers this is a critical activity. This opens up another strategic choice for organisations: that of outsourcing. Should an organisation perform all activities itself or is it better off using the skills of other parties? Much will depend on where the organisation obtains its competitive advantage.

As an example, chocolate confectionery companies in the UK will sell Easter eggs promoting their brands and products every spring. Mars, for instance, will provide chocolate eggs containing mini Mars products, or in packaging highlighting Mars products around the egg. The reason that you might be tempted to buy one of these eggs is because it has Mars products associated with it. Mars therefore doesn't have to produce the egg itself – that activity can be outsourced. After all, it would be expensive to maintain production facilities for chocolate eggs for only a couple of months a year.

However, you might buy a Cadbury's Easter egg because it is made of Cadbury's chocolate. Therefore Cadbury's needs the operational capability to produce Easter eggs. The company has focused on marketing and sales activities to develop the Cadbury's Creme Egg into a product that is sold all year round, thereby making the operation viable. The decision whether or not to outsource can often be bound strongly to an organisation's competitive strategy and focuses on how strategic the activity is to the organisation.

Exam hint: do the organisation's activities support its competitive strategy? Has it allocated its resources strategically? Does the organisation have enough information to identify crucial value-creating activities?

As illustrated by the case of Dell, a critical aspect of the value chain is that the activities within it must support one another. This is also true of the firm's links with its suppliers and intermediaries. It is not helpful if an organisation has developed a



competitive advantage by being flexible to the customers' changing needs if its suppliers cannot match that approach. If a company such as Dell decides to build computers to order, rather than hold large stocks, and then finds that it has to hold high stocks of component parts to overcome problems of supply, it removes the cost advantage it would have enjoyed from holding little in the way of finished goods stock. Dell needs to ensure that its suppliers have the same degree of flexibility.

Similarly, if a company such as Toshiba cannot supply retail outlets quickly with stock replenishments, then PC World may be encouraged to increase stock levels, increasing its cost base – and, possibly, the price to the consumer – thereby eroding the value added by the manufacturer. It's therefore important that organisations consider the impact of the value system when seeking to sustain their competitive advantage.

Exam hint: do the activities in the organisation's value chain support each other and the competitive strategy? Has the organisation considered the value system?

Every activity within the value chain that adds value has an information component. This component comprises all of the steps involved in the collection, manipulation, communication and presentation of the data necessary to perform the activity. Where the data is significant, "information intensity" is built into the organisation's value chain. Dell, for example, needs to feed customer-order information back to its

operations and inbound logistics in order to meet customer demand.

We can also use the value chain approach to identify opportunities to use information strategically. For example, by using point-of-sale information to improve inventory management, Tesco can reduce costs and support its strategy of providing "exceptional value and choice to customers". Similarly, the use of technology in procurement via e-auctions – an effective mechanism for communicating supply contract information – allows the supermarket giant to keep its procurement costs down, again helping to sustain its competitive advantage.

The technology development activity can be used to provide information systems that add value to the customer and also generate a competitive advantage. For example, Otis has developed a system called Otis Elevator, which combines a call centre, (a strategic choice by the company) with lifts that self-diagnose malfunctions and maintenance needs (service activity). This allows the company to offer computerised diagnosis and despatch an engineer within 40 minutes. The information collected also enables Otis to improve its designs and produce more reliable lifts, and allows the company's call centre (now web-based) to provide superb customer relationship management. As a result, it continues to win highly lucrative contracts.

Exam hint: has the organisation exploited the information and/or the information technology in its value chain?

Information that comes through the value system is also highly valuable. Wal-Mart was an early exponent of collaborative planning, forecasting and replenishment (CPFR), which is much more than simply linking sales data back to a supplier so that stocks can be replenished just in time. This may cause the supplier to hold stocks, so CPFR is more about linking planning and forecasting information systems together through the supply chain. The retailer therefore assures a higher level of service to the consumer by eliminating stock-outs, and it also obtains a better service for itself from the suppliers.

From the suppliers' point of view, the forecast is more accurate, which leads to a more stable demand plan and then to a more stable manufacturing plan. This in turn leads to less inventory, more revenue via the collaborating channel and higher profits all round. At the end, the consumer gets the product at a competitive price.

Exam hint: has the organisation exploited the information and/or the information technology in its value system?

Final level exam questions will require a high element of evaluation. By asking yourself the questions highlighted in this article you will be able to discuss the relevant issues, assess how effectively an organisation is performing its activities and suggest ways to make improvements. ■

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