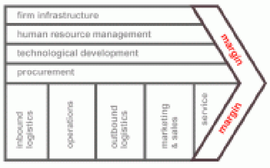
value chain analysis



characteristics

author:	Porter, Michael E.
country:	United States
period:	1985
type:	model
role:	consultant
activity:	analyse and design
topic:	strategic management, org. design & development, finance & accounting and marketing & sales
abstr. level:	organisation
perspective:	rational
status:	final
module:	classics I
comments:	6

description:

Michael Porter published the Value Chain Analysis in 1985 as a response to criticism that his Five Forces framework lacked an implementation methodology that bridged the gap between internal capabilities and opportunities in the competitive landscape. This framework focused on industry attractiveness as a determinant of the profit potential of all companies within that particular industry. However, significant differences in performance exist between companies operating within the same industry that can be explained either by the company's participation in a successful strategic group or by a firm's specific competitive advantages.

Value Chain Analysis helped identify a firm's core competencies and distinguish those activities that drive competitive advantage. The cost structure of an organisation can be subdivided into separate processes or functions assuming that the cost drivers for each of these activities behave differently. Porter's strength was to condense this activity based cost analysis into a generic template consisting of five primary activities and four support activities. The nine activity groups are:

Primary activities:
1. *inbound logistics* : materials handling, warehousing, inventory control, transportation;
2. *operations*: machine operating, assembly, packaging, testing and maintenance;
3. *outbound logistics* : order processing, warehousing, transportation and distribution;
4. *marketing and sales* : advertising, promotion, selling, pricing, channel management;
5. *service*: installation, servicing, spare part management;

Support activities:
6. *firm infrastructure* : general management, planning, finance, legal, investor relations;
7. *human resource management* : recruitment, education, promotion, reward systems;
8. *technology development* : research & development, IT, product and process development;
9. *procurement*: purchasing raw materials, lease properties, supplier contract negotiations.

By subdividing an organisation into its key processes or functions, Porter was able to link classical accounting to strategic capabilities by using value as a core concept, i.e. the ways a firm can best position itself against its competitors given its relative cost structure, how the composition of the value chain allows the firm to compete on price, or how this composition allows the firm to differentiate its products to specific customer segments.

assets:

- cost driver categories
  ProvenModels • editor PM • version 0.1 • 39 KB
- customer needs chart
  ProvenModels • editor PM • version 0.1 • 124 KB
- industry profit pool
  ProvenModels • editor PM • version 0.1 • 79 KB
- value chain analysis
  ProvenModels • editor PM • version 0.1 • 89 KB
- value chain linkages
  ProvenModels • editor PM • version 0.1 • 30 KB

pros:

- Value Chain Analysis provides a generic framework to analyse both the behaviour of costs as well as the existing and potential sources of differentiation.
- Porter emphasised the importance of (re)grouping functions into activities to produce, market, deliver and support products, to think about relationships between activities and to link the value chain to the understanding of an organisation's competitive position.
- The value chain made clear that an organisation is multifaceted and that its underlying activities need to be analysed to understand its overall competitive position. An organisation's strengths and weaknesses can only be identified in relation to the profiles of its direct competitors. Competitive advantage is derived from an integrated set of decisions on these key activities.
- The Value Chain model was intended as a quantitative analysis. It can also be used as a quick scan to describe the strengths and weaknesses of an organisation in qualitative terms.
- With the Value Chain Analysis, Porter tried to overcome the limitations of portfolio planning in multidivisional organisations. The concept of Strategic Business Units stated that businesses within a conglomerate should act independently while headquarters should be responsible only for budgetary decisions to be based on a business unit's position in the overall portfolio. Porter used his Value Chain Analysis to identify synergies or shared activities between Strategic Business Units and to provide a tool to focus on the whole rather than on the parts.

cons:

- The quantitative analysis is time consuming since it often requires recalibrating the accounting system to allocate costs to individual activities. Porter provided qualitative guidance for a quantitative exercise. His analysis began with identifying the relevant activities that lead to competitive differences and are significant enough to influence the organisation's overall cost base.
- The Value Chain Analysis should be accompanied with a customer segmentation analysis to mix the internal and external view. A feature or product provides the firm with a differentiating competitive advantage only if customers are willing to pay for it. Customer value chains need to be analysed to determine where value is created.
- The Value Chain is used to analyse a firm's position in relation to its direct competitors with the assumption that rivalry drives profitability. This excludes other assumptions such as customer bonding in Alexander Hax's delta model.
- The Value Chain Analysis was developed to analyse physical assets in product environments. Other authors amended the model to accommodate intangible assets and service organisations.

references:

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