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THE VALUE CHAIN

4 STEPS FOR IDENTIFYING UNIQUE VALUE



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The sequence of activities that a provider performs in delivering products or services is known as a “value chain”¹. Value chain analysis breaks down the activities of a firm into its basic elements such as R&D, product development, marketing, etc. The value of these activities (as perceived

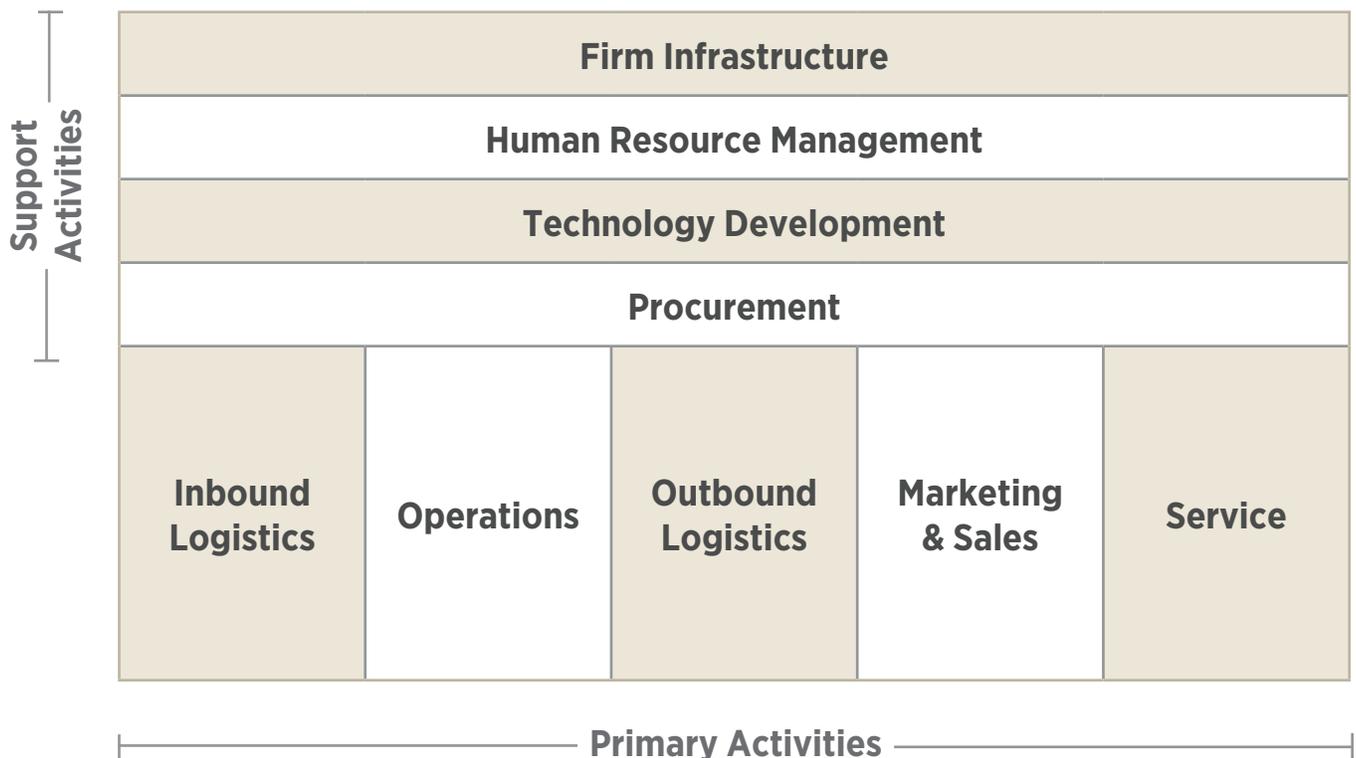
by customers) is then weighed against the ability of the company and its competitors to deliver them.

The purpose of completing a value chain analysis is to evaluate how a provider can deliver unique value. The key to a useful

value chain analysis is to think of each segment as a value creating activity, instead of as a cost.

The Value Chain was first introduced by strategy pioneer Michael Porter. Porter offered the following model for evaluating a value chain:

PORTER'S GENERIC VALUE CHAIN



Here are three examples of well known brands that have created differentiation by leveraging elements within a value chain:

Charles Schwab

Charles Schwab disrupted the market for stockbrokers by offering an entirely new value proposition. *It is not that Schwab offered different benefits; it is that it magnified the significance of some features over the others.*¹ While investors may value advice, Schwab investors gravitated to a low cost alternative that redefined the cost-benefit of executing a trade. Customers of this type offered a sizable enough market that Schwab was able to carve out a sustainable business. Schwab identified a benefit (advice) that was over serving the market and demagnified its importance.

Personal Computers

Perhaps no industry in the last decade has been more competitive than PC's (personal

¹ Understanding Michael Porter by Joan Magretta-Harvard Review Press

computers). While assembly of PC's and distribution to consumers through retail or online channels delivers value, it is the providers of chips (Intel) and software (Microsoft) that capture a disproportionate level of perceived value.² Microsoft and Intel command much higher market capitalization than companies such as Dell and Best Buy who operate further downstream in the value chain.

Auto Industry

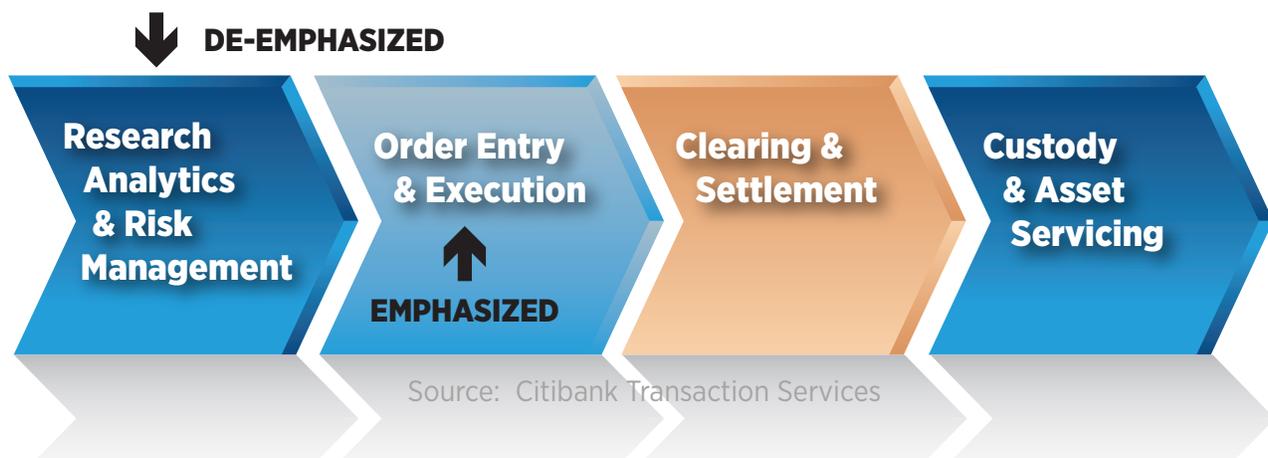
A value chain analysis makes a distinction between delivering the most value, and measuring relative cost vs. relative value. Customers may value warranties as a differentiator amongst companies. Some competitors (such as BMW or Hyundai) may excel in delivering such a benefit, which may be the source of some advantage. What is critical is that the providers measure the perceived value of the feature

² How to Drive Value Your Way by Michael Jacobides and John MacDuffie Harvard Business Review July/August 2013

vs. the incremental cost to provide it. Many companies use warranties in this way because as a percentage of revenue, the cost of warranties is very low. It is important to note that warranties should not be offered blindly, companies should conduct betas to measure cost and carry reserves to mitigate any risks.

Today, the auto industry has been disrupted again by companies such as Tesla, who are magnifying the significance of batteries. In many industries, such as Intel in the PC industry, it is a provider "upstream" that is able to capitalize on its unique capabilities by selling its component to other providers – in this case, OEM's. It is unknown if such an "integrator" will emerge to sell batteries across the automobile industry.

An additional benefit of a value chain analysis is that it forces the marketer to look beyond existing capabilities and to evaluate them against those offered by others in the context of customer needs.



Here is a step-by-step guide for conducting a value chain analysis. The example below is for a fictitious company producing vitamin supplements.

VALUE CHAIN ANALYSIS

Step 1: Identify the Activities of the Value Chain

Break down each component of your product into activities within its life cycle. Do not list support functions such as HR that do not directly contribute to the value perceived by clients.

Step 2: Assign a True Cost to Each Activity

Quantify the costs associated with each step in the value chain. Ideally, this would include a very specific accounting of labor costs associated with production or delivery of a service, down to a per unit basis. Often companies employ an activity based costing technique to gather such information, which may require the use of a consulting or accounting firm.

Step 3: Measure the Relative Value of Each Segment

Perhaps the most difficult element within Value Chain Analysis is gauging the benefits that customers or clients value most. Unlike the other steps, this requires information external to the organization.

This is typically accomplished through some type of customer insight study, customer survey, customer advisory board or focus group. The concept of actually asking customers what they value (including benefits offered by competitors) may be intimidating, but is absolutely necessary. Online polls are an emerging tool where opinions of potential customers can be gathered at low cost.

Step 4: Weigh Strengths and Weaknesses of Competitors for Each Activity

Evaluate your organization's ability to deliver unique value in each activity and compare that with the capabilities of your competitors.

In the example below:

- Each value based activity is listed
- A total direct cost is calculated and assigned
- The ability of the company to provide unique value is articulated by a + or - (strength or weakness)
- The ability of competitors to provide unique value is articulated by a + or - (strength or weakness)
- The value of each activity, as perceived by customers, is ranked.

Value Chain Analysis for Vitamin Company

The data reveals that the most important features to customers are the custom formulation produced for them, the ability to talk to a customer service agent on the phone, and the fact that their confirmation has unique usage information about the product.

While factors such as product quality, packaging and cycle time may be intuitive benefits that may be the focus of manufacturers; they are not the features with the greatest relative value vs. relative cost.

In fact, the greatest “value add” for the provider may be in the confirmation (at virtually no cost) which delivers greater benefit in relative terms than the production of the product itself.

This analysis can be the foundation of many important management decisions. For example, the decision of outsourcing production or customer service should not be made based on cost savings, but on relative value delivered to a customer. In this example, customers value the customer

service agent more than fast cycle time, and an argument could be made to outsource production and keep customer service in house.

Thus, the value chain analysis is an immensely powerful tool in identifying how to deliver unique value, and to create an infrastructure that supports it.

To complete your own value chain, complete the template (note this can be blown up as a poster to be used as an interactive exercise).

Activity	Value \$	Company	Competitor A	Value Rank
R & D	\$2.50	-	+	
Formulation	\$2.75		-	1
Testing	\$1.00		-	
Marketing	\$4.00	+		
Customer Service	\$4.50		+	2
Production	\$6.00	+	+	
Shipping	\$3.00			
Invoicing	\$0.50			
Confirmation	\$0.25			3

