Simple Tools and Techniques for Enterprise Risk Management, Second Edition
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Appendix 10
Value Chain Analysis

This appendix should be read in conjunction with Section 8.8.6.

CONFIGURATION OF RESOURCES

Competitive advantage is derived in part from the configuration of resources rather than simply the uniqueness of those resources. Therefore the analysis of a business should examine the link between resources and how they form part of a system, with the objective of adding value. This is an important concept as it can be applied right across a business and affects all major processes. Value added is the amount by which the selling prices exceed input costs. Input costs include bought-in products and services, salaries and the cost of capital equipment. Businesses exist to add value to a product or service. The ability to add value is closely linked to profitability. The identification of value added will allow a business to focus on improvements or strategic change on areas where little value is added. If any primary activity is making a loss for instance, it may be appropriate to outsource it, provided this does not introduce extensive risk, which is difficult to manage.

Michael Porter's concept of a value chain is a useful tool to examine value added across a business (Porter 1991). Examining, modifying and managing the value chain (the primary sequential activities of a business) can produce sustainable competitive advantage. Porter states that "competitive advantage results from the business's ability to perform the required activities at a collectively lower cost than rivals, or perform some activities in unique ways that create buyer value and hence allow the business to command a premium price".

The value chain identifies five primary and four support activities, as illustrated in Figure A10.1. A principal use of value chain analysis is to identify a strategy mismatch between different elements of the value chain. If a company competes on the basis of low costs, then every part of the value chain should be directed towards low costs. Friend and Zehle (2004) provide a topical example, low cost airlines which have looked at every aspect of the value chain and taken out costs at all stages of their business delivery: "Bookings are taken only via the internet rather than through travel agents; seats cannot be reserved; there are no paper tickets, free meals or drinks or lounges; and flights depart from secondary airports with lower landing fees."

The five primary activities are the sequential logistics, production and marketing processes, as described below. The primary activities can also be thought of as the main vertical functions of a business:

- Inbound logistics is the activity of receiving goods or services from suppliers and moving them onto the operations activity.
- Operations are where the production of the product or services takes place. Production may be broken down into further steps, for example producing intermediate goods from raw materials and then turning intermediate goods into the final product. Make or buy decisions can be made at every stage.

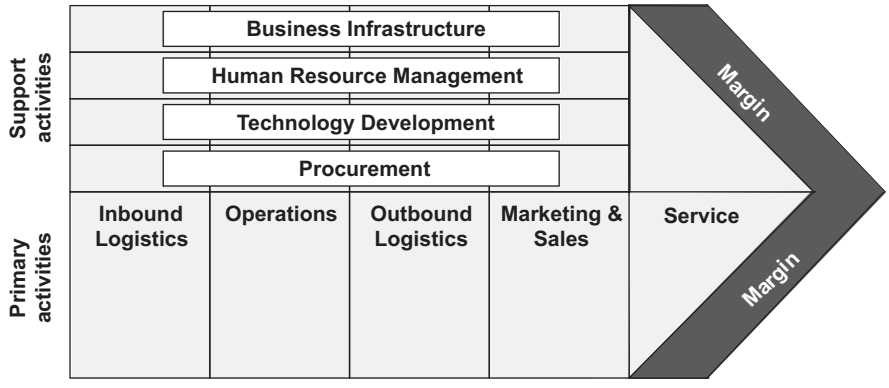

Figure A10.1 The value chain (Porter 1991)

- Outbound logistics covers order fulfilment, which is the warehousing of the finished goods and the distribution of the products or service to the customer. This is commonly outsourced.
- Marketing and sales include pricing, packaging and advertising as well as market research.
- Service refers mainly to after-sales service.

Support activities are horizontal in that they contribute to the different primary activities. For instance, the procurement department will deal with purchasing across all of the functions. The value chain has four support activities.

- Business infrastructure includes activities such as accounting, facilities, planning and general administration.
- Human resources management covers recruitment, training, labour relations and salaries.
- Technology development includes the development of new products or services or the enhancement of existing products and services.
- Procurement includes the purchasing of raw materials or intermediate goods as well as vehicles, office supplies and energy supplies.

REFERENCES

Friend, G. and Zehle, S. (2004) *Guide to Business Planning*. Profile Books Limited, London.
Porter, M.E. (1991) Towards a dynamic theory of strategy. *Strategic Management Journal*, 12, 95–117.