

# A Significance of Value Chain Analysis in Assessing Competitive Advantage of an Organization

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## **Abstract**

*Value chain analysis is a powerful tool for managers to identify the key activities within the firm. Value chain analysis is essential to an understanding of markets, their relationships, the Participation of different actors, and the critical constraints that limit the growth There in, competitive advantage of an organization lies in its ability to perform crucial activities along the value chain better than its competitors. A company may benefit from cost advantages if it either reduces the cost of individual activities in the value chain or the value chain is essentially reconfigured, through structural changes in the activities. A systematic analysis of the value chain can facilitate effective outsourcing decisions. Therefore, it is important to have an in-depth understanding of the company's strengths and weaknesses in each activity in terms of cost and differentiation factors. The research focuses on where are a company's unique capabilities in the value chain. How relevant are these capabilities to building a competitive position. Value chain analysis is concerned with what the organization is good at. Once strategic and non-strategic activities have been clearly understood, an organization should then identify specific strategic value chain activities that it is good at.*

**Keywords:** Competitive Advantage, value-creating processes, Internal Differentiation Analysis, Vertical Linkage Analysis

## **Introduction**

A value chain is a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market. The concept comes from business management and was first described and popularized by Michael Porter in his 1985 best-seller, "Competitive Advantage: Creating and Sustaining Superior Performance". Competitive advantages give a company an edge over its rivals and an ability to generate greater value for the firm and its shareholders. The more sustainable the competitive advantage, the more difficult it is for competitors to neutralize the advantage.

## **Objectives**

- To understand about value chain analysis.
- To understand the value chain approach for assessing competitive advantage.

## **Rational**

As barriers to international trade have diminished and as access to goods and services has grown, customers can locate and acquire the best of what they want, at an acceptable. Price, wherever it is in the world. Under growing competition and, hence, rising customer expectations, a company's penalty for complacency becomes even greater.

## **Scope**

This is addressed to managers, and more specifically to management accountants, who may lead efforts to implement value chain analysis in their organizations.

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The concepts, tools and techniques presented apply to all organizations that produce and sell a product or provide a service.

### **Review of Literature**

Institute of Management Accountant describes the value chain analysis to organizational goals, strategies and objectives to appreciate the organizational and managerial accounting challenges. The goal is to provide management with sufficient options to sustain its competitive advantage in an ever-changing business environment. According to **Shank and Govindarajan**, the industry value chain starts with the value-creating processes of suppliers, who provide the basic raw materials and components. It continues with the value-creating processes of different classes of buyers or end-use consumers, and culminates in the disposal and recycling of materials.

### **Research Methodology**

Type of Research of my study is descriptive procedure of value chain approach of various companies all the data is collected from the books, publication, Records of the companies, Websites.

### **Competitive Advantage**

A competitive advantage is an advantage gained over competitors by offering customer's greater value, either through lower prices or by providing additional benefits and service that justify similar, or possibly higher, prices. Competitive advantage for a company means not just matching or surpassing what competitors can do, but discovering what customers want and then profitably satisfying, and even exceeding, their expectations. An advantage that a firm has over its competitors, allowing it to generate greater sales or margins and/or retain more customers than its competition.

### **Value chain**

- The value paid by the customer will be greater than the cost of all value added activities resulting in a profit.
- Cost advantage & differentiation opportunities are analyzed throughout the value chain to become more competitive.

**Cost Advantage:** By better understanding cost & squeezing them out of the value adding activities. A firm enjoys a relative cost advantage if its total costs are lower than the market average.

**Differentiation:** By focusing on those activities with core competencies & capabilities in order to perform them better than its competitors. A differentiation advantage occurs when customers perceive that a business unit's product offering (defined to include all attributes relevant to the buying decision) is of higher quality, incurs fewer risks and/or outperforms competing product offerings. Factors that provide unique customer value.

### **Competitive advantages derive from the activities the business does which are**

- Done better than competitors.
- Done differently than competitors.
- Create unique benefits.
- Done at a lower cost than competitors

The basic model of Porters Value Chain is as follows:

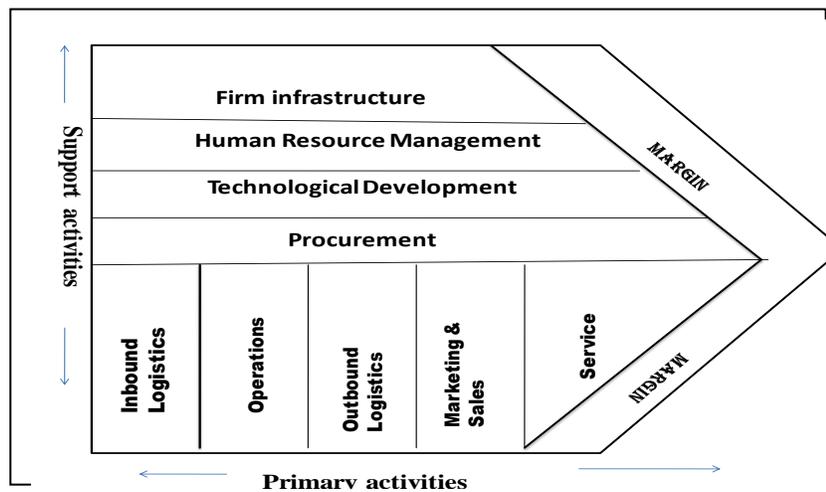


Fig 1.1 Basic model of Porters Value Chain

### Value Chain Approach for Assessing Competitive advantage

Most corporations define their mission as one of creating products or services. For these organizations, the products or services generated are more important than any single step within their value chain. In contrast, other companies are acutely aware of the strategic importance of individual activities within their value chain. They thrive by concentrating on the particular activities that allow them to capture maximum value for their customers and themselves. The way that the value chain approach helps organizations assess competitive advantage is through the following types of analysis:

- **Internal cost analysis**
- **Internal differentiation analysis**
- **Vertical linkage analysis**

### Internal Cost Analysis

Organizations use the value chain approach to identify sources of profitability and to understand the cost of their internal processes or activities.

**The principal steps of internal cost analysis are**

- **Identify the firm's value-creating processes**

Large businesses still organize themselves as cost, revenue, profit and investment centres. The key is to classify value activities according to their true contribution to the firm's competitive advantage. For Example Competitive advantage is achieved in inbound logistics stage of the business by British Airways through establishing on-going relationships with suppliers, sophisticated system for stock control and professional training.

- **Determine the portion of the total cost of the Product or service attributable to each value creating Process**

Dell has competitive advantage over its competitors in online sales (Dell is the first company to make \$1 million online sales on computers); therefore, the company has to focus on promoting its new products online.

- **Identify the cost drivers for each process**

For example, large pharmaceutical companies enjoy economies of scale that lower their unit costs for expensive R&D. Higher capacity utilization may result in lower per-unit product costs and higher potential profits.

- **Identify the links between processes; and evaluate the opportunities for achieving relative cost advantage.**

The operations of Dell has been very effective in terms of managing the inventory levels near to zero and making its suppliers locate their warehouses and factories near to Dell's own manufacturing and assembly unit. This indicates that the company has been applying the JIT manufacturing.

### **Internal Differentiation Analysis**

The value chain approach is also used by organizations to identify opportunities for creating and sustaining superior differentiation. In this situation, the primary focus is on the customer's perceived value of the products and services. As with internal cost analysis, internal differentiation analysis requires firms to first identify their value-creating processes and primary cost drivers. They are then ready to perform a differentiation analysis using the following guidelines:

#### **Identify the customers' value-creating processes**

Perdue (chicken) Quality conscious consumers of chicken more tender, golden chicken at a moderate price premium. Dominos (pizza) A good pizza, delivered hot to your door within 30 minutes of ordering, at an moderate price premium.

#### **Evaluate differentiation strategies for enhancing Customer value**

Dimension of Comparison Dominos Pizza Hut Unique Selling Proposition (USP) 30-minute Home Delivery Frame Dining Experience Market Penetrations strategy – Redefining their recipes.

#### **Determine the best sustainable differentiation strategies**

Competition with Pizza Hut resulted in Price cuts, discounts. Initially high price; as Pizza Hut offer "Comeback Value to our customer" because of its USP – Dining Experience. Dominos Pizza Hut Promotion Introduce Pizza mania (Large Pizza – Rs.129/-) Discount coupons Tie-up with Discovery Channel – Co branding Direct Mailing and Pizza Training Classes Campaign like – Pan in your Name Innovative Menu

### **Vertical Linkage Analysis**

Linkages among value-creating processes do not end with the activities within a firm. The greatest competitive advantage may come out of linkages between a firm's value-creating activities and those of its suppliers, channels or users. Value chains target competitive advantage. They are a way of modelling the organisation in order to answer question activity by activity. Once an organisation has modelled its value chain it can

- Can we enhance the value added by that activity?
- Is there an opportunity to reduce the cost of that activity?
- Is there an opportunity to eliminate that activity?
- Can we use that activity to differentiate the organization?

In order to answer these questions the organization must study the primary activities that get the product, or service, to the customer and the support activities that facilitate that. In addition, there are linkages between these activity processes. Increasingly it is with improvements to these linkages that information systems can offer the most support and help an organization achieve a competitive advantage.

## IT

Cost-effective software deployment models provide the latest services and applications to users. Advanced computing architectures promote agility while meeting business information requirements.

## Capacity Utilization

Capacity utilization depends on market demand and on scheduling production for the most efficient use of your facilities. A structured approach to capacity planning lets you use capacity utilization rates to determine when you need to expand capacity to satisfy increasing demand for your products.

## Value chain differences in Big Retail chain stores

Value chain Process	Strategic Differences	
	Wal mart	K-mart
Marketing & Sales	Low prices from suppliers	Suppliers raising prices
IT	Mastery of technology by treating IT as core competency Just-in-time inventories - Best SCM in retail industry Continuous improvement in technology by intelligent IT spending	Incompetence SCM technology in retail industry Real time data not shared with suppliers
Services	Opening hours at Wal-Mart generally range from 7.00 a.m. to 11.00 p.m. six days a week, and from 10.00 a.m. to 8.00 p.m. on Sunday. • All Wal-Mart stores maintain uniform prices, except where lower prices are necessary to meet local competition	Not Improved the product line carried to keep the middle class
Firm Infrastructure	Wal*Mart• There are 2485 Wal-Mart stores all over the world. This includes 682 Supercentres, 457 Sam's Clubs, 5 Wal-Mart Neighbourhood Markets and 1007 units of Wal-Mart International. Wal-Mart serves over 100 million customers weekly worldwide. There are 1035000 associates, and the	k-mart should Design the store to be more organized and attractive

	company is America's largest private employer	
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### Explanation

Wal-Mart has achieved competitive advantage by adopting cost leadership strategy and providing consumer goods at lower prices. The cost leadership strategies are helping Wal-Mart to reduce its cost of operations and thus enjoy higher profits as well as the larger market share. Due to its enormous size and large number of stores worldwide, Wal-Mart has the tremendous bargaining power with its suppliers and thus it purchases products at lower prices. The competition of Wal-Mart's low prices is a weakness for Kmart, because they are unable to match these prices. Another weakness is their stores are considered old and outdated, their distribution systems is not very efficient.

### Conclusion

Competitive strategy of the firm is the roadmap that shows the way to gaining sustainable competitive advantage by the firm. Thus, competitive advantage depicts a company's competencies and its capability to survive against the factors prevailing in the firm's external environment. Therefore, gaining competitive advantage entails a set of specialized skills, assets, and capabilities for the organization. Competitive advantage is an important concept because it defines the 'uniqueness' of an organization vis-à-vis its competitors. The strategy by which the sustainable competitive advantage is gained is known as business level strategy of the organization. The internal resources and Competitive advantage examines the economics of a firm's business focusing primarily its ability to generate excess returns on capital and links the business strategy with fundamental finance and capital markets, for a longer period of time. In the end, it is a firm's competitive advantage that allows it to earn excess returns for its shareholders. Without a competitive advantage, a firm has limited economic reason to exist-- its competitive advantage is its reason of life. Without it, the firm will decline. Creating a sustainable competitive advantage may be the most important goal of any organisation and may be the most important single attribute on which each firm must place its most focus.

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