The Value Chain

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INTRODUCTION

What Is a Value Chain?

The sequence of activities a provider performs in delivering products or services is known as a **"value chain."** Value chain analysis breaks down a firm's activities – R&D, product development, marketing, and more – and weighs their perceived value against the ability of the company and its competitors to deliver them.

> The key to a useful value chain analysis is to think of each segment as a **value-creating activity**, not as a cost. The purpose is to evaluate how a provider can deliver **unique value**.

Porter's Generic Value Chain

The Value Chain was first introduced by strategy pioneer Michael Porter, who offered a model for evaluating how firms create value through primary and support activities. Porter identified two categories of activities that together determine a firm's competitive position.

Support Activities (enable the primary chain)

- Firm Infrastructure
- Human Resource Management
- Technology Development
- Procurement

Primary Activities (direct value delivery)

1. Inbound Logistics
2. Operations
3. Outbound Logistics
4. Marketing & Sales
5. Service

REAL-WORLD EXAMPLES

Value Chain Differentiation in Practice

Three well-known brands have created lasting competitive differentiation by strategically leveraging elements within their value chains. Each illustrates a different approach to emphasizing or de-emphasizing activities.

Charles Schwab

Schwab disrupted traditional stockbrokers by de-emphasizing advice – an over-served benefit – and emphasizing low-cost trade execution. This redefined the cost-benefit equation and carved out a sustainable market position.

Personal Computers

In the highly competitive PC industry, chip (Intel) and software (Microsoft) providers capture disproportionate perceived value – commanding far higher market caps than downstream players like Dell or Best Buy.

Auto Industry

Companies like BMW and Hyundai excel with warranties as a low-cost differentiator. Tesla is now magnifying the significance of batteries, potentially reshaping the upstream value chain as Intel did in PCs.

CASE STUDY

The Schwab Value Chain: Emphasis in Action

The following diagram illustrates how Charles Schwab strategically de-emphasized Research Analytics & Risk Management while emphasizing Order Entry & Execution – redefining value for cost-conscious investors.

1. Research Analytics & Risk Management
   ↓ DE-EMPHASIZED
2. Order Entry & Execution
   ↑ EMPHASIZED
3. Clearing & Settlement
4. Custody & Asset Servicing

Source: Citibank Transaction Services

> Schwab's insight was not to build a better mousetrap – it was to recognize which part of the trap customers actually valued. By concentrating resources on execution rather than advice, Schwab created a new category.

4-STEP FRAMEWORK

Value Chain Analysis: A Step-by-Step Guide

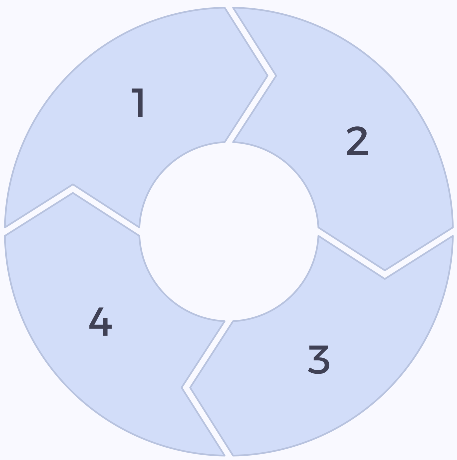
The following four steps guide a complete value chain analysis. The example used throughout is a fictitious vitamin supplement company, chosen to illustrate how the framework applies across industries.

Identify the Activities

Break down each component of your product into activities within its life cycle. Exclude support functions like HR that don't directly contribute to client-perceived value.

Assign a True Cost

Quantify costs for each step, ideally down to a per-unit basis. Companies often use activity-based costing, which may require a consulting or accounting firm.



Measure Relative Value

Gauge which benefits customers value most – requiring external insight via surveys, advisory boards, focus groups, or online polls.

Weigh Competitor Strengths

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

> Each step builds on the last. Skipping ahead – especially to competitor analysis – without first mapping costs and customer value leads to flawed strategic conclusions.

What You'll Need

Cost Data

Per-unit cost breakdowns for each activity, ideally from your accounting or finance team.

Customer Insights

Survey results, focus group findings, or advisory board input on what customers value most.

Competitor Intelligence

An honest assessment of where competitors are strong or weak across the same activities.

Cross-Functional Team

Input from operations, marketing, finance, and sales to ensure a complete and accurate picture.

Identify the Activities of the Value Chain

Break down each component of your product into activities within its life cycle. For a vitamin supplement company, this includes R&D, formulation, testing, marketing, customer service, production, shipping, invoicing, and confirmation. Do not list support functions such as HR that do not directly contribute to the value perceived by clients.

Think of each activity as a discrete step that a customer could theoretically pay for separately. This granularity is what makes the analysis actionable – it forces you to see your business through the customer's eyes rather than through an organizational chart.

✓ Include: Client-Facing Activities

R&D, formulation, testing, marketing, customer service, production, shipping, invoicing, confirmation

X Exclude: Support Functions

HR, IT infrastructure, general administration – unless they directly create perceived value for the client

? Key Question to Ask

Would a customer pay more if this activity were done better? If yes, include it.

Assign a True Cost to Each Activity

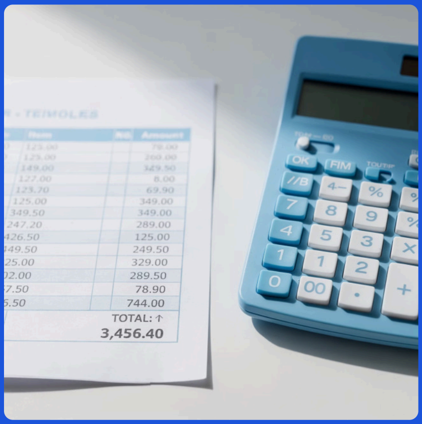
Quantify costs associated with each step – ideally including a specific accounting of labor costs down to a per-unit basis. Companies often employ activity-based costing, which may require the use of a consulting or accounting firm.

What to Measure

Quantify costs for each step, ideally down to a per-unit basis, including labor costs.

How to Do It

Companies often employ activity-based costing, which may require a consulting or accounting firm.



Sample Cost Breakdown — Vitamin Co.

Activity	Cost per Unit
R&D	$2.50
Formulation	$2.75
Testing	$1.00
Marketing	$4.00
Customer Service	$4.50
Production	$6.00
Shipping	$3.00
Invoicing	$0.50
Confirmation	$0.25

Notice that Production carries the highest cost at $6.00 per unit – yet as we'll see in Step 3, it is not the activity customers value most. Cost and value are not the same thing.

Common Mistakes When Assigning Costs

⚠️ Bundling Activities Together

Grouping multiple steps into one line item obscures where costs are actually concentrated. Each discrete activity should be costed separately to reveal true per-unit economics.

⚠️ Ignoring Labor Costs

Many companies track material costs but undercount the labor embedded in each activity. A full activity-based costing model must include time-allocated labor at every step.

⚠️ Using List Price Instead of True Cost

Standard pricing or budgeted rates often mask the real cost of delivery. Use actual cost data – including overhead allocation – to ensure the analysis reflects reality.

Measure the Relative Value of Each Segment

Perhaps the most difficult element of value chain analysis is gauging which benefits customers value most. Unlike other steps, this requires information external to the organization – you cannot determine customer value from internal data alone.

Customer Surveys

Ask customers directly what they value, including competitor benefits. Keep surveys focused and quantitative where possible.

Advisory Boards & Focus Groups

Customer advisory boards and focus groups provide deep qualitative insight into unmet needs and perceived gaps.

Online Polls

An emerging low-cost tool to gather opinions from potential customers at scale – useful for validating survey findings.

The goal is not to ask customers what they want – it's to understand what they value. These are different questions. Customers often cannot articulate value until they experience its absence.

Weigh Strengths & Weaknesses of Competitors

Evaluate your organization's ability to deliver unique value in each activity and compare it with competitors. For each activity: assign cost, rate company and competitor strength (+/−), and rank customer-perceived value. This final step reveals where you have a genuine competitive advantage.

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

A '+' indicates a strength relative to the market; a '−' indicates a weakness. Value Rank reflects customer-perceived importance. The most strategic opportunities lie where your company is strong AND customer value rank is high.

ANALYSIS & INSIGHTS

Key Insights from the Vitamin Company Analysis

The data reveals that the most important features to customers are custom formulation, the ability to speak with a customer service agent, and a confirmation with unique usage information. These findings are counterintuitive – and that's precisely what makes value chain analysis so powerful.

Counterintuitive Finding

Product quality, packaging, and cycle time – intuitive manufacturer priorities – are not the features with the greatest relative value vs. relative cost.

The Confirmation Insight

The greatest 'value add' may be the confirmation – at virtually no cost ($0.25) – which delivers greater relative benefit than production itself ($6.00).

Outsourcing Decisions

Customers value customer service more than fast cycle time. The analysis supports outsourcing production while keeping customer service in-house.

Strategy · Alignment · Scalability

About Optimize

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The Strategy Solution for the Mid-Market

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