

The Fronteira Post

Economic Policy & Corporate Competitiveness

Value Chain Analysis: Smart Platform for Robust Business Strategy Design

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“Value chain analysis plays a key role in understanding the need and scope for systemic competitiveness”

- Raphael Kaplinsky and Mike Morris (____).

The First Important Strategy Design Step!

There are obvious strategic value-additions when a number of persons that are knowledgeable about a particular line of business gather to brainstorm the business challenges as well as forge a future course of action for its improved competitive advantage. This is typical of the so-called business strategic retreat sessions usually organized by many organizations. Essentially, the underlying and primary objectives of such retreat is to pool together the participants' knowledge base on the business area and on the strength of such knowledge develop appropriate framework and tactics that delivers corporate competitive advantages in the market place. What has however remained a challenge is whether indeed these participating “knowledgeable persons” truly possess reasonably accurate knowledge about the nature of competition, the opportunities, constraints and the incentive structure for tapping into those opportunities of its industry/sector.

Other “knowledge” requirements are of the same order and constitute the linkages in productivity, value-creation as well as distributive channels adopted by various competing firms and the underscoring rationale. In the absence of a genuinely “reasonably” accurate knowledge about a business, the design of strategies to guide the future course of the operations of that business may not correctly deliver as much desired competitiveness as should be the case. Appropriate strategy design sequences must give

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paramount priority – at the earliest stages - to data-driven insights which can now be used as first line evidence to direct the brainstorming activities. The data-generated knowledge and insights therefore confirms or disproves existing notions regarding the business and accordingly results in new insights upon which sound business strategic brainstorming and ultimate design must be built.

Since every entrepreneurial endeavor takes place within an external environment in which there is limited control opportunities and an internal one where substantial control can be unleashed, the search for critical pre-strategy design knowledge must occur at both levels in order to make sense. This is quite consistent with mainstream strategy design process. As a rule, one of my preliminary demands any time I am invited to assist with strategy design is an industry value-chain analysis (including the comprehensive value chain maps) with comprehensive overlays and robust industry competitor sampling outcomes. It is inconceivable that firms expect sustainable competitive advantage in implementing strategies which do not substantially factor-in a robust industry value-chain analysis. The value chain analysis when properly conducted, comprehensively delivers knowledge and insights from the competitive environment in which a firm operates. This is traditionally the starting point in the design of sustainable corporate strategy and in business planning. Thus depending on the outcomes of a robust value chain analytical processes, decision makers can now decide on the nature of business plans and strategy to design and adopt.

This essay essentially concentrates on this first indispensable stage. My position is that regardless of the nature of strategy, it is extremely indispensable that a thorough understanding of the environment of competition must be carried out in order to truly measure its current level of competitiveness, the current and potential opportunities, the dynamic structure of the market and the value-creating linkages, sources of current and potential constraints to realizing business goals, channels of value delivery which invariably opens up the strengths and weaknesses of participating firms strategy, the existing quantum of incentives, its structure and those most strategically opportuned to optimize the identified opportunities.

Value Chain Analysis Delivers Rich Market Information

Value chain analysis is increasingly popular because of its fairly holistic approach which typically involves “identifying and mapping the relationships of four

types of features: (i) the activities performed during each stage of processing; (ii) the value of inputs, processing time, outputs and value added; (iii) the spatial relationship, such as distance and logistics of the activities; and (iv) the structure of economic agents, such as the suppliers, the producer, and the wholesaler”². The internal (firm) value chain also provides a robust approach to evaluating firm performance. According to Porter (1985)³ value chain consists in disaggregating a firm into its strategically relevant activities in order to understand the behavior of costs and the existing and potential sources of differentiation”. Value chain analysis therefore aids the understanding of the functioning of particular markets within a value chain system, the role of specific market players (or groups) within this system and their relationship to others⁴.

Why Value Chain Analysis?

Value chain analysis achieves three fundamental analytical goals namely (a) robust end market analysis, (b) chain analysis and (c) competitiveness analysis. In trying to carry out these sets of analyses, four fundamental questions become key: (a) what are the greatest opportunities for improving an industry performance as well as in industry upgrading? (b) what are the constraints to realizing those opportunities both within the value chains and among participating firms? (c) which set of stakeholders in the industry will benefit (and in what relative magnitudes) from the investments in upgrading? And (d) which subset of this group with incentives, skills power will help to drive/make these investments?⁵

In effect therefore the goal of value chain analysis can be broadly seen in terms of its capacity for opportunity and constraint identification as well as in the discovery of the incentives for taking advantage of these opportunities. For instance, in the end market analysis, a value chain study will require a (i) trend analysis using such techniques as the Boston McKinsey Matrix; (ii) unveiling of trade leads which will help in the identification of actual and potential buyers as well as shift analysis from market to buyer; and (iii) buyer surveys and benchmarking that will provide appropriate positioning information.

² The World Bank Group (2007). ‘Moving Toward Competitiveness: A Value Chain Approach’. World Bank P.x

³ Porter M. (1985). ‘Competitive Advantage: Creating and Sustaining Superior Performance’. Free Press New York et al. P33-40

⁴ Herr L. Mathias et al (2009). Value Chain Development for Decent Work. International Labour Organization. P. 87

⁵ Modified excerpts from PowerPoint presentation by Olaf Kula. () “Value Chain Analysis. USAID

Essentially, the understanding of the available opportunities, the constraints to tapping those opportunities as well as those with the incentives to take advantage of these opportunities provides robust competitiveness understanding.

The chain analysis objectives which are inherent in its process elucidates the enormous value that value chain analysis offers. Typically, the analysis starts with the mapping of the industry value chain which is primarily carried out in order to understand the structure of the value chain including: markets, functions, actors, linkages and relationships. Mapping however does not reveal the industry dynamics, the structure of the end markets, finance and other supporting markets as well as the enabling environment. The mapping phase is usually successfully carried out with successful conduct of key informant interviews. The second stage in the chain analysis involves field surveys of all competing firms along the chain and in various market channels.

The third stage involves the analysis of firm data using appropriate framework in order to get to chain level opportunities and constraints, these are placed on the maps if necessary as overlays. In delivering on the expectations at this stage, important questions that value chain analysis answer are: what are the greatest opportunities? What are the factors that have kept these opportunities from being exploited? What are the constraints to upgrading in the chain and its firms?⁶ In general a value chain analysis tries to understand the costs and benefits including the risks of participating in different channels. It also examines the policy design implications.

As would have been observed from the exegesis so far, “value chain analysis overcomes a number of important weaknesses of traditional sector (or industry)⁷ analysis which tends to be static and suffers from the weaknesses of its own bounded parameters ... it struggles to deal with dynamic linkages between productive activities that go beyond that particular sector, regardless of whether they are of an inter-sectoral nature or between formal and informal sector activities”⁸

Value chain analysis is a very vital analytical tool for understanding the policy environment. It also “plays a key role in understanding the need and scope for

⁶ Ibid

⁷ Emphasis is mine

⁸ Raphael Kaplinsky and Mike Morris (). ‘Handbook of Value Chain Research’. Prepared for the IDRC. P2

systematic competitiveness. The analysis and identification of core competencies will lead the firms to outsource those functions where it has no distinctive competencies⁹

Rationalizing Poor Usage of Value Chain Analysis in Business Strategic Planning Setting

Value chain analysis is being widely used in policy setting in order to identify areas of possible intervention by policy makers. Its usage at the corporate level has however been very low. The implication of this has equally been obvious: many firms that ought to have revved up their performance have suffered severe competitive disadvantages. There are many reasons for this: poor understanding of the usefulness of value-chain analysis in business strategic planning; incompetence in following the rigorous process demanded by the technique in order to arrive at robust outcomes; unwillingness to wait for the time required for the result of the value-chain study to be completed.

The most obvious setback to the deployment of value chain analysis is the poor understanding by corporate decision makers of the need for and benefits of conducting a value chain analysis. This “understanding-challenge” is of twofold form: the first relates to total ignorance of the tool, while the second has to do with not knowing that the benefits associated with the tool is too strategic to be ignored. This latter group are made up of chief executives who obviously have heard about it but have not bothered to ask further questions regarding its usefulness. For the first group, a good proportion belong to those who feel quite satisfied with the use of the traditional industry analysis techniques. That knowledge-gap however accounts for the observable value-gap between the results from value-chain analysis and the traditional industry analysis. Value-chain analysis when well designed and carried out involves very rigorous industry analysis as well as link analysis and other value delivery influencers. It also generously incorporates the embedded services which are typically ignored in many traditional industry analysis. Value chain analysis therefore gives more wholistic and dynamic perspectives on any industry studied and clearly identifies all the points of opportunities and constraints in the entire value creating chain. And as already noted, the analysis also presents the capability status of competitors as well as the opportunity-leveraging incentives that are open to each one of them. Ultimately on its own it lays open the grounds for

robust competitiveness optimization strategy design for any discerning organization/competitor.

Let us examine the issue of poor capability to deliver on the demands of value chain analysis from another perspective. Today, value chain analysis for instance is more widely used for products. The reason is quite obvious. It is easier to track product making and supply/demand chain more than it possible is for services. Thus, the fact that most services value chain appear difficult to track has made lot of the services sector loose out on this wonderful value-adding resources for its business strategy design. ValueFronteira’s team of analysts are however able to deal comprehensively with the challenges of a service value chain. Another capability challenge that is causing substantial set-back in the use of value-chain analysis is the required analytical rigour at various stages of the research. At various stages in the research, value chain analysis requires the extensive use of sampling techniques to obtain the data required for its analysis. Robust analytical techniques are further deployed as may be necessary depending on the nature of variables of interest in order to obtain relevant magnitudes. It naturally requires some level of training and capacity enhancement to be able to successfully deliver on these. The result is obvious: those who cannot invest in that competence enhancement will naturally choose an easier option. It is also important to state that the easier options are usually more expensive in the long-run.

Forward-looking organizations that are keen on designing appropriate competitiveness optimization strategy must inevitably deploy the techniques of industry value-chain analysis for its study of the environment of competition. Firms need not be discouraged by the inadequacies of their own capacity to deploy this tool/technique. There are a few consulting firms around that can provide assistance in this respect. The critical advice here is that in order to optimize the benefits; see clearly the hidden opportunities and constraints in particular product or service line, good entrepreneurs must carry out a value chain analysis.

What is the Way Forward?

The realization that no robust competitive strategy or business plan can take place without a rigorously conducted value chain analysis will constitute a psychological take-off point for decision makers. Even the so-called strategy-by-design that tries to jettison the mainstream strategy development process cannot really be very successful without a good understanding

⁹ Ibid. P11

of the productive-competitive environment in which the business exists. Nevertheless, this psychological base is not necessarily enough. As the saying goes, “faith without good work is dead in itself”. Similarly, it is worth knowing that what is required for result-delivering strategy starts with recognizing and carrying out a robust value-chain analysis.

As a matter of fact, not only should a baseline industry value chain analysis be conducted on a firm’s product and service lines, periodic revisions of the value chain analysis in order to find out strategic shifts in the opportunity and constraint factors, as well as in the incentive structures, beneficiaries and the behavior of entire market participants is extremely important. In a highly competitive business environment, the pursuit of competitiveness equally requires the aggressive monitoring of market dynamics. The independent strategic decisions of each of the participating firms will invariably result in regular changes in the industry value-maps and delivery channels. These changes are what a strategically focused firm requires to know ahead of other competing firms in order to sustainably design and implement strategies that outsmart the industry rivalry. This is the time to start.

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1. Competitiveness strategy design and implementation, driven essentially by data-mining, economic theory and business research methods;
2. Marketing research, competitive intelligence, value chain analysis, industry analysis and other strategic business studies;
3. Economic policy research and project impact analysis;
4. Intelligence gathering and analytics for fraud, criminal detection and counter-terrorism;
5. Training on business analytics, research methods and executive economics.

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