What Is Value Chain Analysis?

Value chain analysis is a way for businesses to analyze the activities they perform to create a product. Once the activities are analyzed a business can use the results to evaluate ways to improve its competitive advantage.

Competitive Advantage

Competitive advantage is what sets your business apart from competitors. And to develop an advantage, you'll need a clear idea of your target market, the benefit your product provides to the target market, and a solid understanding of your competitors and their offerings.

A business can gain a competitive advantage in one of the following areas.

1. Cost Leadership

The goal of a cost leadership strategy is to become the lowest-cost provider in your industry or market. Companies who excel with a low-cost strategy have extreme operational efficiency and use low-cost materials and resources to reduce the overall price of their product or service.
Cost leadership examples: McDonald’s and Walmart

2. Differentiation

With a differentiation strategy, the competitive advantage is gained by offering a unique or highly specialized product or service. The business needs to dedicate time and resources to innovation, research, and development. A successful differentiation strategy allows the business to set a premium price for its product or service.

Differentiation examples: Starbucks and Apple

It’s best to pick a single competitive advantage to focus efforts on. Depending on which competitive strategy you choose the goal of your value chain analysis will be to either reduce costs or differentiate to improve margins. Then you’ll have a clear idea of your business’ goals, how you plan to provide value, and it narrows the scope of changes that might need to be made to improve efficiency.

Porter’s Value Chain Analysis

Harvard Business School professor, Michael Porter, introduced a simple value chain model in his book, “Competitive Advantage”. He developed the steps to perform a value chain analysis and split business activities into two categories: primary and support.

Value Chain Analysis Steps

Value chain analyses require research and can take time to develop. Below are the general steps it takes to create a value chain analysis:

1. Determine the business' primary and support activities.

Together, the primary and support activities make up the value chain. And they include each action required in the development of a product or service, from raw material to final product.

2. Analyze the value and cost of the activities.

The team tasked with creating the value chain analysis should brainstorm ways each activity provides value to customers and the business as a whole. Compare the activity to the competitive advantage you’re trying to achieve (cost leadership or differentiation) and see if it supports the goal.

After the value analysis is complete, take a look at the cost of the activities. Is the activity labor intensive? How much does X raw material cost? Asking questions similar to these will help identify which activities are cost-effective and which are not. This where areas for improvement can be identified.

3. Identify opportunities to gain a competitive advantage.

Once the value chain analysis is complete, the primary stakeholders in the business can see an overview of where the business is excelling and where improvements can be made operationally.

Begin with the improvements that take minor changes and provide high-impact results. After the easy wins are identified and actioned, you and your team can tackle the bigger challenges that might be hindering efficiency.
The value chain analysis gives businesses a clear idea of how to adjust their actions and processes to provide the most value to their target market and increase profit margins for the company.

Primary and Support Activities

Identifying the primary and support activities is the first step in creating a value chain analysis. These are the key processes and systems a business uses to develop its product or service.

Primary Activities

There are five primary activities and they include all the actions that go into the creation of a business' offering.

1. Inbound Logistics

This is how materials and resources are gained from suppliers before the final product or service can be developed.

2. Operations

Operations are how the materials and resources are produced, resulting in a final product or service.

3. Outbound Logistics

Once a product or service is finished, it needs to be distributed. Outbound logistics describes this delivery process.

4. Marketing and Sales

This is how your product or service is presented and sold to your ideal target market.

5. Services

This is the support a business provides for the customer which can include support and training for the product, warranties, and guarantees.

Support Activities

Support activities help the primary activities in creating an advantage over competitors, and they include:

1. Firm Infrastructure

This entails all the management, financial, and legal systems a business has in place to make business decisions and effectively manage resources.

2. Human Resource Management

Human resource management encompasses all the processes and systems involved in managing employees and hiring new staff. This is especially important for companies that provide in-person service, and excellent employees can be a competitive advantage.

3. Technology Development
Technology development helps a business innovate. And technology can be used in various steps of the value chain to gain an advantage over competitors by increasing efficiency or decreasing production costs.

4. Procurement

This is how the resources and materials for a product are sourced and suppliers are found. The goal is to find quality supplies that fit the business' budget.

Example

Below is an example of a value chain analysis for McDonald’s and it’s cost leadership strategy.

Inbound Logistics

McDonald’s has pre-selected, low-cost suppliers for the raw materials for their food and beverage items. It sources suppliers for items like vegetables, meat, and coffee.

Operations

The business has is a franchise and each McDonald’s location is owned by a franchisee. There are more than 37,000 McDonald’s locations worldwide.

Outbound Logistics

Instead of formal, sit-down restaurants, McDonald’s has fast-casual restaurants that focus on counter-service, self-service, and drive-through service.

Marketing and Sales

Its marketing strategies focus on media and print advertising, including social media posts, magazine advertisements, billboards, etc.

Services

McDonald’s strives to achieve high-quality customer service. And it provides its thousands of employees with in-depth training and benefits so they can best assist their customers.