

Can Value Chain Analysis lead to Business Transformation?



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“The Sky is falling.” - Chicken Little

In response to recent economic conditions, organizations are looking to transform themselves in order to stay competitive and solvent. However, just as Chicken Little didn't fully understand his environment, so some companies are desperately adopting business transformation – simply because they feel they have to.

In this article, we suggest that Value Chain Analysis can be used as part of a process for deciding candidates for Business Transformation. We will present a brief overview of Business Transformation and Value Chain Analysis, and describe a couple of hypothetical business transformation cases.

As you read this article, ask yourself, “Is my organization agile enough to transform by changing rapidly, or are we running scared like Chicken Little?”

Business Transformation

Managers are attempting to adopt a philosophy of Business Transformation to deal with changing economic and market pressures. But what is Business Transformation? According to Mike Morrison, *“Business Transformation is a change management strategy which has the aim to align People, Process, and Technology initiatives of a company more closely with its business strategy and vision. In turn, this helps to support and innovate new business strategies.”*¹⁰

Minor business transformations could include efficiency improvements to an organization's processes, while larger business transformations might involve changes to the organization's strategic direction – redefining its business objectives, adopting new organizational structures, and/or changing its resources (e.g., new technology, outsourcing). Larger business transformations impact many areas of an organization. *“At a basic minimum, such transformation should result in better customer operations, better product operations, and better corporate operations that produce better profits, better return on assets, and better positioning for the future for sustainable competitive advantage”*¹¹

So, obviously, to successfully execute a business transformation, the organization must consider the impact on its culture – its people, its customers and its processes. Before making changes that will impact the culture, the organization must be diligent in choosing the right things to

¹⁰ <http://rapidbi.com/created/businessstransformation.html>, September 17, 2009

¹¹ http://www.infosysconsulting.com/our_services.htm

transform. But how does the organization decide how to transform itself? It makes sense to revisit the business strategy to ensure it still makes sense, but then might the analysis of the internal and external value chains help in determining transformation goals?

Value Chain Analysis and Business Transformation

Introduced by Michael Porter¹², value chain analysis reviews all the activities that an organization performs to deliver its products (or services) to determine the value that each adds to the ultimate product (or service). It considers primary activities, such as inbound and outbound logistics, operations, marketing, sales and services; and support activities like facilities management, human resources, technology, and procurement.

Applying value chain analysis will enable the organization to understand which activities are core to its business (i.e., those value-added activities that provide a unique advantage over its competitors). It will likely want to protect these and minimize risks against them. They may want to consider incremental changes to these activities, but they are not likely candidates for large business transformation.

In times of uncertain economic conditions, there is value in building financial and operational flexibility to the remaining, non-core activities. If an organization understands which of its value chain activities is non-core, it may attempt to reduce the committed, fixed costs that are associated with them. Striving to apply variable costs to these value chain activities results in an agile organization being able to transfer the costs to other resources quickly.

A Successful Example: Let's consider a multi-national company that manufactures, markets, sells, and distributes shoes. Upon reviewing its value chain, it concluded that its distribution process, although good, was really a non-core activity. It divested its distribution assets and hired them back to provide its logistic services. The divested distribution company was also able to broaden its core activity by offering logistics services to a broader client base.

Understanding its core competencies generated improved results for the shoe company and for the distribution company. But, for the shoe company, it recognized that the value chain analysis was not a one-time event, but an on-going process. It had created a culture in which change was to be embraced and not feared. The shoe company followed its initial success by reviewing its value chain once again. This time, to the surprise of many, it determined that manufacturing was no longer a core value chain activity. Further rounds of divestiture and outsourcing followed, and the result was a successful transformation to a marketing and sales organization, which outsourced to efficient logistics and manufacturing organizations.

¹² Competitive Advantage: Creating and Sustaining Superior Performance, Michael E. Porter, The Free Press, New York, 1985.

A Cautionary Tale: True core activities should not be needlessly exposed to risk. A manufacturer of specialty business electronic devices had a strong, long-standing client base. The selling cycle was heavily influenced by large discounts offered to customers at the end of each quarter to boost sales. Product, therefore, had to be delivered the last month of every quarter putting pressure on manufacturing. As the industry requirements changed, it became apparent that the company needed to redesign its products so that they would easily configure to suit the individual client's needs. The options were to retool their existing manufacturing or to outsource. It was decided to close its manufacturing and to adopt an outsourcing strategy. However, the outsource manufacturers were never able to match the timeliness of product customization required by the end customer (driven by the sales cycle) resulting in a large loss of clients.

The manufacturer exposed this important value chain activity (manufacturing) to too much risk. For this transformation, it might have been better to adopt a parallel manufacturing strategy until it could be certain that the outsource manufacturer was capable of producing in a timely manner, or the company could change the selling cycle.

Summary

Value Chain Analysis provides a mechanism by which organizations can evaluate core and non-core activities, and help to expose and prioritize transformation possibilities. Often, Business Transformation is only on the executive agenda during bad times – either during global recessions, or when competition gets fierce. But, Business Transformation should be ongoing.

Organizations that are doing well in today's economy have probably had transformation as part of their strategy all along. According to Beth Ellyn Rosenthal *"It is time for organizations to recognize the need to transform continuously, and becoming more agile is a great way to achieve that ongoing."*¹³

Continuously revisiting the business strategy and analyzing the value chain exposes transformation possibilities and creates an agile organization. Agile organizations are not reactionary to market conditions; they understand their core competencies and are able transform quickly to take advantage of economic and market circumstance.

If your organization is not agile, ask yourself how you might incorporate value chain analysis to support a business transformation philosophy.

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¹³ Business Transformation Outsourcing Circa 2009, Beth Ellyn Rosenthal, Outsourcing Journal, <http://www.outsourcing-journal.com/nov2008-business.html>