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VALUE CHAIN ANALYSIS – BASIC ELEMENT OF AN ORGANIZATION'S COMPETITIVE ADVANTAGE

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Abstract: *Competitive advantage is a difference in relative prices or the relative costs and it results from differences in their work done. These differences may occur in two different ways, namely either the organization performs better the same types of activities, or it chooses different types of activities. To establish whether between an organization and other competitors in the same industry there are differences in terms of relative prices and relative costs, it is recommended to make use of Porter's value chain, the more so as these differences are determined by the activities of the organization. Value chain plays an important role in the diagnosis of an organization's competitive advantage because through it we can get an insight into the mode of action of costs and the influences they have on the strategy that the organization has taken. Also, through the value chain there can be identified the potential sources of differentiation of products or services offered by the organization.*

Keywords: value chain, competitive advantage, profit margin, value added, cost analysis.

1. Introduction

Competitive advantage is a difference in relative prices or the relative costs and it results from differences in their work done. When organizations make competitive advantage, it means that there must be differences in its activities and those carried out by other competing organizations. These differences may occur in two different forms, namely either the organization performs better the same types of activities, or choose different types of activities.

The mere improvement of operational efficiency does not provide a competitive advantage, because as soon as the organization creates a good practice, the rivals will try to copy it. Therefore, basically by copying best practices, organizations do not only increase its sights in front of competitors. Even if all competitors will get absolute improvement in operational effectiveness an improvement will not actually be achieved for anyone.

The stake is not only on the fulfilment of the same activities as competing organizations. Organizations wishing to obtain a competitive advantage through sustainable differentiation in price or cost are doomed to have strong setbacks. Japanese companies which are considered to be the best in competition in terms of "operational effectiveness" are condemned by M. Porter to obtain a reduced profitability. Competitive rivalry is considered by Porter as the process acting against a company's ability to maintain differences in relative price and relative cost.

To establish whether between an organization and other competitors in the same industry there are or not differences in terms of relative prices and relative costs, it

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is recommended to make use of Porter's value chain, especially as these differences are determined by the activities of organizations.

The value chain of an organization is a sequence of all the activities that take place within it and create value and generate costs. Activities, as well as value chain in which they are included, are the cornerstone of competitive advantage.

2. Theoretical considerations regarding entrepreneurship

Michael Porter has studied how an organization can compete in the market, so as to obtain and maintain a competitive advantage over competing organizations. Basically, an organization must choose two options:

- to choose the most efficient way to compete, and in this sense, the organization may seek to obtain products or services that it achieved at lower costs than those of competitors, or by differentiation, adding value in areas that customers consider important;
- to choose the activities in which the organization wishes to obtain competitive advantage.

Starting from the idea that an organization's strategy should be chosen in such a way as to lead to a favourable relationship between relative price and relative cost, we can say that the competitive advantage of that organization is linked to the creation of a higher value, for the effective use of resources. Therefore, we can say that competitive advantage is given by the superior performance resulting from the ability to operate in a sustainable manner with high prices, low costs, or both.

To better understand the actions that should be taken by a manager to influence prices and costs we must go to the level of actual activities taking place in the organization, those that shape the things where it excels at.

The range of activities that an organization carries out to design, produce, sell, distribute and support the product through various services is called value chain. In turn, the value chain is part of a larger value system or general assembly of the activities involved in creating value for the final user, regardless of who performs those activities.

Value chain concept was introduced by Michael Porter; however, the vast majority of managers use it to refer to a series of chained activities. Yet, many managers lose sight of the importance and meaning of the value chain. The value chain is important because it is a very effective tool through which an organization can be decomposed into its relevant activities strategically, so that we can focus on those which are sources of competitive advantage. Thus, basically those specific activities can be identified within an organization leading to higher prices or lower costs.

Value chain analysis is a systematic method to study the primary activities and support activities that are performed within an organization.

Through this method, managers can identify ways to reduce costs and differentiate products and services he performs within the organization. As it is known, Michael Porter has argued that competitive advantage is created and maintained when organizations make the main activities either much cheaper, or much better than competing organizations.

The value chain highlights the total amount to which an organization achieves its products or services or its global income, and consists of value-activities that the organization carries out and within their profit margin. Value-activities are those activities through which the organization creates a product or service, different technically and technologically. The margin is the difference between the total value and the total cost of their value-activities [1].

The entire spectrum of activities which an organization carries out has the purpose of providing offers that have a market value, so it can be considered that the value of all these activities is the sum of money that customers are willing to pay to purchase the

product or service produced by the organization.
Michael Porter argues that value is measured by total revenue obtained by selling products or services that the organization has achieved. If the value obtained from the sale of such products or services is higher than the costs, the organization is considered to be profitable, and the difference between them is called the margin.
Analyses made for the diagnosis of an organization are based on added value, which is obtained by carrying out all of its activities. In a competitive analysis, there may be a point where this approach may not be effective, and an explanation for this would be that in terms of costs, the organization may choose voluntarily for them to be high in order to give strong differentiated products, or may choose to contract all activities for which it is not a leader regarding costs, in order to preserve "domination by costs".
According to the model proposed by Michael Porter, the organization's activities were divided into two categories: primary and supportive.
In the category of primary activities there were included [3]:

- logistics upstream - in this category of activities there were included supply activities of raw materials, parts, components, equipment, machinery, etc.;
- production - transforming inputs into finished products in manufacturing activities, assembly, inspection, packing, maintenance, etc.;
- downstream logistics – physical distribution activities from the organization, to distributor or customer, order management, transport, interim inventory management, delivery, etc.;
- marketing and sales – all techniques and means by which the consumer is made aware of the product's or service's existence and how to obtain it;
- service – all activities to keep the product's value by installation, training the user for proper usage, repairing, etc.

Primary activities are related to the four categories of support activities which are the following [2]:

- supply – the acquisition process of resources necessary to carry out the main activities;
- technology development - consists of the know-how related to product, research and development, product design, improved techniques and work processes, etc.;
- human resources management - all activities related to recruitment, training and motivation of staff within an organization;
- organization's infrastructure - includes organizational structure, planning activities, financial control, and the elements of organizational culture).

Each of the primary and support activities involve certain costs, but also adds value to the product or service made in an organization. For any organization, it is important to find ways to reduce costs, but should not lead to reduced quality of products or services provided. It may also be accepted, however, increases in costs, given that they lead to increased product quality or customer service.
Porter argues that in the analysis of costs and opportunities for differentiation of products and services offered by the organization, compared to those of the competition, it is important to divide the primary activities and support activities, which were called subtasks. This division should be done with great care so as to be consistent, in order to be useful for the proper division of the cost items.
Issues that need to be resolved concern the level of value chain to be built within an organization. First, it must be designed for overall organization, and then, if necessary, detailed for all strategic segments.
The general rule is that the main activities are exercised differently, while supporting

activities are more homogeneous. The rule seems logical since the establishment of competitive advantage depends directly on the conduct of the main activities within an organization.

With regard to supporting activities, the answer is more nuanced problem as they may be common to several strategic segments. Virtually all segments are likely to experience high influence from organizations' management, the culture of the organization or the way of organizing.

The reason which required the construction of the internal value chain of an organization also applies to the sharing of work between this and its various partners, upstream and downstream of it, so that there can be set a new value chain, called the external value chain.

External value chain must be drawn to take account of other participants in the business of the organization who have a significant influence on internal chain. These key participants are those who have a real and decisive influence in obtaining competitive advantage and this category may include: major suppliers, distribution channels and market sectors, i.e. the rearrangement of marketing sectors.

External value chain is in fact an analysis of pathways in which organizations operate, with a major influence on the creation of an organization's competitive advantage and enables highlighting existing links, in terms of activities between participants in succession: suppliers - organization - distributors - customers.

Through this analysis of the external value chain, it can be made possible [4]:

- to observe the current distribution of activities between the organization, suppliers, distributors and customers and comparing costs with obtained benefits;
- to explore possible ways of reducing costs through better coordination between the organization and its suppliers and distributors and even the transfer of activities in order to reduce cost of sales;
- Other forms of image-sharing activities or tasks and examination of a balance of forces between the "actors" of the chain.

The construction and analysis of the value chain, both external and internal, have as essential purpose the understanding of ways to add / re-add the value of products and services offered by the organization. The re-awarding of value is to refuse trivializing products and thus recreating a differentiation of the offer from that of competitors. In this respect, the external value chain must be designed so as to allow the organization to maximize creative capabilities, and thus exploit the internal value chain.

To carry out the value chain analysis of an industry, it is very important to start from designing the value chain. For its construction it is necessary to identify the sequence of all the activities carried out within an industry. The value chain of an industry is the model through which it is highlighted how it creates value, and where most of the organizations found their position. Graphical representation of a value chain within an industry may be represented as in Figure. 1

Through value chain it can be noticed how far upstream and downstream are the activities of that industry extended. There can also be highlighted which are the main activities that create value across the value chain path and from them there can be made a comparison between competing organizations' value chain to understand the differences in pricing and cost.

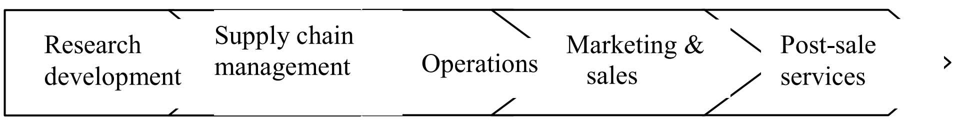

Figure no. 1: Representation of value-creation activities for the customer [5]

Depending on the industry to which we refer, some categories of activities are more or less important for the competitive advantage. It is important for managers and investors to identify key value creating activities that are specific to a particular industry. In cases of multiple competing business models, it is important to trace the value chain for each of them, and then to identify the differences between the rivals.

The next step in the value chain analysis, after outlining the industry chain which the organization is part of, is designing and then comparing it with its own value chain. In order to make the comparison the value chain of the organization is positioned parallel to the industry one and then it is to identify the differences between the two chains. The purpose of this comparison is to identify those activities within the industry that the organization carries out and to capture every major step in the process of value creation.

This is also the way to compare the value chains of competing organizations, and through this it can be seen which value creating activities of each organization are and the differences between these organizations in terms of value creation. If, after comparing the value chains of organizations, it can be noticed that they are the same, we can conclude that the compared organizations are engaged in a competition for being "the best". Therefore, we can say about the compared organizations that they do not want to "be unique", as suggested by Porter, in order to hold a competitive advantage and thus the obtained profit from the industry can be reduced.

Continuing the analysis of the value chain, Michael Porter calls for focus on those factors that determine the price for those activities that have or may have an impact on differentiation. In this respect the organization can create a higher value of the goods or services provided by performing some activities in a distinctive way, or performing other activities than those of competitors by allowing them to add value without increasing the measured costs.

The value for buyer can occur along the entire value chain and can come from: product design, the choice of resources used or the production process itself, the experience in sales or in after-sales services and support. Whether the client is an organization or an individual, examining how it fits into the overall value system is essential to understand how to create value for the customer.

The next step in the value chain analysis is to focus on activities that generate costs. For that, special attention should be given to those activities of an organization that cause a large or increasing percentage in costs. Relative cost position which is occupied by an organization is given by the cumulative cost of carrying out all activities in the value chain.

As stated previously in the analysis, there is or there may be differences between the cost structure of an organization and the one of the competitors. Consequently, all costs associated with each activity, including not only direct operational costs and asset costs, but also indirect costs that arise when performing each activity should be determined as accurately as possible. Therefore, there must be identified specific indirect costs that could be eliminated if certain activities would be stopped.

For each activity, the cost advantage or disadvantage depends on activities that generate costs or on a number of factors that influence the relative cost. In order to determine the real value of cost analysis all the data available to the organization should be studied, in order to identify what actions can be taken to improve activities.

The competitive advantage, as defined in the previous sections, is a difference in relative prices or the relative costs and comes from differences occurring in the work performed. When an organization achieves competitive advantage, it means that there must be differences in its activities and the ones carried out by other competing organizations. These differences may occur in two different forms, namely either the organization performs better the same types of activities or it chooses different types of activities.

Michael Porter uses the term "operational effectiveness" which refers to the ability of an organization to perform similar activities better than the competition. Most managers use the terms "best practices" or "execution". Regardless of the term used, it is the multiplicity of practices that enable an organization to get the most out of the resources it uses.

However, the mere improvement of operational efficiency does not provide a competitive advantage, because as soon as the organization creates a good practice, the rivals will try to copy it. Therefore, basically by copying best practices, organizations do not only increase its sights in front of competitors. Even if all competitors will get absolute improvement in operational effectiveness an improvement will not actually be achieved for anyone.

The stake is not only on the fulfilment of the same activities as competing organizations. Organizations wishing to obtain a competitive advantage through sustainable differentiation in price or cost are doomed to have strong setbacks. Japanese companies which are considered to be the best in competition in terms of "operational effectiveness" are condemned by M. Porter to obtain a reduced profitability. Competitive rivalry is considered by Porter as the process acting against a company's ability to maintain differences in relative price and relative cost.

To establish whether between an organization and other competitors in the same industry there are or not differences in terms of relative prices and relative costs, it is recommended to make use of Porter's value chain, especially as these differences are determined by the activities of organizations.

The value chain of an organization is a sequence of all the activities that take place within it and create value and generate costs. Activities, as well as value chain in which they are included, are the cornerstone of competitive advantage.

3. Conclusions

The value chain plays an important role in the diagnosis of an organization's competitive advantage because through it we can get an insight into the mode of action of costs and the influences they have on the strategy that the organization has taken. Also, through the value chain, potential sources of differentiation of products or services offered by the organization can be identified.

As a conclusion to the value chain analysis we can state that for the first time we begin to see each activity not only as a cost but as something that should add value no matter how small the finished product or service is.

The second consequence of the use of value chain is that it forces managers to look beyond the boundaries of their own organization, its activities, and to find that they are part of a larger value system, which includes other competitors. Thus, each member of the value system is required to understand the role it has to fulfil within the whole process of creating value, regardless of the distance it is to the final user.

The independence of the value chains has major implications. Therefore, the management used across boundaries, i.e. between the organization and its clients, or between the organization and its suppliers, or between business partners, can be as important to the strategy as the management developed within the organization.

The value chain was a major breakthrough for the analysis of relative costs and the value created in an organization. The value chain helps managers to focus on activities that cause costs and create value for customers.

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