5 step value-chain analysis for customers' strategic needs

Business, Marketing

Value-chain analysis is used for many purposes, but the process of examining customers' value chains is relatively new. In our five-step process, Step 1 explains how internal and external value chains can be used separately and in related ways. Step 2 shows how to construct a customer's value chain. Step 3 shows how to identify the customer's business strategy by examining this value chain and using other kinds of information. Step 4 explains how to use additional information and intelligence to leverage that understanding into strategic needs and priorities.

Finally, Step 5 explains how a firm's marketing function can best use this method of value-chain analysis as a new strategic capability. Step 1: An overview of value-chain analysis Value chains may be defined in two ways: (1) within a company they describe the various value-added stages from purchasing materials to distributing, selling, and servicing the final product (Porter's 1985 concept),[3] and (2) they also delineate the value-added stages from raw material to end-user as a product is manufactured and distributed, with each stage representing an industry. 4] For convenience, we will refer to these two definitions as ‘‘ internal'' and ‘‘ external'' value chains, respectively. The internal value chain is a key concept in the field of strategic management that has been thoroughly explored. In contrast, the external value chain has not been studied as extensively. The external value chain consists of the important upstream/supply and downstream/distribution processes. However, even though these processes occur outside the corporation, the strategic opportunities they reveal and areas of risk they highlight warrant careful study. Consider:

Outsourcing – involves transferring certain primary or support functions in the internal value chain to the external value chain. B Vertical integration – involves taking control of one or more additional stages of the external value chain and making them internal. B Horizontal expansion – involves new product lines or expanded channels of distribution, including geographic expansion. B Strategic alliances with suppliers – involves more closely managing external suppliers as if they were part of the company's internal value chain, but without actually owning them (for example, Toyota's Kaizen ystem, wherein key suppliers are located very near a factory and receive all kinds of help and training from Toyota to ensure smooth and efficient production). One of the most complex value chains today can be found in the oil industry. This chain has nearly 30 significant elements, starting with the search for oil (at the upstream end) and including field production, transportation (pipelines and supertankers), refining and processing and, lastly, consumer gas stations (at the ‘‘ downstream’’ end).

Internally, the oil-industry value chain processes a broad range of products, including such major categories as oil/lubricants, gasoline, petrochemicals (plastics), fertilizers/pesticides, natural gas, power generation/electricity, and convenience stores. The firms that are considered major integrated oil companies participate in a significant number – sometimes all – of these external (upstream and downstream) and internal value-chain elements.

In a 2006 issue of Strategy &Leadership, authors Wayne McPhee and David Wheeler suggested that strategists should use Porter's concept to consider value-chain operations beyond the boundaries of the firm. Since its introduction, value-chain analysis has proven immensely valuable in three principal ways – cost analysis and reduction, differentiation, and product development – but the standard practice was for firms to analyze only their own value chain. Step 2: How to construct a customer's value chain First, recognize that you need to construct both internal and external value chains for a particular customer.

The internal value chain follows Porter's original concept, which includes value-added steps from purchasing to distribution as well as support functions such as R&D and human resources. It's tempting to let this generic diagram serve as the customer's value chain, but it must be tailored to the particular customer. To produce a useful value-chain analysis, members of your engineering or sales team should ask the customer how its business processes add value and whether any have unique best-practice features.

To perform the external value-chain analysis, team members should ask the customer a set of getting-to-know-you questions. What does your supply chain (the upstream value chain) look like? What role does your company play in it? How do your products reach their customers (the downstream value chain)? Your final diagram models only this single customer's value chain and it represents virtually everything the customer does to add significant value. If your relationship with the customer permits a candid exchange of information, have the customer validate the value chain you have created.

As an example of how thediagnosticprocess works, consider how a supplier to Wal-Mart might learn to enhance its value. [6] The objective of creating both internal and external value chains is to understand Wal-Mart well enough to be able to discern its implicit and explicit strategic concerns. Exhibits 3 and 4 depict preliminary pictures of Wal-Mart's internal and external value chains. Getting to this initial stage is relatively easy – adding more detail, nuance, and understanding takes more time, involves interviewingWal-Mart executives, and more closely observing how the firm operates.

Step 3: Inferring the customer's business strategy Even long-time suppliers have trouble distinguishing critical customer activities from sometimes urgent but ultimately nonstrategic ones. Understanding your customer's business strategy is therefore crucial. Value-chain analysis helps a supplier distinguish between the activities of the customer's firm that directly support its competitive strategies – for its products and for enhancing key capabilities – and ordinary operations. For example, routine operations like billing customers or servicing the fleet of company vehicles must be done, and done well.

But there is little if any competitive advantage to be gained from the superior execution of such activities. Nor are they likely to provide an opportunity for gaining new sources of revenue and profit. It is the customers' strategic activities and projects that offer the potential for future profits and command the attention of your customers' senior management. So by supporting strategic activities, B2B service providers stand to gain the high-margin work they hunger after, the work that produces the highest returns, and the work that should be their constant priority.

The Fluor case Fluor Corporation is a global engineering and construction company providing major capital facilities for a vast range of industrial clients in many vertical markets. With as many as 2, 000 projects under construction employing 40, 000 workers in more than 50 countries at any time, Fluor operates in all geographic regions of the globe and in all parts of its customers' supply chains, delivering engineering and construction management services – in sum, a full range of B2B services.

The questions of where Fluor should concentrate its resources to meet its customers' most urgent needs can become enormously complex. To rationalize this process, Fluor must determine which customer projects – the ones that address its customers' greatest strategic needs and, hence, have potentially the greatest margins – have the highest value. For many years, Fluor has known the critical importance of understanding every one of its B2B customers' businesses. But that was not enough. The questions for Fluor's marketing team became, ‘‘ How can we learn each customer's business strategy and strategic needs? ' Some of the many different sources of information about a customer's strategy are: B Marketing communications including printed materials (brochures and advertisements), media communications (press releases) and marketing websites reveal new product directions and customer targeting; these provide insights into market positioning and marketing strategy. B Financial-community reports (annual reports, SEC filings, as well as meetings with financial analysts) shed light on internal strategic initiatives in addition to market-positioning moves.

Annual reports form the basis of this Fluorcase study, but 10Ks and analysts' reports could prove equally useful. B Theacademicliterature is replete with surgical dissections of strategically successful companies and industries. Business-school cases abound featuring companies like Apple and industries like automobiles. Wal-Mart, for one, has been the focus of manyHarvardBusiness School cases. [8] B Many companies make their published strategic plans available to interested parties. For example, British Petroleum has published its strategy on its corporate website since 2000.

B Consultants that specialize in competitive intelligence. B Face-to-face conversations with your customers. Step 4: Discovering the customer's strategic needs Strategic activities are the activities a firm must implement in order to realize its strategy or strategies. Every strategy has such a set of activities. Insofar as a company finds doing any of these activities difficult, potential suppliers have been trained to see these as ‘‘ needs. ’’ But, suppliers need to differentiate between operations that are difficult and ones that are strategic.

For example, an innovation strategy requires a system for generating ideas and picking the best ones, cost estimating, engineering, R&D, prototype construction and testing, and market-acceptance testing. The pharmaceutical industry relies on a great many B2B service providers to support its new-drug-development programs in the drug-formulation (R&D)

stage and also B2B service providers that develop new systems to expedite regulatory approval. Value-chain analysis identifies both as key strategic functions.

Step 5: Making value-chain analysis a strategic capability of the marketing department Engineering/construction companies have developed at least two approaches to break the forces of commoditization in their industry: 1. Project screening and selectivity. Not all projects are created equal or represent equal opportunity. Service providers should select projects on the basis of projected margin, not projected revenue. They must pursue projects that build on their strengths and core competences, projects where they can apply their best talents to serve their customers.

This is done by first serving customers' commodity work to position them to then pursue customers' strategic opportunities. This is the approach used in the Fluor example. 2. Become selected customers' strategic business partner. Such practice puts the business-services provider right in the customers' lap, a decidedly advantageous position to be in when strategic opportunities are brewing. It also leads to many sole-source or noncompetitive-bid opportunities and, potentially, to higher margins. 1. The method described in the article is based on actual experience of one author when he worked for Fluor Corp. . A recent example is Ram Charan, What the CustomerWants You to Know: How Everybody Needs to Think Differently about Sales, Portfolio (Penguin Group), 2007. The application of value-chain analysis to B2B clients of engineering and construction management services was originally suggested by Don F. Coleman of Fluor Corporation in

May, 2000. 3. Michael E. Porter, Competitive Advantage: Creating and Sustaining Superior Performance, Free Press, 1985. 4. Stanley C. Abraham, Strategic Planning: A Practical Guide for Competitive Success, Thomson South-Western, 2006, 214. . Wayne McPhee and David Wheeler, ‘‘ Making the case for the added-value chain,’’ Strategy & Leadership, Vol. 34 No. 4, 2006, Exhibit 1, p. 41; exhibit used with permission. 6. The supplier could have many other customers, and could replicate this process with those other customers. Typically, doing such an analysis would be reserved for the supplier’s top 3-5 customers. 7. The authors found little in the literature about B2B marketing practices based on knowledge of the customer’s value chain and business strategy. 8.

See, for, example Harvard Business School Case #9-794-024, ‘‘ Wal-Mart Stores, Inc. ,’’ August 6, 1996, which provides a thorough review of Wal-Mart’s business practices up to its international (horizontal) expansion. 9. Michael E. Porter, ‘‘ What is strategy? ’’ Harvard Business Review, November-December 1996. 10. HBS Case #9-794-024, op. cit. 11. Harvard Business School Case #9-302-102, ‘‘ Robert Mondavi and the Wine Industry,’’ May 3, 2002. Mondavi’s flagship brand ‘‘ Woodbridge’’ is a rare example of a brand name pointing, not to product benefits, but up the value chain to process benefits.