Value chain analysis technique in somerfield plc

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Somerfield Plc is a chain of medium and small-sized supermarkets that operates in the UK. In 2006, there was a decline when nearly 40 of its stores were sold due to under performance. The company was acquired by the co-operative group in March 2009. The conversion process is still in progress. It's chief competitor is Sainsbury's. In this report we shall discuss Somerfield's inefficiency in managing its supply chain and show how Porter's value chain analysis model can be applied to efficiently manage the supply chain by breaking it down into ' value activities' and increasing the interdependence between Somerfield and its suppliers.

Introduction:

The following report is a study of implementing value chain analysis technique in Somerfield Plc to suggest possible changes that would have enhanced the performance of the chain of stores and increased its market share. The three main links are the supplier, customer and the channel value chains and the former is discussed in detail.

Introduction to Value Chain Analysis

Value chain analysis, a concept developed by Michael Porter in his book " Competitive Advantage: Creating and Sustaining Superior Performance", identifies sources of competitive advantage for a firm by examining the activities it performs and understanding the behaviour of costs in these strategically relevant activities (Barnes, 2001).

Shank (1989) defines value chain as " the linked set of value-creating activities all the way from basic raw material sources for component

suppliers through the ultimate end-use product delivered into the final customers' hands".

The value chain consists of value activities and margin. Value activities are " technologically and economically distinct activities an organisation performs to do business" (Porter and Miller, 1985). In his book, Porter (1985) identified five primary value activities and four support value activities that a firm performs. The primary activities of an organisation are concerned with the creation of a product or a service, its marketing and delivery to the buyer whereas support activities help improve the effectiveness or efficiency of these primary activities by providing the infrastructure and input required. (Porter and Miller, 1985).

Margin was defined by Porter (1985) as the difference between the cost of performing all the activities in the value chain and the price customers were willing to pay for the final product or service.

The basic model of the value chain analysis is as follows:

Source: Porter (1985)

Primary Activity

Description

Inbound Logistics

All those activities concerned with receiving and storing externally sourced materials.

Operations

The manufacture of products and services – the way in which resourceinputs(e. g. materials) are converted to outputs(e. g. products)

Outbound Logistics

All those activities associated with getting finished goods and services to buyers.

Marketing and Sales

Essentially an information activity – informing buyers and consumers about products and services (benefits, use, price etc.)

Service

All those activities associated with maintaining product performance after the product has been sold.

Source: Tutor2u

Secondary Activity

Description

Procurement

Activities concerned with how resources are acquired for a business (e. g. sourcing and negotiating with materials suppliers)

Human Resource Management

Those activities concerned with recruiting, developing, motivating and rewarding the workforce of a business.

Technology Development

Activities concerned with managing information processing and the development and protection of " knowledge" in a business.

Infrastructure

Concerned with a wide range of support systems and functions such as finance, planning, quality control and general senior management.

Source: Tutor2u

In order for a firm to gain competitive advantage and create value for customers, it must either perform an activity in such a way that it provides superior value to customers as compared to its competitors or perform a value creating activity that its competitors cannot perform (Hitt, Ireland and Hoskisson, 2008).

Strategic Decisions Supported by Value Chain Analysis

Value chain analysis identifies where in the value chain a firm can differentiate or reduce costs (Shank and Govindarajan, 1992). According to Hergert and Morris (1989) " The first difference between value chain planning and other approaches is the emphasis on identifying the source of competitive advantage".

Hergert and Morris (1989) assert that by " applying value chain an organisation can look beyond itself and maximize its ability to create value". According to Porter (1985) value chain distinguishes between different types of relationships or ' linkages' such as the relationship between different

business units of a firm or the relationships between the firm and its customers and suppliers.

The value chain analysis model will be implemented in Somerfield to support their supply chain management practices by analyzing the cost of activities of the firm and its suppliers in order to identify opportunities to reduce the supply chain costs.

Somerfield's traditional accounting techniques are rather limited in taking advantage of coordinating interdependence in the value chain and focus more on value addition. According to Shank (1989) the value added concept misses the opportunity to exploit linkages with suppliers and customers by starting the cost analysis at the point of purchase and ending it at the completed sale. The figure below shows a comparison of the value added, total cost of ownership and value chain analysis concepts:

Source: Dekker H. C (2003)

Hergert and Morris (1989) concluded that when it comes to supporting strategic planning the traditional accounting systems have several deficiencies such as not focusing on responsibility centres instead of critical activities, not accounting for interdependence between subunits, while cost and performance of one subunit often depends on the costs and performance of others and lastly the inability of traditional accounting systems to accumulate data about cost drivers.

How Value Chain Analysis Improves Performance: J. Sainsbury Case study

Since Somerfield does not perform all activities in the value chain by itself it will form part of a ‘ value system’ defined by Porter (1985) as including the value chain of a firms suppliers, the firm itself, its distribution channels and its buyers. The ‘ value system’ is illustrated in the diagram below:

Source: Porter (1985)

Somerfield will use the concept of value chain analysis and value system in order to improve the efficiency of its supply chain and add value by reducing costs. The supply chain consists of “ all activities involved in moving the product from the end of the suppliers production line and onto the supermarket shelf” (Dekker H. C, 2003).

The model being implemented in Somerfield will be similar to that of Sainsbury. The supply chain structure will be divided into different activities reflecting the supplier’s activities, Somerfield’s distribution activities performed in both the primary consolidation centre (PCC) and regional distribution centres (RDC) and retail activities related to the supply chain (Decker H. C, 2003).

Source: Decker H. C, 2003

According to Decker (2003) prior to the implementation of this model Sainsbury had little contact with its suppliers about the functioning and performance of the supply chain and little insight into the costs and performance of supply chain activities. In applying the concept of value chain analysis in interfirm relationships, Sainsbury realized the effect of supplier’s performance on its own and the importance of developing a mutually cooperative relationship with its suppliers.

In Decker's (2003) case study Sainsbury distinguished three types of suppliers based on volume and strategic importance in order to manage its supply chain. The three groups were referred to as “ core suppliers”, “ middle-large suppliers” and “ small suppliers”. With the core suppliers Sainsbury formed the Supply Chain Development Group and focused mostly on these to improve supply chain management. This was done by exchanging information and initiating several improvement projects.

The “ middle-large suppliers” were treated as a group in order to save costs and implemented techniques such as ‘ cross-docking' whereby suppliers delivered directly to PCC's instead of RDC's after which deliveries to RDC's were bundled and transported . Decker (2003) argues that “ This practice can result in large efficiency gains, as each supplier can reduce its number of deliveries” from many to one, while Sainsbury transports only once to every RDC.

Whereas for the ‘ small suppliers' Sainsbury realised that specific operations with these would have little impact on costs and performance and therefore involved them in general operations such as the ‘ Web-Electronic Data Interchange' developed for all suppliers as a measure to reduce costs. (Decker, 2003)

Source: Decker H. C, 2003

Limitations of value chain analysis

One area of concern in this technique is the customer's perspective of value. The link between the evaluation of activities and total pricing becomes difficult with the generic view point of value. Trade publications and journals

are sources to identify how value is created and which activities play a key role in generating that value.

To improve the product, the company's value chain has to be reconfigured or the individual activities have to be altered to attain differentiation advantage. The overall advantage can be from any activity. It is difficult to attribute a detailed activity level costing unless a systematic approach like ABC (Activity Based Costing) is employed.

The low cost strategy and differentiation practice overlap when the quality becomes a strategic concern in order to achieve their ' best costs' strategy. For example, Ivory Soaps, a product of Procter & Gamble became cost leader from product differentiator which caused concern about the customer's perspective of value. On the other hand, Somerfield Plc, make their own products and sell them at lower costs than other brands. A portion of sales of higher quality products affect the sales of their own affordable products.

The advent of outsourcing has made value chains more elastic. Hence systematic analysing is necessary for making effective outsourcing decisions. The refining of the models on a constant basis is necessary for overall control.

Another limitation of the value chain model is that of value in theoretical and practical terms. (Svensson, 2003) Real value is truly assessed through customer feedback and anything prior to that is just theoretical value.

Furthermore, " the highest returns in the global commodity markets are skewed towards the latter stages of the value chain…" (UNCTAG, 2007)

According to this report, transnational corporations are seeing a noticeable growth in size, influence and power while the early part of the chain (which provides the raw materials) is declining in importance and its bargaining power of those who carry them has diminished.

Role of management accounting in implementing value chain analysis

Management accounting helps organizations in strategic, performance and risk management. Its data is the mechanism deployed for the overview of the whole internal structure to facilitate control within an organization.

Somerfield's management accountants when applying Value Chain analysis in its business operations;

1. Act as a strategic partner and provider of decision based financial and operational information as regards implementation of the Value chain concept.

2. Forecasting and planning, performing variance analysis, reviewing and monitoring costs and all other factors associated with a switch to the Value chain system.

3. Training &development of all employees on the basic concept and peculiarities of Value chain concept, its advantages as well as its limitations.

4. Continuous evaluation of the internal operational process with a view to maximizing the potentials of the Value chain concept and also effectively managing its short comings.

Role of management Accounting in Value Chain Analysis:

Cost Advantage :

Done by reducing the cost of individual activity or reconfiguring the value chain.

Costs are assigned to activity,

Costs from the report to be modified to reallocate them to value creating activities.

Differentiation:

Can arise from any part of the value chain. For example, by unique inputs unavailable to competitors or high service levels through unique distributions channels.

Uniqueness in individual activity to alter final product or reconfigure the whole chain.

Firm has to be creative to introduce product differentiation.

Drivers for Value Chain activities:

Economies of Scale

Interrelationships between activities

Capacity Utilization

Forward or backward integration

Linkages among activities

Policies and Decisions

Degree of Vertical Integration

Scale

Timing of Market Entry

Institutional Factors

Conclusion and Recommendations

The effective management of the activities of value chains of a company determines its profitability. The key point is to ensure that the customer's willingness to pay for the company's products and services exceeds the cost of the value chain activities, reasonably. The gap between the model and its practical implementation should be low as it could get too time-consuming. The logic behind the model has been tested and proven profitable. The process is summed in the following steps.

Break down the key activities

Assess potential for adding value through cost differentiation or advantage.

Focus on activities that will enable company to attain competitive advantage.

The analysis is done mainly for core competence. The company's annual reports have to be compared to study the changes in the costing activities over the period. They also lay out the profitability of each activity in the value chain and its contribution to the overall profitability. These can be

compared to the reports of its competitors to determine the effectiveness of their competitive strategies.

The value chain decisions will shape the organisational structure and determine the managerial skills required to develop and survive in a competitive environment.