Business Analysis for Engineers
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Lecture-26
The Need for Value

Good morning, class. The last couple of sessions, we saw about the concept of strategy. And, in the video, that followed the session, you would have also understood that, a majority of those, who undergo this course on strategy, realise that the perception they had, towards strategy was totally different. And, after seeing the video, they understand that strategy as a concept, outside is misunderstood.

And, after understanding also, we should realise that, it is not easy to formulate strategies because, you understand what strategy is, as a concept by itself. The reason I am making this statement is, assume that you know what strategy is, that you are not carried away by the popular misconception, of what actually it is. Now, that we know, what strategy is. In a nutshell, we understand that we need to do, things differently, and gain a sustainable competitive advantage.

And, in a nutshell, that is a strategy. And, if we know, that this is what strategy is all about. We should not fall into the trap, just because we know the theory behind strategy. It is not that, it is as easy to come out with a strategic plan, as it was easy to understand it. But, that does not mean that, formulating strategy or coming out with a strategic plan, is a difficult task. A number of practitioners, management consultants, adopt different models.

And, the very endeavour of each of these models, is to come out with a strategic plan, after very clearly understanding that, this is the strategy. And, different people use different models. And, as I told you in my initial classes, that I would be attempting to come out with, popularly followed models. That does not mean that, these are the only models, that are available.

Different practitioners, come out with different models. Or, they follow different models, that are existing, in their attempt to come out with a strategic plan, for an organisation. And, one such model, which can also be used as a strategic input was the, Michael Porter's 5-Forces, that we used to analyse an industry, to characterise an industry. And, how that characterisation, is a critical input, to devise a strategic plan for an organisation. Likewise, today we will be looking into, a Value Chain Analysis model.

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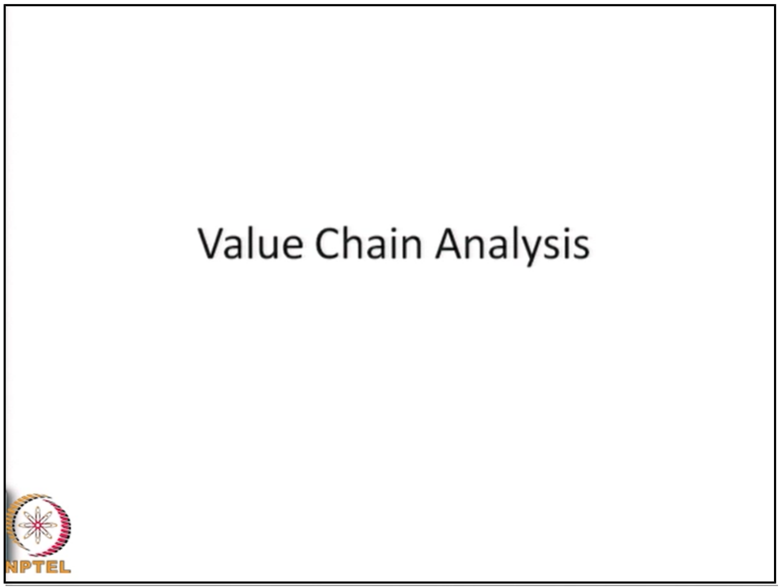

A Value Chain Analysis, as another tool, that would help us in formulating, a strategy for an organisation.

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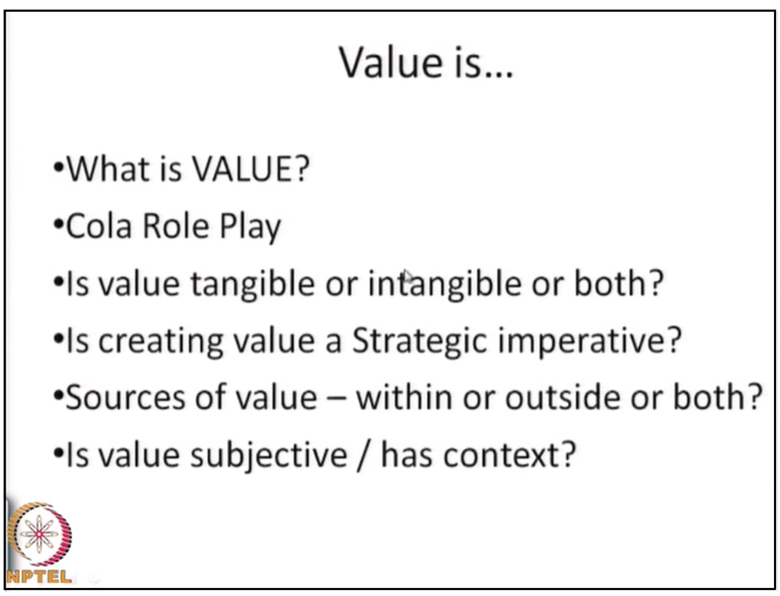

Now, this Value Chain Analysis, the underlying assumption is that, everybody needs to understand, that there is something that is valuable. Valuable to whom? Valuable to a number of stakeholders, associated with the organisation. And, this Value Chain Analysis, we are concerned about, an important stakeholder. In this case, being the end-user. Let me first begin, by asking this question, what is value? Can we define value? And, there are many views, to the definition of value.

And, you will find different peoples, coming out with different definitions for it. But, the common understanding is that, there is a need for uniqueness, in whatever be the value proposition, that each organisation puts forward. And, it is this uniqueness, perceived to be unique, from a critical stakeholder. In this case, the end-user. That is important for organisations to gain, that sustainable competitive advantage.

So, we must understand that, any product, any service, and as a result of which any organisation has something unique, that it offers to the end-user. And, this perception of uniqueness, in the product or the service that is been delivered, can be understood as the value proposition. To make it simple, we say that, this is the value, that this organisation through its product or service, delivers to its customer. And, not that the organisation thinks, that this is the value.

It is the other way that, the customer or the end-user feels, that this is the uniqueness, that the end-user gets out of using this product, or availing the service. And, if this uniqueness is able to provide a sustainable advantage, a competitive advantage, then we characterise that uniqueness, with this term, value. And, I will just begin, by a role-play exercise, so that you will understand this better. Because, many think that, value is an abstract concept.

And, this role-play, we will understand how, that value is not abstract, except that, it is hidden in different forms. And, the way we perceive the hidden uniqueness, and the way we articulate and convey that this uniqueness is the value proposition of the product or service, is what makes the difference between, successful organisations. Those organisations, that have sustainable competitive advantage, vis-à-vis, others that who are not able to, despite having some hidden values, not forcefully able to bring that, as a competitive advantage.

And, I will start this role-play, by using the cola products. So, what I will try to do is, I will have somebody volunteering. And, try some of the cola products. And predominantly, it is going to be, the Coke or the Pepsi. And, let us see whether, the volunteer is able to identify, what these products are. So, let us begin, this role-play. I will have this volunteer stand here, facing the camera, so that he does not see the product. And, while I do this, what I will do is, I will just give him some samples of different cola varieties. I will make sure that, he does not know, what he is drinking.

“Professor - Volunteer conversation starts”. You do not know, what I am giving you, right. Because, there is a mirror there. So, make sure, you do not know, what you are drinking. So, I just give him the first sample. So, can you tell me, what product is this. Both are cola products. May be a Pepsi. So, he says, this is a Pepsi. Okay. So, it is one-on-one. The next product is, another cola product. And, by the way, all of them are cola products.

Coke. He says, it is a Coke. Okay. Here. Coke sir. Coke. Okay. Fanta sir. Fanta. Okay. Mirinda sir. Mirinda. Pepsi sir. Pepsi. Looks to me, that he is a big, he is a connoisseur of cola drinks. Sprite sir. Sprite. So, it was Sprite. This one. Mirinda sir. Mirinda. Here. He got 6 on 8, so far. Sprite sir. Sprite. So, this is the last attempt. So, thank you. Sprite sir. Sprite. Okay. So, thank you. Probably, you can have, this and this, while you get in. **“Professor - Volunteer conversation ends”**

Now, the exercises I gave him different varieties of, the various cola products. I had a 7-up, a Sprite, Mirinda, a Fanta, Coke, Pepsi. And, in Coke, I had a regular Coke, as well as a Diet Coke. Now, the 10 samples, that he tasted, the score was 6 on 10. And, I must admit that, this is a very high score. Because, I have tried this experiment before, have not got results, above a 40% hit rate. But still, the purpose of this role-play is to ask this question, what is it in the cola products, that makes people or big fans of the cola product, to identify the taste of such cola products.

Or, to identify the product itself, with just one sip. And, in this case, the hit rate was 6. When I ask him the question, whether you used taste, some would say, yes. And, very natural because, this is something, that we are drinking. And, we can identify it, only because of taste. But further, if I probe and ask the question, whether you drink a Coke or a Pepsi, because it tastes better, one over the other. And, the response, that I have got from different people is that, a majority of them do not say, it is because of the taste.

And, look at this unique situation where, something that we eat, and invariably we assume that, we eat something because it is good to taste. And, here is a product where, majority of the consumers, assume that, let us say, they take it because of the taste, are not able to identify the product, with its taste. 50%, 40%, 30% in some cases, all the samples have been identified wrongly. And, in some cases, people do not admit that, they consume a cola product, because of its taste.

They say it, I mean, I am brand conscious, and I have always been a Coke fan. Why? They have different reasons, other than the taste. Which means, they perceive that, the value a Coke gives to its consumer, is different from, the value that Pepsi would give to its consumer. And, mind you, this magic, I call the black sugar water of both the cola products, be it Pepsi or Coke, a majority of them find that, there is absolutely no difference.

And, of course, there would be a slight difference. But, very difficult to differentiate, just based on taste. Unless, you are as good as, the volunteer who did it before, it is very difficult. Should the question be the, value proposition from the, taste in the product? It could be. I am not saying, no. It could be. For some, the value proposition is the image of drinking a Coke, or the image of drinking a Pepsi. And, this value proposition is different, from a value that is driven by the product itself.

Another example. You ask people, especially those who are fond of bikes, this Harley-Davidson bike. Though, it has unique product characteristics. But, the imagery of owning a Harley-Davidson bike, is to convey the message that, the masculinity of the person riding the Harley bike, is perceived to be more, as against a person just driving an ordinary motorbike. And, that is the value proposition. Equivalent example. You ask somebody in India, how he feels to ride a Bullet motorbike.

And, the imagery that we get is, riding a Bullet motorbike is that, that macho image, as against driving a TVS Suzuki, or a Hero Honda. Though, it has unique product features. Of course, that will also be one of the reasons. But then, it also delivers a different value proposition. So, we need to understand that, the value that a product or a service delivers, is unique and also provides, not only a perception that has got to do with the intrinsic product features, but also it tends to provide an imagery to the end-user, which itself can be the value proposition.

And, we saw that in the, cola example. And, examples like, the Bullet, or the Harley-Davidson, are the ones that suggest that, the image that an end-user will have, by using a product, is also a value proposition. So, the next question is, in that case, is value tangible, or intangible. Tangible, if you are able to feel, the value that gets delivered. You go to a restaurant. And, you go to this restaurant, because this particular dish tastes well. And, that is why, you go to this restaurant. Then, it is a tangible value proposition.

You buy a particular product. You buy a particular textile. Because, you feel that, this textile gives you, that element of comfort. And, if you are able to feel the tangibly, then that is the value proposition. There is also a different set of values, which need not be really visible, or fell tangibly, but could be hidden in some intangible forms. That is also, a value proposition. You go to a premium restaurant. And, though you have the same variety of food, that you have in other places. And, assume that, the quality is the same, but then, you still go to certain set of restaurants.

Or, you use certain niche products. Of course, assuming that the quality is same. Then, the value proposition is a little intangible, which is not directly reflected in the product features. Or, it could be a combination of both. There could be a value proposition, that has a tangible, as well as an intangible component in it. Next question is, then, is there a need to create value. And, the quick and simple answer is, yes because, we are fundamentally making an assumption, that creating value is a strategic imperative.

And, is only, if you are able to create a value, that is perceived to be valuable by the end-user, then we can do something that is sustainable. And, not only sustainable, it gives you that competitive advantage. And, whether that value has to be created, within an organisation, or outside the organisation, is the next question. Whether the source of that value has to be, within an organisation, or outside the organisation or, possibly, both within and outside the organisation. And, we will see, examples of that also.

But, the quick simple answer is, values are within the organisation, as well as outside the organisation, or a combination of both, if you need to really synergise, the values within and outside the organisation. And, the next question is, is value subjective. Do we have a context to it? At times, yes. For example, let us say, we are going across a desert. Where, they need to quench thirst, often arises. And, at one point of time, you run out of water supply. You do not have enough stocks.

The value that, a source of water will give to somebody, who is not having water supply, especially when he is on this desert walk, is phenomenally high. And, that is why, if you are on such an expedition, you would not really bother, whether that water is served in a disposable glass, whether it is served as a bottled water, or whether it is given in a different form, hot water or cold water. Whatever be the form in which it is served, it becomes little immaterial.

Because, at that point of time, the value of water is so high. And, at times, even end up paying more, than what you actually would otherwise pay. So, it has a context. And, at the same time, it can also be subjective. The same water, for somebody who cleans the restaurant table, has no value at all. In fact, more water on restaurant table, is more work for the cleaner. So, there is an element of subjectivity in value. And also, we need to see the context behind which, a particular product or service delivers the value.

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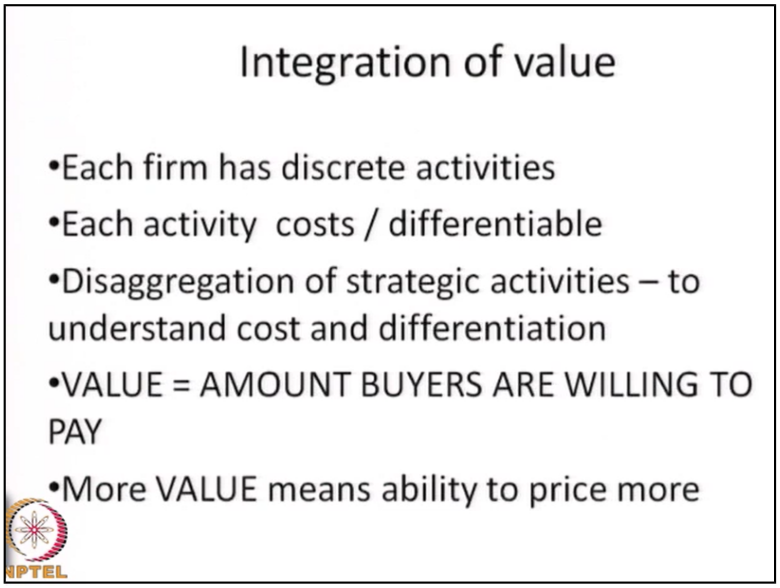

Now, it is this understanding, that is required, before we move forward. Now, we need to understand that, each firm, each organisation, can be split into different set of discrete activities. Each operation can be characterised, to belong to a particular type of activity. And, you have different type of activities, in any organisation. And, each of the activity, when it is carried, has a particular cost to it.

Remember, when we were talking, accounting in management accounting, a very briefly touched about, activity based costing also. It means that, any unique set of activities, has a cost element in it. So, to perform an activity, the organisation incurs a cost. And, just as, you have cost to any activity, there is room to perform, the same activity in a different way. So, every activity has to be viewed, with a perspective that, it can be performed differently, from what you used to do before, or from what competition is doing.

So, there is a scope for, isolating cost of an activity. And also, there is scope for, trying to see, if we can do this activity in a different way. And, by doing differently, we are able to deliver some additional benefit, to the end-user. Now, it is this idea, that forms the fundamental basis, for a Value Chain Analysis. That, we are able to disaggregate, various activities of an organisation. And that, we are able to individualise the cost, and the differentiability, of each of this activity.

And, after doing all this, either we try to reduce the cost, or we are able to do a particular activity in a different way, then we are at a position, to even charge, or price the product or a service, more. Because, a reduction in cost, or the propensity to do it, in a different way, is enough reasons for, increasing the price with the hope that, the end-user is willing to pay that extra price. And, if that end-user is willing to pay that extra price, then you have some value element in it.

See, there is no point in doing the same thing, and then expecting, an incremental price for it. Because, the end-user, will not be able to appreciate the difference. Or, if you are able to reduce the cost of a particular activity, then your margins will improve. Either way, the profitability is increased. So, more value means, there is an inherent benefit. And, from an organisation point of view, the benefit is the ability to price the product or the service, more.

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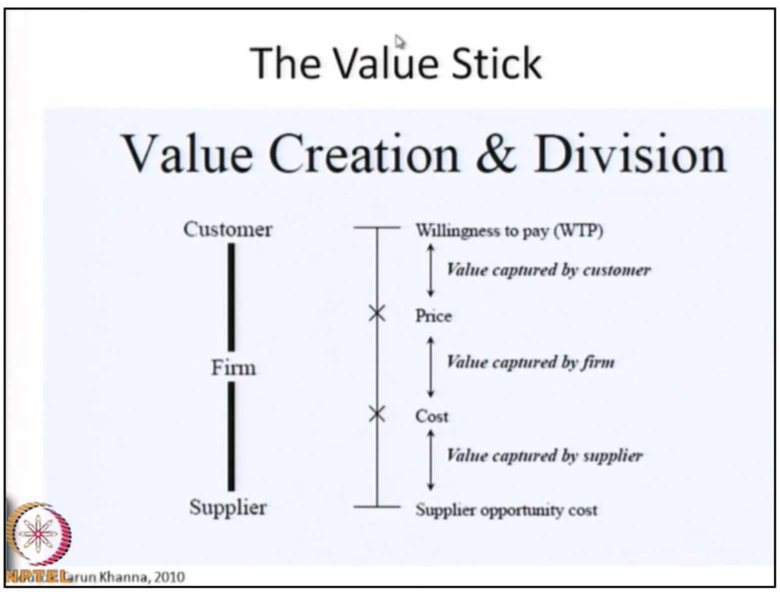

And, I will explain this, by just demonstrating this value stick. And, any organisation will have, a supplier or a vendor. Then, the organisation itself, or the firm itself, and then the end-user. And, if you are able to split, the value across these three stakeholders. Why is that, a supplier is providing that input to the firm, when there is an alternate opportunity. He thinks that, giving it to your firm, he is able to capture some value.

So, you buy it from your supplier, and that is your cost. And, to the supplier, it is the value that, he is able to capture, by selling it to the firm. And then, what is the value, that you are capturing.

You are able to do a lot of operations, and you are selling it for a price. And, if there is a propensity to pay more, then that is the value, that is captured by the customer. Who thinks that, given various choices, the reason that I am choosing this firm's product is, because I find that there is some incremental value.

And, that value is captured by the difference between, the price, and the willingness to pay that extra price, that the customer has. So, you will be able to understand that, this value stick, and as a result of which value per say, is not just inherent to the firm. And, as we go, I will explain that, it can also be outside to the firm. So, the willingness to pay more, and if that is quantifiable, then that is the measure of the value proposition, that the firm gives to its end-user.

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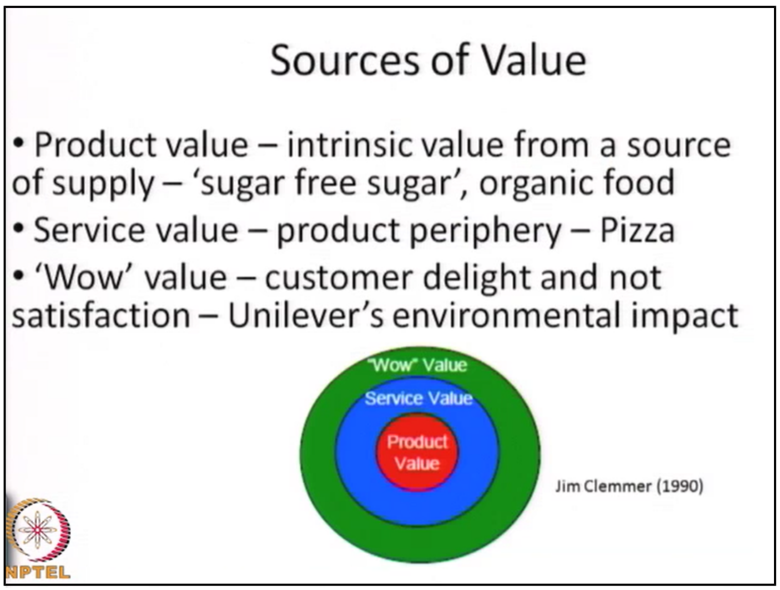

Now, there are different sources of value. And, I told you that, it could be within the firm, outside the firm. It could be, tangible or intangible. But, it has to emanate from, a particular source. And, if it is as direct as, a value that comes out of a product. It means, that the product is delivering something, that is intrinsic and inherent to the product itself. And, that is the main source of supply of this value. And, a good example would be, Sugar-Free sugar. How is it different from, the regular sugar?

The value proposition, that Sugar-Free sugar delivers, is from the product itself. It is not unrelated to the product. Sugar-Free sugar is not purchased, because it comes in different packaging. No. Likewise, organic food. Organic food is not being purchased, because it is being delivered. It is home delivery. No. Organic food is being purchased because, the characterisation of organic food, is directly related to the product characterisation.

And, the value that I get, is from its intrinsic, it is internal to the product itself. It comes from the product. So, the source of that value, is very much within, the product that is being delivered. Or, you could have a value proposition, that can come out from the service, that has been offered, which is a little peripheral to the product. And, if somebody says that, I can deliver a particular order of pizza within 30 minutes, that is a service proposition.

And, if you find that, there is a value, that you are prepared to pay more, as long as my pizza arrives within 30 minutes, from the time that I order, it has got nothing to do with the flavour of the pizza. The fact that, the service level is different. Another example could be, the airline industry. The fact that, the in-crew service is excellent, it has got nothing to do with the quality of the pilots, or the quality of the aircraft. It is something, that has got to do with, the service level.

And, there is value, in that service also. The third one is the, Wow factor. Where, it is not just customer satisfaction that is important, the end-user must be delighted by using it. And, good examples could be, if you go to a fast food joint, or a food joints nowadays, you will find some play areas separate, for kids to play. And, it is got nothing to do with the menu, that the food joint offers. Likewise, Unilever's Value Chain has a lot of stress on the environmental impact, that the product, after its use creates.

So, it has got nothing to do with the product. It has got nothing to do with, even the service value of the product. It is after the product, that is been used. So, it has got nothing to do with the product or the service. And, I will show you a small video that explains, what I am trying to say. But still, I am able to feel that, this is a unique value proposition. Despite the fact that, it has got nothing to do with, the product per say, or the service with which, this product is delivered.

But still, I have something, that tells me, yes this is something, that I perceived to be very valuable. And, that I call, or Jim Clemmer calls it, the Wow value. If you look at the sources of value, at the heart comes the product value, another value proposition could come from the service levels, or something that is unrelated to the product or the service, but definitely delivers some value proposition for which, customers are willing to pay more. I am not saying, these are the only three. But, these are predominantly, the three sources of value.

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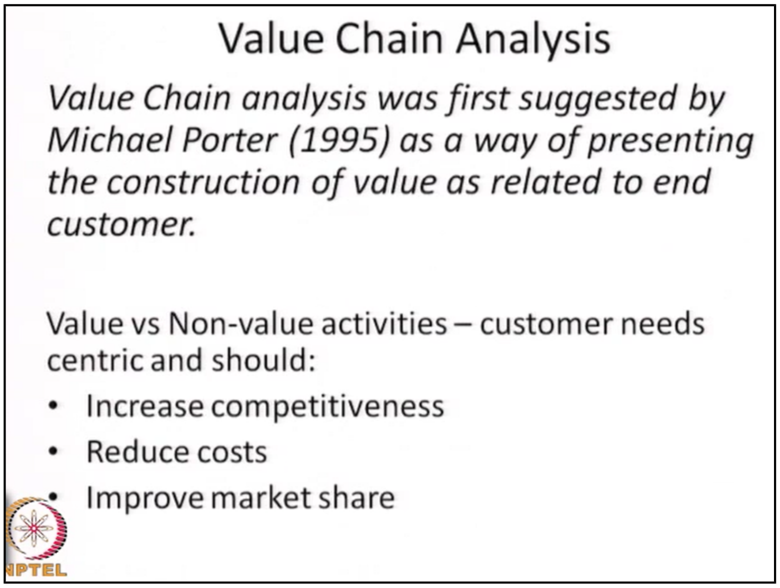

Now, putting all this in proper perspective, and provide a structure based on which, every organisation can create a Value Chain, which they can use it internally to analyse, or for consultants to look at the Value Chain of an organisation, to see where we can build values, in which activities we can build values. Michael Porter in 1995, formulated this Value Chain. The structure was to present, the firm as, a construction of various value activities, which are more related to the end-user.

Because, the fundamental assumption is, any activity is non valuable, if it is not able to synchronise itself with the needs of the end-user, or it is not able to really add value to the end-user. So, if you find that there is an activity, that is customer need centric, the reason that you are doing this this way is because, a customer would feel, the end-user would feel that, there is a benefit, then that is a value activity. Some activities, which has got nothing, that can generate this uniqueness, are non-value activities. And, we are not concerned about those set of activities.

We are concerned about those activities, that are end-user centric. And, why should we be concerned about that. Because, these are the activities, that have the potential to increase, the competitiveness of the product or the service, that is been delivered. Or, these are the activities, that needs to be viewed, if at all we think that, we can reduce cost of particular activities, we need to look at these activities. And, as a result of this, as I said, if we are able to do this, if we are able to differentiate, or reduce cost of such activities, there is, this benefit, or the chance to price it more.

So, it increases profitability. And, at times also, it improves market share, because of the competitiveness. So, you build your top line by market share, or strengthen your bottom line by improving the profitability. And, whatever be the way, at the end of the day, it delivers, by way of an increased profitability, or an increased market share. And, we should be concentrating only on those activities, which Michael Porter's identify. He identifies a set of activities, that he thinks is very critical for any organisation.

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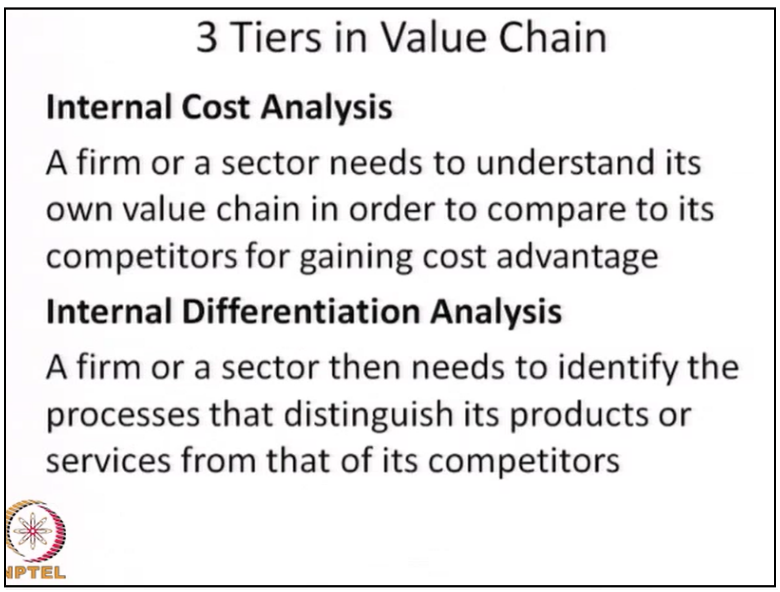

And, why? As I said before, every organisation needs to understand, its own Value Chain. So that, it can compare its Value Chain with its competition, to gain that cost advantage. Or, it needs to understand its own Value Chain, so that is able to distinguish, its product or service from its competition. Because, it is able to do certain things, in a different way. And, that is the uniqueness, and that is the differentiating factor, from competition.

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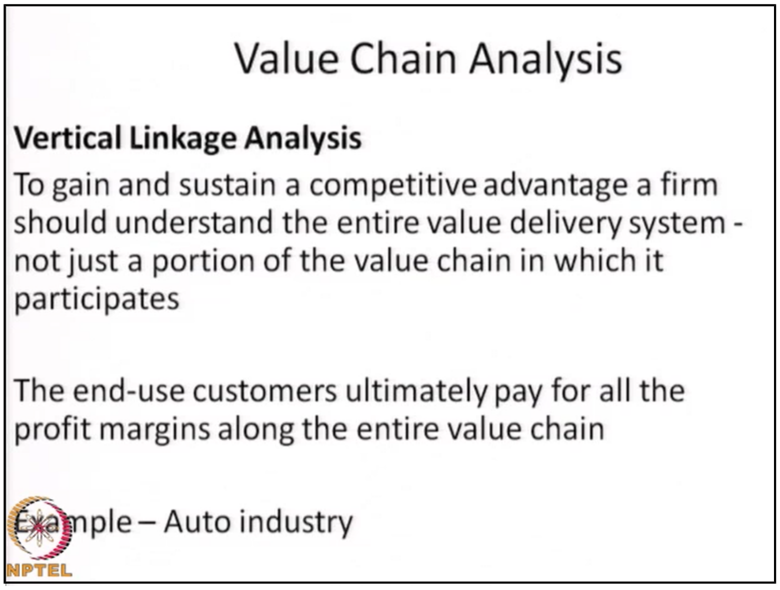

Or, it should also be able to understand, the entire value delivery system, which is not just the Value Chain of the firm itself, but the Value Chain right from, the supplier to the end-user. So, it can be as, all pervasive as, including a Value Chain of, a supplier to the Value Chain of, the end-user. Because, the end-user ultimately pays for all the profit margins, along the entire Value Chain. Because, if a supplier is making profit, it is not being reduced, by the original equipment manufacturer.

The profit gets added onto the cost price of the OEM. And, OEM's profit gets transferred to a dealer. The dealer's profit gets transferred to the end-user. So, at the end of the day, it is the end-user, who ultimately pays for all the profit margins, that lie across the entire Value Chain. So, it is not enough, if you just understand the Value Chain of the firm. It also makes sense to understand, the Value Chain of the suppliers. Or, the Value Chain of those, who are involved after, the firm delivers the product and service, before it reaches to the end-user.

A typical example could be, the auto industry. Suppose, I want to buy a car. It is not that, I just walk into, the factory of a Tata Motors, or a Ford, and just buy a car. The entire ecosystem of the automobile industry, has various stakeholders. You will have raw material suppliers, auto component suppliers. You will have the original equipment manufacturer. In this case, a car manufacturer. You will have a dealership network.

And, then finally, at the dealer's place, you go and buy a car. But, the understanding is that, the end-user pays for the profit margins, for all the stakeholders involved in this. Which includes, the suppliers, the firm, the dealer. And, the value, that is captured by the supplier, or the firm, or the dealer. And, assuming that, the value is the willingness to pay, is the one that is actually the price, that the end-user pays.

And, if you are able to do something competitively, across these Value Chains, then you are delivering something, that is unique and valuable to the end-user. So, there is a linkage. Or, within the firm, the value delivered by one activity, improves the performance of a sequential activity. And hence, linkages are also established. So, you should understand that, Value Chains are linked within an organisation, and also outside the organisation.

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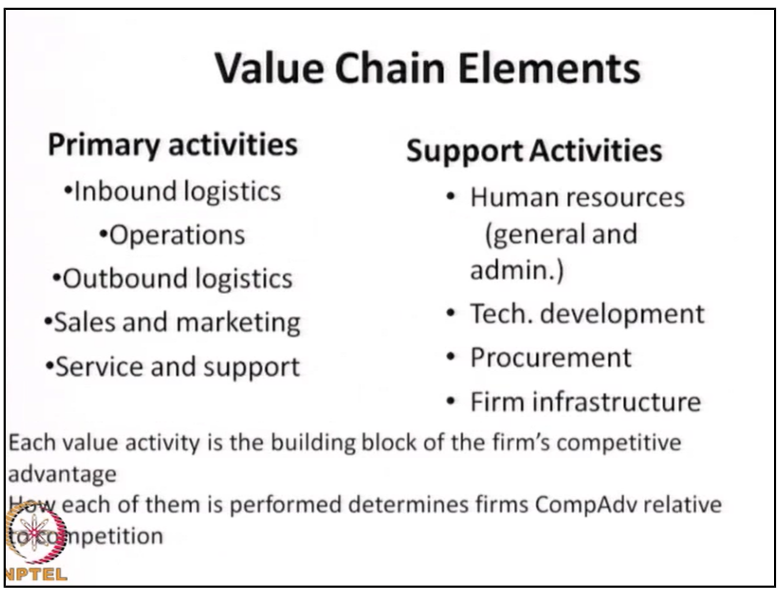

And, to identify those set of activities, Michael Porter identifies, these activities under two broad categories. The primary activities, and the support activities. The primary activities being, Inbound logistics, Operations, Outbound, Sales and Marketing, Services and Support. Support activities being, Human Resources, R&D or Technology Development, Procurement, and Firm Infrastructure. And, by enlarge, each of this value activity, in some way or the other, forms the building block of any firm.

And, the assumption is, each of them have something in it, that can give some competitive advantage to the firm. And, how each of these activities are being performed, determines the competitive advantage, that an organisation gets, relative to its competition. In next class, we will just get into some of the finer details of each of these activities. And, I will give you an example for you, to appreciate this concept better, and a couple of videos for you to understand, what this is all about. So, next class, we will start with, the analysis part of the Value Chain. Thank you.