A Guide to Understanding

The Porter's Value Chain and ERP

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Understanding the Porter's Value Chain and ERP

Every business leader knows and understands the importance of a sound strategy to take the business to the next level. The question then arises – how do we develop a sound strategy? This is best achieved by analyzing the business and understanding the key drivers. Then put in place a strategy to maximize the drivers. But what needs to be analyzed?

Using Frameworks

This is when the hard work starts – fortunately there are a number of strategy gurus who have already done the hard work for us, and assembled a number of very useful frameworks that focus the analysis efforts onto key areas of the business. So which frameworks do we need to use, you ask?

The analysis will start at a high level and use a few generic frameworks which will give us some valuable insights into the business and highlight a few critical areas that will need further scrutiny. As the scrutiny delves deeper and deeper into the industry specifics and business functionalities, we employ the specific frameworks developed to analyze those areas of the business.

One of those gurus, if not the greatest of the gurus, is Michael Porter of Harvard Business School. He has developed a number of very useful frameworks, one of these being **Porter's Value Chain Analysis**. This is a very useful framework from a number of areas and the focus of this article.

Porter's Value Chain Analysis

Every organization whether supplying goods or services has a value chain i.e. the collection of activities that are performed by a company to create value for its customers. Porter's Value Chain Analysis dissects the organization's activities into a generic value chain and highlights the key tenets of Value Creation in the Value Chain. Value Creation will create a competitive advantage for the organization.

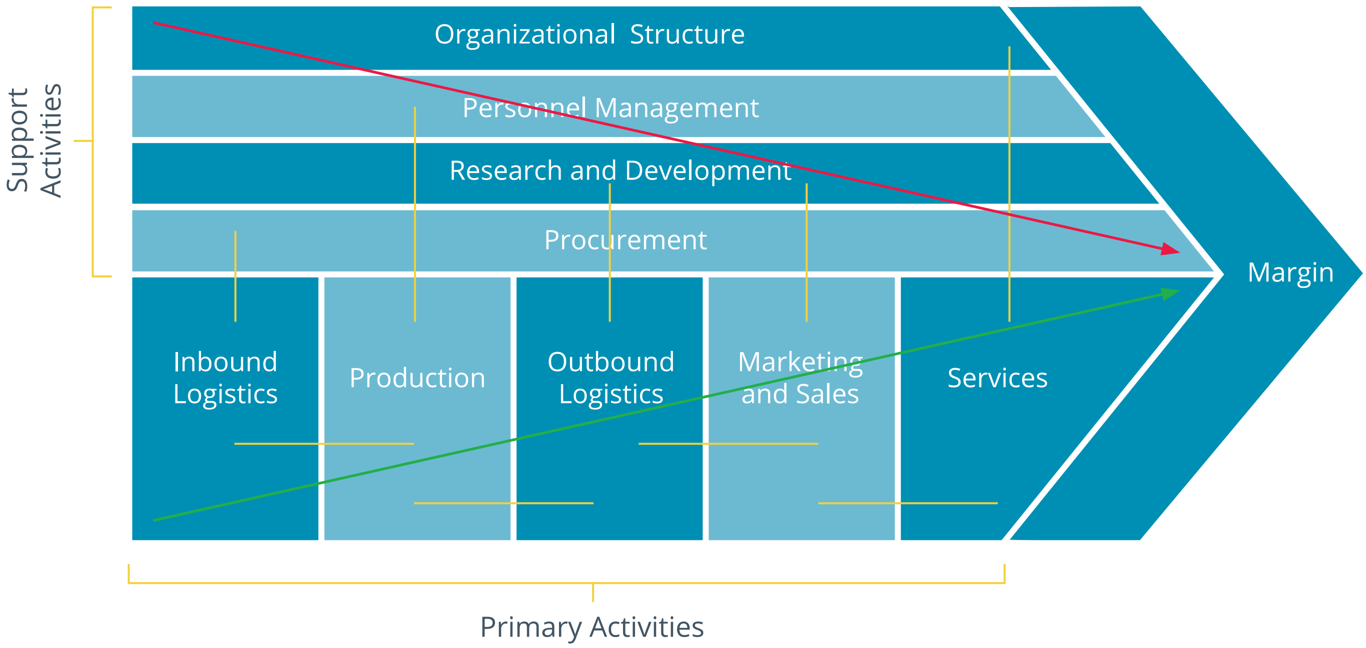
The strength of Porter's Value Chain Analysis is the focus on the systems and activities with customers as the central principle rather than on departments and expense categories. It links systems and activities to each other and demonstrates what effect this has on costs and profit.

Using Porter's Value Chain Analysis

While it appears to be a straightforward, the framework looks at a number of key aspects in a business.

The model is depicted below, and has separated the generic activities of the organization into nine key activities. These nine activities are further grouped into:

- **The Primary Activities** (Inbound Logistics, Production, Outbound Logistics, Marketing and Sales, and Services) directly add value to the customer, and consequently add value to the business.
- **The Secondary Activities** (Organizational Structure, Personnel Management, Research and Development, and Procurement) support the organization's Primary Activities and will also affect the value of the business.



How to Identify and Add Value?

The lower half of the diagram (the Primary Activities) is the successive steps that the material follows as it flows through the operations process. The raw materials enter the organization via **Inbound Logistics**, are transformed into goods in **Production** and delivered to the customer or stored in the warehouse, the **Outbound Logistics** function. **Marketing and Sales** sell the goods and **Services** takes care of support for the product. Every one of the Primary Activities physically handles or directly supports the product and the customer. The value creation increases as the product flows through the value add steps (Green arrow).

The upper half of the diagram (the Support Activities) erodes the value created (Red arrow) by the operations as it is costs that the company must bear to support the operations. This is not to say that the functions are not required, but rather that these functions need to be focussed on supporting the value creation process. The **Organizational Structure** houses the executive team, who sets strategy, manages the finances etc. The **Personnel Management** is the Human Resources function which looks at how we manage the workforce, while the **Research and Development** function looks at better technology, cheaper manufacturing methods and builds the future range of products. **Procurement** ensures that the required raw materials are in the warehouse ready for production.

The right hand side is the margin, or profit the business makes.

To add value, the margin must be maximized in the Primary Activities and minimized in the Secondary Activities. But How?

Ensuring Integration throughout the Organization

The secret lies in the strength of the linkages between the functions. The Yellow Lines indicate some of the linkages that exist, but in reality there will be a wagon wheel of linkages between every function on multiple levels of leadership. The horizontal yellow lines link the Primary Activities while the vertical lines link the Primary Activities and the Support Activities.

Example: Let us examine a linkage (which creates a series of linkages to other functions): **Organizational Structure to Service** – the service costs of a particular product are twice every other product based upon analysis by Finance. **Services** feedback to **Organizational Structure** and **Organizational Structure** trigger a series of investigations by **Research and Development** which culminate in a finding that the products are poorly packed. The **Personnel Management** function are tasked to develop and train the staff to better pack the item while **Research and Development** develop a new packaging system. It is this synergy that adds the value to the organization.

To manage, monitor and leverage for optimal value creation, all these linkages across the supply chain require a comprehensive business system like an ERP (Enterprise Resource Planning) system. Although an ERP system cannot mitigate incorrect strategy, it will ensure full integration across the organization.

Conclusion

Research into a number of industries has shown that organizations in the same industry, manufacturing the same product, range from making huge profits to underperforming and even liquidated. The conclusion was that the better the linkages i.e. the effective communication between departments and people, the better the organization performs.

Simply put, the better the integration of your ERP, the better the communication (of critical information) and the better your organization is likely to perform.

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