Strategic accounting

Value-chain analysis as a tool of strategic accounting

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Key question: explain the concept of „value-chain analysis”

Companies should remain committed to enhancing their long-term competitiveness by providing high-quality products and services at reasonable, competitive price.

A good way to achieve this aim is to ascertain where a firm’s products are located in the value chain

Value-chain analysis is a method for decomposing the firm into strategically important activities and understanding their impact on cost behaviour and differentiation
A value chain describes the linked set of value-creating functions that are required to bring a product or service to the customer. It begins with basic raw materials from suppliers, moving to a series of value-added activities involved in producing and marketing a product or service and ending with distributors getting the final products or services into the hands of the ultimate customers. Michael Porter (1980, 1985) has developed value-chain concept as a tool to help businesses analyse their cost structures and identify competitive strategies.
Value-added analysis and value chain analysis: how do they differ? (1/2)

- Value-added analysis involves classifying activities as value-added and non-value-added. This concept is adopted to identify which activities to keep and which to eliminate.

- The following activities in organisations tend not to add value to the core activities: preparation time; waiting time; unnecessary process steps; overproduction; set-up times; transportation/distribution; materials waste, communications, etc.
Value-added analysis and value chain analysis: how do they differ? (2/2)

- Value-chain analysis places emphasis on understanding the total value of all operations across the business, as well as the industry.
- By considering the value chain organisations, can determine areas where cost can be minimised (for cost-leadership strategy) and areas where customer value can be enhanced (for product differentiation strategy).
Value-chain cost management methodology involves the following steps:

1. Identify the value chain, then assign costs, revenues and assets to value activities
2. Diagnose the cost drivers regulating each activity
3. Develop sustainable competitive advantage, either through controlling cost drivers better than competitors, or by reconfiguring value chain
Within the value chain framework, costs are classified into **structural** and executional.

- Structural cost drivers derive from a company’s choices about its underlying economic structure:
  1. Scale – the size of the investment in manufacturing, R&D and marketing resources
  2. Scope – the degree of vertical interation
  3. Experience – how many items in the past has the firm already created and what is it doing again?
  4. Technology – what process technologies are used in each step of the firm’s value chain?
  5. Complexity – how wide a line of products or services is being offered to customers?
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- Executional cost drivers are the determinants of a firm’s cost position that hinges on its ability to execute them successfully. These cost drivers may include:
  1. Workforce involvement
  2. Total quality management
  3. Capacity utilisation
  4. Plant layout efficiency
  5. Product configuration
  6. Linkage with suppliers and customers
Porter’s Value Chain

Figure 12. Porter’s Value Chain. (Source: Michael E. Porter, *Competitive Advantage* [New York, 1985], 37.)
The value-chain framework

R&D => design => production => marketing => distribution
Discussion questions

• What are the differences between the corporate and an individual product’s value chain?
• What are the problems with using traditional accounting methods in the value added chain? Explain how strategic management accounting can be used to overcome these problems.
• If a company has „cost leadership” as its strategy, how can accounting contribute to meeting this goal?
• Why is strategic management accounting necessary for the value-chain concept to be successful?
• Explain the relationship between the value chain, strategic planning and decision-making. Give examples.
References

- D.N. Chorafas, Strategic Business Planning for Accountants. Methods, Tools and Case Studies, Elsevier, USA 2007
Thank you for your attention

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