

Strategic Management - The Competitive Edge

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Lecture 15

Firm's value chain

Welcome to this session. Now, we look at one more model given by Porter. This is called the firm's value chain. So, these are two important contributions given by Porter, one is with respect to the generic strategies and other with respect to the value chain model. If you look at this model what you are having on the x-axis is the primary activities, the vertical axis is given by the support activities.

So, when you are looking at the primary activities it can be with respect to inbound logistics that is raw materials or it can be with respect to operations that is machining, assembly, testing or it can be with respect to outbound logistics that is distribution or marketing and sales, this can be with respect to advertisement, promotion, etc. And the last being with respect to services installation, repair, etc.

To do all these primary activities you require a number of support activities also. What are the support activities? It can be with respect to procurement that is purchasing of raw materials, machines, supplies. It can be with respect to technology development, that is R&D, process and product development. Or it can be with respect to human resource management that is recruitment, training development. Or it can be with reference to firm infrastructure that is general management, accounting, finance, planning.

So, in order to support the primary activities a firm should have support activities. Suppose, you are able to provide all these activities at a cost, let us say X, you designated this cost X for all this and you are able to provide this with at 0.8X let us say, that is the entire value chain. So, the left 0.2X will be the profit margin.

So, you are able to provide all the support activities to the primary activities of the company and still able to save about 20 percent which contributes to the profit margin. So, this is what the present day firms are really trying to find out; what is the method they should adopt whether they should price their services higher, especially the IT services or whether they should resort to cost cutting exercise sizes so that the profit margin can increase.

So, because if you really look at the IT industry, there were reports saying that nearly 40 percent of this GDP with respect to the IT industry comes from Bangalore only in the country. So, that

means to say it is a huge contribution, which is coming from one city. So, many refer to it as a Silicon Valley in India. Now, that brings you to one important question.

So, in order to reduce this cost, you may adopt so many methods. So, if you look at the risks that are involved, that is you must be able to manage these risks and still come out unscathed in the marketplace. So, what are the types of risks that you may encounter? The risks that you are likely to encounter with respect to cost leadership, if you just go to this slide, it tells you cost leadership is not sustained, when competitors imitate.

Suppose, there is an imitation of your product possible by the competitor, then your leadership is not sustained. So, I was giving you the example of Gillette Mach3, not able to imitated by a competitor, the result is leadership sustains. When too many technology changes happening with respect to your product, which you are not able to implement, then you are leadership that is cost leadership likely to get affected.

The third one other bases for the cost leadership erode. So, suppose the competitors are able to compete on the other basis of product differentiation, which you are giving and able to give them at a comparatively lower rate, then what is likely to happen, the proximity in differentiation is lost. So, suppose you come to the differentiation strategy, differentiation is not sustained when again competitors imitate bases for differentiation; become less important to buyers.

Suppose, a buyer thinks there is not much to choose between A and B. So, this is what is happening with respect to so many service providers, it was happening with respect to mobile service providers for a very long time till this player Jio came into the marketplace and offered its services at a much lower price compared to the other players, the cost leadership of the other players eroded.

So, the Jio's market base went up like a rocket in the Indian market. So, if you see almost all Indian market is getting choked through Jio. So, the player who is very close, who is giving a fight to Jio is Airtel but really not able to dislodge Jio from the market leader's place.

So, the risks of focus could be when the focus strategy is imitated. This is what so many service providers are trying to do with respect to the leader. They are saying we are able to provide these services at a much lower price; then the largest segment becomes structurally unattractive.

So, the structure erodes, broadly targeted companies overwhelm the segment, the segment's differences from other segments narrow, the advantage of a broad line increase, which can happen with respect to generic strategy of Porter, this is what is called risk analysis which a company should do essentially do with respect to all the three generic strategies- cost leadership,

differentiation and focus.

That actually brings you to one important aspect that is the quality of the product or the service which you are putting out into the market; what should characterize the quality of the product or what should be the dimensions of quality. So, the dimensions of quality of the product are given in this particular slide here. And it is also available to you in my book on Strategic Management. So, these are called the eight dimensions of quality, the eight dimensions of quality with respect to the product.

Page number 121 gives you the eight dimensions of quality. Again, given here summarized- one is performance that is the primary operating characteristics set such as washing machines cleaning ability. Suppose, in the Indian context, let us say you want to go in for a washing machine.

Your decision may be more guided by the fact that the washing machine that you want to purchase should be very close to your hand wash. So, it should not be looking like a machine wash. So, some of the entrants in the market came out with their product saying that it is very close to the handwash. No other manufacturer gives you this type of washing machine which is very close to the handwash, etc

So, this is the primary operating characteristic and the differentiating factor. Then the second one is features, bells and whistles like cruise control in a car that supplements the basic functions. So, if you go to any advanced model of the car in the present day Indian context it gives you this feature cruise. What is this cruise? Suppose you are going on a highway and you want to maintain that speed maybe 60, 70 or 80 Km/h. So, you put this cruise feature on, you can drive this car or the car drives itself at this speed and it keeps on going at that speed till you apply your brakes; then the cruise function gets switched off and you come back to the manual mode where you control your speed.

Then the third characteristics or the dimensions of quality is what is called reliability. What is reliability? Reliability is probability that the product will continue functioning without any significant maintenance. So, this is what is important with respect to any consumer durables. So, your product must be able to function without too much of maintenance.

So, let us say this washing machine, every day it gives you a lot of sound and when it is going to that function of drying it gives you so much noise, where the housewife rushes to the washing machine thinking that something has gone totally wrong.

Some of these newer brands of washing machines like Panasonic, LG automatic, even when it is going to the drying function, you find that the noise that is emanating from this machine is very less. So, in other words, these types of well-established brands in the marketplace, they will be able to perform reliably without significant maintenance.

Then the fourth characteristic or the dimension of quality is what is called conformance that is the degree to which a product meets the standards. When a customer buys a product out of a warehouse, it will perform identically to that viewed on the shop room floor, again none better than an automobile. So, you see on the floor of the showroom, he gives you so many of these things saying that this performs like this, but when you take it out to the road, you find that many of the things which he claimed are not really there. So, this is happening on a routine basis to the American automobile industry. Now, it is happening to the Indian automobile industry also.

The fifth dimension is what is called the durability. Number of years of service a consumer can expect from a product before it significantly deteriorates. So, how does it differ from reliability? Differs from reliability in that a product can be durable, but still needs a lot of maintenance.

So, in the present-day context, automobile, take any well-known brand, suppose, almost all the brands are coming what is called the tubeless tires. So, earlier there used to be a tube and that tube will take the air pressure that is you fill the tube with air pressure and then suppose there is a puncher this tube had to be taken out from the tyre and the nail had to be removed both from the tube as well as from the tire. What is in the present-day context? In the present-day contest, there is a tube which is almost attached to the tire. So, when he is putting puncher, you are not going through the same motions as you used to do earlier. So, these are type of things which is coming in. So, the ease of putting puncher with respect to the modern-day car let us say is can be a good example of this servicability.

Then, aesthetic how a product looks, feels, sounds, tastes or smells no better example than the different brands coming out in the Indian market. So, name it you have it.

Then perceived quality, products overall reputation is especially important if there are no objective, easily used measures of quality. So, suppose you are not having this what do you call well established measures of quality, suppose you are not able to apply to a product then the consumers perceived quality comes into play.

He may say go in for this product instead of the other product. So, his value decision becomes a pointer.

So, this is what characterizes the eight dimensions of quality. This is given on page number 121

of the Book on Strategic Management; and exhibit on page number 120 tells you with respect to the focus strategy at Morgan Motor Company. So, this is something which is a real-life case.

You can read that, when you read that you will find that this Morgan Motor Company makes three models ranging in price from 35,000 dollars to 50,000 dollars. It has no long-term debt and enjoys steady growth in sales and profits. Sports cars with reputations, comparable to those of the Morgan, sell for 150000 and upwards; that is Morgan is able to give you that sports car at one-third price of the other players.

For the person who needs a personalized car- Morgan is available in 35,000 hand painted colors. The company employs just enough skilled workers to build 10 cars a week for an annual capacity of fewer than 500 cars. Because the company receives about 600 to 800 new orders each year, the current waiting list for a new Morgan is about 2500 to 5000 cars. That is about 10 years production. The firm's response to a rapidly changing automobile industry seems perfectly tuned to staying in the propitious niche that is a niche market.

According to Charles Morgan, grandson of the founder, we believe the Morgan policy of gradual and carefully considered change will enable us to maintain the car's qualities and unique appeal and thereby ensure its survival for the foreseeable future. It is a very good case study in this type of generic strategies, which has happened in the automobile industry.

We stop here. Thank you.