

Brief contents

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CHAPTER 1

'New Economy' – New Business Models – New Approaches

LEARNING TOPICS

On completing your study of this chapter you will have been introduced to and considered the following topics:

- The 'new economy'; a new business environment
- The changing attitudes towards the ownership and management of assets in the 'new economy'
- The importance of network design and management in the 'new economy'
- Clusters, value nets, value streams and value chains as new business models
- Why business structures are seen as processes rather than functions
- The new concepts and a new vocabulary in the 'new economy'
- Value led management
- A model for value chain analysis, planning and control

Introduction

Business operates everywhere in an environment that is increasingly dynamic and challenging. Markets have globalised, technology has become all embracing, and relationships with suppliers, customers and competitors are undergoing constant change. *New business models* are emerging, ones in which competitive advantage is based upon *managing processes* that facilitate rapid and flexible responses to 'market' change, and ones in which new *capabilities* are based upon developing unique relationships with partners (suppliers, customers, employees, shareholders, government and, often, with competitors). The business model has often taken second place to strategy in management thinking and focus. Normann (2001) discusses 'a new strategic logic'. He suggests that: '... managers need to be good at *mobilizing, managing, and using* resources rather than at formally *acquiring* and necessarily *owning* resources. The ability

to reconfigure, to use resources inside and particularly outside the boundaries of the traditional corporation more effectively becomes a mandatory skill for managements.’

Drucker (2001) noted that while the traditional response to market pressures was vertical integration on a large scale, citing Standard Oil and Ford as leading examples, today even the large corporations are leading the changes in strategic posture. General Motors, for example, are creating a business for the ultimate car consumer – they aim to make available what car and model most closely fit that consumer’s preferences. As Drucker noted, the changes to facilitate this are not just sales and marketing driven, but encompass design and development, and production responses. Products and services now have multiple applications and business organisations are redefining their core capabilities and processes. In other words, ‘value chains’ are competing with ‘value chains’. At this macro, industry level, value chains can be seen as business network structures, or confederations, that are developing from traditional corporations.

Magretta (2002) suggests, using the example of American Express in the nineteenth century, that: ‘a successful business model represents a better way than the existing alternatives. It may offer more value to a discrete group of customers. Or it may completely replace the old way of doing things and become the standard for the next generation of entrepreneurs to beat.’ Magretta adds substance:

... all new business models are variations on the generic value chain underlying all businesses. Broadly speaking, this chain has two parts. Part one includes all the activities associated with making something: designing it, purchasing raw materials, manufacturing and so on. Part two includes all the activities associated with selling something: finding and reaching customers, transacting a sale, distributing the product or delivering the service. A new business model’s plot may turn on designing a new product for an unmet need ... Or it may turn on a process innovation, a better way of making or selling or distributing an already proven product or service.

Magretta cites Dell as a company that has created a powerful business model by identifying value chain processes that it will engage in, and seeking partners, complementors, to undertake those it will not. In this way Dell, by selling directly to end-users, has the vital information necessary to manage inventory better than its competitors *and* avoids the high costs of holding inventory and the very high cost of obsolescence due to the rapid application of technology. A question that must be asked is, is there a generic approach or model that may be used to understand the successes of Dell, Wal-Mart and others?

Processes designed around value creating networks

The holonic, or virtual, organisation structure is one model that is finding favour. According to McHugh et al. (1995), the holonic organisation or network is:

... a set of companies that acts integratedly and organically; it is constantly re-configured to manage each business opportunity a customer presents. Each company in the network provides a different process capability and is called a holon.

Holonic networks are not hierarchical structures – rather, each business within the structure is equal to each of the others. The network is in dynamic equilibrium and it is self-regulating. Access to, and exchange of, information throughout the network is open, as is access to and exchange of information across the network boundaries. The network is evolutionary and is constantly interacting with its environment. It is a knowledge network, a learning organisation. McHugh et al. suggest a number of advantages accrue to holonic networks:

- Asset leverage; increased utilisation from distributed operations through synergy
- Speed; specialist inputs enhance time-to-market
- Flexibility and agility; the ability to meet requests for changes in order size and delivery pattern as well as for product and service changes within existing response times
- Faster growth and increased profitability; through improved response (time) rates
- Increased customer loyalty; longer and more profitable customer relationships
- Shared assets and lower total capital investment; investment by partner organisations is limited to its core processes and working capital requirements are influenced by a 'just-in-time' approach
- Shared risk at reduced levels; risk is reduced by being dispersed among network members *and* because of the high aggregate level of expertise that is deployed

It follows that a 'network' or value chain design should reflect these advantages. To do so will result in:

- Lower investment in fixed costs and working capital
- Lower operating costs due to optimal economies of production and increased customer response (reducing customer acquisition costs and increased transaction values)
- Reduced business risk (defined here as fluctuations in planned market volume (and market share(s)))
- Reduced financial risk (defined as the probability of failure to achieve a target return on net assets)
- Decreased response times (both time-to-market, a strategic consideration, and operationally, the order cycle time)

There are four roles within such a network. First, operational roles are occupied by specialists, each of whom bring a core capability that combines with

others to produce or to deliver the product that the end-user buys. Examples include manufacturing and logistics. The second role is to supply a support process, such as procurement or customer service management and/or facilities; McHugh and his co-authors suggest this is a functionally oriented role and that typically there is only one member supporting the value chain. Emerging examples of this can be seen in the large B2B buying exchanges appearing in industries such as the automotive industry. The third role is that of resource provider to the operational role members. Resources include skilled labour (such as designers), information/data management services and, increasingly important, customised facilities (such as those required for computer chip manufacturing). Fourth, an ‘integrator’ role completes the structure. The integrator has one of two functions (and may well perform both): one is to provide the initial ‘strategic vision’ around which the virtual organisation is structured. The other is a coordinating role within the value chain, identifying, matching and directing resources. Piore and Sabel (1984) provide an example of the integrator roles taking place in the Italian textile-apparel industry located around Prato. Small specialist companies have developed long-term relationships with one another along the value chain. An ‘impannatore’ undertakes a strategic visionary role, together with an organising and coordinating role. The result is a very competitive value chain that offers currency and competitive prices in a fashion led industry.

Clusters, value nets, value streams and value chains

More recently the concepts of *clusters*, *value nets*, *value streams* and *value chains* have focused interest due to the increasing influence of *virtual integration* as an alternative to *vertical integration*.

Clusters

Value creation through clusters has been well documented in the applied economics literature. Porter (1990) defined clusters as:

... a geographically proximate group of interconnected companies and associated institutions in a particular field linked by commonalities and complementarities.

Porter identified the components as: end-product or service companies; suppliers of specialist inputs; financial institutions; firms in related industries; firms in downstream industries; producers of complementary products; specialised infrastructure providers; governmental and other organisations providing dedicated education and information inputs, and trade associations.

Porter explored a number of examples using a basic model comprising four interrelated components to explain international successes. First, *factor conditions* (that is, basic factors of production that are necessary to compete successfully and to create competitive advantage). Second, *firm strategy, structure and*

rivalry (the goals, strategies and organisation structures that when managed creatively result in international competitive advantage). Third, *related and supporting industries* (the presence of national supplier or related industries that are internationally competitive). Fourth, *demand conditions* (the quality and quantity of home demand has an impact on economies of scale and upon innovation, both important influences on competitive advantage). While these remain important, the developments in information communications technology have reduced their impact. The costs of *interconnectivity* have modified their importance. The use of EDI and net and web based communications has reduced the time as well as costs of transactions management, thereby making it possible to expand supply and manufacturing bases across international boundaries. Porter revisited clusters (1998), talking of:

[connections] broader than industries, capture important linkages, complementarities, and spillovers of technology, skills, information, marketing and customer needs that cut across firms and industries ... Such connections are fundamental to competition, to productivity, and especially to the direction and pace of new business formation and innovation.

In a broader context it can be argued that clusters comprise an effective combination of knowledge, technology, relationship and process management, that together, in a particular combination, provide an 'organisation' with the means of developing competitive advantage. The important issue is that success is driven by entrepreneurial vision, a vision that identifies not only the opportunities but the unique (or exclusive) alternatives for combining 'cluster capabilities', assets and resources that achieve both customer and corporate satisfaction.

Value nets

Parolini (1999) argues that the changes in the business environment require a new or different approach to strategic analysis, suggesting that models developed in the 1970s and 1980s are limited to a fundamentally different economic paradigm. Parolini comments (as does Dunning 1997) on the changes in 'strategic boundaries', suggesting that the 'new business model' is characterised by an emphasis on specialisation *and* a capacity to identify and participate in alliance networks. For Parolini a shift in emphasis has occurred (at least amongst the successful organisations) in which the focus has shifted from the inward, enterprise focused perspective to an outward, customer focus that considers how additional value (relative to that offered by competitors) can be delivered to customers via *value creating systems*.

Value creating systems were identified by Normann and Ramirez (1994) who argued that successful companies focus their strategic analysis and decisions on the value creating system (VCS) – the suppliers, business partners and customers – and how they can work together to *co-produce* value. Parolini proposes a basic difference between Porter's original value chain and the approach taken by Normann and Ramirez (and indeed subsequent approaches), suggesting:

... the former [Porter] takes the company value chain as his starting point, whereas the latter (Normann and Ramirez) underline the greater importance of the value creating system.

This comment does not identify the fundamental difference: *value creating systems (VCS) first consider customer expectations then consider the capabilities, assets and other resources required to meet customer value drivers – or exceed them!* Of course there are constraints: from a corporate viewpoint customer expectations typically represent an ideal that may be unrealistic, so they need to be viewed within the context of corporate value drivers.

Parolini (1999) summarises the main characteristics of the value creation system thus:

- A set of activities creates value for its end-user customers
- Activities use tangible and intangible resources that are linked by information flows
- End-user value is influenced by the way in which the end-user uses the delivered value
- End-users can (and often do) participate in value creating activities
- Value creation is successful only when a coordinating activity (or process) is present and links customer expectations to the economic activity of the VCS
- VCS partners may participate in more than one value creation system

Bovet and Martha (2000) use the term *value nets* in an argument suggesting them to be ‘... a business design that uses advanced supply chain concepts to achieve both superior customer satisfaction and company profitability’. And: ‘... a value net begins with customers, allows them to self-design products, and builds to satisfy actual demand’. The customer (business unit) is central to the decision process, is surrounded by the company (or business unit), which in turn is surrounded by a constellation of providers that perform some or all of the sourcing, assembly and delivery activities. The authors offer five characteristics that distinguish a value net business from the traditional business model:

- *Customer aligned* Customer expectations initiate sourcing, building and delivery activities in the net. ‘The customer commands the value net.’
- *Collaborative and systemic* Companies engage suppliers, customers and possibly competitors in a unique network of value creating relationships. ‘Each activity is assigned to the partner best able to perform it.’
- *Agile and scalable* Flexible manufacturing and distribution enhanced by information flow design facilitates responsiveness. ‘Everything in the value net, physical or virtual, is scalable.’
- *Fast flow* Lead times are rapid and compressed. ‘Rapid delivery goes hand in hand with reliable and convenient delivery.’
- *Digital* E-commerce is a key enabler. However, it is the flow of information and its ‘intelligent use’ that drives the value net. ‘Rule based, event driven

tools take over many operational decisions. Distilled real-time analysis enables rapid executive decision making.'

Value net advocates argue that identifying the *activities* involved in end-user satisfaction does have problems. One problem concerns the extent of the analysis; the VCS activity system could become too large to be analysed effectively, resulting in a waste of management time on activities that the individual company cannot influence in any way. Parolini suggests:

... it is important to have an overall reference model but, within the framework of this model, the magnifying glass needs to be used to scrutinise only those parts of the system that the company under investigation can influence in some way.

Sawhney and Parikh (2001) ask questions concerning value trends in the network age. They contend that value in a networked world behaves very differently than it does in the traditional, bounded world. They suggest the elements of infrastructure that were once distributed among different machines, organisational units and companies will be brought together. Shared infrastructure (*value in common infrastructure*) will include not only basic information storage and dissemination but common functions such as order management, and '... even manufacturing and customer service'. This is a similar view to that proposed by Hagel and Singer (1999).

They also suggest *value in modularity* as a trend. Here their concern is with the entire range of 'devices, software, organisational capabilities and business processes'. These will be 'restructured as well-defined, self-contained modules', and 'value will lie in creating modules that can be plugged into as many different value chains as possible'. Examples of modularisation can be found in automobile production. And they conclude: 'value in orchestration' will become '... the most valuable business skill'. Modularisation will require an organisational ability, so the authors suggest: 'Much of the competition in the business world will centre on gaining and maintaining the orchestration role for a value chain or an industry.'

A fundamental difference between the value net model and Porter's value chain model is that the VCS is considered to be a set of value creating activities (rather than companies), and these activities are defined from the final customer's point of view. Parolini argues that:

Taking the VCS as the focal point of strategic analysis is of utmost importance for those companies who want to avoid being trapped in outdated perspectives as to how to compete in their particular industry, and which understand that there is little sense in enjoying a strong competitive position and having a high bargaining power in relation to their direct customers, if they (and their customers) form part of a losing system.

This assumes that all organisations are primarily customer focused. Value net analysts assume that if customer satisfaction is maximised then so too is shareholder

value, or perhaps (as the arguments of many suggest) shareholder interests may be ignored!! This approach clearly has problems. Understanding customer expectations is essential, but the claim that meeting them precisely guarantees shareholder satisfaction does not follow. Many practitioners would argue that corporate expectations are the overriding consideration and that provided these are met the parameters of shareholder value are satisfied. This may imply that often customer value expectations are optimised within constraints set by corporate value drivers and that marketing objectives such as market share may be revised, but, they argue, the business will remain viable.

Value streams

Hines et al. (2000) offer an operations led ‘lean management’ perspective to value creation. They argue that:

This focus on value is therefore translated across functional and company boundaries in both design and delivery of the appropriate product-service bundle ... the lean message suggests that the focus of attention should not be on the company or functional department but instead on the complete value stream. The value stream is the set of tasks and activities required to design and make a family of products or services that are undertaken with a group of linked functions or companies from the point of customer specification right back to the raw material source.

And:

Value stream thinking goes beyond simplistic academic models of single buyer/single supplier relationships or even supply chains involving one customer, a local firm and its single supplier. Instead, a more realistic approach is adopted involving a complete network of companies arrayed in each tier of supply ... the lean approach seeks to go beyond partnership rhetoric and seeks solutions at the value stream level that will benefit all the organisations involved.

The value stream concept uses ‘value stream mapping’ to identify and differentiate between processes that create value *and* waste. Hines et al. refer to their own research in which waste and value generating processes are identified; the waste producing processes are eliminated while opportunities to enhance the value generating processes are sought. They argue that the value adding processes make the final product/service more valuable to the end-consumer than it otherwise would have been.

Value stream mapping is in effect the identification of seven ‘commonly accepted’ areas of waste (based upon practices in Toyota): overproduction, waiting, transportation, inappropriate processing, unnecessary inventory, unnecessary motion (an ergonomics consideration), and defects. There is an array of ‘mapping tools’, each being used where it brings focus to a specific area of waste.

The authors suggest a fundamental difference between value stream and value chain thinking. Their classification of these differences suggests an operations management focus to the value stream concept:

The difference between the traditional supply or value chain and the value stream is that the former includes the complete activities of all the companies involved, whereas the latter refers only to the specific parts of the firms that actually add value to the product or service under consideration. The value stream is, therefore, a far more focused and contingent view of the value adding process.

As we will demonstrate, this is clearly not the case. The supply chain and the value chain are two very different and quite distinct concepts. Furthermore neither includes *all* of the activities of the companies involved. It is arguable that specialist supply chain companies may be engaged in all of the activities involved, but increasingly they work with partner organisations who offer cost efficiencies or processes they themselves do not have. The whole concept of the value chain is one of cooperation and collaboration. Organisations such as Dell identify specialist process owners and work with them within an exclusive business model that integrates and coordinates the owners of relevant and efficiently managed assets, processes and capabilities that create added value via innovative products or innovative processes. The value chain approach is driven by the notion of delivering end-user satisfaction through a low capital intensity (high 'return') business model.

Value chains

The value chain approach offers a model that includes both customer and corporate expectations. It offers a means to undertake strategic and operational analysis of an opportunity at a macro (process) level and at a micro (activity) level. As with the value net approach it starts with an assumption that there are no constraints on *how* customers' value expectations may be met. But it then adds the constraint that unless the innovator/visionary, with its partner organisations, meet specific financial objectives the VCS (the value chain system) cannot survive. Needed are both *feasibility* (customer perceptions are equal to or exceed their expectations) and *viability* (stakeholder partner perceptions are equal to or exceed their expectations). Furthermore it is argued that free cash flow is the primary requirement for success. *This view is based on the simple premise that profit (in all its variants) is opinion: cash flow is fact!* (Ellis 1999).

The value chain: integrated demand and supply chains

Supply chain management supporters have argued that that the supply chain has attempted to meet all the changes identified within the 'new economy'. Yet supply chain management has focused on moving products and services *downstream* towards the customer. Typically the supply chain is coordinated by

manufacturing companies or dominant resellers who use in-house manufacturing and distribution facilities to achieve market based objectives such as market share volumes and customer penetration. Meanwhile, demand chain management changes the emphasis towards ‘customisation’, *responding* to product and service opportunities offered by specific customers or customer groups sharing particular characteristics. The preference is to outsource rather than own the functions and processes that facilitate and deliver value. The focus is on asset leverage and communication through distributed assets and outsourcing. There is thus a large incentive to integrate supply and demand chains – it provides new opportunities for creating (or adding extra) market value. Working both together results in more specific and manageable value propositions and increases the returns to value chain participants. There is an interdependent relationship between supply and demand: companies need to understand customer demand before they can manage it, create future demand and, of course, meet the level of desired customer satisfaction. Demand defines the supply chain target, while supply-side capabilities support, shape and sustain demand.

Processes not functions

More recent views of the value chain model suggest the importance of taking a *process* based perspective of the organisation, and extend this with the idea that processes are not simply *intra-organisational* but have become *inter-organisational* and often *intercontinental*!! Value chain analysis identifies the core processes and core capabilities involved in meeting the essential corporate and customer value drivers. Thus, according to Johansson et al. (1993), ‘A core business process “creates” value by the capabilities it gives the company for competitiveness.’

Core business processes are the processes identified by the organisation as being central to its strategy for competitive advantage. Normann (2001) suggests that the core business process of a company in the long term is to form new ‘dominating’ ideas. There is a similarity here with Porter’s argument for what constitutes long-term success. Long term the company requires a strategy for value delivery that not only offers competitive advantage through differentiation but is built around a core process to renew (or perhaps form new) ‘dominating’ ideas – the drivers of long-term competitive advantage. Normann contends:

No other process in any organisation is more fundamental in the long term than this renewal of the dominating ideas, this re-appreciation of an organisation’s identity and the way of manifesting it, in the face of environmental change.

Hammer (2001) argues that as businesses become accustomed to the *customer economy*, ‘process thinking’ becomes essential. ‘In order to achieve the performance levels that customers now demand, businesses must organise and manage themselves around the axis of process; moreover, they must apply the discipline of process even to the most creative and heretofore most chaotic

aspects of their operations.' And: '... processes are what create the results that a company delivers to its customers'. Hammer continues by offering a *customer economy* definition of a process:

... an organized group of related activities that together create a result of value to customers.

Hammer's discussion of this definition suggests increasing opportunities for the virtual organisation. He establishes a process as a *group* of related activities that work *together*, pointing to the fact that value is created by the entire process. It is the result of 'value production and coordination'. Activities are *related* and *organised*, with none of them irrelevant, and performed sequentially, giving some structure to the process and requiring process management. Effective process management is *result* oriented.

A strategic perspective is taken by Armistead et al. (1999). The authors identify themes 'associated' with business process management. Strategic choice and direction suggest that because an organisation cannot pursue every opportunity it makes choices or trade-offs; these determine the resource patterns of the organisation and, eventually the development of core competencies. These, in turn, lead to competencies that influence subsequent strategy. Strategic business process management forces companies to 'examine their form and structure' as having an influence on boundaries, structure and power within organisational design. An important component of the authors' model is the market value chain, which 'links the stages which add value along a supply chain'. They suggest that *within* an organisation the market value chain can be taken to be a conceptualisation of the core processes and activities which represent the organisation in process terms: 'They capture the activities which start and end in the organisation and link with other organisations in the chain.' They further suggest that the market value chain reinforces the resource based view of the organisation because it forces the identification of core processes from which core competencies and competitive advantage emerge. Performance management is another perspective of strategic business process management which 'relies on the management of resources and on a series of measurement systems', without which progress towards goals and any necessary corrective action are not possible. Organisational coordination occurs internally and externally (that is, with both suppliers and customers). This is particularly 'pertinent as the boundaries of internal processes become more ill-defined'; it could be argued that it is even more important for the boundaries between value chain organisations (such as in the 'prosumer' relationship between customer and supplier, which we will introduce shortly). This perspective adds emphasis to the importance of relationship management. The authors also identify knowledge management as a component of their model. Business process management enhances organisational learning and knowledge management. It 'provides a framework for organisational learning and can incorporate the management of knowledge'. Clearly these are determined by the specific application but suffice it to say they are essential to the successful performance of the value chain.

New concepts and a new vocabulary

Accompanying these new approaches is a new vocabulary. Terms such as *prosumerism* – the involvement of consumers in the design of products (a creative role that results in products that meet *specific needs* of customers). *Co-productivity* is a more operational role on the part of suppliers, distributors and customers in which they undertake tasks that hitherto were the role of other channel/chain participants. *Co-opetition* (often also known as *co-ompetition*) describes the situation in which competitors work together to meet individual objectives using mutual facilities. *Co-destiny* is used to ascertain the extent to which members of a business coalition share the same objectives, strategies and values. Examples of how these concepts are being introduced into new business models will appear in subsequent chapters.

Another important concept is that of *value migration*. Value migration occurs as both economic and shareholder value flows away from obsolescent (and obsolete) business models. Slywotzky (1996) argues that new models offer the same benefits to customers but at lower cost by changing the model structure. This change often results in a restructuring of profit sharing throughout the business model. Uren (2001) quotes Schremp (CEO, DaimlerChrysler) who expresses the view that ‘... within 10 years the price of a car will represent only a quarter of the total value provided to a customer with the balance consumed in maintenance, finance and other services’.

Value migration is the shift of business designs away from outmoded designs toward others that are better designed to maximise utility (value) for customers and profit for the company. Slywotzky contends that business designs (in a similar way to products) also have cycles and reach economic obsolescence. Customer expectations have a tendency to change over time but business model designs tend to stay fixed. By combining both, alternative added value structures may be evaluated.

Slywotzky measures the power of business design by using market value relative to the size of the company (the latter measured as revenue). Thus we have:

$$\text{Power of business design} = \frac{\text{Market value}}{\text{Revenue}}$$

where market value is defined as the capitalisation of a company (shares outstanding multiplied by current share price plus long-term debt).

Uren also identifies differences between Qantas and Ansett, suggesting that Qantas, with its international networks and travel agency links, together with an investment in services, is building a strong advantage. Similarly in the B2B sector Amcor and Visy (both in packaging) are using IT based e-commerce systems to increase customer service. In each of these examples, four basic issues emerge. First, that of the ‘value’ of the brand as being enhanced by service extensions or additions to the basic product. Second, that of the increased importance of intangible assets and the shift in investment patterns. Third, that of the importance of partnerships/alliances in the containment of fixed asset

investment, and therefore increased utilisation, albeit the assets are shared. Fourth, that of the way business organisation or 'models' have changed; virtual enterprises have expanded, as has the principle of outsourcing, such that the maxim 'Why own it when you can rent it?' has resulted in many businesses opting for a new model.

The basis for adopting the alternative (or new) model rests on a simple thesis. Some competencies or capabilities are 'distinctive' and as such offer possibilities of sustainable competitive advantage; others, the 'reproducible' competencies/capabilities, offer no such benefits and in fact are readily available in supply markets. Uren's observations suggest that typically distinctive competencies/capabilities are 'intangibles'. They also substantiate the inference to be drawn from Brookings Institution findings concerning the fixed asset ownership of large manufacturing and mining companies in the US: fixed tangible assets as a proportion of total assets fell from 67 per cent in 1982 to 38 per cent by 1992. By 2000 this was reported to be less than 30 per cent. These topics will be discussed in detail in subsequent chapters.

A question arising from the Brookings Institution research concerns the reasons for this continuous trend. Two possibilities appear likely. One is that businesses are investing less in fixed tangible assets because they are increasingly benefiting from the 'asset leverage' resulting from partnership arrangements. The other is that more investment is occurring in brands, research and development, knowledge based intellectual property, patents and franchise building. Clearly we need to know if overall total assets are increasing or whether there is a shift in investment. Perhaps both are occurring. The important point would appear to be the strategic implications of such decisions.

Investment by high-tech companies in fixed assets may not be the wisest use of opportunities. Technology life cycles are shortening, making profit *and* capital recovery difficult. The investment in intangible assets such as R and D strengthens the organisation, as does the investment in brands and corporate reputation. Clearly both are important but both have risk issues to be concerned about. The risk with R and D investment concerns time-to-market and eventual success. The risk with building strong brands and a reputation is more difficult to deal with as many of the activities may not be within the direct control of the brand owner. Problems can occur, and are occurring, for many of the international brand owners as their partners come under question concerning ethics and conformity to social responsibility demands.

Value migration is a significant factor in a number of industries. Industries undergo structural changes as end-user customer expectations change. For example, numbers of industries have become more service oriented in recent years, reflecting supplier efforts to differentiate their value offer between target customer groups. Another example concerns the application of new technology to both product and production processes. In both these examples we see changing patterns of value production, suggesting that the structure of the added value contributions from value production processes results in a shift (or 'migration') of value in the industry value chain. The significance this has for organisations that work in partnership networks is that due to changing patterns of value migration some firms may find it necessary to reposition

themselves within the value chain, leave the network, or perhaps develop more relevant processes and capabilities.

Gadiesh and Gilbert (1998) offer a similar model based upon the notion that ‘Successful companies understand that profit share is more important than market share.’ A ‘profit pool’ is defined as the total profits earned in an industry at all points along the industry’s value chain. The pool may be ‘deeper’ in some segments of the value chain than in others and variations may be due to customer, product and distribution channel differences, or perhaps there may be geographical reasons. Often the pattern of profit concentration differs markedly from revenue concentration. Gadiesh and Gilbert use the US automotive industry to demonstrate the variations of revenue and profit distribution and to provide an approach to mapping profit pools:

- *Define the pool:* determine which value chain activities influence the organisation’s ability to generate profits, now and in the future.
- *Determine the size of the pool:* develop a baseline estimate of the cumulative profits generated by all profit pool activities.
- *Reconcile the estimates:* compare the outputs of steps two and three and reconcile where necessary.

The authors recommend that the model be used to identify profit trends and to create an awareness of the implications of future structural shifts. The profit pool approach does explain why a number of the large automotive manufacturers are questioning their long-term viability as just manufacturers and are researching the feasibility of involvement elsewhere in the value production system. However, in the virtual organisation the strategic implications are more significant. Profit pools can be used to identify structural options and to question them in terms of optimal stakeholder value delivery. Additionally we can identify trends, establish scenarios and identify not only where relationship strategies and structures need to be changed but also the financial implications of each of the options.

Gadiesh and Gilbert argue that many companies ‘... chart strategy without a full understanding of the sources and distribution of profits in their industry’. Plotting the revenue, profits (and therefore cost profiles), productivity and cash flow characteristics of alternative value chains enables options to be identified in the knowledge and understanding of critical financial performance parameters.

Value led management

The argument developing here is that corporate structures (as well as decision making processes) are changing. The point may be made a little stronger: it is becoming very clear that ‘value’ is migrating in many industries. For example, the automotive industry is experiencing a shift in value profile. Hitherto, value was maximised in the production process; current indications and expectations for the future are that it will migrate towards the marketing and service processes.

Three major changes are suggested. The first concerns the emphasis on

performance. Currently many organisations emphasise cost led efficiency as a primary objective. Not only is this constraining, but it has been shown not to be in the shareholders' interests: cost reductions typically have a negative impact on customer service and this, in turn, has the same impact on revenues. The second change involves a switch from an internal focus in which assets and resources *must be owned* to one of cooperation and collaboration in which assets and resources are *managed*. The third change is one in which the organisation becomes *proactive* in its operations and this obtains for both customer and supply markets. *Market responsive* organisations tend to be inflexible and typically have very slow 'time-to-market' responses. In other words they are imitators rather than innovators!!

This notion can be expanded upon. The role of the entrepreneur is to balance the allocation of resources between *transformation inputs* and *interaction inputs*. Central to the decision is not who owns the inputs but rather how they may be incorporated into the business organisation and how this then is structured to ensure that customer and stakeholder expectations may be met. There are three important decision areas. First, there are decisions that influence physical products; quality and production costs are important and the resource allocation decision can be influenced by production alternatives that offer an organisation the opportunity to utilise the production facilities of partner organisations that have production expertise or cost advantages. Here, the management of 'intangible assets' can add differentiation to the physical product and improve the customer appeal by a 'brand promise' that in some way increases customer perceptions of the benefits received. Second, there are decisions concerning innovative product and/or service design; designs that increase, or extend, 'value-in-use' for customers also differentiate both the organisation and its products. Third, there are decisions concerning where, how much, and by whom investment should be made in both tangible and intangible assets, and how these should be integrated and coordinated. The 'virtual community' approach that value nets and chains propose offers to increase an organisations' abilities for focused response, flexibility of response and an ability to organise a 'timely' response.

Tapscott and Caston (1993) proposed a 'generic' model of the value chain/virtual organisation. By modifying their model and using it to contrast the traditional and emerging organisation, the structural *and* resource inputs requirements of the new model become apparent. The significant, and perhaps fundamental, difference is its interrelationship focus. The emphasis shifts from ownership and intrafunctional capabilities towards those based upon cooperation and collaboration, and towards managing inputs without necessarily owning them. This in turn suggests that profitability becomes less significant. Rather the value delivered to the shareholders is oriented towards free cash flow discounted to give a net present value.

A model for value chain analysis, planning and control

A number of approaches have been proposed for implementing the value chain model. Many have been somewhat conservative in their approach and are

essentially modified supply chain models. Typically the reasons given for these are that the marketing concept now fundamental to most organisational philosophy ensures that any decisions made at strategic or operational levels of a business are customer based. Our research suggests this not to be a safe assumption. The notion that an effective supply chain alone will ensure adequate customer satisfaction through reducing costs and therefore prices is not necessarily an adequate model by itself. Sainsbury's (the UK former market leader in food retailing) noted in the late 1990s in an annual report the positive impact on overall profitability of its increased logistics productivity, and saw this as a key corporate strategy. This reflected a business model dominated by a downstream oriented supply chain, assuming a relatively 'steady state' amongst its customers. The problems that Marks & Spencer, and to a degree Sainsbury's, experienced during the 1990s and again in 2004 were not because they mismanaged the operational efficiency of the business, but rather because they missed the shift in customer expectations and did not appear to respond to those expectations.

It can be argued that the future cannot hold much that is different for either company (or for that matter any company that shares this philosophy) if the current attempts to apply stringent cost control on operational activities continue, rather than the strategic issues of making the organisation effective in the marketplace being tackled. This suggests that a purely mechanistic supply chain approach entirely driven by *cost efficiency* needs to be replaced with a broader view of overall *effectiveness*. It is interesting to recall a comment by Porter (1996) concerning the mistakes that can be made by confusing *operational efficiency* with *strategic effectiveness*. Porter is suggesting that the attraction of the cost efficiency offered by the increasing range of production techniques has directed management towards short-term profitability at the expense of increased strategic advantage gained from understanding customer value expectations. Clearly both Sainsbury's and Marks & Spencer would appear to have been doing just this!!

Figure 1.1 outlines the approach that will be taken by this text. It is based upon a substantial period of researching and teaching value chain analysis and management. The model proposes a number of simple philosophies. The first concerns the approach taken by an increasing number of organisations which appear to assume that simply by being efficient they will succeed. There is ample evidence to conclude that while a certain amount of 'leanness' is essential, continuous cost reduction very soon has an impact on response to the customer and by the customer! This suggests a second philosophy; by developing a clear understanding of the *demand chain processes* that are involved in customer satisfaction and of the strategy decisions based upon this analysis, an optimal approach to both customer and shareholder expectations can result. A third philosophy is the acceptance that increasingly market opportunities are often more successfully pursued by collaborating with other organisations. Quite frequently this can include not simply closer liaison with suppliers and distributors, and possibly customers but also with competitors!!!

Figure 1.1 is proposing that the value chain is an integrated management activity that first explores and understands markets that appear attractive;

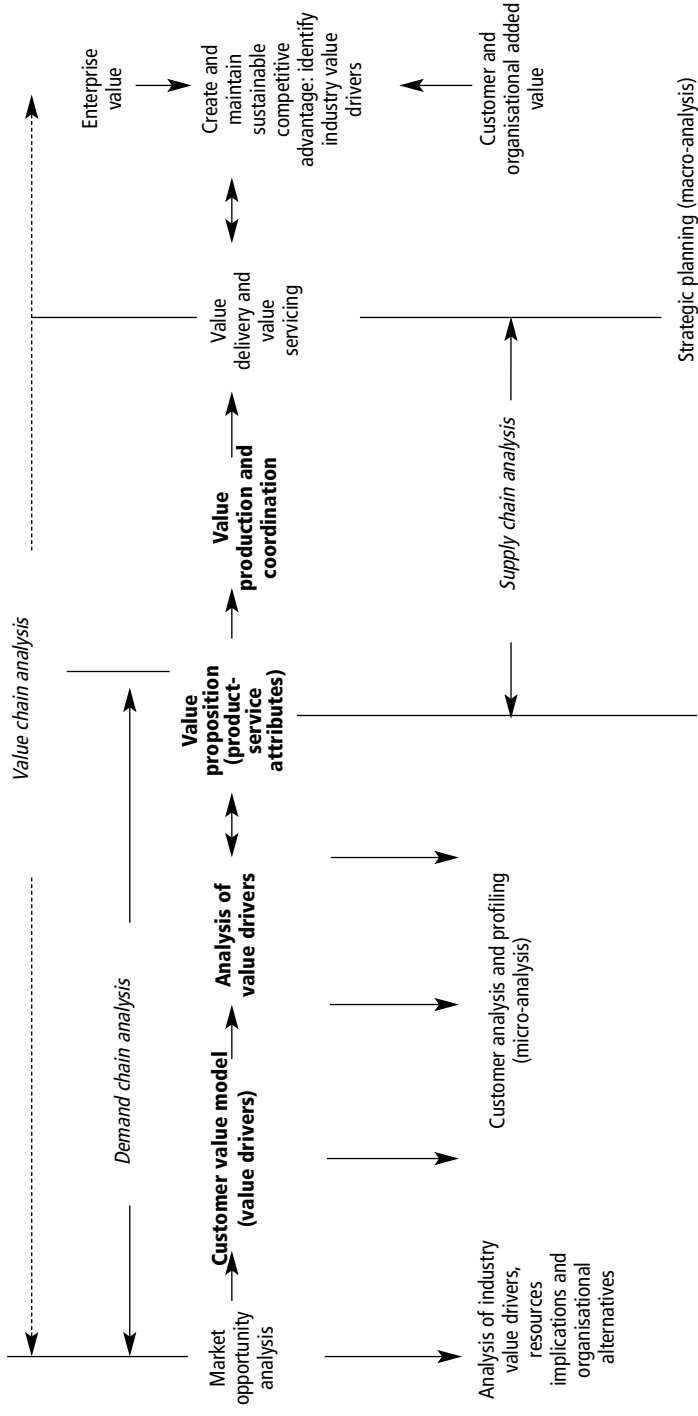


Figure 1.1 Strategic operations planning: an overall industry perspective of value chain analysis

second, through processes such as *market opportunity analysis* identifies the industry drivers and resource requirements; third, considers the potential organisational alternatives that are available and that are likely to prove to be successful in achieving realistic marketing and financial objectives. An important outcome is a model of customer value expectations, the *customer value model*, and from this a very clear understanding of *customer value drivers*. Together these provide a thorough understanding of customer demographics and socio-economics, and these in turn provide the basis for planning an effective product-market strategy from which a *value proposition* may be developed. The value proposition is important from two aspects: it identifies for the customer what it is the organisation is offering in response to customer expectations, *and* it identifies for the external and internal stakeholders what their roles and tasks comprise if those expectations are to be met.

It is at this point that supply chain decisions can begin to be considered. In all the models currently emerging is a shared view that unless a demand chain profile is established it is unlikely that a cost-efficient supply chain can be devised. Within this decision-set it is not unusual to find product and process design processes, procurement decisions, as well as an integrated inventory management/manufacturing process. Hence *value production and coordination* decisions now closely reflect customer product and purchasing behaviour preferences, and furthermore, extend well beyond the single organisation, becoming inter-organisational and often intercontinental in their nature. The continued advances being made in information communications technology, making information transfer more accurate and rapid at decreasing costs, are largely responsible for these developments.

For ongoing success the organisation must ensure that it establishes a strong market position by creating *sustainable competitive advantage* that insulates it from the obvious competitive activities of other organisations.

This model forms the structure for the remainder of this text. Subsequent chapters explore both the model and the developing management philosophies, processes and activities that underlie its successful implementation.

Concluding comments

Some lessons have been there to be learnt and issues for consideration have been identified. Boulton et al. (2000) make a useful contribution when they contend:

The encompassing challenge that companies face in this new environment is how to identify and leverage all sources of value, not just the assets that appear on the traditional balance sheet. These important assets including customers, brands, suppliers, employees, patents, and ideas – are at the core of creating a successful business now and in the future ... But what assets are most important in the New Economy? How do we leverage these assets to create value for our own organisations in a changing business environment? What new strategies are required for us to create value?

The authors continue by making the point that the new business models comprise asset portfolios whose success is influenced by the interaction of the assets. Furthermore, in the 'new economy' business model, asset portfolios are far more diversified than those of traditional organisations and include intangible assets such as relationships, intellectual property and leadership. They suggest that new business models are becoming commonplace in 'every industry' in the new economy:

In these emerging models intangible assets such as relationships, knowledge, people, brands and systems are taking center stage. The companies that successfully combine and leverage these intangible assets in the creation of their business models are the same companies that are creating the most value for their stakeholders.

For Boulton et al. it is clear that 'the ultimate success of each of these companies depends not on its ability to make the most of just one or two assets, but on its skill in optimising all assets that make up the business model'. They broaden the definition of an asset by way of the following considerations:

- Assets are tangible and intangible and extend beyond the balance sheet. They should be located where they will be strategically effective.
- Assets are, therefore, both owned and leased, controlled and uncontrolled. They offer sources of value that are within an organisation's control and outwith it.
- Assets are sources of both financial and non-financial benefits. Intangible assets such as customers provide information as well as cash from sales revenues. Employees provide skills and ideas and, over a period of time, knowledge and learning. organisations provide processes and systems
- Assets have distinct lifecycles.
- Assets include internal and external sources of value. The asset base of the virtual organisation includes numerous external relationships.

Pebler (2000) summarises the development of virtual organisation structures and offers a prescription for the future virtual organisation:

The virtual enterprise of the future will be much more dynamic and sensitive to the need for tuning operational parameters of the enterprise as a whole, including capital spending for both producers and service companies, optimising the whole chain of value creation. The future world will be characterised by knowledge management and collaborative decision-making by way of virtual teams. Virtual enterprises will be empowered by a willingness to do business in more productive ways and by information technologies that eliminate barriers between stakeholders and radically improve work processes.

CASE STUDY 1.1

Value chain integration: the 'new economy' business model vs the traditional approach

(Based upon 'United States vs. China: value chain integration – the China Vision: opportunities and challenges for US manufacturers, a White Paper – Grant Thornton LLP', Anonymous contribution, *Industry Week*, October 2005)

A US management services company, Grant Thornton, issued the results of a study suggesting that Chinese manufacturing plants show greater tendency towards value chain integration than their US counterparts. Their white paper compares and reports upon 'extensive integration' between manufacturers' suppliers and their customers. The report suggests that integration with suppliers for Chinese manufacturers is 29 per cent as against 11 per cent for US manufacturers, and with customers 33 per cent as against 16 per cent for the US sample.

Grant Thornton draw some interesting conclusions. They suggest that many manufacturers operate in markets that are becoming viewed as commodities, and that being tightly integrated with customers creates an opportunity more readily to provide 'total solutions' that extend well beyond mere products. They find that the high-performing plants in China were joint ventures involving foreign enterprises, while state owned and private plants were based upon the more traditional vertically integrated model. They continue by suggesting that the joint ventures are more integrated because of the 'Western' management approaches but also because they (the joint venture models) are provided with the opportunity to apply new and proven business models. Grant Thornton also suggest another reason, namely that the joint ventures are also more integrated because 'their customer is often their parent or partner firm'. The report also suggests cost advantages to this kind of integration.

Discussion topics

Does the Grant Thornton report imply a greater sophistication as regards organisational structures and business relationships in the emerging economies in respect of the view they are developing?

Are there problems confronting organisations who adhere to the traditional business models?

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