*Strategic Management*, 9e: Chapter 8 study guide

Resource-based strategic options derived from the value chain[[1]](#endnote-1)

From Penrose[[2]](#endnote-2) to Hamel and Prahalad[[3]](#endnote-3) the development of strategy options based on resource considerations is reasonably well established. This section is concerned only with the *value chain*.

*Resource-based business options* are those that arise from the analysis of the organisation examined in Chapter 4. There was a period in the 1970s and 1980s when the focus shifted to environment-based opportunities, but the resource-based approach has now regained its deserved role as a means of generating options. It is particularly relevant when market opportunities are limited, either because the market is only growing slowly or because the organisation itself has very limited resources. For example, public sector organisations with limitations placed on their resources by government may find that resource-based options provide more scope than environment-based opportunities.

Identifying sources of value added: upstream and downstream

Value can be added early in the value chain, i.e. *upstream*, and later in the value chain, i.e. *downstream*. Examining where and how value can be added by the resources of the organisation will generate strategic options.

*Upstream* activities are those that add value early in the value chain. Such activities might include procurement of raw materials and the production processes. To add value here, it is useful to buy in bulk and make few changes to the production process, thus keeping costs low and throughput constant. This is assisted if the organisation produces *standardised* items. Upstream value is added by low-cost efficient production processes and process innovations... Value is also added by the efficient purchase of raw materials and other forms of procurement.

*Downstream* activities are those that add value later in the value chain. These activities may rely on *differentiated* products for which higher prices can be charged. Such product variations may mean stopping the production line and making changes, which incurs extra costs. The resources may also involve elements of advertising or specialised services to promote the differentiated items. Downstream value is also added by research and development, patenting, advertising and market positioning.

**Examples of the location of the main source of value added in different single-product** industries

|  |  |  |
| --- | --- | --- |
| **Main resources** | **Examples of industries** | **Location: primarily upstream or downstream?** |
| Raw material extraction | Coal, oil, iron ore | Upstream |
| Primary manufacture to produce standardised output | Paper and pulp, iron and steel, basic chemicals | Upstream |
| Fabrication of primary manufacture | Paper cartons, steel piping, simple plastics | Upstream |
| Further added value through more complex manufacture, patents and special processes | Branded packaging, cars, specialist plastic products | Downstream |
| Marketing and advertising | Branded products | Downstream |

Many organisations are, of course, involved in adding value both upstream and downstream. For example, News Corporation would clearly have resources in the downstream part because its magazines and books are targeted at specific groups of customers. However, it would also use largely undifferentiated newspaper and printing inks to produce its products, which would be located upstream.

Nevertheless, some organisations are *primarily* located either upstream or downstream. Some examples for different industries engaged in one main business are shown in the Table

Resource implications of upstream and downstream value added

Using the concept of upstream and downstream value added, it is possible to develop resource options. For example, if *standard* products are required, then economies of scale may be possible. Other resource options that might produce standardised products more cheaply will also deserve investigation – the upstream activities of the list below.

Possible resource options associated with upstream and downstream activities

**Upstream resource options might include:**

 Increased standardisation of products

 Investment to lower the costs of production

 Operations innovation to lower the costs of production or improve the quality

 Capital investments that add value

 Seeking many customers from a wide range of industries that require a common product without variation.

**Downstream resource options might include:**

 Varied products targeted at particular market segments

 R&D and product innovation to add more value

 Advertising investment and branding

 New increased services to add value.

For *differentiated* products that are carefully targeted at niche markets, it will be necessary to promote them carefully, with resources based on downstream activity. The resource options more likely to be associated with downstream activities are also shown in Exhibit 1.

Key strategic principles

 Resource options can be developed by considering the value chain of the organisation. This is particularly important because the chain will help to identify competitive advantage.

 Value can be added early in the value chain, *upstream*, or later in the value chain, *downstream*. Examining where and how value can be added will generate strategic resource options.

 Upstream activities add value by processing raw materials into standardised products. Resource options concentrate on lower costs.

 Downstream activities use intermediate products to manufacture differentiated items targeted at specific customer needs. Resource options focus on R&D and marketing areas.

1. This section has benefited from the paper by Galbraith, J R (1983) ‘Strategy and organisational planning’, Human Resource Management, Spring–Summer, republished in Mintzberg, H and Quinn, J (1991) The Strategy Process, Prentice Hall, Englewood Cliffs, NJ, pp315–324. Galbraith’s concept has been applied to the value chain, although he did not use this terminology. [↑](#endnote-ref-1)
2. Penrose, E (1959) The Theory of the Growth of the Firm, Oxford University Press, Oxford. [↑](#endnote-ref-2)
3. Hamel, G and Prahalad, C K (1994) Competing for the Future, Harvard Business School Press, Boston, MA, Ch1. [↑](#endnote-ref-3)