

Adding Value

What is added value?

Adding value sounds like a bit of business jargon – and it is! However, it also has quite a precise meaning which is important. So it is worth learning this:

Adding value = the difference between the price of the finished product/service and the cost of the inputs involved in making it

Added value is equivalent to the **increase in value** that a business creates by undertaking the production process.

It is quite easy to think of some examples of how a production process can **add value**.

Consider the examples of new cars rolling down the production line being assembled by robots. The final, completed and shiny new car that comes off the production line has a value (price) that is more than the cost of the sum of the parts. Value has been added. Exactly how much is determined by the price that a customer pays.

Alternatively, imagine a celebrity chef preparing a meal at his luxury restaurant. Once the cooking is complete, the meal is being served and sold for a high price, substantially more than the cost of buying the ingredients. Value has been added.

You don't have to use robots or have the culinary skills of Gordon Ramsay to "add value". For example, businesses can add value by:

- **Building a brand** – a reputation for quality, value etc that customers are prepared to pay for. Nike trainers sell for much more than Hi-tec, even though the production costs per pair are probably pretty similar!
- **Delivering excellent service** – high quality, attentive personal service can make the difference between achieving a high price or a medium one
- **Product features and benefits** – for example, additional functionality in different versions of software can enable a software seller to charge higher prices; different models of motor vehicles are designed to achieve the same effect.
- **Offering convenience** – customers will often pay a little more for a product that they can have straightaway, or which saves them time.

A business that successfully adds value should find that it is able to operate profitably. Why? Remember the definition of adding value: where the selling price is greater than the costs of making the product.

By definition, a business that is adding substantial value must also be operating profitably.

Finding ways to add value is a really important activity for a start-up or small business. Quite simply, it can make the difference between survival and failure; between profit and loss.

The **key benefits to a business of adding value** include:

- Charging a **higher price**
- Creating a **point of difference** from the competition
- **Protecting** from competitors trying to steal customers by charging lower prices
- **Focusing** a business more closely on its target market segment

An example of added value



Consider what happens to the ingredients in a packet of Tyrrells Crisps.

Actually, Tyrrells call their crisps “potato chips”. According to their website:

“We grow our own potatoes and turn them into great tasting, crunchy potato chips. We’re in control from ‘seed to chip’, and that’s what makes our chips deliciously unique.”

The main ingredient for a packet of potato chips is, unsurprisingly, potatoes.

So, how much **added value** is created by the production process, turning potatoes into crisps (sorry, chips)?

It is time to do some maths! We’ll try to keep it simple!

Potatoes are sold by farmers at around £125 per metric tonne. That’s 1,000 kg of potatoes, which equals around 12.5 pence per kilogramme.

What about a packet of Tyrrells crisps? The typical 50g grab bag of Tyrrells costs the retailer around 50 pence to buy (the consumer then pays about £1 per packet).

If there are 50 grams of potato in a bag, then the sales value of 1kg of Tyrrells crisps would be approximately : $50 \times 20 \times £0.50 = £500$

So, for each tonne of potatoes, Tyrrells is turning something that they could sell for £125 into something they sell for £500.

The difference between £500 and £125 is not quite the total added value. Tyrrells has to take account of the other production costs (e.g. labour, energy, and other ingredients).

However, you can see how the production process of turning the humble potato into bags of premium-priced crisps is a good example of a business that is “adding value”.