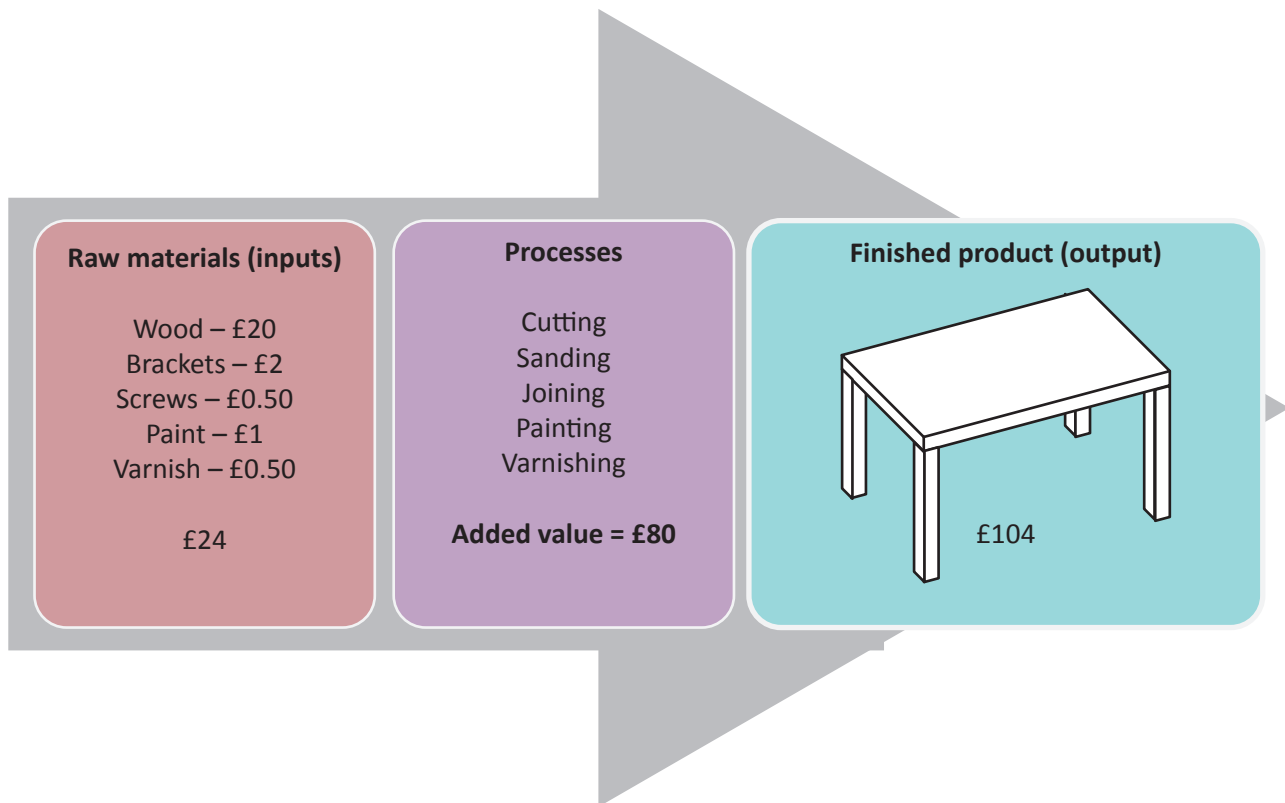


Chapter 23

Added value

During the production process a business adds value to the raw materials which it uses when making a product.

Calculation of added value – the difference between the cost of purchasing raw materials and the price for which the finished good is sold for.



In the example above a carpenter uses inputs such as wood, screws and other raw materials to make a table. The total cost of all the materials adds up to £24. In order to make the table the carpenter has carried out a variety of processes. The final output – the table – is sold for £104. The added value in this case is £80 ($£104 - £24 = £80$).

Added value **is not to be confused with profit**. Out of the £80 added value in this example the wages of the carpenter plus any overheads his business may have, such as transport and insurance, must be deducted.

Added value does not only apply to the production of goods – **it also applies to the provision of services**. For example, when a wholesale business buys a thousand tins of baked beans from a manufacturer it will sell the beans on for more than it paid for them. This difference in price is regarded as added value. The wholesaler has provided a service and has therefore added value by making it convenient for local retailers to come to the warehouse and pick up the amount of baked beans they need to sell to their own customers in their shops.

How might added value be increased?

There are a variety of ways in which added value may be increased for both goods and services:

- Purchasing cheaper raw materials – however, care must be taken that quality is not compromised

when doing this. As a business grows it may be able to take advantage of purchasing economies of scale and achieve greater added value as a result.

- Improving the efficiency of the production process – for example, this may be achieved by purchasing up-to-date machinery or by training the workforce.
- Raising the price of the product – price elasticity of demand is a key issue here. If the business raises the price of a product, the demand for which is price sensitive, it will result in a fall in overall revenue – which is clearly something it would not want to do.
- Achieving brand status for a product can create added value. Chanel perfume sells for a great deal more than the majority of its competitors, but the processes involved in production will be virtually identical.
- Offering additional services with a product can result in added value. A telephone helpline to help with technical questions, or the willingness to install new equipment and ethically dispose of old equipment are examples of this.
- Improving customer access or convenience is a well-proven method of adding value. Drive-through fast-food outlets and home-delivery pizza are typical examples.

Discussion themes

How is value added different to profit?

How is value added calculated?

How does a business add value to its goods and services?