2.2 Value and Its Creation

2.2.1 The Concept of Value

The perception of value in business markets has attracted attention from both academics and practitioners and has been broadly used in the marketing discipline (Parasuraman 1997; Anderson 1995; Wilson & Jantrania 1994; Anderson, Jain & Chintagunta 1993). The rudimentary notion is that business markets can solitarily be understood by applying the concept of value (Walter, Ritter & Gemünden 2001, 367). Indeed, Slater (1997, 166) has argued that "*…the creation of customer value must be the reason for the firm's existence and certainly for its success*".

Contention over the characterization of value is an ancient issue which could be traced back at least to Aristotle (Vargo, Maglio & Akaka 2008, 147). Aristotle[5] introduced the formal concept of value and first differentiated between two meanings: '*use-value*' and '*exchange value*' (in Vargo et al. 2008, 147). In the middle ages, medieval Schoolmen were documented for stressing *use-value* in economic exchange and proposing that the basis of exchange was found in the needs of consumers (Dixon 1990). Prior to the proper development of economics, use-value was frequently acknowledged by those who accepted the role of satisfaction and fulfillment in value. Galiani[6] (1751, 304 in Dixon 1990) noted "*it is certain that nothing has a price among men except pleasure, and that only satisfactions are purchased*".

Adam Smith (1776) introduced the dialogue on value and value creation into the enlargement of economics and the study of market exchange. According to Smith[7] (in Vargo et al. 2008), "*the word VALUE, it is to be observed has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods which the possession of that object conveys*". After that, in the neoclassical economics the 'products' (good) embedded with 'utilities' (exchange-value) became the focus of value creation in marginal utility theory (Marshal 1927; Walras 1954).

Studying the phenomenon of value and how value is created and consumed is challenging and complex in numerous ways. First of all, despite extensive interests from academics and businesses, the concept of '*value*' has often not been evidently defined in studies of the subject. Indeed, according to Khalifa (2004) the idea has become one of

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[5] Aristotle 4th century B.C.

[6] Galiani, Ferdinando (1751) Della Moneta.

[7] Smith, Adam (1776/2000), Emphasis in original.

the most *clichéd* and *misused* concepts in the social sciences in general and in the management literature in particular. As an intangible concept, the study of value is complicated due to the different number of meanings and definitions depending on the perspective taken. The phenomenon is dynamic – value is not constant, but changes over time. It is also context and actor dependent – what is considered as *value* depends on where this judgment is made and by whom.

This lack of settlement among scholars with respect to the conceptualization and measurement of ‘*value*’ is a result of its rather nebulous nature which has been labeled as ‘complex’ (Lapierre 2000), ‘multifaceted’ (Babin, Darden & Griffin 1994), ‘dynamic’ (Parasuraman & Grewal 2000) and ‘subjective’ (Zeithaml, 1988). Nevertheless, recognizing the concept of value is important, as Anderson, Narus and Das (2009, 10) appreciated value conceptualization by way of “*the cornerstone of business market management because of the predominant role that functionality or performance plays in business markets*”.

In short, value can be viewed as a trade-off among benefits and sacrifices (Flint et al. 1997; Biong, Wathne, Parvatiyar 1997). Some scholars define value with the perspective of business markets monetarily (Anderson & Narus 1999; Anderson et al. 1993), whereas others use a comprehensive value definition, which also embraces non-monetary revenues such as competence, market position, and social rewards (Biong et al. 1997; Wilson 1995; Wilson & Jantrania 1994).

In the context of this study, value is recognized as the perceived trade-off between various benefits and expenses gained through interactions between client organization and the product/service provider firm. Those benefits and expenses can originate from the interaction under question as well as from associated relationships on which the focal interaction has an influence or is stimulated by those other relationships (cf. Walter et al. 2001).

Understandably, the measurement of value by an objective measure such as the monetary measurement is greatly relative considering multifaceted value creating systems. The argument for selecting and using the value perception in this study rests on the commonly understood meaning of the concept – relative usability, worth, importance or merit (cf. Forsström 2005).

2.2.2 Traditional Understanding of Value Creation

Until the mid-1980s, value creation mechanisms and processes was understood based on the conceptualization that value is produced by the firm through a sequential and established set of activities. After the value is *produced by the firm*, it is *delivered to the customer* in exchange of money or some other valuable returns. The legacy concept of *value production* can be understood by the application of 'value chain management' framework of Michael Porter (Porter 1985, 11 – 15), as shown in Figure 5 below.

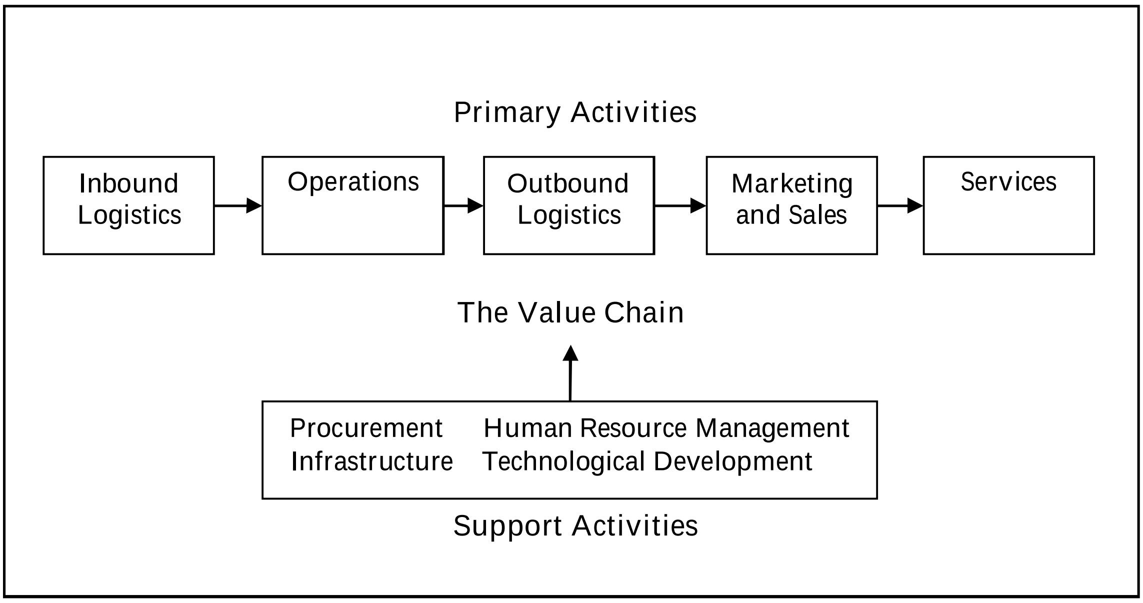

Figure 5: Value chain of a firm (Porter 1985, 12)

Porter's (1985) value chain framework considers value creation at the firm level. Value chain analysis recognizes the activities of the firm and then studies the economic implications of those activities. It comprises four steps: (1) outlining the strategic business units, (2) classifying critical activities, (3) defining products and (4) determining the value of an activity. The firm-centric view of the traditional value creation concept shows in the way Porter (1985, 38) defines value:

> *"The amount buyers are ready to pay for what a firm supplies them. Value is measured by total revenue … A firm is profitable if the value it commands exceeds the costs incurred in creating the product".*

According to the traditional value chain framework, value can be generated by differentiation along each step of the value chain, through activities resulting in products and services that decrease buyers' costs or raise buyers' performance. As the figure 5 shows, the customer or client is not present in the 'value chain', leaving the perspective on the firm as the 'sole creator' and 'deliverer' of value. According to the traditional approach, the interactions between companies and customers are not considered as a source of value creation (Normann & Ramirez 1994; Wikstrom 1996).

In the legacy concept, the firm and the client seized precise roles of production and consumption. The market – considered as an accumulation and combination of different sets and subsets of clients – contemplated as a 'target' for the offerings by the firms (as shown in figure 6), which indicates the company-centricity of the traditional concept of a market. Subsequently, client relationship management was conceptualized by the firms as pointing, achieving and managing the 'target' clients (Prahalad & Ramaswamy 2004b, 6).[8] Figure 6 below depicts the traditional perspective of value creation.

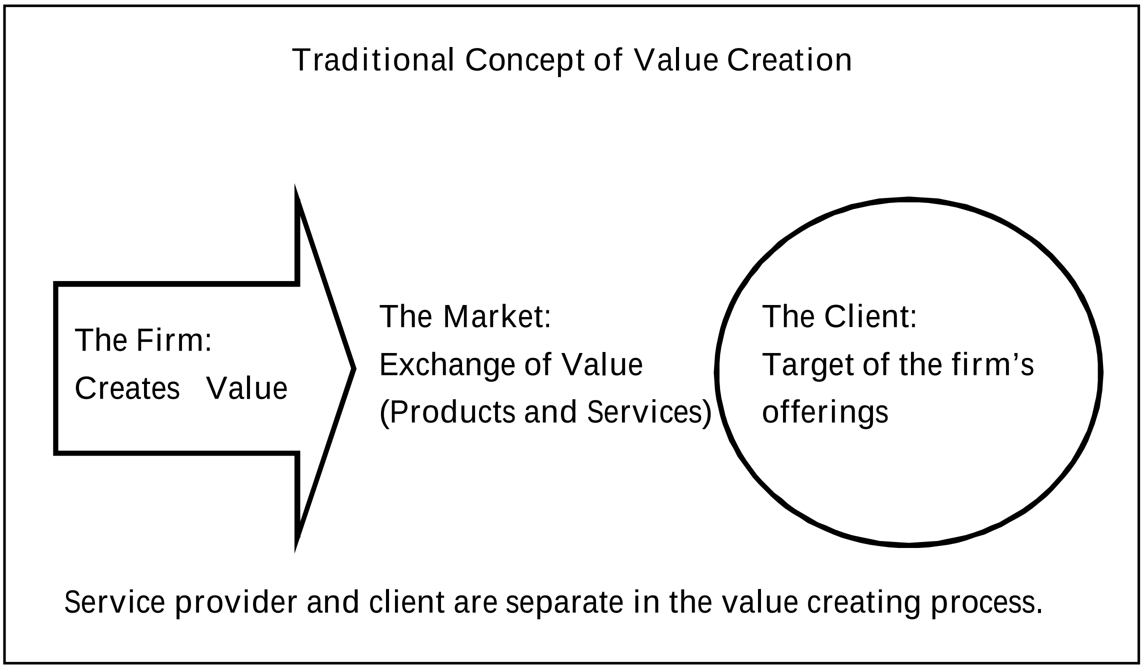

Figure 6: Traditional understanding of value creation (Modified from Prahalad & Ramaswamy 2004b, 7)

The traditional view of value creation is referred to as *goods-dominant (G-D) logic* and is grounded on the *value-in-exchange* meaning of value (Vargo & Lusch 2004a). According to G-D logic value is created (manufactured) by the firm through manufacturing and associated activities and distributed in the market, typically in exchange of goods and money. Customers or clients are considered as entities that are exogenous and abolishes value through consumption (Ordanini & Pasini 2008, 290). From this G-D logic perspective, the roles of '*producers*' and '*consumers*' are distinct.

To understand the traditional concept of value creation further, an automobile can be considered as an example. An automobile is constructed out of metal, plastic, rubber, and other parts by a manufacturer. In their basic form, the metal and other raw materials components cannot be used as transportation. The manufacturer produces or sources

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[8] From a firm's point of view, IBM's goal provides a clear picture on how value creation is perceived from a traditional perspective, as the firm states that its goal is to '*Strive to lead in the creation, development and manufacture of the industry's most advanced information technologies, including computer systems, software, networking systems, storage devices, and microelectronics. We translate these advanced technologies into value for our customers through our professional solutions and services businesses worldwide*' (Source: IBM Egypt official website).

components, assembles them together and delivers the automobile to customer, hence creates the value for the customer. In other words, by transforming raw materials into something that customers want, the automobile manufacturer embeds value in the automobile. In this understating, value is created by the firm in the form of a good. After the value is created, this valuable good is exchanged in the marketplace for money (or possibly other goods), and value is measured by this exchange transaction (Vargo, Maglio & Akaka 2008, 147).

Needless to say, the inheritance perception of a market is company-centric. So is the understanding of value creation. Subsequently, targeting and managing the ‘right’ customers/clients is what the firms conceptualize as customer relationship management. In doing so, firms concentrate on the locus of interaction – the exchange – as the center of economic value extraction. *The interactions between companies and clients are not considered as a source of value creation* (Normann & Ramirez 1994; Wikstrom 1996) in the conventional perceptions. Value exchange and extraction are the principal functions executed by the market which is detached from the value creation process, as shown in figure 6 above (Prahalad & Ramaswamy 2004b, 6). In the conventional system as firms choose the products and services they will produce, by implication they make a decision that what is of value to the customer/client. In this traditional system customers or clients have little or no role in value creation and the roles of ‘producers’ and ‘consumers’ are distinct.

2.2.3 Shifting Dynamics of the Market

From a service and firm centric view, the meaning of value and the process of value creation are swiftly shifting to *customized client involvements*. An increasing number of academics are pointing to the critical importance of business interactions for value creation (see, e.g. Biong et al. 1997; Sheth & Sharma 1997; Ravald & Grönroos 1996; Anderson, Håkansson & Johanson 1994). In addition, value creation is regarded as the utmost purpose for a client firm and a supplier firm engaging in a relationship (see, e.g. Grönroos 1997; Anderson 1995; Wilson 1995).

As the market dynamics are shifting, informed, networked, empowered and active clients along with the firms are increasingly participating in the value creation activities. This two way interaction between the firm and the client is turning into the locus of value creation and value extraction. Prahalad and Ramaswamy (2004b) argue that clients today have more options of products and services than ever before, but the choices are not being able to satisfy them properly. Conversely, firms are less able to differentiate themselves irrespective of investing in greater service and product variety.

Clients are fundamentally altering the characteristics of the market where the market has become a setting in which clients play an active role in creating and competing for value. The major changes are identifiable and distinguishable – formation of client communities, management of client diversity and formulating client specific experiences. (Prahalad & Ramaswamy 2000).

Due to the wide range of information and communication technology development, it’s simple for the clients in the new economy to form virtual communities by their own. Moreover, these connected client communities can be quite tightly knit, which could accommodate a wide range of traits. These client communities can exercise a powerful influence on the market (Algesheimer & Dholakia 2006, 1). Clients now have access to information networks to control their selection of choices and diversions. So huge promotions from the service providers’ side do not create sufficient impact on their supplier selection decisions (Weber 2009). Rather their active information search, accumulation and analysis works as their major decision making factors.

As firms embrace the market as a setting or forum, they turn out to be more exposed to client diversity. Clients' experiences of a product or service and therefore their judgment and decision of that product or service will differ according to their individual ways of realizing values. To develop product portfolios and affective design in the changed market, the diversity in clients’ needs must be understood and considered (Khalid 2006, 409). In the changing contemporary market dynamics clients are not satisfied to accept generalized and imitated services fabricated by knowledge intensive service providers, like professional business software development services (PBSDS) firms. Progressively more, they pursue to shape those services by themselves, both individually and through interaction with experts or other clients. Here, it is of importance to differentiate between personalization and customization. Customization concept accepts that the firm will design and deliver products or services to suit client's needs. On the other hand, personalization is about the client’s embryonic as a co-creator of the content of their experiences. (Prahalad and Ramaswamy 2000).

As value shifts to specific and tailored client experiences, the market is becoming a setting for participations, interactions and combined efforts between client communities and firms. Client’s participation in the new ‘*market*’ concept is a magnitude of infringement from the goods-dominant perceptual simulations that no longer assist the continuous renewal of strategies and competencies (Ballantyne & Varey 2006). In the present context exchange activities are of combined expressions of three features: *knowledge renewal, communicative interaction* and *relationship development*. For successful value creation companies along with their clients will have to select opportunities with the highest potential pay-off, as well as structure relationships to manage risks while reducing the effort required to fully realize the new value as the market modify its dynamics (Kambil, Friesen & Sundaram 1999).

2.2.4 Co-Creation Approach of Value Creation

As a result of changing dynamics of the market, there has been a paradigm shift in stance and understanding of value creation in the last few years. Contemporary marketing literatures and practices congregate around the impression that especially when it comes to services, clients or customers play different foundational roles in value-creation mechanisms. As recently presented through the notion of the *service dominant logic (SDL),* the customer or client is always a co-creator of value, not a target of that value, because the customer/client mobilizes knowledge and other resources, and these customer/client efforts affects the success of a value proposition.

Rendering to this view, the client becomes embedded in the service offering and eventually is responsible for the value added to the process (Vargo & Lusch 2004a). As an example, if a client organization does not share its business challenges, strengths and weaknesses appropriately, a consultant may be obliged to deliver sub-optimal service – not due to his or her own deficiencies but because of poor client participation (Ordanini & Pasini 2008, 290). The excellence of a service exchange visibly hinge on the customer or client in the sense that the way they, particularly in a B-to-B context, contribute in the process determines the ultimate service delivery and thus the level of satisfaction (Ernst 2002, 4).

The progressively knowledgeable nature of the clients and their increasing awareness of the negotiating clout are working as main change agents for the service providers to adopt an implicit (if not an explicit) negotiation with the clients. It also requires the service providers to employ high-quality interactions which facilitate a specific client to co-create value with the firm. *Values are cooperatively created by both the firm and the client* (Prahalad & Ramaswamy 2004b, 7).

According to service dominant logic (S-D Logic), a service firm offers an application of knowledge and competencies for the benefit of the client firm, which makes it the basis of any economic or social exchange (Vargo & Lusch 2004a). Both the firm and the clients have their unique abilities, characteristics and inputs, and these elements from both sides are put together to function in a synchronized way and hence co-create the value jointly. Figure 7 below provides visualization of the concept.

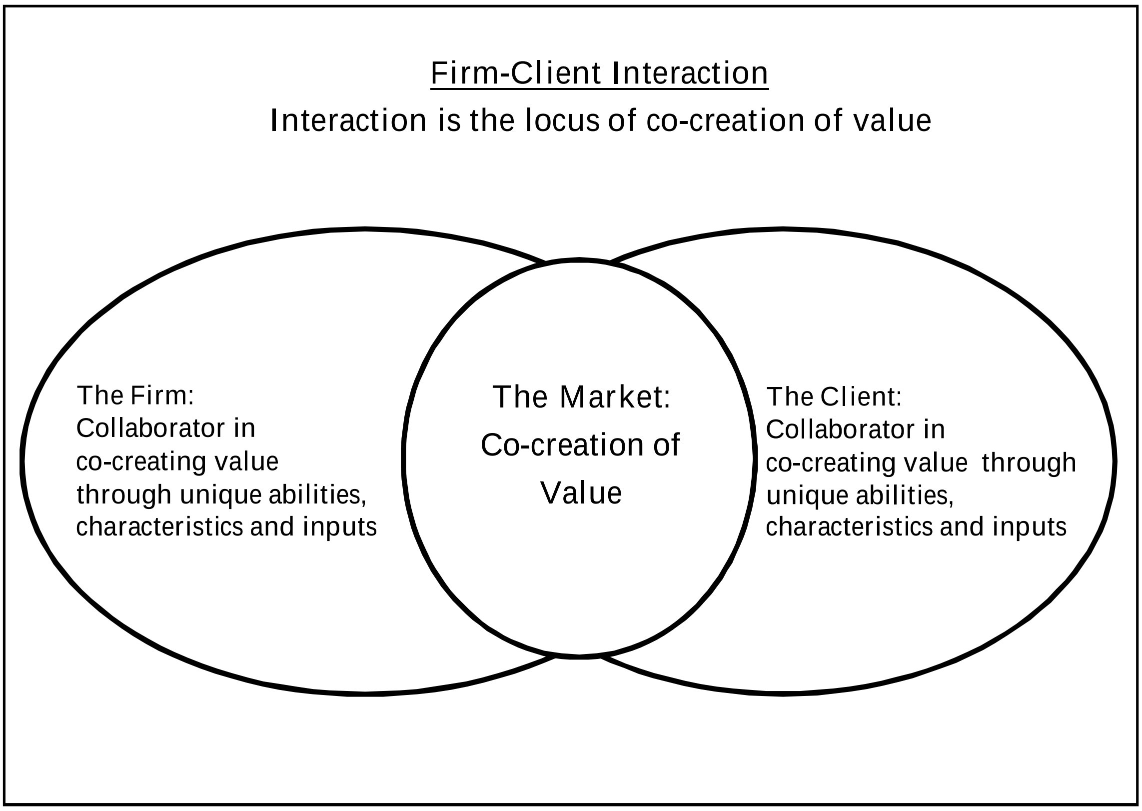

Figure 7: Co-creation approach of value creation (Modified from: Prahalad & Ramaswamy 2004b, 11).

The basic idea of S-D logic (Vargo & Lusch 2004a) is, marketing inherited a model of exchange which was rooted in economics. It had a dominant logic grounded on the exchange of goods with manufactured output. The goods-dominant logic concentrated on tangible resources, embedded value and transactions. In the contrary, S-D logic also recognizes clients as well as suppliers are resource integrators, consistent with the concept of co-creation of value (Cova & Salle 2008, 270).

The assumption that artifacts, human beings and society can be considered as mutually separated entities is no longer valid. In the physical world, they are thoroughly interconnected to each other, so it need to be understood that value is created through interaction between them (Ueda, Takenaka & Fujita 2008, 55). To appropriately create value of a service and to realize the same, it is required that clients and service providers work together to transform some state such as material goods, information goods or networks and processes that is possessed or controlled by the client (Hill 1977; Gadrey 2002).

This shift from a *firm-centric view* to a *co-creation view* is not only about negligible changes to the traditional system, as co-creation is neither the transmission or outsourcing of activities to clients nor a customization of products and services, nor is it a scripting or performing of client proceedings around various offerings the firms (LaSalle & Britton 2002; Schmitt 1999). In the co-creation notion, every point of interaction between the company and the client are prospects for both value creation and extraction (Prahalad & Ramaswamy 2004a). Moreover, from the traditional company-centric view the co-creation notion differs in the firms' approach that companies have gone downstream toward the clients:

> *"They've moved beyond the factory gate to tap into the valuable economic activity that occurs throughout the entire product life" (Wise & Baumgartner 1999, 133).*

S-D logic forwards the orientation of marketing from a 'market to' attitude where customers are promoted to, targeted, and captured to a 'market with' attitude where the client and the service provider are collaborators in the entire value creation process (Lusch & Vargo 2006b). For Lusch and Vargo (2006c, 283) "*Organizations exist to combine specialized competences into complex service that provide desired solutions*[9]".

Co-creation of value is collective generation of value that creates an effective solution as a whole system through mutual interaction between varieties of agents. In a co-creative system, unlike a simple emergent system, the elements are agents that make a decision (Ueda et al. 2008, 53). The idea of collective value creation can be visualized in figure 8.

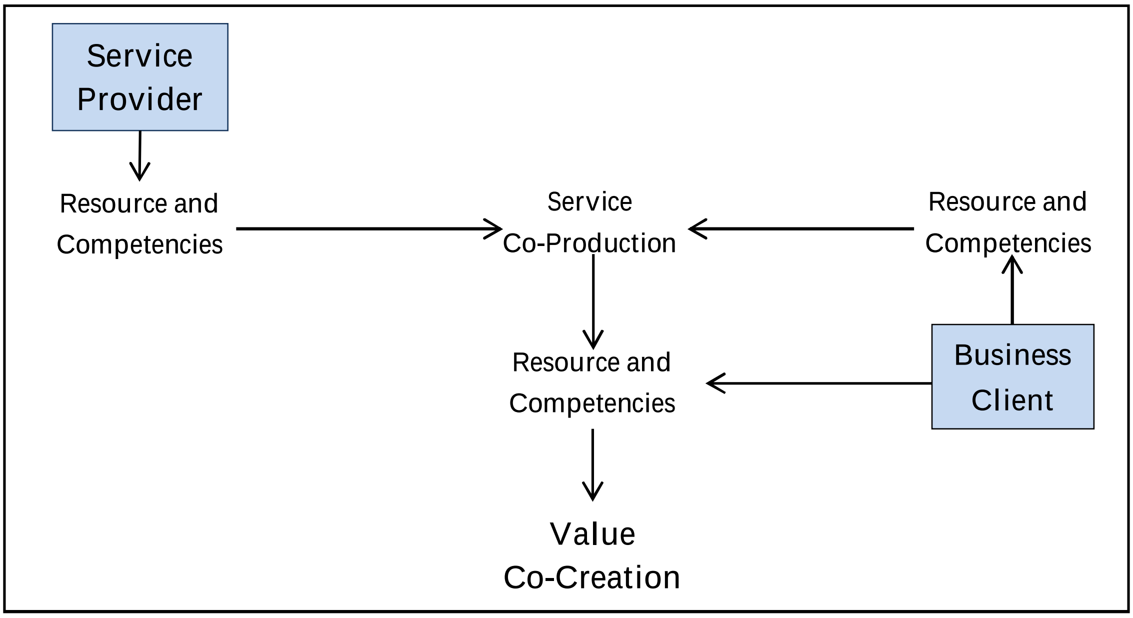

Figure 8: collective value creation according to S-D Logic (Ordanini & Pasini 2008, 291)

As the figure shows, in a co-creative system the agents cause a behavioral solution to emerge through organization of their own internal structures and moreover they interact

[9] S-D Logic: Fundamental Premise no. 9.

with each other (Ueda et al. 2008, 53). Through the interactions of resources and competencies of the service provider and the client the ultimate value is co-created.

To create value through co-creation system, the building blocks of interactions between the firm and consumers that facilitate co-creation are: *Dialog, Access, Risk-benefits* and *Transparency* (DART), which are emerging as the basis for interaction between the consumer and the firm as shown in figure 9 below. (Prahalad & Ramaswamy 2004b, 9).

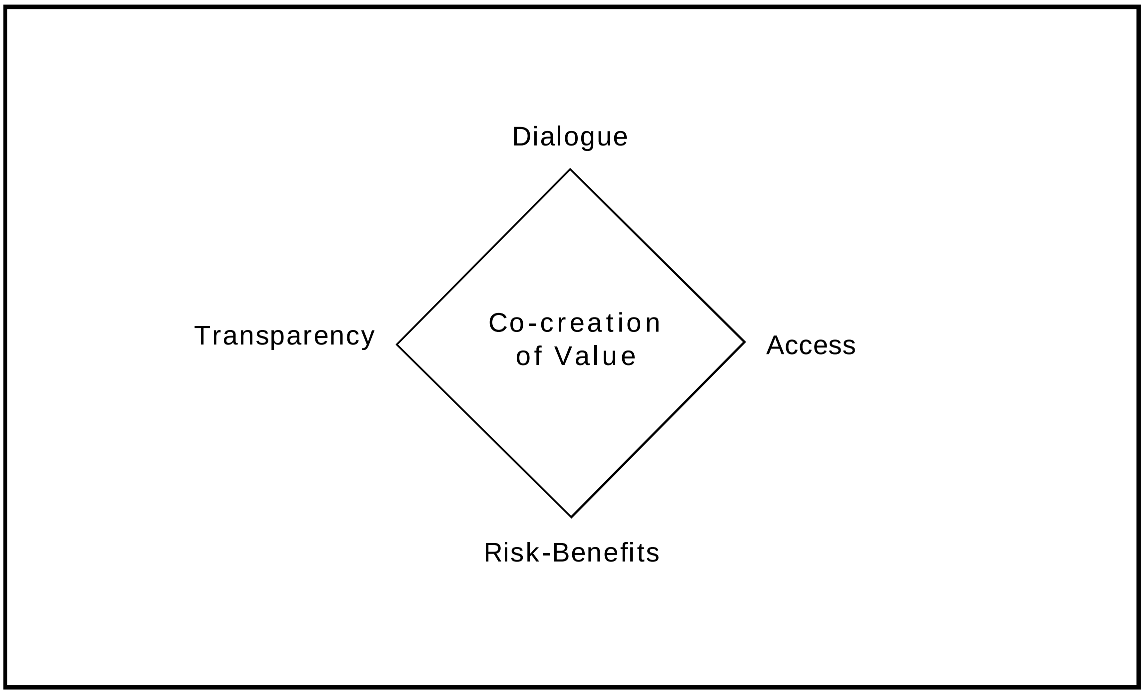

Figure 9: Building blocks of interactions for co-creation of value (Prahalad & Ramaswamy 2004b, 9)

Dialog is an imperative element in the co-creation notion from the perspective that markets can be regarded as a set of conversations between the client and the firm (Levine, Locke, Searls, & Weinberger, 2001). Dialog ensures interactivity, higher cooperation and the capability and aptitude to perform to both the service providers and their clients. However, engaging in dialog can be difficult for clients if they do not possess similar level of access and transparency to information compared to their service providers. Thus, both access and transparency plays vital role to ensure a meaningful dialog. More importantly, dialog, access and transparency can lead to a flawless evaluation by the client about the risk-benefits of any decision and thus the service performed. (Prahalad & Ramaswamy 2004b, 9).

2.2.5 Value Co-Creation Process

The process of value co-creation includes procedures, tasks, mechanisms, activities and interactions which drive the co-creation of value. Understanding the process of value co-creation accentuates the prerequisite to view the association between the provider and the client as a longitudinal, dynamic and interactive set of activities and experiences performed by the provider and the client within a framework. The understanding also requires appreciating the co-creation tools and practices that are partially overt and deliberate and partially based on routine and unconscious behavior (Payne et al. 2008, 85).

The value co-creation process comprises the supplier creating superior *value propositions*, with *client is partly responsible and determining the value* when the goods or service is consumed (Payne et al. 2008; Payne & Frow 2005). Together, supplier and client have the opening to create value through tailored, co-produced offerings. *The co-creation of value is an anticipated goal as it can support firms in highlighting client's point of view and in refining the front-end manner of ascertaining clients' needs and wants* (Payne et al. 2008; Lusch & Vargo 2006).

In the value co-creation process, business clients typically participate at several points in the service progression (Bendapudi & Leone 2003). From a generalized perspective, the first initiative taken by the client is to select the service provider and take preparation for their own tasks in the service. Then while the service is being performed, clients complete their principal responsibilities, along with frequently interacting with the service provider, technology or other customers. Finally, after the service is co-created and value is realized, clients may provide feedbacks and often continue executions of the tasks essential to maximize the benefits of the service (Tax et al. 2006, 31).

The process of value co-creation can be divided into three interrelated sub-sets, namely: (i) client value-creating processes, (ii) supplier value-creating processes and (iii) encounter processes (Payne et al. 2008, 86). Figure 10 in the next page illustrates the step by step procedure of the value co-creation process and the interconnectivity present between them.

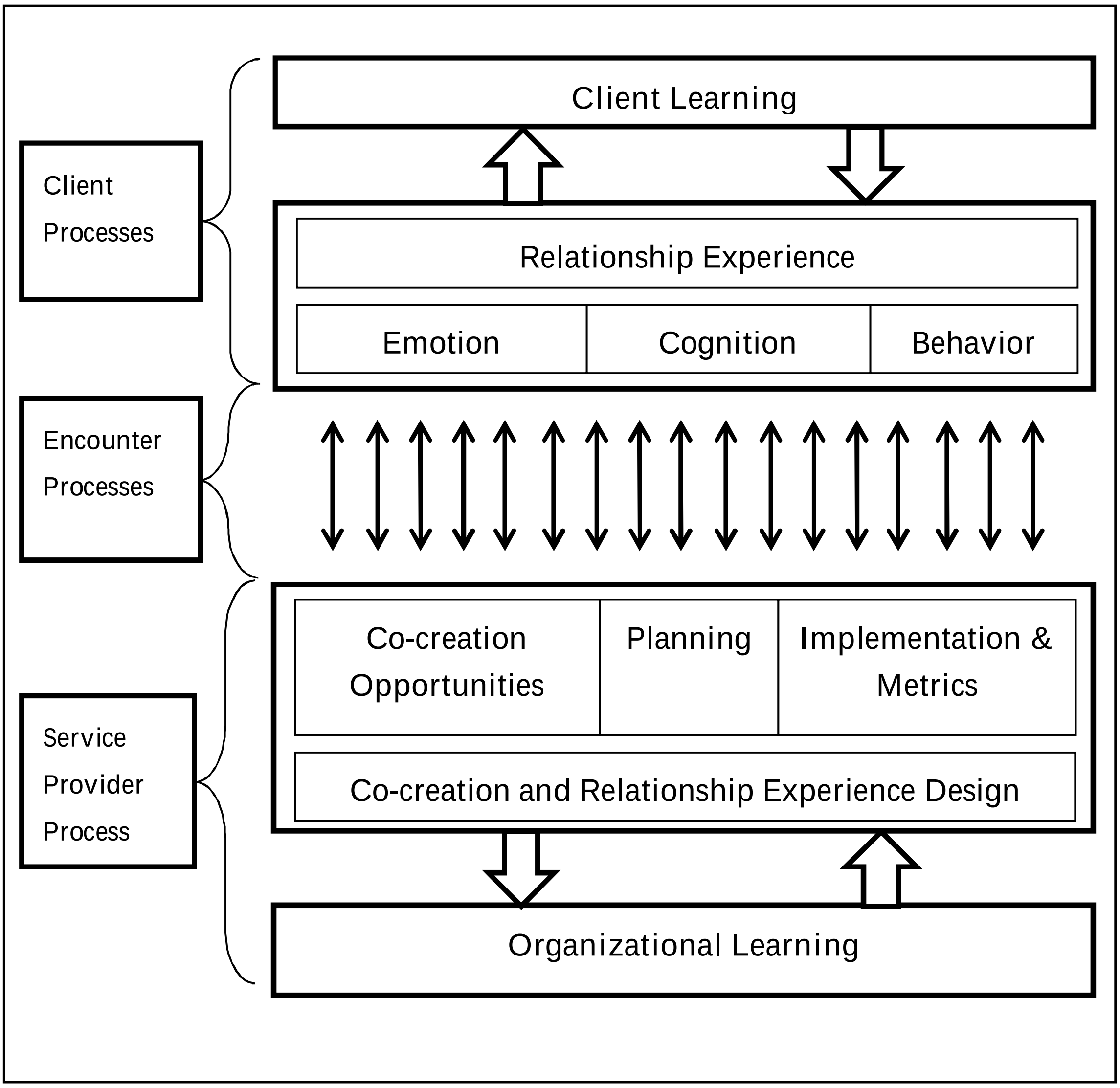

Figure 10: A conceptual framework for value co-creation processes (Payne, Storbacka & Frow 2008, 86)

This framework illustrates an interrelated set of procedures and the recursive nature of co-creation. The arrows in the middle of figure 10 denote varous encounters between the client and the service provider which transpire as outcome of their respective value-creating processes. These arrows pointing to both directions are emphasizing the collaborative nature of encounters.

The arrows between the client processes and client learning specify that the client engages in an education process based on the experience that the client faces during the relationship. This client learning has impact on how the client will involve in future value co-creation activities with the service provider.

Similarly, the arrows between service provider processes and organizational learning designate that as the service provider learns more about the client, more opportunities become accessible for the service provider to further advance the design of the association experience and enhance co-creation with clients. (Payne et al. 2008, 86).

A firm can consider various entities as a client: a customer (payer), a consumer, a competence provider, a controller of quality, a co-producer and/or a co-marketer (Storbacka and Lehtinen 2001). Hence, Normann and Ramirez (1993, 69) argues that "*the key to creating value is to co-produce offerings that mobilize customers*".

As shown in figure 10 above, in the value co-creation process the client's part can be accepted as a sequence of actions performed by the client to accomplish a specific objective. One crucial characteristic of the client's capacity to generate value with the provider is the extent of information, knowledge, skills and other operant resources that they can access and use (Normann 2001).

The second part of the process – the supplier processes, assists co-creation through the design and delivery of relevant resources, skills and professionalism. It involves an assessment of co-creation potentials and designing, analyzing and prototyping value co-creation prospects with clients. It also includes employing client solutions and managing client encounters and developing metrics to measure whether the enterprise is crafting right value propositions (Payne et al. 2008, 88). In the supplier process, establishing relationship with the client itself can also have a key influence on the total value perceived by the client (Ravald and Grönroos 1996), as value is created and delivered over time as the relationship advances (Grönroos 1997).

The encounter process comprises a sequence of reciprocal interactions and transactions occurring between the client and the service provider. Encounters between clients and service providers can be considered as exchange performances, in which the parties involved exchange resources (for example: money, products, work, information, time etc.) as well as collaborative applications in which they jointly perform activities (Payne et al. 2008, 90).

In the value co-creation process, value finally results with the participation of the beneficiary and also determined by the same identity (Holbrook 1987). To summarize it can be stated that a service process to co-create value is an assemblage of resources (For example people, technology, information etc.) combined to other systems by value propositions (Spohrer, Vargo, Caswell & Maglio 2008; Spohrer, Maglio, Bailey & Gruhl 2007). A service process's function to co-create value is to exploit of its own resources and the resources of the client to create the value together (Vargo et al. 2008, 149).