Dynamics of value co-creation in buyer-supplier relationships

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Abstract

This paper investigates how a service-dominant logic of marketing impacts on the interrelationships between value proposition, value-in-use, and customer perceived value in a dynamic supplier-buyer relationship. Value propositions have different foci which place more or less emphasis on value-in-use. A framework is presented which provides a basis for better understanding the dynamics of value co-creation in business-to-business relationships.

Introduction

In academic literature and business practice, increased attention is directed to the importance of value creation in buyer-supplier relationships (Cannon and Homburg, 2001). In line with Normann's (2001) and Ramirez's (1999) calls for alternative views of value creation to that associated with manufacturing, Vargo and Lusch (2004) have proposed a service-dominant (S-D) logic of marketing. They embrace an integrative view of marketing in which service is the norm in the exchange process. S-D logic recognizes value creation as a co-production process and thus the customer relationship is seen as a long-term and dynamic process (Vargo and Lusch, 2004). In order to better understand and grasp the dynamic and temporal aspects of value-in-use, the interactions between customer and supplier need to be taken into consideration. Consequently, linking a process framework of inter-organisational relationships (IORs) to the S-D logic can be helpful when discussing value-in-use for buyer and supplier. With the exception of the studies by Ballantyne and Aitken (2007), Flint and Mentzer (2006) and Vargo and Lusch (2008a), the discussions on S-D logic have generally focused on consumers (cf. Kowalkowski, 2008a). However, Woodruff and Flint (2006) call for more research into customer value phenomena linked to S-D logic.

Thus, a deeper understanding of the notion of value is needed, particularly in a B2B context where relationships are dynamic processes that often span over several years or decades. The objective is to investigate the interrelationships between value proposition, value-in-use, and customer perceived value in a dynamic buyer-supplier relationship. Furthermore, an effort is made to link value-in-use to value creation strategies when discussing the S-D logic as a normative foundation for the marketing strategy of the B2B firm.

S-D logic and inter-organisational relationships

In B2B markets, the customer relationship is an interactive process (Ford, 2001) where resource integration and co-production form integral parts of the value proposition (Prahalad and Ramaswamy, 2004). The time horizon and co-production of value-in-use is often long in B2B markets and Ballantyne and Varey (2006) argue that S-D logic makes the time-logic of marketing exchange open-ended, from pre-sale service interaction to post-sale value-in-use. Capital goods such as airplanes, pump stations and turbines are example of goods that, if properly maintained, can have economic lifetimes of several decades. Such conditions make it necessary for suppliers to understand and manage value creation over time. One important characteristic of B2B markets is the long-term IORs that develop between suppliers,
customers and even competitors (Ariño and Reuer, 2004; Doz, 1996). Ring and van de Ven (1994) propose three key issues for the study of the relationship process; (1) negotiations of joint expectations, (2) commitments for future actions, and (3) executions of commitments. The process is circular with renegotiations of expectations followed by steps 2 and 3. Hence, each step reinforces the increase in trust and reduction of risk. At each step, the assessment of the outcome is based on a validation of the efficiency of the outcome and the equity in the distribution in the outcome. To better understand the dynamics of value creation in buyer-supplier relationships, the work on co-productive IORs can be linked to S-D logic. Applying the S-D logic of marketing in B2B markets together with theories of developing IORs, we argue, could provide a possible way to understand the notion of co-created value and how firms can develop a service-oriented approach at the organisational level. By structuring the discussion around four premises of S-D logic (FP3, FP6, FP7, and FP8), which are particularly relevant when examining value creation in a B2B context, this is further explored. The premises were initially presented in Vargo and Lusch's (2004) seminal paper and refined in two follow-up articles (Lusch and Vargo, 2006; Vargo and Lusch, 2008b).

Value-in-use in business-to-business markets

Value from different perspectives

In S-D logic, goods are seen as distribution mechanisms for service provision and the value of goods is perceived and determined by the customer. That is, goods have no intrinsic value and the value of the business exchange for the customer involves the value-in-use of the goods exchanged (Vargo and Lusch 2004). Furthermore, in an analysis of lifecycle costs, the goods often constitute only a minor part of the offerings’ total cost. In this discussion, value is referred to (co-created) value for the customer firm, although the premise is that some of that value is captured by the supplier firm. When discussing value-in-use from the S-D logic perspective, we refer to the customer’s value-creation processes and consequently, to customer perceived value. Customer perceived value is the differential between value-in-use and cost. Focusing on maximising value-in-use implies that the supplier changes the focus of the value proposition from whether the equipment works (efficacy) to the equipment’s efficiency and effectiveness within the customer’s business processes during its complete lifecycle (Kowalkowski, 2008a). Just as financial feedback in the form of monetary flows is critical for the firm (Vargo and Lusch, 2006), so is the ability to convert value-in-use to monetary terms (Anderson and Narus; 1998). Thus, the supplier must facilitate the customer’s assessing of the worth of the value proposition in monetary terms. Nevertheless, one must also recognise the cognitive judgment of contingent values by the individuals in the buying centre and that not all managed values can be measured or monetised (cf. Ramirez, 1999). For instance, the buyer can be influenced through personal buyer-seller bonds and other means in which the decision taken is not necessarily based on monetised value-in-use only. Besides, during periods of discontinuity and when new, innovative value propositions are offered, it can be very difficult to estimate a priori the accurate measured, monetised value for the complete product lifecycle and/or contractual agreement. Therefore, aspects such as risk and trust are critical during the negotiation of joint buyer-supplier expectations.

Changing value

According to S-D logic, the firm cannot create and/or deliver value independently, but can only offer value propositions and collaboratively create value after the customer’s acceptance of the value proposition (Vargo and Lusch 2004; 2008b). Essentially, value propositions are
promises to perform (Ballantyne and Aitken, 2007). However, there are several ways in which this value can be created and these are to various degrees consistent with S-D logic. The firm can both reduce the costs for providing the offering (internal efficiency) and increase revenues by injecting higher value into the customer’s value-creating processes (external effectiveness) (cf. Anderson et al., 1997). When discussing value creation, Wikström and Normann (1994) refer to these two dimensions as cost efficiency and market efficiency. Market efficiency can be achieved by either relieving the customer (i.e. reducing costs for the customer) or enabling the customer (i.e. increasing customer business performance) (Ravald and Grönroos, 1996). As Ballantyne and Varey (2006) argue, value propositions are reciprocal promises of value. This two-way, equitable exchange can involve a customer and a supplier exchanging monetary resources for a good, as well as a complex project spanning several years and involving a multifaceted network of parties and business relationships. Although the focus might be on one of the value creation strategies, value propositions will generally have an effect on more than one of the value dimensions due to their interconnectedness. Because both parties should benefit from a closer relationship (Morgan and Hunt, 1994) as relationship-specific knowledge facilitate new solutions to marketing and supply problems (Ballantyne, 2004), mutual value should continuously increase over time as the relationship becomes stronger (Anderson et al., 1994). Hence, temporal aspects have to be taken into account when looking at value propositions and assessments which are based on efficiency and equity. In line with Ring and van de Ven (1994), we define equity as "fair dealing", which does not require that an exchange have to give equal value to each party.

Although all three foci of value propositions in Figure 1 (i.e. enabling, relieving and internal efficiency) are critical to various degrees depending on context, market efficiency and particularly the ability to enable the customer to enhance its value-creating activities are inherently linked to S-D logic. Higher market efficiency increases the customer perceived value and by enabling the customer, the value-in-use increases and the value potential is thereby realised. Such value propositions, which focus on efficiency and effectiveness within the customer’s business processes, are particularly consistent with S-D logic. They often imply customised service provision in the form of an integration of knowledge and skills in a complex network of relationships (Sawhney, 2006; Tuli et al., 2007). However, the focus of successful value propositions can be contingent to a high degree on the type of industry and the customer base (Payne et al., 2008), which means that different marketing practices may coexist (Palmer et al., 2006).

**Value distribution**

Since value creation is interactional, the customer is primarily a co-creator rather than a "target" (Vargo and Lusch, 2004). Furthermore, the price that the supplier receives for his offerings (i.e., value-in-exchange) is essentially a co-produced signal (Lusch et al., 2006, p. 274). In a dynamic IOR, values and costs for the customer and the supplier vary over time. Figure 1 describes the temporal development of value and exchange over the life-time of the IOR. The point in time t0 in Figure 1 represents the start of the third step in the IOR process, i.e. when the executions start after a period of negotiations of expectations and commitments for future actions (cf. Ring and van de Ven, 1994). From this point onwards, the costs for the supplier and customer, as well as the value-in-use and thereby customer perceived value, will vary. Although the price stated in the contract might be fixed, relationship costs, equipment uptime and downtime, and other factors influence the total cost for all parties. The "cost for customer" in Figure 1 is the total cost for the customer at a particular point in time and not only the unit price (value-in-exchange). Further, the customer periodically makes value judgments about desired and perceived value, which are subject to change (Woodruff and
Flint, 2006). As the process is circular, re-negotiations take place, and the parties commit through formal and psychological contracts before the new agreement is executed in t1. At this point, the relationship is either further developed or terminated. If further developed, the S-D logic perspective offers the possibility of an untapped, co-created value potential.

![Diagram of Value-in-use in the inter-organisational relationship process](image)

Figure 1. Value-in-use in the inter-organisational relationship process

For instance, a value proposition that enables increased flexibility or economies of scale through better capacity utilisation can have higher value-creation potential. There can be potential value which is not realised, due to suboptimal performance, insufficient value proposition, inadequate products, deficient service processes or infrastructure, lack of supplier and/or customer knowledge, etc. For example, value co-creation opportunities can be discovered by the supplier ‘teaching’ the customer certain co-creation behaviours (Payne et al., 2008). In addition, new technology can bring opportunities for new enhanced offerings and better customer solutions. If a holistic, systemic approach to value creation is taken, value-in-use will increase and the gap between value-in-use and value potential will thus decrease. The additional value potential that emanates from the IOR process implies that the value-in-use can increase after the new contract which takes this potential value into consideration is in place in t1. Likewise, after yet another negotiation and commitment process, there should be a possibility to increase value-in-use during the execution process starting in t2.

**Managing valuation**

The S-D logic is a time-based theory of marketing in which the buyer-supplier relationship can be seen as structural support for the value creation process (Ballantyne and Varey, 2006; Ballantyne and Aitken, 2007) and in which relationships are not seen as being selected, but are developed (cf. Hunt, 1997). This relationship development involves continuous assessment based on efficiency and equity through personal and role interactions (Ring and van de Ven, 1994) and "[e]ven rather discrete transactions come with social, if not legal, contracts … and implied, if not expressed, warranties" (Vargo and Lusch, 2004, p. 12). Ballantyne and Varey (2006) develop this idea further when arguing that relationships are always present wherever there is an interaction between actors. Thus, rather than randomly targeting customers, the supplier should invest in relationship development based not only on
the customer’s expressed and latent needs, but also on the potential of the relationship for financial feedback and on the basis of the customer’s demand abilities (Ford, 2001). Value propositions need to reflect the length and history of the particular relationship as well as the needs of different customer segments. Communication with new customers may differ considerably from communication with long-term customers who are familiar with the supplier (Johnson and Selnes, 2004; Payne et al., 2008). Hence, the success of value propositions and marketing strategies depend also on the customer.

If the customer has a long-term, relational orientation towards suppliers, the conditions for a supplier to successfully conduct a value-creating marketing strategy based on S-D logic are more favourable. This may be obvious, but a possible reason why Vargo and Lusch have not emphasised this is that the S-D logic, implicitly, is consumer focussed. Even if the value-in-use for the customer (i.e. an organisational entity) in an IOR can increase by an S-D strategy being adopted, buyers and other decision makers in the customer firm act within certain boundaries, are allocated more or less resources, and need to subject to the firm’s strategies. If the benefits for individuals within the customer firm are ‘measured’ and rewarded according to specific short-term metrics and results, there may be little incentive to adapt a radically different behaviour. Therefore, the supplier should proactively try to have an influence on customer strategies by e.g. convincing the customer that a more holistic approach, such as a focus on lifecycle costs, will result in a more optimal solution where value-in-use is created through a reduced and better utilised installed base (Kowalkowski, 2008b). Nevertheless, it also requires that the customer is committed (has an intent and a will) to invest relationship costs (time and money) in the IOR. This mutual commitment then is manifested in both formal legal and psychological contracts (cf. Ring and van de Ven, 1994). Working closely with the customer to create value and to develop the relationship, means that the supplier better understands the customer’s needs and objectives with the cooperation. Not all customers are necessarily interested in primarily increasing value-in-use and even if they are, they may be restrained by e.g. poor finances. For example, if the customer does not want to be proactively involved in a non-core/non-strategic production process and therefore chooses to outsource these activities mainly in order to reduce cost, the focus of the value proposition should be to relieve, rather than to enable, the customer.

Conclusions

For the purpose of this paper, the Ring and van de Ven (1994) IOR model is linked to four of the foundational premises of the S-D logic proposed by Vargo and Lusch (2004). Synthesised, the theories can provide a better understanding of the dynamics of value co-creation in buyer-supplier relationships. The framework (Figure 1) provides a more thorough understanding of the executions of commitments through personal and role interactions in the time-based, continuous relationship, with a focus on value-in-use. It addresses the notion that value is system dependent and that opportunities for increasing the value potential may arise during the IOR process. The framework also illustrates that when managing value co-creation, not only value-in-use but also equitable exchange and customer perceived value are critical aspects to take account of. Furthermore, the value-in-use concept is linked to marketing strategy. Depending on the firm’s marketing strategies, value propositions have different foci with more or less emphasis on value-in-use. When taking a co-productive stance on value creation, customer effectiveness becomes as much of a supplier worry as internal effectiveness (cf. Ramirez, 1999). Therefore, it is vital to understand and develop the dynamic IOR process in order to make successful value propositions, particularly when the focus is on increasing customer business performance (i.e. enabling the customer).
References


