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## **The Risk of Service Ineffectiveness due to Value Co-Creation**

Service companies (firms) are hired because they own a particular expertise in their field to solve a customer's problem. To do so they do not act autonomously, but rely on the involvement of their customers for a successful service result. For example, advertising agencies need to arrange communication strategies with their clients, business consultants need to uncover and discuss problems with their customers, event agencies need to gather information from their clients. Literature refers to that process as co-production of value. One important paradigm and research stream that considers this phenomenon is Service-Dominant-Logic (SDL) introduced by Vargo and Lusch (2004). SDL points out the combination of resources of firms and customers as inputs to service systems in order to achieve more effective resource applications for more effective results. This view acknowledges the opportunities for actors when working collaboratively to gain an effective output. However, in practice there are phenomena in which firms and customers do not co-create altruistically, but where opportunism plays a role. In this case, the value co-creation may lead to ineffective results. To shed light on the risks of ineffectiveness due to co-creation, the process of co-creation itself needs to be analyzed. For this reason, we refer to agency theory in order to analyze the behavior of the parties involved in value production and focus on the imbalance of decision power and opportunism as possible sources of ineffectiveness.

## **The Rise of Services and the SDL-Emphasis on Co-Creation**

In general, companies have two options to gain value. They can either 'make' or 'buy' some kind of value (Platts et al. 2002). Statistics show that the proportion of bought services by industrial companies is constantly growing in industrial nations, e.g. USA, European Union, Japan. This indicates a massive structural change from the sectors

of agriculture and industry to (industrial) services (Feinstein 1999). The rise of (industrial) services and with it the opportunity for co-creation can be explained by economic reasons. Specialized firms who provide services with low costs and high quality help customers to keep pace with competitors and cost pressure on the market. Hence, companies increasingly switch from 'make' to 'buy' and engage in transactions or relationships with service firms. Together, value is co-created more effectively and more efficient, however, having (at least) two parties involved may also offer room for opportunistic behavior of one party. SDL rather discounts the latter, but focuses on the positive aspects of co-creation. It votes for a paradigm shift in marketing from a 'goods-dominant logic' (GDL) to a 'service-dominant logic'. This view emphasizes the collaborative nature of value creation (Vargo 2008, Vargo/Lusch 2004), i.e. value creation needs customer involvement in order to gain a customer-determined and co-created benefit. As a part of co-creation the term 'co-production' describes customer participation in the development of the core offering or the creation of firm output (Vargo/Lusch 2006). In contrast to GDL which concentrates on increasing a firm's production-efficiency when unilaterally creating value, SDL points out the customer as a co-creator of value. The customer is seen as an operant resource that actively participates in the value creation process (Vargo/Lusch 2004), which increases the effectiveness of results. Firms (only) offer value propositions to their customers. Their activity is input for the customer's resource-integrating, value-creating activities.

### **Imbalance of Decision Power and Opportunism as Threats to Co-Creation**

This research project aims at elaborating possible risks of co-creation. We believe that an imbalance of decision power between customer and firm and opportunistic behavior may undermine the effectiveness of outcomes. It is proposed that first,

compared to customers, firms own a higher amount of expertise in offering particular value propositions. Otherwise a customer would not engage in an exchange. However, co-creation stresses the integration of resources of both the firm and the customer in the value creation. Hence, a customer of a service-centred firm will integrate its resources in the process despite of lower expertise regarding the demanded benefit. Second, it is assumed that the customer holds more decision power than the firm in the co-creation process. The imbalance of decision power becomes apparent in two stages of the customer-firm-encounter. Before a co-creation process takes place a customer can usually choose from a selection of firms' offerings. A firm's value proposition competes against those of other firms and needs to be accepted by the customer. In the stage of the co-creation process the final decision competence regarding the co-created result should again be with the customer. Regarding the examples in the introduction it is the customer who has the final word about the implementation of a communication strategy, of a consultant's advice, or of an event. Thus, the result of the firm's input in the co-creation-process is always dependent on the decision of the customer. If a customer uses his/her decision power to vote against a firm's propositions in the co-creation process the effectiveness of the co-created result should be reduced. Decisions against a firm's propositions can result from perceptual biases on the customer's side. Perceptual biases are a social-psychological phenomenon and can guide behavior (e.g. Nickerson 1999, Paul et al. 2000). For example, a customer may perceive to have a higher expertise compared to the firm despite a lack of objective knowledge. Biased perceptions can be based on a feeling of being more closely connected to own consumers, having more industry experience, or being more involved in a particular problem compared to a firm. As the customer holds decision power he/she can

undermine a firm's expertise which may lead to ineffectiveness in the process of co-creation.

In general, one would expect a firm to veto in this kind of situation. A firm should be interested in the best co-created result to foster customer satisfaction and reputation. However, we refer to agency theory in order to explain why a firm would nonetheless accept this behavior. Agency theory focuses on situations in which one actor (the principal) depends on the cooperation of a second (the agent) and in which the agent has an information advantage (Kleinaltenkamp/Jacob 2002). Usually, the firm is referred to as agent and the customer as principal when the results of the co-creation process are considered (Haase/Kleinaltenkamp 2008).

The agency theory offers some assumptions about the individual behavior of economic actors which may explain why a firm would accept a customer to undermine its competence despite of better knowledge: individual profit maximization, bounded rationality of actors, and agent's opportunism (e.g. Ross 1973, Simon 1957, Jensen/Meckling 1976). Here we focus on the outcome of opportunistic behavior of a firm; however we also assume the willingness of profit maximization and bounded rationality to be present.

Opportunism is defined as 'self-interest seeking with guile' (Williamson 1975, p. 6) where guile is characterized as 'lying, stealing, cheating, and calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse' (Williamson 1985, p. 47). Wathne and Heide (2000) distinguish between two general forms of opportunistic behavior in interfirm-relationships: active and passive. Both categories may affect wealth creation and distribution, but differ in their mechanisms. Active opportunism means that explicit or implicit rules are violated or in the case of changing circumstances, concessions are extracted. Passive opportunism takes the forms of shirking, evasion of obligations, inflexibility, or refusal to adapt. Opportunistic

behavior can occur under any circumstances (Masten 1988), however there are situations that are particularly vulnerable to opportunism: information asymmetry regarding a party's attributes or actions and (2) a lock-in condition (Wathne/Heide 2000). Information asymmetry describes a mismatch of expertise between two parties that results in one party's limited ability to detect opportunism (Kirmani and Rao 2000). This allows the exchange partner to engage in opportunistic behavior with only a low probability of detection. In a lock-in situation, a party cannot leave a relationship without losses and hence is forced to accept opportunistic behaviour.

In terms of the agency theory, if a firm (agent) is interested in a long-term relationship with a customer (principal) it is assumed that a firm accepts decisions of the customer against better knowledge. A firm may even withhold expert information in the co-creation process in order to please the customer. In this case, a firm can exploit information asymmetry and engage in passive opportunistic behavior which goes along with the risk of restricted value creation.

These thoughts lead to the following research question:

### **Research Question**

*How does the imbalance of decision power between a firm and its customer and opportunism of a firm in a value co-creation process affect the effectiveness of the value creation result?*

### **Research Area: The Advertising Agency-Client-Co-Creation**

In this research project the co-creation process between ad agencies (firm) and their client companies (customer) is analyzed in order to explore risks of ineffectiveness. An ad agency is a professional service of external, independent experts who co-create a value with a customer to solve a particular communication problem. It is

assumed that firms have a higher expertise regarding the development of advertising communication. On the other hand, customers are expected to have a lower objective expertise, but to overestimate their competencies on advertising communication regarding their products. In particular, they may hold perceptual biases (bounded rationality) when assessing the characteristics of their consumers, e.g. overestimating their product involvement (Assael 2004, Solomon et al. 2002). In the process of developing advertising campaigns, these biases can negatively affect the quality of the customer's co-creation input. Additionally, as the customer is likely to have the power to decide about the final advertising design, the firm's expertise may be voted down. If a firm wants to maximize profits and establish a relation with the customer it may accept the customer's propositions to avoid tension in the relationship. This can be regarded as opportunistic behavior as expert knowledge, e.g. on the success factors of advertising, is withheld. This may restrict the effectiveness of service results.

## **Methodology**

In order to analyze the research question, first, data is needed to model the co-creation process. 20 semi-structured interviews will be conducted with practitioners (marketing practitioners in companies and in advertising agencies) regarding how much both sides influence the ad creation process and who finally decides about the design of ads. The interviews shall result in developing a Service Blueprint, which is used to depict service processes between firms and customers (Shostak 1982, 1987, Kingman-Brundage 1989, 1995). The interactions between firms and customers are mapped along the 'line of interaction'. These interactions will be the focus of the interviews to explore who makes decisions (firm or customer), if value propositions (ad drafts/concepts) are changed by the customer, and which criteria are used by the

customer to make these decisions. Second, to uncover different levels of expertise in marketing communication between firms and customers as well as the presence and effects of perceptual biases three online-experiments are planned.

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