

Competing through service: Insights from service-dominant logic

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Abstract

Service-dominant logic (S-D logic) is contrasted with goods-dominant (G-D) logic to provide a framework for thinking more clearly about the concept of service and its role in exchange and competition. Then, relying upon the nine foundational premises of S-D logic [Vargo, Stephen L. and Robert F. Lusch (2004). "Evolving to a New Dominant Logic for Marketing," *Journal of Marketing*, 68 (January) 1–17; Lusch, Robert F. and Stephen L. Vargo (2006). "Service-Dominant Logic as a Foundation for Building a General Theory," in *The Service-Dominant Logic of Marketing: Dialog, Debate and Directions*. Robert F. Lusch and Stephen L. Vargo (eds.), Armonk, NY: M.E. Sharpe, 406–420] nine derivative propositions are developed that inform marketers on how to compete through service.

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Introduction

Business scholars and practitioners are aware that competitive advantage can be *enhanced* through service (Karmarkar 2004). It is also clear that there is a link between competitive advantage and superior performance (Barney 1991; Coyne 1985; Day and Wensley 1988; Hunt and Morgan 1995; Porter 1985). Yet, by almost any definition or measure, there is little evidence of significantly increasing service. In fact, it is often argued that service is actually on decline (Oliva and Sterman 2001), at least in the U.S. marketplace. Paradoxically, managers, though motivated to perform and aware of the links among service, competitive advantage, and firm performance, often fail to execute on that knowledge (cf. Bharadwaj et al. 1993). Additionally, academics, though aware of these links, have not sufficiently informed normative theory to adequately assist in that execution.

We submit the problem is that there is not a full and adequate understanding of the concept of "service" and its role

in exchange and competition. Accordingly, our purpose is to advance this understanding by exploring a relatively new conceptual lens (service-dominant logic) through which we can view exchange, markets, enterprises – including, but not limited to retailers – and *competing through service*.

We argue that competing through service is about more than adding value to products. Importantly, it is also more than the collective roles of marketing, strategic business, human resource, information-systems, financial, and operations management to produce and distribute better products. We argue that *effective competing through service* has to do with the entire organization viewing and approaching both itself and the market with a *service-dominant (S-D) logic* (Vargo and Lusch 2004).

S-D logic is based on an understanding of the interwoven fabric of individuals and organizations, brought together into networks and societies, specializing in and exchanging the application of their competences for the applied competences they need for their own well being. It is a logic that is philosophically grounded in a commitment to collaborative processes with customers, partners, and employees; a logic that challenges management at all levels to be of service to all the stakeholders; a logic or perspective that recognizes the firm and its exchange partners who are engaged in the co-creation of value through reciprocal service provision. It

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is about understanding, internalizing, and acting on this logic better rather than the competition.

Clearly the preceding statement is highly compact and laden with meaning that requires elaboration. Consequently, the purpose of this article is to demonstrate how S-D logic can better inform *competing through service*, the major theme of this special issue of the *Journal of Retailing*, than traditional “goods-dominant” (G-D) logic. We approach this purpose, primarily, by contrasting S-D logic with G-D logic. In doing so, we explicitly rely upon the nine foundational premises of S-D logic (Vargo and Lusch 2004, 2006) to develop nine *derivative propositions* that inform marketers on how to compete through service.

A brief review of G-D and S-D logic

Goods-dominant logic views units of output as the central components of exchange. It developed from both a combination of Smith’s (1776) normative work on how to create national wealth through the “production” and export of surplus tangible commodities and the economic philosophers’ desire to make economics a true science at a time when *Newtonian Mechanics* served as the model for the mastery of nature (Vargo and Morgan 2005). Accordingly, modern economic thought embraced objects (matter or goods) as having innate properties (utility) and relationships to other objects, measured in terms of price mechanisms and value-in-exchange. This economic theory became formalized in the mathematics of calculus and differential equations, and economic science became a foundation for financially engineering and optimizing the economy and the firm (Vargo and Lusch 2004).

As marketing emerged in the beginning of the 20th century, it embraced this G-D logic. Before 1960, marketing was seen as transferring ownership of goods and their physical distribution (Savitt 1990) and was viewed as the “application of motion to matter” (Shaw 1912, p. 764). Consequently, one of the early debates centered on the question: if value was something added to goods, did marketing contribute value?

Even after the discipline had purportedly shifted from a “product orientation” to a “consumer orientation”, first through the marketing concept (cf. Barksdale and Darden 1971; McNamara 1972), then through investigating firms’ implementation of such philosophy (e.g., Kohli and Jaworski 1990; Narver and Slater 1990; Webster 1988), the consumer, as well as competition and most other market variables, remained exogenous to value creation. The leading marketing management textbook in the 1970s (Kotler 1972, p. 42, emphasis in original) stated that “marketing management seeks to determine the settings of the company’s *marketing decision variables* that will maximize the company’s objective(s) in the light of the expected behavior of noncontrollable *demand variables*.” In short, competitive advantage was seen to be a function of utility maximization through embedding

value in products by superior manipulation of the Four P’s, with an assumed passive consumer in mind.

The idea that “service” could increase competitive advantage was developed upon this G-D conceptual foundation. Service was considered, almost simultaneously, as both a type of product (i.e., “services”) and something of a fifth “P” (e.g., Booms and Bitner 1981; Christopher et al. 1991), another tool for maximizing the value of other products. Accordingly, while there has been significant attention toward delineating services as special types of products (intangible goods) and as value-adding enhancements to tangible goods, there has been relatively little theoretical progress in understanding “service” as a stand-alone variable and its role as a *primary* focus of exchange. There is of course exception to this subordinate treatment of service in the service literature (see Fisk et al. 1993), especially in the Nordic school (e.g., Gronroos 2002; Gummesson 1993).

S-D logic superordinates service (the *process* of providing benefit) to products (*units of output* that are sometimes used in the process). Service-dominant logic is grounded in nine foundational premises; eight of which were initially elaborated in Vargo and Lusch (2004) and the ninth in Vargo and Lusch (2006). These are reproduced in Table 1.

When formal marketing thought developed in the early 1900s, marketing was about taking goods and services “to market.” In fact, the American Marketing Association initially (mid 1930s) defined marketing as the set of business activities that direct the flow of goods and services from producer to consumer. After World War II, marketing thought in the U.S. moved to a “market to” orientation in which the market and customer were researched and analyzed and then products were produced to meet customer or marketplace needs. However, under this “marketing concept,” the customer was viewed an *operand resource*—a resource to be acted on. That is, a goods-dominant logic remained and the customer was segmented, targeted, promoted to, distributed to, captured, and then enticed to continue to purchase by the seller using heavy promotional programs where transparency was the exception. The underlying notion was *value distribution* (Webster 1992).

In contrast, S-D logic advocates viewing the customer as an operand resource – a resource that is capable of acting on other resources, a collaborative partner who *co-creates value* with the firm (Vargo and Lusch 2004) – and promotes a “market with” philosophy. Fig. 1 depicts the evolution of marketing philosophies.

In S-D logic, collaboration between the firm (and relevant partners) and the customer allows for a strategic orientation that informs the more tactical “Four P’s.” “Products” are viewed in terms of service flows, in which the service is provided directly or indirectly through an object; promotion is reoriented toward conversation and dialog with the customer; price is replaced with a value proposition created by both sides of the exchange; and place is supplanted with value networks and processes (Lusch and Vargo 2006).

Table 1
Summary and rationale of foundational premises

Foundational premise	Rationale
FP1. The application of specialized skills and knowledge is the fundamental unit of exchange	Service – applied knowledge for another party’s benefit – is exchanged for service
FP2. Indirect exchange masks the fundamental unit of exchange	Micro-specialization, organizations, networks, goods, and money obscure the service-for-service nature of exchange
FP3. Goods are distribution mechanisms for service provision	“Activities render service; things render service” (Gummesson 1995)—goods are appliances
FP4. Knowledge is the fundamental source of competitive advantage	Operant resources, especially “know-how,” are the essential component of differentiation
FP5. All economies are service economies	Service is only now becoming more <i>apparent</i> with increased specialization and outsourcing; it has always been what is exchanged
FP6. The customer is always a co-creator of value	There is no value until an offering is used—experience and perception are essential to value determination.
FP7. The enterprise can only make value propositions	Since value is always co-created with and determined by the customer (value-in-use), it cannot be embedded in the manufacturing process
FP8. A service-centered view is customer oriented and relational	Operant resources being used for the benefit of the customer inherently places the customer in the center of value creation and therefore implies relationship
FP9. Organizations exist to integrate and transform micro-specialized competences into complex services that are demanded in the marketplace	The organization exist to serve society and themselves through the integration and application of resources

Source: FP1–FP8, Vargo and Lusch (2004); FP9, Vargo and Lusch (2006).

In addition, the dominant marketing paradigm assumed the external environments (legal, competitive, social, physical, technological, etc.) as largely uncontrollable and forces to which the firm needed to adapt (McCarthy 1960); S-D logic inverts this assumption and views the external environments as resources the firm draws upon for support by overcoming resistances and proactively co-creating these environments.

This can be illustrated by viewing the ecosystem as an operant resource that is an active party in service provision. For example, because of deforestation along the Panama Canal, more sediment and nutrients flow into the canal. These sediments (and nutrients) clog the canal and, in doing so, indirectly stimulate the growth of waterweeds (Economist April 23, 2005). The government could use heavy equipment to dredge the canal to keep it clean. Alternatively, it could simply replant trees to solve the problem. The trees would trap sediments and nutrients and regulate the supply of fresh water. In brief, the forests would serve as a replacement for build-

ing vast reservoirs and filtration beds (Economist April 23, 2005). These service flows of sediment trapping and nutrition can be a substitute for industrially designed products. Further, the remaining external environments, other than physical or ecological, should be viewed as potential sources of opportunities for collaboration to co-create value.

Fig. 2 represents the elements of this strategic vision. In the following sections, we address how the foundational premises (FPs) of S-D logic (Table 1) inform a “compet-

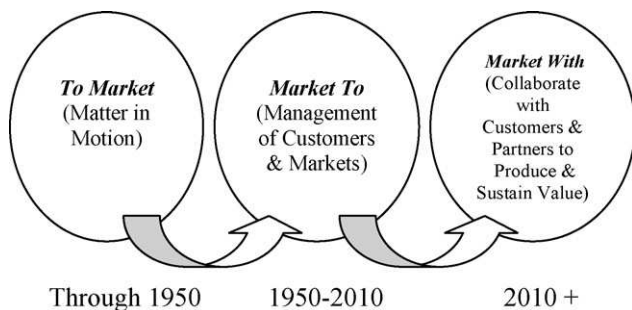


Fig. 1. The evolution of marketing.

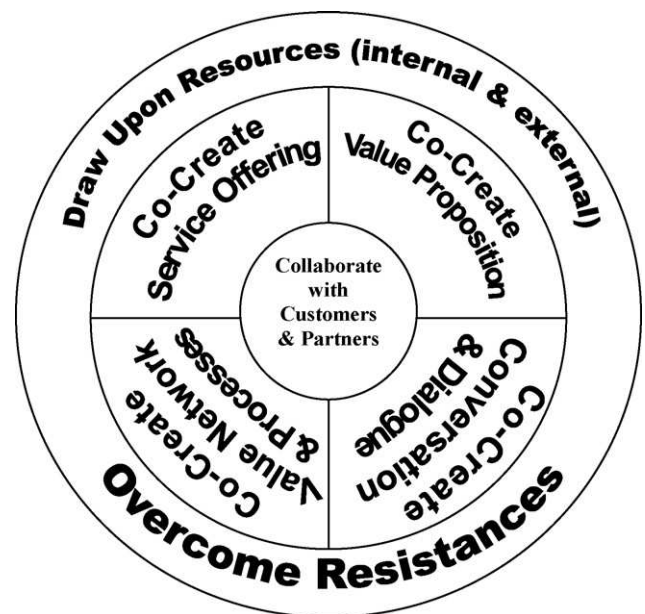


Fig. 2. Service-dominant marketing.

Table 2
Summary and rationale of derivative propositions

Proposition	Rationale
1. Competitive advantage is a function of how one firm applies its operant resources to meet the needs of the customer relative to how another firm applies its operant resources	Since applied operant resources are what are exchanged in the market (FP1), they are the source of competitive advantage (FP4)
2. Collaborative competence is a primary determinant of a firm's acquiring the knowledge for competitive advantage	The ability to integrate (FP9) operant resources (FP4) <i>between</i> organizations increases ability to gain competitive advantage through innovation
3. The continued ascendancy of information technology with associated decrease in communication and computation costs, provides firms opportunities for increased competitive advantage through innovative collaboration	Reduced barriers to technology utilization combined with the trends of open standards, specialization, connectivity, and network ubiquity increase the likelihood of collaboration with firms and customers (FP6, FP8)
4. Firms gain competitive advantage by engaging customers and value network partners in co-creation and co-production activities	Because the customer is always a co-creator of value (FP6), and the firm is a resource integrator (FP9), competitive advantage is enhanced by proactively engaging both customers and value- network partners
5. Understanding how the customer uniquely integrates and experiences service-related resources (both private and public) is a source of competitive advantage through innovation	Since value is co-created (FP6) comprehending how customers combine resources (FP8, FP9) provides insight into competitive advantage
6. Providing service co-production opportunities and resources consistent with the customer's desired level of involvement leads to improved competitive advantage through enhanced customer experience	Expertise, control, physical capital, risk taking, psychic benefits, and economic benefits influence customers' motivation, desire, and amount of participation (FP6, FP9) in service provision through collaboration (FP8)
7. Firms can compete more effectively through the adoption of collaboratively developed, risk-based pricing value propositions	Appropriately shifting the economic risk of either firm or customer through co-created (FP6) value propositions (FP7) increase competitive advantage
8a. The value network member that is the prime integrator is in a stronger competitive position	The ability to effectively combine micro-specialized competences into complex services (FP9) provides knowledge (FP1) for increased competitive advantage (FP4)
8b. The retailer is generally in the best position to become the prime integrator	
9. Firms that treat their employees as operant resources will be able to develop more innovative knowledge and skills and thus gain competitive advantage	Since competitive advantage comes from the knowledge and skills (FP4) of the employees, it can be enhanced by servant leadership and continual renewal

ing through service" strategy differentially from G-D logic and thus allow for the development of nine derivative propositions addressing competing through service. Our overall theme is that applied knowledge and collaboration are the key drivers for firms to more successfully compete through service. To accomplish this, the firm must view external environments, customers, and partners as operant resources (Table 2).

Competing with a service-dominant logic

Service is the basis for competition

The G-D logic of marketing proposes that the tactical manipulation of the 4P's, associated with a (mostly) tangible good, provides the dimensions through which to compete. foundational premise 1 (FP1) of S-D logic counters that it is not products that are the aim of the customer's acquisition, but rather the benefit available through the service of the provider—similarly, Sawhney (2006), in developing a complementary logic, suggests that customers purchase solutions.

It is important to note that we are not arguing that "services" were not incorporated into the G-D logic discussion. They were. However, the traditional G-D logic of competing through "services," viewed services as (1) aids to the production of goods (Converse 1921, p. vi; Fisk et al. 1993), (2) "value-added" activities (Dixon 1990)—things done to and in conjunction with "products," or (3) at best, a particular type (intangible) of product. As a result, attention remained focused on products, units of output—what S-D logic classifies as "*operant resources*" (static, usually tangible, resources that must be acted upon to be useful). In contrast, S-D logic views *service* (a process) as the application of *operant resources* – dynamic resources such as competences (skills and knowledge) that are capable of acting and producing effects in other resources – for the benefit of another party.

Accordingly, S-D logic inverts the role of goods and service by making service superordinant to goods. In S-D logic, service can be provided directly to another entity or network or through goods—appliances, the basis of FP3. Competition, then, is a function of how one firm provides applied operant resources that meet the needs of the customer rela-

tive to another firm providing such applied operant resources. As such, in S-D logic, all competition occurs through service-provision. This has important implications for firms in their attempt to achieve sustainable competitive advantage, both tactically and strategically.

Proposition 1. Competitive advantage is a function of how one firm applies its operant resources to meet the needs of the customer relative to how another firm applies its operant resources.

Knowledge, collaboration, and sustainable competitive advantage

It would be understandable for the reader to anticipate a claim that service is the primary source of competitive advantage. As disquieting as it may be, we argue service *per se* is not the primary source of sustainable competitive advantage. However, neither are goods! As FP4 indicates, the only true source of sustainable competitive advantage is *knowledge*—the operant resources that make the service possible.

S-D logic, grounded in such contemporary work as Hunt's (2000) resource–advantage theory, recognizes that competitive advantage is derived from superior competences. However, this notion of competences as the source of competitive advantage can also be found at least as far back as Smith (1776). What Smith captured in the “division of labor” was not so much about physical work but rather the specialized knowledge and skills behind the work—the *division of competences*. This division of competences via specialization is the basis for exchange.

As competence became more and more specialized, organizations were formed for the internal exchange of micro-specializations that result in macro-specializations. They integrate and transform their resources into higher-order resources with new types of service potential (the basis for FP9 of S-D logic—Vargo and Lusch 2006). These organizations may then exchange with other organizations to form networks that can provide other services.

In this dynamic environment, it is unrealistic for a firm to remain static in their value propositions or offered services; hence, service *innovations* are instrumental. These innovations are dependent upon the collection of competences, which the firm can continually renew, create, integrate, and transform. However, given the integrative nature of service provision, there is one competence that S-D Logic recognizes as pivotal to any firm that wants to have sustained competitive advantage—*collaborative competence*—because it assists in the development of two additional meta-competences that we contend are critical in complex, dynamic, and turbulent environments.

- *Absorptive competence.* The ability of an organization to be able to comprehend from the external environment the important trends and know-how. This will assist in

transforming these external environments into important resources the firm can draw upon for support. Collaborative competency will aid a firm in absorbing new information and knowledge from partners or improve its absorptive competence.

- *Adaptive competence.* The ability of an organization to adjust to changing circumstances. Once again, by developing collaborative competence the entity is able to use its partner firms as mechanisms for adapting to change brought about by complex and turbulent environments and, thus, improve its adaptive competence.

Better collaborative competency, coupled with improved absorptive competence and adaptive competence, can be used by organizations to lower its relative resource cost and enhance its relative value proposition (Hunt 2000). Essentially, lower relative resource costs focuses on efficiency and enhanced relative value focuses on effectiveness. As Hunt implies, the nirvana position is to offer more efficient and effective solutions to the marketplace. S-D logic suggests that the only possible way to realize and maintain this nirvana position is to have superior collaborative competency because it leverages a firm's ability to absorb information and knowledge from the environment, customers, and its value networks and enables firms to adapt to dynamic and complex environments.

Proposition 2. Collaborative competence is a primary determinant of a firm's acquiring the knowledge for competitive advantage.

Collaboration and information technology

Recognizing that what are commonly called the “service revolution” and “information revolution” is the flip side of the same coin, Rust (2004) argues for a better appreciation by marketers of the role of information technology in marketing and business. Information technology, by facilitating the service-integration function, both within the firm and across the entire value-creation network including the customer, has a dramatic effect on the ability of all entities in the value-creation network to collaborate.

S-D logic recognizes technology as bundled, operant resources. New technologies are created by developing new operant resources, finding novel ways to embed operant resources in operand resources and/or finding ways to “liquefy” (Normann 2001) operant resources (i.e., unembed them from operand resources so that they can be employed separately). In reality, these processes usually occur in complementary combinations.

Throughout the Industrial Revolution, we made great strides in embedding operant resources in operand resources—that is, in making goods. These goods function as appliances that allow self-service. Thus, when a person uses an appliance, it is essentially collaborating with the producer of that good and using the knowledge of that producer. From this perspective, perhaps ironically, goods often

play a central role in S-D logic. What we are witnessing today, often referred to as the “Information Revolution,” is the creation, unembedding, and refinement of specialized operant resources that can be exchanged relatively independently of operand resources—pure information (Normann and Ramirez 1993).

We are also witnessing the decline in unit or variable information processing costs (i.e., computation and communication) to the point where they are approaching zero. This is partly because of the rapid increase in the speed of computation, storage, and input/output capability. In less than 35 years, microprocessor calculation ability has increased from 60,000 instruction/s to over 10 billion; storage has grown exponentially—for instance, handheld iPods have 40 gigabytes of storage (and selling for a few hundred dollars), multiples of the storage of million dollar mainframe computers 20 years ago; and comparable strides in input/output capability can be illustrated by single fiber optic strands able to carry close to 1Tb/s (Friedman 2005). However, while unit costs have declined dramatically, the total costs of IT have actually grown in some cases, at least from the user’s perspective. This is because increased computational abilities resulting from the decreased unit costs (i.e., remote sensing, climate controlled facilities, work from home, etc.) often result in the inability of the user to sort through, filter, and use efficiently the information that is created (cf. Mick and Fournier 1998 for other, similar technological paradoxes experienced by the consumer).

Despite this often unintended increase in total costs associated with the information revolution, it appears that as unit computation and communication costs approach zero, more and more entities will be connected and collaboration will become increasingly feasible. Not only could the increased connections and collaborations be with employees and suppliers but also with customers. Because of this increased collaboration, the innovation that is unleashed could be unprecedented. We believe four factors are driving this trend.

Open standards. Contemporary thought is that open standards are relatively new and best illustrated with the open source code of LINUX. However, more abstractly, open standards deal with co-production and collaboration. Arguably, the first effort at open-standards was language itself. Language allows entities to develop and share rules. The consequence of open standards is that information is increasingly symmetric versus asymmetric as more and more information and experiences are shared. As a result, collaboration becomes the norm and innovation is stimulated.

Specialization. As individuals, organizations, and nations become more specialized they need others for what they themselves cannot do. Thus, more and more specialization leads to larger and larger markets. The consequence of intense specialization is increased interdependency among all entities that stimulates more collaboration that, in turn, stimulates innovation.

Connectivity. For hundreds of years buyers have not had much knowledge of what sellers had, and sellers had little knowledge of what buyers demanded. When both had this knowledge, there were often substantial geographic gaps between entities that could only be overcome by heavy reliance on transporting tangible things at high costs and great time delays. Connectivity makes the market system much more timely and quick in responding to changes in demand and supply. The market then becomes highly flexible.

Network ubiquity. The final force that has created an inflection point in the movement toward collaboration is network ubiquity. Increasingly, everyone and everything is connected to each other and each thing. Network ubiquity accelerates the consequences of open standards, specialization, and connectivity. The consequences are higher collaboration and more innovation.

Because of the convergence of these trends, it is logical that all entities (individuals, organizations, and households) will continue to look for ways to transform everything they do using information technology. As a starting point for dealing with this transformation, the mapping of processes consisting of all activities and tasks within and between entities (firm, households, etc.) that are involved in the co-production of service(s) should be undertaken. The goal is to discover ways to use information technology to take waste (usually time or effort) out of the value-creation process, redesign the system to eliminate points of service failure, and/or add valuable experiences to the service-provision process.

This mapping of activities that are involved in the co-production of service can be accomplished with a variety of techniques, often referred to as process mapping, service-blueprinting, or activity mapping (Shostack 1984, 1987; George and Gibson 1991; Kingman-Brundage 1989). All are based on industrial engineering flowcharting. However, in all cases, the focus is on the mapping of processes and *service flows*, rather than merely a task, activity, or function as it relates to a unit of output. For example, it is recognized that customer service problems are not the fault of the customer service department (the department charged with fixing the problem) but that the problem is deeply rooted in a more general process failure. As Shostack (1987, p. 35) suggests, services “must be viewed as interdependent, interactive systems, not as disconnected pieces and parts.” Unfortunately, most enterprises, including retail organizations, are organized to manage compartmentalized tasks and activities and, thus, when a problem occurs the focus is on the local concern and not on fixing the systemic problem.

Service blueprinting, as practiced today, also focuses on processes in the firm as it interacts with customers. A typical service blueprint breaks out four components; customer actions, onstage contact employee actions, backstage contact employee actions, and support processes (Zeithaml et al. 2006). The flowchart or map might use the horizontal axis to represent time and the vertical axis to model these

four components and their subcomponents. Importantly, S-D logic suggests going a step further by mapping the customer's role in value co-creation. This is because value-in-use and the service experiences are central to S-D logic. CRM software could evolve to CEM (customer experience management) software in recognition of the central role of customer experiences.

In summary, information technology is a pivotal force in enabling more collaboration and consequently innovation throughout the entire value network. Hence, our third proposition:

Proposition 3. The continued ascendance of information technology with associated decrease in communication and computation costs, provides firms opportunities for increased competitive advantage through innovative collaboration.

Collaboration: co-production and the co-creation of value

The concept that the customer is always a collaborator is both a foundational premise (FP6) of S-D logic and a popular focus in the contemporary marketing literature (e.g., Bendapudi and Leone 2003; Prahalad and Ramaswamy 2004). However, it is often not recognized that there are two components of collaboration. The most encompassing of these components is the *co-creation of value*. The concept of co-creation of value represents a rather drastic departure from G-D logic, which views value as something that is added to products in the production process. S-D logic, however, argues that value can only be determined by the user in the “consumption” process. Thus, it occurs at the intersection of the offerer, the customer – either in direct interaction or mediated by a good as indicated in FP3 – and other value-creation partners. Therefore, the idea of co-creation of value is closely tied to “value-in-use” and is inherently relational. It is also highly related to the concept of customer experience (Pine and Gilmore 1999; Smith and Wheeler 2002) and also incorporated as a key element of perceived value in Parasuraman and Grewal's (2000) model of the quality–value–loyalty chain.

The second component of co-production involves the participation in the creation of the core offering itself, and therefore, probably more appropriately (than value-co-creation) referred to as “co-production.” It can occur through shared inventiveness, co-design, or shared production and can occur with customers and any other partners in the value network. Common examples can be a person assembling Ikea furniture, a person advising their hairstylists during the hair styling process, and a retailer and a manufacturer co-producing a retail marketing program. Co-production, like co-creation, is also related to the emerging concept of customer experience.

Because both the “co-creation of value” and “co-production” treat the consumer as endogenous, they are different from the production concepts associated with G-D

logic. Clearly, they are also nested concepts with the former superordinate to the latter in the same way, and with similar implications, as the relationship between service and goods in S-D logic. Traditionally, most marketers and consumer researchers have focused upon buyer behavior related to the product and the transaction, and thus focused on only a subset of co-production (for a good review of relevant literature on customer participation see Bendapudi and Leone 2003). However, if, as S-D logic suggests, value is co-created, it is necessary to shift the focus to relationship formation and consumption behavior. It also implies that co-creation and co-production occur not only between the firm and the customer but also involves other parties (value-network partners), and implies that *resource integration* is a primary function of the firm (Vargo and Lusch 2006). We offer the following proposition and expand upon each of these insights in the following discussions.

Proposition 4. Firms gain competitive advantage by engaging customers and value network partners in co-creation and co-production activities.

Co-creation of value

One opportunity for organizations to compete through service is to identify innovative ways of co-creating value. Interactivity and doing things with the customer versus doing things to the customer is a hallmark of S-D logic. Goods may be instrumental in relationships, but they are not parties to the relationship; inanimate items of exchange cannot have relationships (Vargo and Lusch 2004). Consequently, S-D logic places a high priority on understanding customer experiences over time.

For example, recognizing the importance of the use of a good to obtain value, Porsche places a strong emphasis on co-creating value through their Porsche Clubs. With over 500 Porsche Clubs worldwide and 100,000 members, Porsche actively facilitates interaction by having a portion of their marketing department dedicated to club coordination. The Porsche Club of America provides many different activities for their membership, as can be seen in this excerpt from Porsche's (2005) website:

Membership in the Porsche Club of America is open to any Porsche owner 18 years of age or older. Activities range from rallies, autocross and tours to club racing, drivers' education, restoration and technical sessions. In addition, the club holds an annual convention unlike any other: the Porsche Parade, a weeklong gathering held in a different city each year. And, as club members often say, “It's not just the cars, it's the people.”

As parties specialize, they need to rely increasingly upon other entities for value co-creation—that is, they draw increasingly upon and are dependent on the resources of others. Some of these other resources are private and some public. For example, if one purchases an automobile but also

has access to well-built highways, public parks, enforced traffic laws, and so forth, then, over time, one obtains a different service experience than if these public resources were not present. Similarly, if one purchases an automobile and has access to a garage to keep the auto clean and in good condition the experience of using the auto is again altered. In short, the resources that are endogenous to value creation often include those traditionally categorized as belonging to the uncontrollable, “external” environment. This also suggests that the customer is a primary integrator of resources in the creation of value through service experiences that are interwoven with life experiences to enhance quality of life.

Proposition 5. Understanding how the customer uniquely integrates and experiences service-related resources (both private and public) is a source of competitive advantage through innovation.

Co-production of the service offering

Generally, customers are increasingly becoming involved in the co-production of many services (Bendapudi and Leone 2003). For example, compare the service of today’s supermarket in relation to that of the small corner grocer of 100 years ago. The corner grocer of yesterday would take the order, pick the groceries from the store or behind the counter, wrap and package the groceries, deliver the merchandise, and provide credit service. Today customers enter the store and navigate it without assistance, choose the merchandise they desire, move through a self check-out counter where they scan their own merchandise, pay electronically, bag their own groceries, transport the items to their car, and then drive home, unload, and stock their pantry. As this example illustrates, co-production is not new to retailing, but in a large part characterizes the historical evolution of retailing. It also illustrates that the retailer has considerable control and influence over customer experiences and thus should be a vital participant in the management, or as S-D logic states, in the co-creation and co-production of customer experiences.

Based upon the work of Lusch et al. (1992), we posit six key factors that contribute to the extent to which the customer is an active participant in the co-production of a service offering. Retailers and other organizations in order to develop innovative service strategies can use each factor.

1. **Expertise.** *An individual is more likely to participate in co-production if s/he has the requisite expertise (i.e., operant resources).* Recognizing this, Home Depot and Lowe’s offer do-it-yourself (DIY) clinics to teach people such skills. It then offers to sell the tangible products needed to complete these projects.
2. **Control.** *Co-production is more common when a person wants to exercise control over either the process or outcome of the service.* For instance, many households are practicing home schooling their children because they

want to have more control over the educational process and outcomes, providing an opportunity for firms to provide the needs to complete these activities, such as educational software.

3. **Physical capital.** *Co-production is more likely if the party has the requisite physical capital.* For example, for auto or home repair this might involve needed tools, space or both. Retailers such as Taylor Rental or U-Haul can provide some of the needed physical capital.
4. **Risk taking.** *Co-production involves physical, psychological, and/or social risk-taking.* This does not imply that risks are necessarily increased with co-production, since co-production can also reduce risks. For instance, most Western medicines use a goods-dominant logic where the patient is someone that is passive and something is done to him or her in order to cure him or her. However, if the person becomes involved in managing their health and wellness, then the risks of poor health may decline.
5. **Psychic benefits.** *One of the primary reasons people engage in co-production is for pure enjoyment—the psychic (experiential) benefits.* Activities like home gardening, gourmet cooking, personal fitness training, education, or learning a new skill, are all heavily service intense and are engaged in for psychic benefits. For example, Build-A-Bear is a retailer that allows customers to build a customized stuffed animal, which becomes a rewarding experience.
6. **Economic benefits.** *Perceived economic benefits plays a central role in co-production.* Many people participate in co-production because it is a good use of their time. In fact, it can be argued that the rise of self-service retailing, from gasoline stations to mass merchandisers, is primarily driven by the economic benefits. Importantly, value that is created through co-production is tax-free.

The preceding six factors speak not only of the motivations behind the customer’s desire to be involved in co-production, but can also be used to help determine *how much* the customer wants to be part of service operations (Lusch et al. 1992). Furthermore, a firm may decide that it needs to provide certain services that may help the customer be part of service operations. These factors also are the source of many customer contacts or touch points, which form the basis of managing customer experiences (Smith and Wheeler 2002; Schmitt 2003). Thus, firms should consider mapping the entire experience process that is associated with its offerings to include the customer’s level of involvement in co-production activities and processes. This mapping can be the basis for the customer-experience management framework suggested by Schmitt (2003), which includes: (1) analyzing the experiential world of the customer, (2) building the experiential platform, (3) designing the brand experience, (4) structuring the customer interface, and (5) engaging in continuous innovation (Schmitt 2003, p. 25).

Proposition 6. Providing service co-production opportunities and resources consistent with the customer's desired level of involvement leads to improved competitive advantage through enhanced customer experience.

Co-production, co-creation, and pricing

Only casual observation of the American retail landscape is needed to see the pervasive presence of price competition, especially with the lowering of search costs via the Internet (Alba et al. 1997; Bakos 1997; Gourville and Moon 2004; Lynch and Ariely 2000). Does S-D logic provide any insights for retailers and others on how to more effectively compete on the price dimension? This is important because only through lower costs or enhanced revenues can a firm improve its *financial* performance. We know analytically that price per unit multiplied by units sold equal revenue. One could argue that if superior service strategies are to yield improved financial returns, then customers should be willing to pay a higher price per unit of service or to purchase more service. While logically correct, this does not inform the marketer about *how* to achieve better financial returns through superior service strategies. Importantly, S-D logic provides the conceptual tools that can offer insight into the “how” issue.

While it is generally understood that organizations should proactively link co-production and pricing strategies, S-D logic implies extending this price co-production (Lusch and Vargo 2006) link to the firm's value proposition. A value proposition can be thought of as a promise the seller makes that value-in-exchange will be linked to value-in-use. When a customer exchanges money with a seller s/he is implicitly assuming the value-in-exchange will at least result in value-in-use that meets or exceeds the value-in-exchange. A co-produced value proposition can make the price contingent upon the quality of service experience or other agreed upon output. Sawhney (2006) refers to this as gain sharing or risk and reward sharing. Here the value in exchange (price) is tied to the value realized by the customer. Consequently, gain-sharing or risk-based pricing could be a part of developing a service strategy that links financial returns to superior service. If both buyer and seller have something at risk and something to gain, then collaboration will be much more fruitful.

Can a retailer use gain-sharing or risk-based pricing? We argue affirmatively. Consider an example of a retail buyer collaborating with a vendor on a merchandising program. The program might involve a set of integrated services that are tied to value-network management processes – for example, customer relationship management, customer service management, demand management, order fulfillment, manufacturing flow management, supplier relationship management, product development, and returns management (Lambert and Garcia-Dastugue 2006) – involving the retailer, its vendors, and other value-network partners. Adopting “gain sharing or risk-based” pricing, the retailer would pay a price on the basis of the quality and level of service provided and sales revenue achieved. However, for this approach to be successful, the

retail buyer and the vendor (and perhaps other value-network partners) should co-create the value proposition. This co-created value proposition would increase the chances of a win-win situation in a field where intense negotiations have left many vendors feeling underappreciated.

Proposition 7. Firms can compete more effectively through the adoption of collaboratively developed, risk-based pricing value propositions.

Who should be the prime integrator?

S-D logic points toward collaboration and coordination as essential approaches to innovation and competition. They represent means for integrating activities and resources. Vargo and Lusch (2006), in the ninth foundational premise (FP9) identify resource integration as the essential role of the firm. Christensen et al. (2001) identify it as the most critical aspect of innovation. At one end of a coordination/integration continuum are transactional markets where the “invisible-hand” of the marketplace becomes the key coordination mechanism and integrator. At the other end of the continuum are relational markets (i.e., long-term relationships, partnerships, alliances, joint ventures, and networks), which are highly collaborative (Webster 1992). S-D logic embraces relational and collaborative markets. However, under a collaborative model of coordination, who should be the prime integrator?

Retailers have a distinct advantage in being the customer's closest link to the marketplace. As such, it is possible that within the value network the retailer may be positioned best to develop a core competence in market sensing. It can also be argued that investment in manufacturing is increasingly viewed as constraining market responsiveness (Vargo and Lusch 2004)—in fact, even firms historically considered to be primarily manufacturing firms are increasingly outsourcing the manufacturing process. Achrol (1991, pp. 88, 91) identifies “transorganizational firms,” which he refers to as “marketing exchange” and “marketing coalition” companies, both of which have “one primary function—all aspects of marketing.” Achrol and Kotler (1999) envision marketing as largely performing the role of a network integrator that develops skills in research, forecasting, pricing, distribution, advertising, and promotion, and they envision other network members as bringing other necessary skills to the network. Consider that the consumer is also faced with more and more choices and may be receptive to domesticating or taming the market by adopting and developing a relationship with a limited number of organizations (Vargo and Lusch 2004). Rifkin (2000) argues that consumers will develop relationships with organizations that can provide them with an entire host of related services over an extended period.

As such, S-D logic suggests retailing is best characterized as a service-integration function. This is somewhat different from the typical conceptualization of retailing representing

the final link in a directional distribution flow or supply chain. In S-D logic, the retailer is part of a value network comprising all the parties (including the customer) involved in value creation. The retailer differs from other network members by the fact that his exchange with the customer is direct. Since other network partners are increasingly retaining this direct exchange function, the retail/nonretail lines are often blurred. More generally, since all parties to value creation are service integrators, service-based competitive strategies are not limited to traditional retailers.

However, by redefining their role in terms of this integration function and becoming prime integrators rather than distributors, we believe retailers could remain the pivotal link in the value network. For instance, over the past 20 years a group of independent auto dealers has obtained multiple franchises operating as independent businesses but under a common ownership. One of these mega-dealers has the ability to sell a Mercedes, Honda, Ford, Toyota, Kia, Volvo, Chrysler, and so forth. However, the needs of an auto owner are much broader. They need financing, auto insurance, fuel, maintenance, parking, and places to stop for food and lodging, and also assistance on airline and other travel when use of a car is not economical or timely. The mega auto dealer could relatively easily move into this entire market space and be the household's major provider of transportation services. Similarly, PETsMART could be the integrator for a household's entire pet related needs; Home Depot for all the housing related needs; Office Depot for home business related needs, and so forth. This is consistent with Achrol and Kotler's (1999) observation that marketing may become a customer-consulting function.

Proposition 8a. The value network member that is the prime integrator is in a stronger competitive position.

Proposition 8b. The retailer is generally in the best position to become the prime integrator.

While the network member who is the prime integrator is in a stronger competitive position, we posit it is the retailer who is generally in a unique position to become the prime integrator. In a sense, the history of retail competition is largely a history of managing the level and types of service (and value) that the customer co-creates. Furthermore, retail entrepreneurs and innovators offered different approaches to integrate the customer into the value co-creation process.

Notable hypotheses in this area (i.e., *The Wheel of Retailing*, McNair 1958; Hollander 1960, and *The Big Middle*, Connolly 2004; Levy et al. 2005) provide a good lens to view this evolutionary phenomenon.

Hollander's (1960) descriptive notion of a wheel of retailing alludes to such trade-offs as retailers changing their core offering from the entry phase (with assumed relatively low retailer input and relatively high customer input) through the trading-up phase (with an assumed more equal proportion of service load between the customer and retailer at the point

of transaction) to the vulnerable phase (where it is assumed the retailer's input is considerably greater than other phases). Conceptually, however, a firm would be vulnerable at any stage to competitors who are better at integrating resources and services to collaborate with the customer to produce and create higher value, and not just during the vulnerable stage mentioned earlier.

Levy et al. (2005) model the retail landscape along the dimensions of relative offering of the retailer along with relative price and refer to "The Big Middle" marketplace, the space where the largest number of customers is conceptually located and where the largest retailers compete. Under this model retailers . . .

"tend to originate as either innovative [high relative offering, high relative price] or low-price [low relative offering, low relative price] retailers, and the successful ones eventually transition or migrate to the Big Middle [average relative offering, average relative price] (p. 85, items in brackets added).

While the authors, note the oversimplification of the scheme for expository purposes (p. 85), we suggest the model is indicative of the phenomena of retailers actively managing the level of service for which each value co-creator (marketer and customer) is responsible. Accordingly, the retailers' management of the balance of co-creation responsibilities has always led them to follow a more service-centered view.

Despite the advantageous role retailing may serve as a prime service-integrator, and the role that technology can play in aiding service-integration, S-D logic informs all organizations. In the following section, we point out how S-D logic can inform organizations about gaining competitive advantage by becoming more service-centered through the creation of a service culture.

Leveraging employees

One of the hallmarks of S-D logic is the superordination of operand resources in relation to operand resources in their relative roles in competitive strategy. That is, as discussed, it is knowledge and skills, including in some cases a firm's knowledge used in designing and/or making appliances, which drives its success (Vargo and Lusch 2004; Lusch and Vargo 2006). This, of course, implies that the competitive advantage of the firm is more of a direct function of the comparative advantage of competences (c.f. Hunt 2002) than it is the direct comparative advantage of its units of output—that is, its goods. The other hallmark of S-D logic is the idea that value cannot be embedded in operand resources but rather must be co-created through collaboration between firm, customer, and other value-network partner's operand resources (Vargo and Lusch 2004).

As noted, these tenets are, of course, in stark contrast to those adopted from the work of Smith (1776) and canonized during the co-development of economic science and the

Industrial Revolution of the eighteenth and nineteenth century. In the G-D logic that emerged, the primary resources were operand resources such as ore, timber, water, and land. Perhaps, then, it only naturally followed that employees, customers, and markets were also viewed to be operand resources to be manipulated, if not coerced, in the process of value creation.

Besides operand and operant resources being differentiated in terms of their ability to cause changes in other resources, they differ in another important regard. Operand resources are typically depletable and static in nature, while operant resources are capable of being rejuvenated, replenished, and newly created, and are thus dynamic in nature. That is, new, innovative knowledge and skills, often with increased capability for providing increased benefits, and thus increased marketability, can be created endlessly. None of this suggests that a specific set of competences cannot become obsolete, or at least “commoditized.” Indeed, today’s high technology often becomes tomorrow’s “unskilled” labor.

Organizations can reinvent themselves as “service” organizations and develop a service culture by treating employees as the type of resources they are—pure operant resources, rather than operand resources. Reinventing the firm as a service organization using S-D logic requires the organization’s culture and its leadership style to treat employees as operant resources. The leadership of many G-D logic organizations is based largely on the manipulation of rewards and punishments and is, accordingly, a coercive form of leadership. It is also based on asymmetric information with the leader and organization holding much information private and out of the reach of employees and, in turn, employees reacting similarly and withholding vital information from management. Employees are viewed as replaceable operand resources and treated largely in a transactional mode. It is not surprising that these firms find themselves unable to compete and, as such, laying-off or ridding themselves of their most important resources.

By contrast, S-D logic points to all participants in the value-creation process who are being viewed as operant resources. When employees are viewed and treated in this manner they become empowered in their role as value co-creators. Employees as operant resources become the primal source of innovation, organizational knowledge, and value. The role of the leader is to be a *servant-leader* who is there to serve the employees, rather than the employees serving the manager. Hence, employee–manager interaction comprises conversation and dialog and the development of norms of relational behavior such as trust, open communication, and solidarity. In addition, because of open communication, all information is shared and thus is symmetric. In this work environment, employees can develop new and innovative ways of providing service—that is, new competences that allow the firm to compete more effectively. Further, employees of these firms are (should be) assisted in this process of competence augmentation through internally and externally supported training and educational programs.

Proposition 9. Firms that treat their employees as operant resources will be able to develop more innovative knowledge and skills and thus gain competitive advantage.

Managerial directions

Each of the nine propositions that we have presented points directly to one or more managerial implications. However, none of these propositions will result in the achievement of competitive advantage unless the management adopts a service orientation. S-D logic is more than a series of premises and propositions; it is a revised logic of market exchange that informs a revised logic of competing through service. At the core of S-D logic (see Fig. 2) is the requirement that management should understand that value-creation for both the customer and the firm requires collaborating with customers (and other value-network partners). In turn, this requires recognizing that they are operant, rather than operand, resources. It also requires that management should understand that what it primarily brings to the market is its ability to serve some other party through the application of its own resources, primarily operant—that is through a collaborative effort with its own employees. In brief, the most fundamental implication is that firms gain competitive advantage by adopting a business philosophy based on the recognition that all entities collaboratively create value by serving each other.

Some look for boundary conditions that apply to this philosophy. For example, it has been argued that S-D logic is not applicable to a pure commodity type of business. But S-D logic also applies to commodity industries. Competitive advantage is not based on the commodities themselves, but rather on collaborative ability of the firm to allow the commodities to provide service for some other party. That is, competitive advantage is firm-based rather than product-based and thus, while the goods provided might be commodities, the firm can be highly differentiated. In fact, it could be argued that S-D logic is *especially* critical in commodity industries.

As Vargo and Lusch (2004) have indicated, many companies that are selling tangible output have found competitive advantage through the adoption of a service logic. Conversely, many firms typically characterized (i.e., by G-D logic classification schemas) as service organizations, such as the airlines, internal revenue service, health care providers, and so forth, have found themselves at a competitive disadvantage by adopting a G-D logic and focusing on output management versus process management. Stated alternatively, any organization can gain competitive advantage by adopting a service-dominant orientation.

Consider Cargill, one of the oldest and largest privately held firms in the world. The firm produces and distributes crop nutrients and feed ingredients to farmers, livestock producers, and animal feeders. Cargill also originates and processes grain, oilseeds and other agricultural commodities for distribution to makers of food, feed, and other products. From a

distance, most would argue that Cargill is in the business of selling and marketing tangible agricultural products. However, Cargill fundamentally sees itself as a service business with a culture committed to ideas, knowledge, and expertise. In a recent advertisement the firm discussed how it provides its skills and service's to its customers:

“If you're a baking company, how do you add interest and excitement to products that have been around a long time? One bakery wanted to market healthier bread. They turned to Cargill for help and our food experts offered a carefully-crafted[sic] recipe mix that combined good taste and texture with soy protein—allowing them to make the claim they wanted. Now the company feels great about their successful new product—and their consumers feel great about having a healthy new option. This is how Cargill works with customers.”

Additionally, Cargill offers specialized services for farmers, livestock producers, and animal feeders to help them increase animal productivity, market their grain, and process grain, oilseeds, and other agricultural commodities. Cargill understands that the agricultural commodity is simply the platform for service provision. Thus, this historically commodity-based organization, which has been in existence for nearly 150 years, is today appropriately providing service through application of its specialized knowledge, which only incidentally involves the underlying commodities (Cargill 2005).

Although we think of commodities in terms of goods (especially foodstuffs), S-D logic suggests that virtually all firms that focus on units of output will likely become commodity businesses. Likewise, all firms, including “goods” firms can transform themselves competitively by better understanding how they can serve. For example, retailers can focus on selling merchandise and enticing patronage by constantly cutting prices – that is, treating their business as a commodity – or they can focus on co-creating new kinds of value and service experiences with customers and, in all likelihood, sell at prices considerably in excess of their competitors that, on the surface, might appear to operate in the same business or market.

There is another, very central, managerial direction that S-D logic provides, as implied by the outer circle of Fig. 2. It is tied to understanding the nature and scope of available resources (internal and external), including those that might appear to be resistances until they are overcome by and integrated with the organizations' other resources. We discussed some of this in conjunction with the idea of viewing the ecosystem as something to collaborate with in the co-creation of service and also in conjunction with the idea integrating firm, individual, and public resources – for example, to increase the value-in-use of an automobile. Unfortunately, most businesses (including retailers) tend to view external environments as resistances, if not countervailing forces rather than resources. For example, “big box” retailers are facing increased opposition as they enter communities

for a variety of reasons, such as posing potential harm to small retailers, the social fabric of the community, land-use through construction, underprovision of employee benefits, and so forth. It is possible to view these externalities as uncontrollable constraints. But it is also possible to view them as potential resources for the collaborative creation of a better value proposition for both the community and the firm. Consider a big box mass merchandiser on 20 acres that: (1) plants trees near the store and in the parking lot to better protect structures from heat; (2) opens its parking lot to a local farmer's market for fresh produce; (3) sublets interior store space, not only to Bank of America and McDonald's, but to small enterprising local entrepreneurs; (4) provides a room for community meetings; (5) provides part time work to community members that are disabled mentally or physically. A truly S-D retailer would view the entire community as a storehouse of resources to collaborate with to not only help the community but to provide the retailer with relative competitive advantage.

Conclusion

Since the concomitant times of Smith (1776) and the beginning of the Industrial Revolution, we have been taught that exchange is about things, which can be exchanged for other things. Manufacturing was considered a process that embedded value in tangible raw materials. From this perspective, services were, at best, seen as add-ons to the product—providers of special types of value associated with goods (e.g., time, and place utility) and, at worst, as destroyers of value. Given this perspective, the way the retailer has been regarded is exemplary of the way services have been regarded.

However, we have argued that exchange is not about goods, at least not centrally. It is about parties applying their specialized competences for the benefit of another party (i.e., serving them), and in so doing, benefiting themselves. As such, service is exchanged for service (Bastiat 1848; Vargo and Lusch 2004) and goods are merely mechanisms for transferring and applying competences, or as Normann and Rameriz (1993, p. 68) state it: “products are frozen activities.”

With this shift from the G-D logic of exchange, being primarily about goods, to S-D logic, in which exchange is primarily about service, comes commensurate shifts in the way it is necessary to think about resources and value creation, and about competition. In G-D logic, operand resources are primary and embedded with value. This value is objective and these resources are scarce and exhaustible. Embedded value can be released and enhanced by acting on these operand resources—for example, through extraction, agriculture, and manufacturing. It follows that, like natural resources, human resources can be viewed as operand and to be acted upon and value extracted from them. Thus, competition is about creating relative advantage through hoarding resources and/or

adding value to them. If service plays a role, it is through adding value to operand resources.

On the other hand, in S-D logic operant resources are primary. Value comes from the ability to act in a manner that is beneficial to a party. Value is subjective and always ultimately determined by the beneficiary, who in turn is always a co-creator of the value. It then follows that the consumer is also seen as an operand resource. Operant resources are usually not exhaustible, but rather are often scalable, reusable, renewable, and creatable. Therefore, in S-D logic, competition is a matter of knowledge creation and application. It is about the comparative advantage in service provision.

In this light, retailers are primarily service integrators. In concert with their own and other knowledge and skills (including those of other value-creation partners) and the knowledge and skills of the consumer, this service-integration function allows the customization of variety (in G-D logic, captured as sorting and assorting functions) and application for maximum benefit (service) to the consumer's unique situation and uniquely determined value. But retailers are prototypical rather than unique, in this regard. All firms and customers are service integrators. Thus, this logic extends beyond retailing.

Normann and Ramirez (1993, p. 65) capture the essence of this intersection: "Strategy is the art of creating value. [It] is the way a company defines its business and links together the only two resources that really matter . . . : knowledge and relationships or an organization's competencies and customers." "Competing through service" has to do with grasping the distinctions between G-D and S-D logic, between operand resources and operant resources, between value delivery and value creation, between embedded value and the co-creation of value. It also has to do with treating employees, value network partners, and customers as collaborators that work with the firm to co-create value for all stakeholders. Competing through service is about grasping and applying these ideas better than the competition.

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