

On customer knowledge co-creation and dynamic capabilities

by

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Introduction

Whilst the innovation literature makes early reference to the benefits of customer involvement in the new product development process (especially von Hippel, 1982, 1986, 1990; Thomke and von Hippel, 2002), most marketing-related studies of knowledge co-creation only emerged in the late 1990s. In this short paper, I briefly discuss these key papers (including the early innovation perspectives). I identify potential outcomes arising from co-creation (leading to sustainable competitive advantage). Finally, I identify new co-creation capabilities and integrate them into a conceptual framework for advanced market-learning.

First, I justify why it is possible to distinguish knowledge co-creation from more traditional market-learning perspectives.

Differentiating co-creation

Prahalad and Ramaswamy (2000) were the first authors to examine the new role of customers in knowledge-creation. They mapped the evolution of customers through two primary transformations – from being a passive audience for a firm’s offerings to becoming active players and co-creators of knowledge and value. They provide a useful framework that describes the changing role of customers across several dimensions. These are: time frame, the nature of business exchange and the role of the customer, managerial mind-set, the company’s interaction with customers and how it develops products and services and the purpose and flow of customer communication.

Prahalad and Ramaswamy’s framework is similar to Webster’s (1992) conceptualisation of the changing role of marketing management along a transactional-relational continuum. Underneath the overarching passive-active distinction, the framework organises the purpose of the firm’s activities into four categories which relate to Webster’s analysis. These are: (1) persuading predetermined groups of buyers, (2) transacting with individual buyers, (3) building lifetime bonds with individual customers and (4) regarding customers as co-creators of value. In their book, *The Future of Competition: Co-Creating Unique Value with Customers*, Prahalad and Ramaswamy (2004) develop co-creation into a more holistic strategic approach for creating customer value. Their analysis goes beyond learning perspectives alone. It is more concerned with how mutual value can be gained by both the firm and the customer at multiple points of interaction within experience environments.

Another study that distinguishes co-creation is proposed by Gibbert, Leibold and Probst (2002). Their framework appears to be a derivation of Prahalad and Ramaswamy’s. In it, they distinguish customer knowledge co-creation from customer relationship management and knowledge management perspectives using multiple criteria. These are (1) the source of knowledge, (2) managerial axioms (citing “if only we knew what our customers know” as of particular importance), (3) rationale, (4) objectives, (5) metrics, (6) benefits, (7) recipient of incentives, (8) the role of the customer and (9) the corporate role.

A third framework, provided by Garcia-Murillo and Annabi (2002) is more simplistic. It also contrasts customer knowledge co-creation with customer relationship management. However, their model uses just five factors to distinguish the two: (1) Direction of communication (one way or two way), (2) the medium used (technological or personal), (3) the nature of information (data or customer experiences), (4) the objective of each (CRM is

to identify profitable customers and to undertake customised marketing; co-creation is to gather customer ideas, identify service improvement areas and develop new products) and finally, (5) the role of the employee (from having little emphasis on customer learning to being engaged in gathering knowledge from conversations with the customer).

In Table One, I synthesise all three of the above frameworks. Together, the three papers suggest there are several distinguishing factors, capabilities and outcomes entailed by co-creation. I now identify them by reviewing these and other important papers in more depth.

The customer knowledge co-creation literature: key papers

It is possible to organise the knowledge co-creation literature into four sub-domains: (1) new product innovation, (2) communities of creation, (3) marketing and (4) the customer knowledge management literature.

The product innovation literature on co-creation

The concept of direct customer involvement to create knowledge is not new. Eric von Hippel in particular has been studying the contribution of customers to the research and development of new products for some time. His lead-user concept is widely recognised in both academic and practitioner circles. As early as the 1970s, von Hippel found that most product innovations come not from within the company but from end-users of the product (von Hippel, 1977). More recently, Thomke and von Hippel (2002) proposed methods for customers to become co-innovators and co-developers of custom products (I list their stated capabilities in Table Three below). Whilst these innovation perspectives tell us a great deal about how customers can help develop products, what is new is a shift from a perspective of exploiting customer knowledge by the firm to a perspective of knowledge co-creation with customers. This is being achieved by allowing customers to interact among themselves and by involving them as partners in value-creation.

The communities of creation literature

Sawhney and Prandelli (2000a) describe the practice of distributed innovation within “communities of creation”. They suggest that the knowledge required to compete in technology markets is becoming more diverse whilst at the same time, firms are increasingly narrowing their knowledge base in an effort to specialise and focus. In such an environment, firms can no longer produce knowledge autonomously but rather must cooperate with their trading partners and customers to create knowledge. Such a distributed approach to learning and innovation, they suggest, requires new innovation governance mechanisms, one of which is the communities of creation model – a knowledge socialisation mechanism that sits between complete open-source, market-based approaches for innovation and closed, autonomous firm-based approaches.

The community of creation model is grounded in the concept of “ba” suggested by Nonaka and Konno (1998). A *ba* is a shared space for emerging relationships that serves as a foundation for knowledge creation. As Sawhney and Prandelli write, “participating in a *ba* means transcending one’s own limited perspective or boundary and contributing to a dynamic process of knowledge development and sharing. Similarly, participating in a community of creation involves socialising one’s individual knowledge and contributing

Table One
Synthesised framework for distinguishing market-focused learning from customer knowledge co-creation perspectives
(from Prahalad and Ramaswamy, 2000; Gibbert, Leibold and Probst, 2002; Garcia-Murillo and Annabi, 2002)

Dimension	Traditional market-focused learning capability	Customer knowledge co-creation
Knowledge sought in	Employee, team, company, network of companies or Customer database	Customer experience, creativity and (dis)satisfaction with products and services
Axioms	‘If only we knew what we knew’	‘If only we knew what our customers knew’
Rationale	Unlock and integrate employees’ knowledge about customers, sales processes and R&D. Mining knowledge about the customer in the company database	Gaining knowledge directly from the customer as well as sharing and expanding this knowledge
Objectives	Efficiency gains, cost saving and avoidance of re-inventing the wheel Customer base nurturing, maintaining company’s customer base	Collaboration with customers for joint value-creation
Metrics	Performance against budget Performance in terms of customer satisfaction and loyalty	Performance against competitors in innovation and growth, contribution to customer success
Benefits	Customer satisfaction and retention	Customer success, innovation, organisational learning
Recipient of Incentives	Employee or Customer	Customer
Nature of business exchange and the role of the customer	Customers are seen as passive buyers with a predetermined role of consumption OR customers are captive, tied to a product or service by loyalty schemes	Customers are active partners in value-creation process. They are part of the enhanced network and co-create and extract business value. They are collaborators, co-developers and competitors.
Corporate role	Encourage employees to share knowledge with their colleagues Build lasting relationships with customers	Emancipate customers from passive recipients of products to active co-creators of value

to the creation of a joint output that is superior to the sum of the individual outputs, because new knowledge is created through the emerging relationships” (p.25).

To manage communities of creation effectively, Sawhney and Prandelli propose a series of capabilities and processes that firms must master. I include these in my capabilities analysis shown in Table Three (which summarises all co-creation capabilities found in the literature).

The marketing literature

Sheth, Sisodia, Sharma (2000) introduce the concept of co-creation marketing. They state that:

“With an increase in customer-centric marketing, customers will have an increasing role in the fulfillment process, leading to "cocreation (sic) marketing." Cocreation marketing involves both the marketer and the customer who interact in aspects of the design, production, and consumption of the product or service. We see this process in services (e.g. hairstyling) but will increasingly see it for physical products. For example, in coming years, General Motors plans to allow customers to customize an automobile that will be manufactured to their specifications. The key aspect of co-creation marketing is customer-firm interaction, and the internet is a key platform.”

Sheth et al. (2000) also suggest that the extent of co-creation marketing depends on how much customer knowledge a company is able to accumulate and use. Co-creation marketing enables and empowers customers to aid in product creation, pricing, distribution and fulfillment and communication. It can enhance customer loyalty and reduce the cost of doing business.

Vargo and Lusch (2004) develop links between value co-creation and the service-centred model of marketing. As they state, it reflects a view of marketing that means more than simply being customer oriented; rather, it means collaborating with and learning from customers by being adaptive to their individual and dynamic needs. They contrast this with the more conventional value creation process where companies and consumers had distinct roles of production and consumption. In this scenario, products and services contained value and markets exchanged this value, from the producer to the consumer. Value creation occurred outside markets. By contrast, the service-centred marketing logic implies that value is defined by and co-created with the customer rather than embedded in physical products.

Parvatiyar and Sheth (2000) provide a concise definition of co-creation for relationship marketing, stating that it is best defined as,

“the ongoing process of engaging in cooperative and collaborative activities and programmes with immediate and end-user customers to create or enhance mutual economic value at reduced cost.” (p.9)

Parvatiyar and Sheth (2000) articulate the views of many scholars who argue that the separation of production and consumption is not a normative goal. Rather, marketers and their firms must recognise the advantages, if not the necessity, of viewing the consumer as a co-producer. Others concur. Normann and Ramirez (1993: 69) state that "the key to creating value is to co-produce offerings that mobilize customers." Lusch, Brown, and

Brunswick (1992) provide a general model to explain how much of the co-creation or service provision the customer will perform. Oliver, Rust, and Varki (1998) echo and extend the idea of co-creation in their suggestion that marketing is headed toward a paradigm of "real-time" marketing, which integrates mass customization and relationship marketing by interactively designing evolving offerings that meet customers' unique, changing needs. Prahalad and Ramaswamy (2000) note too that the market has become a venue for proactive customer involvement. They argue for co-opting customer involvement in the value-creation process.

Sawhney and Prandelli (2000b: 212) discuss the linkages between co-creation and relationship marketing. They suggest that although a perspective of customers as knowledge co-creators is consistent with relationship marketing, it "goes beyond its traditional conceptualisations". Whereas relationships with customers have traditionally been viewed as one-way as firms import knowledge about customers within their boundaries, in the networked world, firms can establish two-way relationships based on new mechanisms for direct co-operation in knowledge and value creation.

The customer knowledge management literature

Sawhney and Prandelli (2000b) also provide the most comprehensive analysis of capabilities for customer knowledge co-creation. First, they identify a number of antecedents for both the customer and the firm to participate in knowledge co-creation. These are, from the customer's point of view:

- *Customers must be able to speak the same language as the firm.* To be able to contribute their own knowledge, customers first need to absorb the firm's specific knowledge and to understand its meaning.
- *Customers must deeply trust in the firm.* Any information they share must not be used against their own interests
- *Customers must be motivated* to take part in the knowledge creation process. This motivation can derive from an awareness of the relevance of their knowledge contribution or from incentives.

Second, from the firm's perspective of utilising customer knowledge:

- Firms need to develop *absorptive capacity* with dialogue for their customers' knowledge; that is an ability to recognise the value of customer knowledge, sense and incorporate it within the firm. The first step in doing this is to select the best knowledge assets on the market. As well as scanning, it includes dialogue.
- *Organisational sharing capacity* for co-creation emphasises mechanisms for integrating customer and organisational knowledge assets and then reproducing them internally. Sawhney and Prandelli suggest that as strategy becomes interactive, involving more dialogue and collaboration with customers, there must be wider dispersion of information and decision-making throughout the organisation.
- *Deployment capacity* concerns how firms act upon customer knowledge. Firms need to overcome the bias that "R&D knows best" when moving from passive involvement of customers to active co-development with customers. However, as an incentive for

knowledge contributions, firms must recognise individual customer rights in the outputs created with their knowledge. This calls for new capabilities in intellectual property rights management.

Along with Sawhney and Prandelli (2000b), the works of Gibbert, Leibold and Probst (2002) and Gibbert, Leibold and Voelpel (2000) are rooted in the knowledge management literature. They introduce the concept of “customer knowledge management” or CKM, which refers to the management of knowledge from customers. In their 2002 paper, Gibbert et al. propose five styles of CKM which draw on all of the literature on co-creation.

Sustainable competitive advantage outcomes from co-creation in the literature

The literature suggests that customer knowledge co-creation helps firms to investigate if and to what extent the customers’ views differ from the ‘way we do things around here’ in the firm. This could help shed new light on the question why some core competences turn into core rigidities (Leonard-Barton, 1995). Nonaka and Takeuchi (1995) argue that such “perturbations” can allow the development of a creative chaos that favours new knowledge creation in a context that is always changing.

Sawhney and Prandelli (2000b) suggest that a virtuous cycle of knowledge co-creation between a firm and its customers increases the uniqueness and inimitability of the firm’s knowledge, thus making it a potentially self-renewing source of entrepreneurial rents (Dierickx and Cool, 1989). A second positive effect of knowledge co-creation processes for suppliers are “short-loops” within the mechanisms of learning by errors. As Sawhney and Prandelli (2000b: 268) conclude,

“Higher innovation potential, better fine tuning in respect of market needs, increased customer satisfaction, major switching costs, shorter loop of learning errors and reduced information ambiguity could thus be the most significant output of a knowledge creation process that transcends the firm’s boundaries”

In Table Two below, I summarise the numerous potential outcomes from customer knowledge co-creation that are mentioned in the literature.

Table Two - Sustainable competitive advantage outcomes from the co-creation literature

Sustainable Competitive Advantage Outcome	Authors
A greater ability to sense emerging market opportunities before the competition	Anderson and Narus, 1991; Nonaka, 1994; Nonaka and Takeuchi, 1995
More effective “unlearning” of established assumptions and practices through open-mindedness, shared vision and an enhanced commitment to market experimentation and organisational learning.	Anderson and Narus, 1991; Nonaka, 1994; Nonaka and Takeuchi, 1995
Higher innovation potential, effectiveness and predictability; creating more innovative new products	von Hippel, 1982, 1986, 1994; Gibbert, Leibold and Voelpel, 2000;
Validate the knowledge already accumulated in the organisation	Gibbert, Leibold and Voelpel, 2000;
Better and faster response to latent customer needs	Leonard and Rayport, 1997.
Shorter loop of learning errors	Sawhney and Prandelli (2000b)
Faster customer access to knowledge about, and resolution of, customer	Sawhney and Prandelli

service problems	(2000a)
Higher perceived customer switching costs arising from the customer's ongoing knowledge investments in the firm.	Sawhney and Prandelli (2000b)
An enhanced ability to co-create mutual value on an ongoing basis; value in the form of personalised, unique experiences for the customer and higher profitability and growth through higher levels of customer loyalty for the firm	Prahalad and Ramaswamy, 2004
Creative stretching of existing products, services and skills to generate additional revenue and efficiency	Sharma et al., 2002
Expanded market share	Sharma et al., 2002

Conceptual framework of new market-learning processes and capabilities for customer knowledge co-creation

Based on the above analysis of the co-creation literature and previous work into market-learning capabilities, a conceptual framework of market-learning processes and capabilities for customer knowledge co-creation is shown in Figure One below.

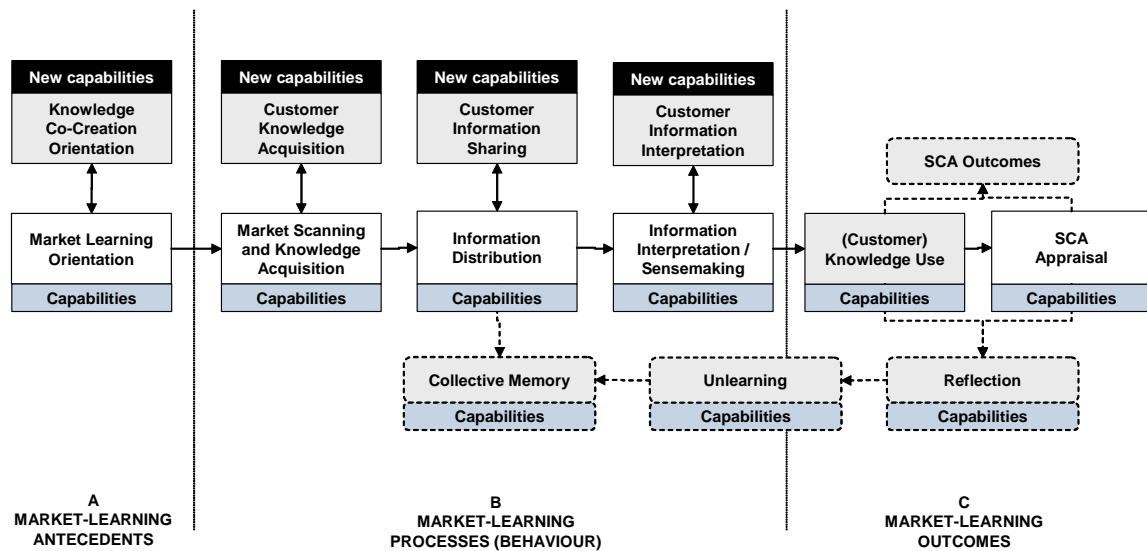


Figure One – Adapted conceptual framework of new market-learning processes and capabilities for customer knowledge co-creation

In Table Three, I list all the new capabilities for customer knowledge co-creation that can be found in the literature.

Table Three – Customer knowledge co-creation capabilities found in the literature

FRAMEWORK COMPONENT	KNOWLEDGE CO-CREATION CAPABILITIES FOUND IN THE LITERATURE
A. Market-learning Antecedents	<p><i>Knowledge Co-creation Orientation</i></p> <p><i>Firm antecedents</i></p> <ul style="list-style-type: none"> - High employee flexibility to engage in dialogue with a diverse and evolving customer base (Campbell, 2003) - Developing long-term stable relationships with “learning partners” that benefits both partners (Glazer, 1991; Miles and Snow, 1992; Mohr and Spekman, 1994; Ruekert, Walker and Roering, 1985) - Employee empowerment (Campbell, 2003) - Reworking employee compensation plans and promotion decisions to incentivise co-creation (Sharma et al., 2002) - Creating necessary transparency for effective collaboration (Prahalad and Ramaswamy, 2004) <p><i>Customer antecedents (all Sawhney and Prandelli, 2000a, 2000b)</i></p> <ul style="list-style-type: none"> - Customers must be able to speak the same language as the firm. - Customers must deeply trust in the firm and have a sense of belonging - Customers must be motivated with regular reminders of the benefits of co-creation (Sawhney and Prandelli, 2000b; Sharma et al, 2002) - Keeping customers excited and actively involved in co-creation (Prahalad and Ramaswamy, 2004)
B. Market-Learning Processes (Behaviour)	<p><i>Customer Knowledge Acquisition</i></p> <ul style="list-style-type: none"> - Developing an ability to recognise the value of customer knowledge, sense and incorporate it within the firm. The first step in doing this is to select the best knowledge assets on the market. As well as scanning, it includes dialogue (Sawhney and Prandelli, 2000b) - Choosing the right customers (Sharma et al., 2002; Thomke and von Hippel, 2002) - Developing a user-friendly tool-kit for customers (Thomke and von Hippel, 2002) - Evolving the customer tool-kit continuously and rapidly satisfying leading-edge customers (Thomke and von Hippel, 2002) - Accommodating a wide base of heterogeneous customers (Prahalad and Ramaswamy, 2004) - Creating communities of creation. The capability of putting together customer groups of expert knowledge that interact not only with the company, but also importantly with each other (Sawhney and Prandelli, 2000b; Wilkestrom, 1996). <p><i>Customer Information Distribution</i></p> <ul style="list-style-type: none"> - Developing new mechanisms for integrating customer and organisational knowledge assets and then reproducing them internally. Sawhney and Prandelli (2000b) suggest that as strategy becomes interactive, involving more dialogue and collaboration with customers, there must be wider dispersion of information and decision-making throughout the organisation. - Maintaining a balance between high internal variety and flexibility, and chaos (Sawhney and Prandelli, 2000a) - Building a platform for ongoing, active multiparty dialogue between the firm and its communities of consumers (Prahalad and Ramaswamy, 2004;

FRAMEWORK COMPONENT	KNOWLEDGE CO-CREATION CAPABILITIES FOUND IN THE LITERATURE
	<p>Normann and Ramirez, 1993)</p> <ul style="list-style-type: none"> - Activating knowledge-sharing at the point of customer contact (Day, 1994a) - Interacting effectively with competent customers who will increasingly recognise and leverage their own value to the company (Prahalad and Ramaswamy, 2004) - Creating new relationships or new ways to combine and manage existing relationships (Sawhney and Prandelli, 2000a; Normann and Ramirez, 1993) - Developing an environment where knowledge can be co-created and shared continuously (Prahalad and Ramaswamy, 2004) - Making customers more intelligent as well as firm offerings (Normann and Ramirez, 1993)
C. Market-Learning Outcomes	<p><i>(Customer) Knowledge Use</i></p> <ul style="list-style-type: none"> - Developing a Deployment Capacity concerns how firms act upon customer knowledge. Firms need to overcome the bias that “R&D knows best” when moving from passive involvement of customers to active co-development with customers. - New capabilities in intellectual property rights management. As an incentive for knowledge contributions, firms must recognise individual customer rights in the outputs created with their knowledge. (Sawhney and Prandelli, 2000a) <p><i>SCA Appraisal</i></p> <ul style="list-style-type: none"> - Application of Grant’s (1991) criteria for assessing the potential of co-creation capabilities that generate knowledge capable of building sustainable competitive advantage <p><i>SCA Outcomes</i></p> <ul style="list-style-type: none"> - See Table Four above for a list of potential SCA outcomes derived from co-creation

Summary

A number of conclusions can be drawn from the above analysis. First, given the widely acknowledged importance of customer knowledge in developing an advanced market orientation, one might expect the co-creation perspective to have a clear meaning, a richer tradition of theory development and a related body of empirical findings. On the contrary, a close examination of the literature reveals a lack of clear definition, little careful attention to measurement issues and no empirical studies. Further, the literature pays little attention to the contextual factors that may make the co-creation perspective more or less appropriate for a particular type or size of business as well as the cognitive factors underpinning individual managers' understanding and response.

Although acknowledging the need for new skills and capabilities, the organisational learning or marketing literature does not yet adequately define or empirically identify the nature or scope of the capability changes required for co-creation of knowledge with customers. This is despite the suggestion that new dimensions of customer knowledge research could provide an expanded view of organisational epistemology (von Krogh and Roos, 1995, one that "includes the customer as a knowledgeable agent in the knowledge creation process" (Gibbert, Leibold, and Probst, 2002: pp.467-8)

In this paper, I have developed an integrated conceptual view of capabilities for customer knowledge co-creation. This has not been done previously, especially from multiple research domains of strategy, marketing management, customer relationship management, market-learning, innovation management and the organisational learning literature. Various authors have recognised the need for, and absence of, a simple and integrated framework for *the management of customer knowledge* (Winer, 2001; Bose and Sugumaran, 2003; Massey et al 2001). Others point to the need for a single, unified and comprehensive view of customer needs and preferences across all business functions, points of interaction and audiences (Shoemaker, 2001; Tiwana, 2001; Wiig, 1999).

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