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Managing value appropriation in buyer-supplier relationships: The role of commercial decision resources

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ABSTRACT

The resource-based view explains firms' value appropriation in buyer–supplier relationships by pointing to sustained differences in economic efficiency across firms. Firms with more efficient resources create more value than competitors, which in turn provides a “protective cushion” against competition. However, just as firms may differ in the economic efficiency of their resources and in the value they create, they may also differ in their information processing and how successful they are at value appropriation. Building on the literature on decision-making under uncertainty in psychology, I argue that firms may increase their value appropriation in exchange relationships by investing in commercial decision resources that allow for more effective information processing in commercial decisions. Examples of commercial decision resources include IT-based systems for product costing and tracking customers/competitors, the design of commercial organization, control systems, and commercial experience and skill.

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1. Introduction

How do firms appropriate value in exchange relationships? According to the resource-based view (RBV), firms' value appropriation in buyer–supplier relationships may be explained by differences in the economic efficiency of the resources controlled by firms. Firms with more efficient resources create more value than competitors, which in turn provides a “protective cushion” against competition (Peteraf & Barney, 2003). However, recent research indicates that the resource and demand sides are not sufficiently integrated in the basic RBV model (Kraaijenbrink, Spender, & Groen, 2010; Priem & Butler, 2001; Priem, Butler, & Li, 2013) and that differences across firms in how they price their products may affect value appropriation in unaccounted ways (Bergen, Ritson, Dutta, Levy, & Zbaracki, 2003; Dutta, Zbaracki, & Bergen, 2003; Hallberg, 2008; Liozu & Hinterhuber, 2013). I argue that these differences in pricing are in turn likely related to the nature of individual commercial decision-making and the outcome of social cognitive processes (see Felin & Foss, 2005; Powell, Lovallo, & Fox, 2011), and the specific organizational measures firms take to handle individual mistakes, cognitive biases, and other potential shortcomings in commercial decision-making.

Building on the decision-making under uncertainty literature in psychology (e.g., Kahneman & Lovallo, 1993; Tversky & Kahneman, 1974), I argue that bounded rational decision-makers in uncertain exchange relationships are subject to important cognitive decision biases and that firms differ in the commercial decision resources they develop to correct for these biases.¹ A novel insight is that firms by employing commercial decision resources that match the structure of their decision environment may gain an advantage that considerably increase their commercial and financial leverage in business transactions.

The basic argument concerning the RBV is that commercial decision resources constitute a subset of resources that do not really conform to the standard conception of resources in the RBV as affecting firms' value creation by either increasing the perceived customer benefit and/or lowering the economic cost of the firm's products or services (labeled productive or competitive resources). Rather, commercial decision resources affect firms' value appropriation in exchange relationships by allowing for better commercial information processing and thus more accurate pricing of

¹ Uncertainty is defined as unlistability of outcomes and epistemic heterogeneity resulting from differential cognitive framing and mental models (see O'Driscoll & Rizzo, 1985). The primary focus of this paper is on what is termed *commercial uncertainty*, that is, uncertainty concerning the perceived customer benefits and costs of the firm's products and services.

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products and services. By highlighting the mechanism of information processing and its link to value appropriation, commercial decision resources effectively complement the standard notion of value creating productive-/competitive resources in the RBV (Peteraf & Barney, 2003) and more recent contributions that highlight persuasive resources as directly related to value appropriation (Brandenburger & Stuart, 2007; Chatain & Zemsky, 2007; Ryall & Gans, 2015). In addition to contributing to the refinement of the basic RBV model by developing a more microlevel account of important aspects of firm performance related to value appropriation, this paper sheds light on key questions related to the strategic impact of sales force management (e.g., Slater & Olson, 2000), pricing capability (e.g., Dutta et al., 2003), pricing routines (e.g., Zbaracki & Bergen, 2010), and value-based pricing (e.g., Hinterhuber, 2008; Nagle & Holden, 2002).

Examples of well-researched decision biases that may substantially distort commercial decisions are the endowment effect, the status quo bias, and loss aversion (Kahneman, 2003). Firms recognize these cognitive challenges in commercial decision-making and develop different means to counter or correct potential mistakes by employing particular types of commercial decision resources. Examples include the use of IT-based systems for product costing and tracking customer and competitors, the design of commercial organization, control systems, and commercial experience and skill. The theoretical foundation that joins these different types of commercial decision resources together is the currently underdeveloped mechanism of commercial information processing and the realization that organizations need to make specific investments in this area to maximize their potential value appropriation in exchange relationships.

2. Value appropriation

This section identifies different approaches to explain firms' value appropriation in management research and introduces relevant research on decision-making under uncertainty in psychology. To pinpoint the function of commercial decision resources in exchange relationships, the paper particularly focuses on how value appropriation has been addressed in the RBV and how insights from other theories or literatures that management scholars typically rely on have informed this discussion.

2.1. Value appropriation in the RBV

The standard model in the RBV places virtually no weight on product market pricing and associated social cognitive challenges as mechanisms that may affect firms' value appropriation (see Peteraf & Barney, 2003, p. 315). Rather, the RBV holds that firms gain competitive advantage, and ultimately superior financial performance, by acquiring and controlling valuable and rare resources that cannot be easily imitated or substituted by competitors (Barney, 1991; Peteraf, 1993). The superior value creation resulting from these resources is assumed to provide a "protective cushion" against price-/quality competition, which in turn affects the focal firm's possibilities of appropriating created value in product market exchange relationships (Peteraf & Barney, 2003). Therefore, the RBV builds on the asymmetrical assumption that although firms are heterogeneous in terms of their productive factors and value creation, the same firms are assumed to be fundamentally homogeneous with regard to how they collect information, price their products, and govern their commercial relationships outside strategic factor markets (Foss & Hallberg, 2014).

The RBV explains firm performance in terms of resources that have intrinsically different levels of efficiency and are subject to particular isolation mechanisms (Peteraf, 1993). Competitive

advantage, the dependent variable, is defined as a firm's ability to "create more economic value than the marginal (breakeven) competitor in its product market" (Peteraf & Barney, 2003, p. 314), whereas the independent variable is defined as the set of scarce critical resources, which are owned or controlled by the firm, that "generate differentially greater value" (Peteraf & Barney, 2003, p. 316). The economic value created by an enterprise is in turn defined as "the difference between the perceived benefit gained by the purchasers of the good and the economic cost to the enterprise" (Peteraf & Barney, 2003, p. 314). Therefore, the RBV can be described in terms of the effect of differential resources on the level of perceived benefit and the economic cost of output, the difference between which is equivalent to value creation.² The differential value creation of firms is, in turn, assumed to affect value appropriation through the differentiation or cost advantages that some firms are able to sustain relative competition. In other words, the superior value creation that some firms are able to sustain based on their unique resources provides "a protective cushion" against product market price competition that allows these firms to appropriate value (Peteraf & Barney, 2003, p. 315).

Consider the example used by Peteraf and Barney (2003: 315) to illustrate the underlying economic logic of competitive advantage. Imagine two single business firms competing in a product market with a single buyer demanding only one product unit. If firm A because of its superior resources creates \$180 of economic value for each unit it sells to the buyer and firm B who lacks the superior resource only creates \$150 of economic value for each unit, there will, after competition has eliminated the marginal competitor, be a residual value \$30 to be distributed between firm A and the buyer. Peteraf and Barney (2003) view this residual value of \$30 as an economic rent that is attributable to firm A's more efficient resources. However, the situation is in fact once competition has forced the marginal competitor to withdraw, a bilateral monopoly where the appropriation of the \$30 surplus value is indeterminate without invoking additional explanatory concepts beyond heterogeneity in productive factors (\$30 residual value) and competitive structure (one buyer demanding one product unit). There are many additional factors that may influence how created value is appropriated in exchange relationships. Such factors include how persuasive negotiators are at the two firms; how price-, quality-, and quantity decisions are influenced by lack of accurate information about costs and customer willingness-to-pay; and the information processing ability of commercial decision-makers.

Although not paying much attention to the complex mechanisms that determine value appropriation in product markets, the basic RBV model is much subtler concerning the mechanisms that determine value appropriation in factor markets (see Barney, 1986). In fact, the notion of value appropriation primarily enters the RBV in the form of the price paid for the critical resources in strategic factor markets. Therefore, for a resource to give rise to competitive advantage, the focal firm is assumed to realize an informational advantage (or be lucky) and come in possession of the critical resource by paying a price for that resource that is less than its true economic value (Barney, 1986). Although the strong focus on distributional mechanisms in strategic factor markets may be upheld as a strength of the standard RBV model because it simplifies matters greatly, it nonetheless leaves the theory open to criticism concerning its ability to explain actual profits and financial performance. For example, Coff (1999, 2010) holds that internal

² The practice of defining value creation in terms of perceived benefits minus economic cost is adopted from Peteraf and Barney (2003). This terminology is easily translated into the value-price-cost framework (Tirole, 1988) by substituting the term value for the term perceived benefit.

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