Companies spent the 20th century managing efficiencies. They must spend the 21st century managing experiences.

The Co-Creation Connection

by C.K. Prahalad and Venkatram Ramaswamy

Illustration by Steve Moors

For more than 100 years, a company-centric, efficiency-driven view of value creation has shaped our industrial infrastructure and the entire business system. Although this perspective often conflicts with what consumers value — the quality of their experiences with goods and services — companies see value creation as a process of cost-effectively producing goods and services. Now information and communications technology, the Internet in particular, is forcing companies to think differently about value creation and to be more responsive to consumer experiences. In fact, the balance of power in value creation is tipping in favor of consumers.

C.K. Prahalad
(cprahalad@aol.com) is the Harvey C. Fruehauf Professor of Business Administration at the University of Michigan Business School, Ann Arbor. He is also the founder and chairman of Praja Inc., a pioneer company in interactive event experiences.

Venkatram Ramaswamy
(venkatr@umich.edu) is professor of marketing, the Michael R. and Mary Kay Hallman Fellow of Electronic Business, and the director of the Community for Business Innovation at the University of Michigan Business School.

The disconnect between what companies and consumers value traces back to the early-20th-century industrial principles. Frederick Winslow Taylor's scientific management focused on lowering unit costs of production. The value chain, a concept introduced by Michael Porter in the 1980s, gave managers an integrated framework to identify and manage costs of designing, producing, marketing, delivering, and supporting goods or services. And Michael Hammer and James Champy's business process reengineering was widely interpreted as implicitly linking cost reduction and internal efficiencies to value creation.

During the 1990s, notions of the extended enterprise and the boundaryless organization encouraged managers to broaden their search for efficiencies and discover ways of creating value from their supplier network and beyond. Starting in 1995, the Internet further invigorated the corporate pursuit of efficiency, this time expanding it to include all the activities directly involving or affecting the company–customer relationship. Still, throughout this evolution, the assumption that internal cost efficiency is the source of value creation has remained unchallenged.

Consumers appreciate and expect efficiency when it improves their experience with a product or service. But most of the time, managers are so preoccupied with operating efficiently that they don't even think about value in terms of the consumer's experience. (See Exhibit 1.) Ask yourself: Do you as a consumer of a digital camera think about the complex sourcing patterns and logistics that the manufacturer has to deal with, or are you thinking about the fun you will have when you bring the camera to the beach to record your children's first ocean swim?

Because companies have historically controlled all business activities involved in the creation of the things they sell, it is their view of value that is dominant. Indeed, the consumer typically has little or no influence on value created until the point of exchange when ownership of the product is typically transferred to the consumer from the firm. This is true whether the consumer is a company or an individual.

Now consumers are challenging this corporate logic of value creation. Spurred by the consumer-centric culture of the Internet — with its emphasis on interactivity, speed, individuality, and openness — the consumer's influence on value creation has never been greater, and it is spreading to all points in the value chain. (See "The Five Powers of the Connected Consumer," page 7.)

And therein lies a fundamental challenge for business. Companies have grown used to viewing consumers as passive target markets for what they create. But, interestingly, markets are not passive; they are now becoming more like forums, largely because of the Internet. In the "market as a forum," consumers actively define value the way *they* see value — as experiences — and push companies to see it the same way. Today's companies know just how dramatically 40 million consumers networking with each other and challenging the status quo online, in categories as different as music and mortgages, are shaking up the business world.

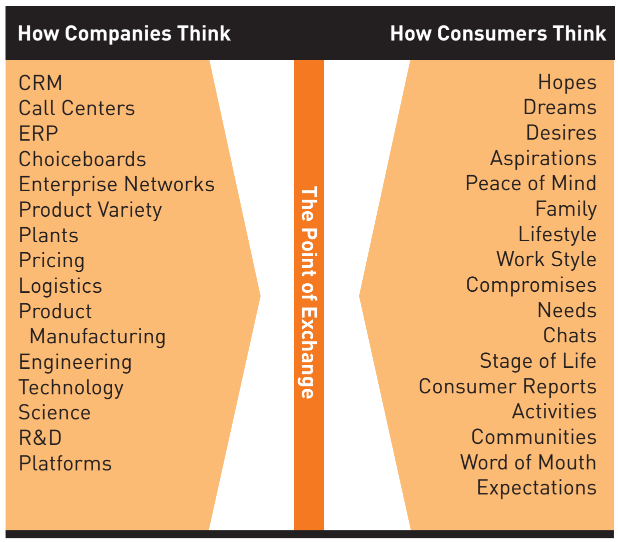
In this environment, we believe companies need to embrace a new approach to value creation, one in which the basis for value shifts from products to experiences;

consumer influence is spread across the value chain (in research and development, design, manufacturing, logistics, service, and points in between); conflicts between companies and consumers are more visible and resolved more productively; and companies don't dictate how value is created.

In short, companies must learn to *co-create* value with their customers.

Although it is only human to feel threatened by a loss of control, it makes little sense for companies not to be open and engaged with consumers. By partnering with them in the value creation process, companies can better balance the objectives of value creation, managing the bottom line (cost and investments) and the top line (growth and revenues). Furthermore, co-creation is becoming a competitive imperative. Information illuminating what consumers value is voluminous, and it flows freely in information networks. If your company does not capture this intelligence to create more fulfilling experiences for consumers, your competitors will.

Exhibit 1: **Value Creation: How Companies and Consumers Think**



The Art of Co-Creation

How do companies co-create valuable experiences with consumers?

The traditional company-centric view says: (1) the consumer is outside the domain of the value chain; (2) the enterprise controls where, when, and how value is added in the value chain; (3) value is created in a series of activities controlled by the enterprise before the point of purchase; (4) there is a single point of exchange where value is extracted from the customer for the enterprise.

The consumer-centric view says: (1) the consumer is an integral part of the system for value creation; (2) the consumer can influence where, when, and how value is generated; (3) the consumer need not respect industry boundaries in the search for value; (4) the consumer can compete with companies for value extraction; (5) there are multiple points of exchange where the consumer and the company can co-create value.

In the customer-centric mass production and marketing of automobiles, for example, suppliers provide raw materials, components, subcomponents, and systems to manufacturers, who create value by assembling these inputs into vehicles. Consumers actively decide what vehicle to buy, but companies decide what their choices will be. Cars are sold by dealers acting as intermediaries for the automakers. For companies reliant on this scenario, value creation is defined solely by extracting profit from end consumers.

The Saturn Corporation, billing itself as "a different

In a market forum, consumers define value as experiences and push companies to see value the same way.

kind of car company," has spurned the industry's traditional ways. In 1985, when the General Motors Corporation launched Saturn, it didn't just start a new car company, it created a "community." Saturn works with its customers in the design, manufacturing, and sales processes, and it engages Saturn owners to help continuously innovate and improve its cars.

Consumers think about the place of a car in their life — how it fits their budget, their desire for comfort, their need for peace of mind, their aesthetics. Companies think about their competitive strategy and their operations — engineering, differentiation, logistics, pricing, and, above all, revenue and profit. Although these views of value do clash, they're not irreconcilable. Saturn is a company trying to merge these two ways of looking at value.

In the pages that follow, we present a framework — a new value creation paradigm — to suggest how companies can better understand the consumer's view of value and productively work with them to co-create more satisfying value for both sides.

Elements of Exchange

The point of exchange is often the place where the conflict between the traditional company view of value and the consumer view of value is most exposed. Although companies are not inclined to interact with consumers at all points in the value chain, opportunities for exchanges between the company and the consumer neither begin nor end when a consumer purchases something from a company. Indeed, the point of exchange need not be restricted to where the company and the consumer trade money for finished goods or services.

If experience is the critical source of value for consumers, we need to identify the factors that determine experience. We call these the elements of exchange, and they are:

- How *transactions* are managed.
- How *choices* are determined.
- How the *consumption experience* is staged.
- How *price* and *performance* relate.

By examining the four basic elements that constitute an exchange, companies can explore how current management approaches may positively or negatively affect customer experiences, and discover better ways to create value.

• **Transactions.** Companies have been quick to spot emerging technologies that reduce transaction costs by having consumers perform functions formerly handled by employees (i.e., customer self-service). Gas stations' transitioning from full-service to self-service was an easy win for gasoline retailers and consumers. Companies asked customers to fill their own tanks and pay through devices on the pump. And what drivers lost in attendant service they happily traded for the convenience of self-service and, sometimes, better prices.

But most customer self-service scenarios aren't this smooth. Managers are usually so preoccupied with the cost advantages of self-service that they misjudge its consequences on the customer experience. Or worse, they don't consider the consequences at all. Anyone who has been foiled by automated multiple-choice customer service over the phone, or who has been left on hold listening to bad music, knows the limitations of call centers. When hospitals, laboratories, and pharmacies put health records, diagnoses, and prescription information online to cut costs, are they taking into account consumer concern about privacy?

On the Web — the ultimate self-service technology — corporate indifference to the consumer experience occurs constantly. Witness the number of abandoned "shopping carts"; perhaps shoppers who stop short of purchasing find the interfaces confusing or don't feel secure using a credit card online. For the consumer who doesn't believe a company will not sell his or her personal data to someone else, giving profile information in exchange for the convenience of "one-click" purchasing or instant recognition on a password-protected Web site may not be worth the risk. Companies also have greatly underestimated how differently older and younger people view issues like privacy and security online.

The key issue in automating transactions is consumer heterogeneity. Customers differ in their skills, their propensity for problem solving, and their willingness to spend time to learn a new system, as well as their willingness to trust it. This is true whether it involves the Web or any other system that is unfamiliar.

Self-service works best when it's applied by companies that manage their costs and the customer experience with equal care. Southwest Airlines Company works hard to make sure its standards for being prompt, accurate, and friendly are the same whether the customer exchange is made through an automated channel or handled by an employee. Similarly, Lands' End Inc. has invested in self-service technology and superior agent training so that the consumer experience on its Web site is as good as its catalog operation consumer experience.

• **Choice.** Elaborately structured distribution and communications channels allow companies to control a consumer's choices. But when companies don't offer the same choices across channels, they risk antagonizing the customer. One clothing retailer trying to optimize inventory management and pricing by channel charged $48 for a shirt online and marked the same shirt down to $24.99 in a retail store. Over time, consumers will recognize such differences, and they might accept them, but only if an explicit policy exists that says online and in-store pricing (or styles and colors) may differ.

Information technology has opened a whole new opportunity for manufacturers to cost-effectively offer customized products faster and cheaper. In the computer industry, companies like the Dell Computer Corporation have an impressive competitive advantage in build-to-order PCs. Now BMW is offering a "custom" car, delivered in 12 days. For the Z3 roadster, the automaker offers a choice of 26 wheel designs and 123 console options.

Mass customization allows companies like Dell and BMW to offer variety, but who decides what can be customized? Customization ultimately is a matter of what can be built and delivered to suit the efficient operation of a company's value chain. Even in the most sophisticated mass-customization schemes, the customer chooses from a menu dictated by the company.

Thanks to the Web, companies can become much more astute about what consumers like and don't like, and that knowledge will greatly improve companies' ability to be innovative and to anticipate consumer needs. On the Web, consumer-to-consumer recommendations, new ideas, critiques, musings, and more are having a powerful influence on choice. About.com (owned by Primedia Inc.), one of the most popular consumer word-of-

The Five Powers of the Connected Consumer

Before the Internet liberated information, companies could do everything — choose materials used in products, design production processes, craft marketing messages, control sales channels — with no interference. Now, consumers exercise their influence in every part of the business system. Nevertheless, companies should welcome, not resist, the consumer powers detailed below.

1. Information Access. With access to unprecedented amounts of information, consumers have knowledge to make much more informed decisions. This is causing companies across industries to cede control over value creation and develop new ways of doing business. Consider health care. More than 70 million Americans have reportedly used the Internet to learn about diseases and treatment options and investigate how to get involved in clinical drug trials. Consumers now question their physicians more aggressively and participate more fully in choosing treatments. This is dramatically altering traditional pharmaceutical sales practices. In the U.S., it is driving consumer-centric "defined-contribution" health-care reform wherein companies give employees information and ask them to assume more responsibility for selecting and managing their own health-care benefits.

2. Global View. The Internet is the first single source of information that gives consumers the ability, 24 hours a day, to see what is happening around the world. That is changing the rules for how companies compete. For example, multinationals are more exposed to consumer scrutiny of product price and performance across geographies, which means those businesses have less latitude to vary the price or quality of products sold in multiple regions. But it also means companies have more information to sharpen global strategies. New competitors and potential partners for large companies are also emerging in the global marketplace. Even poor artisans in Rajasthan, India, can sell high-quality table linen on the Web for $10 and deliver it to buyers in the U.S. in about a week, and for one-tenth the cost of comparable linen in the United States.

3. Networking. Consumers naturally coalesce around common skills, interests, and experiences. The Internet amplifies this by encouraging an unparalleled ease and openness of communication among perfect strangers. Indeed, "communities of interest," where individuals confabulate and commiserate without geographic constraints and with few social barriers, exist all over the Web. People participating in a chat area may know nothing more about those they're chatting with than the interest they share. The power of consumer

mouth sites, is host to discussions about more than 50,000 subjects, from allergies to zebras. Content, organized by topic, is kept fresh and credible with a thorough oversight system run jointly by About.com and its community members. Sites like About.com are trying to establish businesses promoting consumer-to-consumer communication, but thousands of Web sites exist that buzz with conversations about what consumers value and don't value. Companies need to listen, learn, and absorb this valuable intelligence.

Even in the world of drugs for treating life-threatening diseases, consumer advocacy in online support groups seems to be as influential as company marketing. For example, when Novartis AG began clinical trials of a promising leukemia drug, word spread so fast that the company was overwhelmed with demand from patients seeking participation.

• **Consumption Experience.** Companies like the Starbucks Corporation and Walt Disney Company are highly attuned to human behaviors, preferences, and tastes because experiences are the essence of what they sell. But the fact is, companies that manufacture products bear just as much responsibility as restaurants and entertainment companies for enhancing or diminishing the value of consumer experience. For example, most antibiotics are prescribed to be taken several times a day for two to three weeks. If you forget to take the pills, the medicine is ineffective, and many people don't remember to complete the full cycle. The pharmaceutical company Pfizer Inc. saw this behavior as an opportunity to make it easier for people to take medicine the way it was prescribed. It introduced an antibiotic called Zithromax that typically requires an initial dosage of two pills followed by a daily single pill for only four days. Then Pfizer marketed Zithromax in a blister pack called the Z-pak, which clearly reminds users of their daily dosage requirement and how much they have left to take. Pfizer effectively became the patient's partner in making it as networks is that they're independent and based on real consumer experiences, not what the company tells them they will experience.

Such networking among consumers turns traditional company-controlled marketing and advertising upside down. For example, rather than attempt to shut down unofficial Hobbit fan sites, New Line Cinema co-opted them, to help spread word of mouth and create buzz about its movie *The Lord of the Rings*. Gordon Paddison, senior vice president of worldwide interactive marketing, reached out to the more than 400 fan sites before the movie was released to communicate with the early influencers and give them insider tips.

Consumer education and feedback sites are struggling to prove themselves as viable businesses. But this does not diminish their utility as places where consumers can compare and share information, and places where companies can learn what consumers are thinking.

4. Experimentation. Consumers use the Internet to experiment with and develop products, especially digital ones. The German research company Fraunhofer Institute for Experimental Software Engineering released MP3 as a freely available compression standard that accelerated the transmission of digital audio.

The collective competence of software users has enabled the codevelopment of popular products, such as the Apache Web server software and the Linux operating system.

The ability of consumers to experiment with each other goes beyond software and digital products. Cooks can share recipes. Gardening enthusiasts can share tips on growing organic vegetables. Homeowners can share stories about their home improvement projects. The list goes on. Companies that choose the path of co-creation can tap into consumers' creativity for the development of products and services.

5. Activism. As people learn, they become more discriminating in their choices about what they buy, and as they network, they become emboldened to speak out. Now consumers provide unsolicited feedback to companies and to each other. There are hundreds of "sounding-off sites" on the Web that target specific companies and brands. AOL Watch, for example, publishes complaints from former and current AOL customers. The Web has also become an influential tool for social groups focused on such issues as child labor and environmental protection to get corporate attention and promote reform. Although activism might seem menacing to companies, it also opens the door to competitive opportunity.

— C.K.P and V.R.

easy as possible for the medicine to do its curative work.

Zithromax now dominates its market. Consumers like Zithromax's shorter cycle and the convenient reminders to take their pill. Doctors, too, applaud these features, because they make the drug more effective. With the Z-pak, Pfizer has creatively incorporated the consumption variable into the manufacture and design of the product to increase its value.

• **Price-Performance.** The traditional psychology of price setting, largely based on cost structures, is becoming increasingly irrelevant. Further, the relationship between price and performance is no longer implicit and controlled by companies; it is explicit and debated by consumers.

Independent consumer-feedback Web sites, such as Epinions.com, PlanetFeedback.com, and BizRate.com, allow people to share price information recommendations, reviews, and comparative price information for thousands of products. Search engines like Google are also powerful tools consumers can use to collect and compare price and performance data.

Global television and the Internet make it easier for people to see the kinds of products companies sell in different regions and countries and compare them to what's offered in their own market. That is altering consumer desires and raising consumer expectations, especially in developing countries. Consumers in emerging-market countries (e.g., India, Brazil, and Indonesia) with annual incomes sufficient to purchase cars, refrigerators, branded clothing, and other mainstays of comfortable living expect these products to be affordably priced and to meet global quality standards and local cultural requirements.

The new challenge for companies accustomed to producing lower-priced, and often inferior, goods for these markets is to raise the consumer experience bar and make a profit. For example, Hyundai in India is successfully selling its Santro sedan for the equivalent of about $8,000. The Santro's driving performance is comparable to that of a compact car sold in the U.S. for about $11,000, and it has comfort features, such as spacious seating and headroom, that are highly valued by consumers in India.

Even the world's 4 billion poorest consumers, who earn less than $1,500 a year, are aspiring to a better life and demanding more goods and services. This situation represents a huge opportunity for companies to change their mind-sets and their business models (e.g., "the poor can't afford or have no use for consumer products," or "we can't make money in this market"). In 1995, Unilever PLC's subsidiary in India, Hindustan Lever Ltd. (HLL), drastically altered the management of its value chain so it could sell a detergent, called Wheel, to the poor. HLL decentralized its production, marketing, and distribution and quickly established sales channels through thousands of small storefronts. HLL adjusted the cost structure of its detergent business so it could sell Wheel at a very low price point and still make money. Today, Wheel has gross margins and a return on capital as good as, or better than, HLL's higher-end cleaning products, and Unilever has used this business model to create a new detergent market in Brazil.

Patients at India's Aravind Eye Hospital, the world's largest eye-care facility, pay about $10 for cataract surgery, compared to $1,600 for equivalent care in the United States. The hospital, which operates on more than 200,000 patients per year, gives 60 percent of its care at no cost and still is highly profitable. Between 1998 and 1999, Aravind's total income was Rs. 230.6 million (about $5.2 million), with a profit of Rs. 110.1 million (about $2.5 million), and return on capital of more than 200 percent on surgery and its lens manufacturing arm. Like Unilever, Aravind is testing this business model in other regions.

Building Blocks for Co-Creation

Businesses operate in a networked environment in which it is possible both to learn continuously about what people want and need, and to interact with them in ongoing exchanges of value. But companies need to be much more aware of where these opportunities to interact with consumers exist.

We suggest there are four building blocks for co-creating value. *Dialogue* at every stage of the value chain encourages not just knowledge sharing, but, even more importantly, understanding between companies and customers. It also gives consumers more opportunity to interject their view of value into the creation process. In short, *access* challenges the notion that ownership is the only way for the consumer to experience value. By focusing on access to value at multiple points of exchange, as opposed to simply ownership of products, companies can broaden their view of the business opportunities creating good experiences. *Risk reduction* assumes that if consumers become co-creators of value with companies, they will demand more information about potential risks of goods and services; but they may also have to bear more responsibility for handling those risks. *Transparency* of information is required to create the trust between institutions and individuals.

1. Dialogue. Dialogue is creating shared meaning. In dialogues, people listen and learn from each other; in the most productive dialogues, people communicate and debate as equals. Dialogue helps companies to understand the emotional, social, and cultural contexts that shape consumer experiences and provides knowledge companies can use to innovate. Dialogue with consumers is central to Harley-Davidson Inc.'s being able to co-create a multigenerational "way of life." Building a forum for dialogue was how, early on, America Online Inc. created a community — a group of enthusiasts whose shared interests bonded them to the service at the same time that it gave the company insights into service improvements. Dialogue was what kept a loyal community of Macintosh users together when Apple Computer Inc.'s product development began to wane. And it is dialogue that is helping the personal-computer manufacturer to recover with the introduction of the new iMac.

Dialogue involves more than listening and reacting. It requires deep engagement, lively interactivity, empathetic understanding, and a willingness by both parties to act, especially when they're at odds. What is happening in the music industry today is the antithesis of dialogue. If the record labels were listening, they would hear that consumers don't object to paying for music. They just want to create their own musical experiences once they've paid for it. People have been packaging their own music for years (in the 1970s, parents of Napster and MP3 player fans made custom cassette tapes by copying songs from long-playing records). Why, with even better technology available today to duplicate and mix their own music, would consumers want anything else?

While recording companies fight the battle against "illegal downloading" and resist changing their business models, music sales are declining and sales of blank CDs are soaring. "If the industry doesn't change the way we do business, we're going to be bankrupt," Val Azzoli, cochairman of Atlantic Records, told the *New York Times* in February 2002. The Sony Corporation shows just what's at stake. Its music sales are currently about $4.6 billion, compared to about $40 billion in sales from consumer electronics, including CD burners and MP3 players.

2. Access. Ownership is the traditional way to look at the transfer of value from the company to the customer. But you don't need to own something to experience its value. Indeed, access without ownership is desirable for consumers and can be very profitable for businesses. Thinking in terms of access expands a company's view of potential markets.

Over the past decade, numerous companies serving European and U.S. cities have begun to offer a novel service for people who want more than just a rental car; they want the convenience of having a car they don't own at their disposal all the time. For example, in Switzerland, people who join Mobility CarSharing receive a personal access device that unlocks a dedicated pool of cars, which are rented on a pay-as-you-drive basis, making the service ideal for running short errands, visiting friends in the suburbs in the evening, and the like. What do Mobility CarSharing and similar companies sell? A new urban lifestyle that is not only economical and convenient, but also reduces pollution and parking problems.

In the music industry, consumers are not fighting for all music to be free; they just want more freedom to choose how they access music once they've paid a fair price. This is a classic instance of the consumer being shut out of the value creation process.

The successful coupling of access with dialogue in the computer community's Open Source movement has had a significant influence on traditional players in the industry as they see its benefits. For example, to promote the use of Linux, the open source operating system, IBM is putting $40 million of its software tools in the public domain. More important, in 2001, IBM made the largest commitment of any computer maker — about 20 percent of its R&D budget ($1 billion) — to Linux and Apache Web servers.

3. Risk Reduction. The obligations and responsibilities of the firm and consumers for risk management will always be debated. But it is safe to assume that as consumers become more involved in co-creating experiences with companies, they may be willing to take on more responsibility for managing risk exposures, if companies are willing to reveal more information about the risks associated with the products and services they produce. One key issue in the Firestone-Ford tire case centered on the amount of knowledge Ford and Firestone had about risks associated with the combination of vehicle, tire pressure, and driving conditions. How much should Firestone and Ford have shared with consumers?

In a world where good information is widely available, consumers, within the limits of their technical knowledge, should be able to make more informed choices about risks. Companies can be a part of that process by being both forthcoming in the discussions of risk with the general public, and by disseminating appropriate methods for assessing personal risk and societal risk. Labeling is one way of explicitly passing on to

The world's largest houseboat maker shows how the pieces of the co-creation model — dialogue, access, risk reduction, and transparency — fit together.

the consumer more responsibility for risk. But that is not enough. Companies will need to be more willing to engage in open dialogues with concerned people. Companies should not approach their communications defensively. On the contrary, proactive risk communication and management offers new opportunities for firms to differentiate themselves.

4. Transparency. In the wake of the Enron debacle, shareholders are demanding more transparent, or thorough, financial disclosure; but transparency is also necessary for consumers of goods and services to become co-creators of value. When companies make vital business-process information visible to consumers, companies, in effect, relinquish control of the value creation process before the traditional point of exchange.

The Federal Express Corporation has high levels of transparency in its logistics system. Customers can log on to its Web site and check the progress of packages in real time using the same information that FedEx employees use; large corporate customers can also reroute packages themselves. Individuals have choices they wouldn't have if FedEx controlled all the information, and that improves the customer experience.

This same type of information transparency has created a revolution in the trading of securities. Global agency brokers like Instinet Group Inc. build transparency into their trading systems so that customers can monitor in real time how much the fund manager's trading is costing them.

In June 2001, Eli Lilly and Company launched a new e-business research venture called InnoCentive LLC. It brings together, via its Web site, companies and researchers from around the world seeking solutions to scientific problems. Significant cash incentives are awarded to researchers who offer the solution judged "best" by the company that posted the problem. InnoCentive represents a bold open source approach to innovation for industries that in the past have been closed and private.

Sumerset Houseboats, the world's largest houseboat manufacturer, based in rural Kentucky, shows how all the pieces of a co-creation model — dialogue, access, risk reduction, and transparency — can fit together. Imagine interactively codesigning the layout and configuration of your dream boat, negotiating specs and prices, connecting with the factory to participate in your boat's construction, and monitoring its progress in real time. Now imagine a personal Web page where you can review drawings; access architectural, aesthetic, and structural expertise; and consult a customer representative. You can see pictures and read the biographies of the people who are crafting your boat. You can critique design elements and fully furnish your boat before it is delivered. You can have dialogues with other Sumerset customers and a wider community of avid sailors.

What is co-created in this process is not just a boat, a physical artifact, but also experiences. Even before owners set sail, they begin to form an emotional attachment to their boat while building their stake in the outcome of the value creation process.

The company also benefits. Sumerset and its suppliers learn more about the end consumer and access new ideas for design, engineering, and manufacturing. Everyone from design engineers to carpenters gains a deeper understanding of consumer desires and the potential value trade-offs. This reduces investment risk for the company as well as the risk the consumer won't be satisfied.

A Quiet Revolution

As the noise from debates about the old economy and the New Economy dies down, it is easier to detect a quieter revolution — fomented by a shift in how value is perceived and created. Movement toward a market environment in which companies and consumers co-create experiences is gaining momentum, but as with any change in deep-seated assumptions about competition and strategy, the adjustments for companies will be complicated and trying.

First, companies must embrace the notion that consumers can become partners in the co-creation of experiences. Only by letting go of the company-centric view of value creation, once and for all, can companies proceed with the difficult and long-term work of making lasting reforms to the business system. Managers must make a major transformation in the way they conceive of the tasks of value creation, and therefore change how firms are organized. Management disciplines and the relationships between disciplines need to be reexamined — market research, product development, logistics, branding, pricing, and accounting, among others.

Companies are getting more used to competing on the basis of their adaptability and how fast they innovate and apply knowledge, and they are rising to the challenge of keeping down the costs of experimentation as they test new ideas. But business competition is a lot more unpredictable when innovation and flexibility, rather than efficiency, are the main drivers of value.

Firms also need new and different IT strategies and applications that incorporate the principles of a more balanced system of value creation, and a system more sensitive to the consumer's perception of value. A new information architecture that allows a company to maintain a consistent brand identity and quality of customer experience across channels, for example, is an essential strategic asset. Likewise, IT vendors need to work with companies to come up with replacements for today's company-centric business software systems.

Companies can and will make the adjustments to thrive in a world where value is co-created in experiences. But it will take time, courage, and stamina to compete in a different value creation space. If companies rise to the challenge, they are sure to discover an exciting new era of business creativity and opportunity. +

Reprint No. 02206

Resources

J. Philip Lathrop, Gary D. Ahlquist, and David G. Knott, "Health Care's New Electronic Marketplace," *s+b*, Second Quarter 2000
www.strategy-business.com/press/article/?art=19291&pg=0

C.K. Prahalad and Stuart L. Hart, "The Fortune at the Bottom of the Pyramid," *s+b*, First Quarter 2002
www.strategy-business.com/press/article/?art=229761&pg=0

C.K. Prahalad and Venkatram Ramaswamy, "Co-Opting Customer Competence," *Harvard Business Review*, January–February 2000
www.hbsp.harvard.edu/hbsp

Neil Strauss, "Behind the Grammys, Revolt in the Industry," *New York Times*, February 24, 2002