

CO-CREATION EXPERIENCES: THE NEXT PRACTICE IN VALUE CREATION

C. K. PRAHALAD AND VENKAT RAMASWAMY

Consumers today have more choices of products and services than ever before, but they seem dissatisfied. Firms invest in greater product variety but are less able to differentiate themselves. Growth and value creation have become the dominant themes for managers. In this paper, we explain this paradox. The meaning of value and the process of value creation are rapidly shifting from a product- and firm-centric view to personalized consumer experiences. Informed, networked, empowered, and active consumers are increasingly co-creating value with the firm. The interaction between the firm and the consumer is becoming the locus of value creation and value extraction. As value shifts to experiences, the market is becoming a forum for conversation and interactions between consumers, consumer communities, and firms. It is this dialogue, access, transparency, and understanding of risk-benefits that is central to the next practice in value creation.

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INTRODUCTION

The word “market” conjures up two distinct images. On one hand, it represents an aggregation of consumers. On the other hand, it is the locus of exchange where a firm trades goods and services with the consumer. Implicit in this view is a critical assumption that *firms can act autonomously* in designing products, developing production processes, crafting marketing messages, and controlling sales channels with little or no interference from or interaction with consumers.¹ Consumers get involved only at the point of exchange. Firms aggregate consumers into “meaningful segments” for ease of exchange. Both of these images of the market are being challenged by the emergence of connected, informed, empowered, and active consumers. Consumers now seek to exercise their influence in every part of the business system. Armed with new tools and dissatisfied with available choices, consumers want to interact with firms and thereby “co-create” value (Prahalad & Ramaswamy, 2004). The changing nature of the consumer-company interaction as the locus of co-creation (and co-extraction) of value redefines the meaning of value and the process of value creation. In this article, we discuss how the *concept of a market* is undergoing change and transforming the nature of the relationship between the consumer and the firm.

CONSUMERS, MARKETS, FIRMS, AND VALUE CREATION: THE TRADITIONAL SYSTEM

In the traditional conception of process of value creation, consumers were “outside the firm.” Value creation occurred inside the firm (through its activities) and outside markets. The concept of the “value chain” epitomized the unilateral role of the firm in creating value (Porter, 1980). The firm and the consumer had distinct roles of production and consumption, respectively. In this perspective, the market, viewed either as a locus of exchange or as an aggregation of consumers, was separate from the value creation process (Kotler, 2002). It had no role in value creation. Its role was value exchange and extraction. The market,

defined as an aggregation of consumers, was a “target” for the firm’s offerings.²

Needless to say, the traditional concept of a market is company-centric. So is the process of value creation. Consequently, firms conceptualize customer-relationship management as targeting and managing the “right” customers. Firms focus on the locus of interaction—the exchange—as the locus of economic value extraction. The interactions between companies and customers are not seen as a source of value creation (Normann & Ramirez, 1994; Wikstrom, 1996). Value exchange and extraction are the primary functions performed by the market, which is separated from the value creation process, as shown in Figure 1. It is no surprise that the flow of communications is also from the firm to the consumer, as the market is a place where value is exchanged and the consumer has to be persuaded such that the firm can extract the most value from transactions.

Informed, connected, empowered, and active consumers are increasingly learning that they too can extract value at the traditional point of exchange. Consumers are now subjecting the industry’s value creation process to scrutiny, analysis, and evaluation. Consumer-to-consumer communication and dialogue provides consumers an alternative source of information and perspective. They are not totally dependent on communication from the firm. Consumers can choose the firms they want to have a relationship with based on their own views of how value should be created for them.

Online auctions for hotel rooms and airline reservations are just one example of this growing phenomenon. The popularity of businesses such as eBay suggests that the auction is increasingly serving as the basis for pricing goods and services online. From the customer’s perspective, the advantage of the auction process is that prices truly reflect the utility to that customer, at a given point in time, of the goods and services being purchased. That doesn’t necessarily mean that prices are lower, only that the *customer pays according to her*

¹ We use the terms “consumer” and “customer” interchangeably throughout the paper.

² We use the term “offering” to denote products and services. Our point of view applies equally to conventional distinctions of “products” versus “services.”

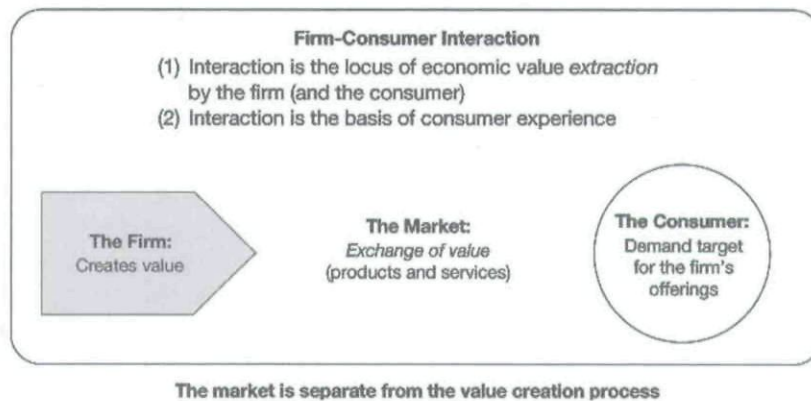


FIGURE 1

The Traditional Concept of a Market

Source: Prahalad and Ramaswamy (2004)

utility rather than according to the company's cost of production.

As customers become more knowledgeable and increasingly aware of their negotiating clout, more businesses—from automakers to cosmetic surgery clinics—will feel pressure to adopt an implicit (if not an explicit) negotiation. An auction is one approach to this negotiation process. Armed with knowledge drawn from today's increasingly transparent business environment, customers are much more willing than in the past to negotiate prices and other transaction terms with companies. We are moving toward a world in which value is the result of an implicit negotiation between the individual consumer and the firm. Therefore, value creation, for an automaker, for example, is the result of individualized negotiations with millions of consumers.

The consequences of not recognizing this shift can be high. As long as firms believe that the market can be separated from the value creation process, firms in search of sources of value will have no choice but to squeeze as much costs from their "value chain" activities as possible. Meanwhile, globalization, deregulation, outsourcing, and the convergence of industries and technologies are making it much harder for managers to differentiate their offerings. Products and services are facing commoditization as never before. Companies can certainly not escape being super efficient. However, if consumers do not see any differentiation they will buy smart and cheap. The result is

the "Walmartization" of everything, from clothes to DVD players.

Is there an antidote to this dilemma? We think so. Firms continually reduce costs and the consumers negotiate away the cost reductions in price erosion. But to find the antidote, companies must escape the firm-centric view of the past and seek to co-create value with customers through an obsessive focus on personalized interactions between the consumer and the company. Further, doing so will require managers to escape their product-centered thinking and instead focus on the experiences that customers will seek to co-create. We need to challenge the traditional, distinct roles of both the consumer and the company and examine the impact of a convergence of the roles of production and consumption; or the convergence of the roles of the company and the consumer.

CO-CREATION EXPERIENCES AS THE BASIS FOR VALUE CREATION

High-quality interactions that enable an individual customer to co-create unique experiences with the company are the key to unlocking new sources of competitive advantage. Value will have to be jointly created by both the firm and the consumer (see Table 1).

In the traditional system, as firms decide the products and services they will produce, by implication they decide what is of value to the customer. In this

system, consumers have little or no role in value creation. During the last two decades, managers have found ways to partition some of the work done by the firm and pass it on to their consumers—be it self-checkout (e.g., gas pumps, ATMs, supermarket checkout), involvement of a subset of customers in product development (e.g., industrial customers help design the products they need as airlines do with Boeing), or a range of variants in between. Consumers find some of these beneficial. Firms such

as Disney and Ritz Carlton have found interesting ways to stage an experience for consumers (Pine & Gilmore, 1999). In all variations of consumer involvement, from self-checkout to participation in a staged experience, *the firm is still in charge of the overall orchestration of the experience*. Yes, they focus on consumer experience, but their consumers are basically treated as passive. Such companies disproportionately influence the nature of the experience. They are primarily product-centric, service-centric, and, therefore, company-centric. The focus is clearly on connecting the customer to the company's offerings.

TABLE 1

The Concept of Co-Creation

WHAT CO-CREATION IS NOT

- Customer focus
- Customer is king or customer is always right
- Delivering good customer service or pampering the customer with lavish customer service
- Mass customization of offerings that suit the industry's supply chain
- Transfer of activities from the firm to the customer as in self-service
- Customer as product manager or co-designing products and services
- Product variety
- Segment of one
- Meticulous Market research
- Staging experiences
- Demand-side innovation for new products and services

WHAT CO-CREATION IS

- Co-creation is about *joint* creation of value by the company and the customer. It is not the firm trying to please the customer
- Allowing the customer to co-construct the service experience to suit her context
- Joint problem definition and problem solving
- Creating an experience environment in which consumers can have active dialogue and co-construct personalized experiences; product may be the same (e.g., Lego Mindstorms) but customers can construct different experiences
- Experience variety
- Experience of one
- Experiencing the business as consumers do in real time
- Continuous dialogue
- Co-constructing personalized experiences
- Innovating experience environments for new co-creation experiences

This firm-centric view of the world, refined over the last 75 years, is being challenged not by new competitors, but by communities of connected, informed, empowered, and active consumers. We believe that there is an emerging disconnect between the opportunities for value creation and differentiation enabled by a networked, active, informed consumer (and consumer communities), their expectations and capabilities and the constraining force of the traditional concept of a market. The more than 1.3 billion cell phones and the proliferation of PCs around the world are creating ubiquitous connectivity. For example, more than 70 million Americans have visited www.WebMD.com. More than 500 chat rooms exist on just cancer alone. A visit to the doctor today is qualitatively different than it was 10 years ago. Patients want to engage in dialogue. They want to understand the risk-benefits of alternate modalities of treatment. They have access to more information than ever before, regardless of quality. Consumers expect transparency. "Don't hold back, tell me the truth," is often the approach. Doctors may not like this. It takes time. It exposes them and the quality of their expertise. It is hard to hide behind authority. However, the doctor now has a better patient. Because he or she understands and is involved, the patient is more willing to comply with the treatment modalities that they have *jointly developed*.

Put yourself in the position of a patient. What is of value here? Is it the medications, the hospital, the equipment that is used, and the expertise of the doctor? Surely, all these are critical. But what differentiates one hospital from another? One doctor from another? For the patient, it is the *experience of co-creating* with the doctor a modality of treatment that takes into account his or her peculiar circumstances.

Patient A may live alone and find it difficult to follow the diet regimen. She may need help. A different patient with the same medical condition may have totally different circumstances or context. His experience may depend on taking care of his children. He wants to indulge his children in the American ritual and must make it to the little league games without appearing to be very sick. The traditional view of the hospital and its product—medical treatment—has not disappeared. Rather, what has emerged as the basis for *unique value to consumers* is their experience (which is contextual). The quality of that experience is dependent on the nature of the involvement the customer (patient) has had in co-creating it with doctors, counselors, and others. Individual involvement can go beyond the treatment modality to the process of diagnosis, therapy, counseling, and wellness indicators. It can vary from patient to patient, and depends on how each patient chooses to co create his or her own unique experiences. What we need to create is an experience environment within which individual patients (consumers) can create their own unique personalized experience. Thus, *products can be commoditized but co-creation experiences cannot be.*

BUILDING BLOCKS OF INTERACTIONS: DIALOGUE, ACCESS, RISK-BENEFITS, AND TRANSPARENCY (DART)

Let us look at what has changed. How do we build a system for co-creation of value? First, we have to start with the building blocks of *interactions* between the firm and consumers that facilitate co-creation experiences. Dialogue, access, risk-benefits, and transparency (DART) are emerging as the basis for interaction between the consumer and the firm (see Figure 2). These *building blocks of consumer-company interaction* challenge the strong positions managers have traditionally taken on labeling laws, disclosure of risks (as in smoking or genetically modified plants), transparency of financial statements, and open access and dialog with consumers and communities.

Dialog is an important element in the co-creation view. Markets can be viewed as a set of conversations between the customer and the firm (Levine, Locke, Searls, & Weinberger, 2001). Dialog implies interactivity, deep engagement, and the ability and willing-

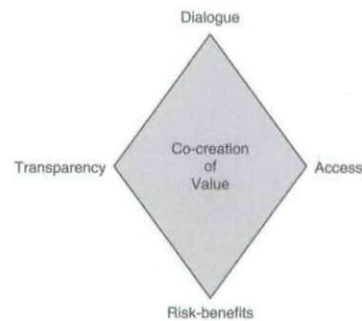


FIGURE 2
Building Blocks of Interactions for Co-creation of Value

ness to act on both sides. It is difficult to envisage a dialog between two unequal partners. So, for an active dialog and the development of a shared solution, the firm and the consumer must become equal and joint problem solvers. Dialog must center around issues of interest to both—the consumer and the firm and must have clearly defined rules of engagement. For example, buyers and sellers engage in a dialogue in eBay. The rules of engagement are evolving but clear at any point in time.

But dialog is difficult if consumers do not have the same access and transparency to information. Firms have traditionally benefited from exploiting the information asymmetry between them and the individual consumer. Because of ubiquitous connectivity, it is possible for an individual consumer to get access to as much information as she needs from the community of other consumers as well as from the firm. Both access and transparency are critical to have a meaningful dialog.

More importantly, dialog, access, and transparency can lead to a clear assessment by the consumer of the risk-benefits of a course of action and decision. Should I change my medication? What are the risks? Instead of just depending on the doctor—the expert—the patient has the tools and the support structure to help make that decision—not in some generic risk category but “for me”—with a medical condition, a lifestyle, or social obligations. This is a personalized understanding of risk-benefits.

The progress towards DART cannot be stopped. The case of the patient-doctor interaction is not isolated.

We believe that the opportunities for value creation are enhanced significantly for firms that embrace the concepts of personalized co-creation experience as the source of unique value. Personalizing the co-creation experience differs from the concept of “customers as innovators.” Customers of a firm like General Electric Plastics assume much of the task of developing a custom resin for a specific application. By providing access to tools and a library of compounds, GE shifts effort and risk to its customers (Thomke & von Hippel, 2002). When the process works well, both parties benefit. GE saves development time and reduces its risk, while customers can get what they want with greater speed and accuracy. But as long as the process remains firm centric and product centered, it is at best a variant of the current dominant logic.

The same applies to the conventional approach to product or service customization. Starting from a traditional firm-centric view of value creation, managers focus on providing products and services to a single customer at low cost. This process leads to mass customization, which combines the benefits of “mass” (large-scale production and marketing and therefore low cost) with those of “customization” (targeting a single customer). The focus on product-feature development leads to increased product choice for consumers. On the Web, for example, consumers can customize products and services ranging from business cards and computers to home mortgages and flower arrangements, simply by choosing from a menu of features. But such customization tends to suit the company’s supply chain, rather than a consumer’s unique desires and preferences.

Personalizing the co-creation experience means fostering individualized interactions and experience outcomes. It involves more than a company’s à la carte menu. A personalized co-creation experience reflects how the individual chooses to interact with the experience environment that the firm facilitates. We are suggesting a totally different process—one that involves individual consumers on their terms—a broad challenge that business leaders must face (Prahalad & Ramaswamy, 2003).

Once we discard the “firm-centric” view of value creation and accept the “co-creation” view, the evidence of this shift is visible in a wide variety of industries. For

example, video games could not exist without active co-creation with consumers. At the other extreme, traditional firms like John Deere are building extensive networks that allow farmers to share their experiences, dialogue with the company and among themselves, and increase their productivity. The OnStar network of GM is another case in point. The system has the potential to allow individuals to construct their own experience. GM provides the platform. As an individual, I can decide to seek advice on restaurants or ask them to alert me to breaking news or the progress of my favorite football team. These are all possibilities. Individuals construct their own experiences. Ebay and Amazon are further examples of this trend—both facilitate the process of personalized experiences, both involve communities, both facilitate dialogue.

The transition from a firm-centric view to a co-creation view is not about minor changes to the traditional system. Note what co-creation is *not*. It is neither the transfer or outsourcing of activities to customers nor a customization of products and services. Nor is it a scripting or staging of customer events around the firm’s various offerings (e.g., La Salle & Britton, 2002; Peppers & Rodgers, 1993; Schmitt, 1999; Seybold, 1998). That kind of company-customer interaction no longer satisfies most consumers today. The change that we are describing is far more fundamental. It involves the co-creation of value through personalized interactions based on how each individual wants to interact with the company. Co-creation puts the spotlight squarely on *consumer-company interaction as the locus of value creation*. Because there can be multiple points of interaction anywhere in the system (including the traditional point of exchange), this new framework implies that all the points of consumer-company interaction are critical for creating value. Since no one can predict the experience a consumer will have at any point in time, the task of the firm is one of innovating a robust experience environments (Prahalad & Ramaswamy, 2003). Hence, our view of value co-creation challenges both images of a market: as an exchange of product and service offerings and as an aggregation of consumers. Traditional economics focuses squarely on the exchange of products and services between the company and the consumer, placing value extraction by the firm and the consumer at the heart of the interaction. In the co-creation view, all points of interaction

between the company and the consumer are opportunities for both value creation and extraction.

The co-creation view also challenges the market as an aggregation of consumers for what the firm can offer. In the new value co-creation space, business managers have at least partial control over the experience environment and the networks they build to facilitate co-creation experiences. But they cannot control how individuals go about co-constructing their experiences. Co-creation, therefore, forces us to move away from viewing the market as an aggregation of consumers and as a target for the firm's offerings. Market research, including focus groups, surveys, statistical modeling, video ethnography, and other techniques were developed in an effort to get a better understanding of consumers, identify trends, assess consumer desires and preferences, and evaluate the relative strength of competitors' positions. Within this framework, the ultimate concept in customer segmentation is one-to-one marketing.

While debates rage about the adequacy of our marketing methodology, the underlying vision of consumers as targets (prey) is rarely questioned. But what if the consumers were to turn the tables? What if consumers were to start investigating companies, products, and potential experiences in a systematic way? Is it sufficient for companies to "sense and respond" to customer demands? Do managers need market foresight—besides market insight? Must they

learn to anticipate and lead, and further, to co-shape expectations and experiences?

In co-creation, direct interactions with consumers and consumer communities are critical. Consumer shifts are best understood by being there, co-creating with them. Firms must learn as much as possible about the customer through rich dialogue that evolves with the sophistication of consumers. The information infrastructure must be centered on the consumer and encourage active participation in all aspects of the co-creation experience, including information search, configuration of products and services, fulfillment, and consumption. Co-creation is more than co-marketing or engaging consumers as co-sales agents. It's about developing methods to attain a visceral understanding of co-creation experiences so that companies can co-shape consumer expectations and experiences along with their customers.

Thus, in the emerging concept of a market, the focus is squarely on consumer-company interaction—the roles of the company and the consumer converge. The firm and the consumer are both collaborators and competitors—collaborators in co-creating value and competitors for the extraction of economic value. The market as a whole becomes inseparable from the value creation process, as shown in Figure 3.

Co-creation converts the market into a forum where dialogue among the consumer, the firm, consumer

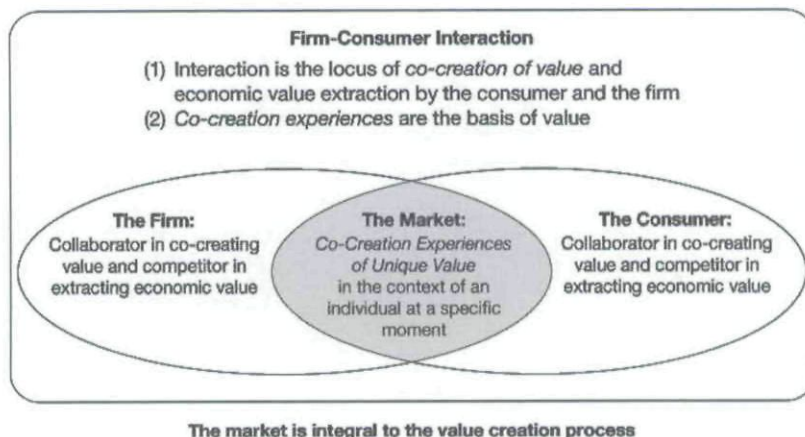


FIGURE 3

The Emerging Concept of the Market

TABLE 2

Transformation of the Relationship Between Firms and Consumers

FROM	TO
<ul style="list-style-type: none"> • One-way • Firm to consumer • Controlled by firm • Consumers are "prey" • Choice = buy/not buy 	<ul style="list-style-type: none"> • Two-way • Consumer to firm • Consumer to consumer • Consumer can "hunt" • Consumer wants to/can impose her view of choice • Consumer wants to/is being empowered to co-construct a personalized experience around herself, with firm's experience environment

Source: Adapted from Prahalad & Ramaswamy (2005).

communities, and networks of firms can take place. The transformation of the relationship between firms and consumers is shown in Table 2.

THE MARKET AS A FORUM FOR CO-CREATION EXPERIENCES

Co-creation of value fundamentally challenges the traditional distinction between supply and demand. When the experience, along with the value inherent in it, is co-created, the firm may still produce a physical product. But the focus shifts to the characteristics of the total experience environment. Now demand is contextual. Given that customers cannot predict their experiences, co-creation of value may well imply the death of traditional forecasting. Instead, the focus shifts to capacity planning, the ability of the experience network to scale up and down rapidly, and for the system to reconfigure resources in real time to accommodate shifting consumer desires and personalization of co-creation experiences. Such a system may be highly demanding, yet it promises incredible efficiency gains as well. We must view the market as a *space of potential co-creation experiences* in which individual constraints and choices define their willingness to pay for experiences. In short, the market resembles a forum for co-creation experiences.

The market as a forum challenges the basic tenet of traditional economic theory: that the firm and the

consumers are separate, with distinct, predetermined roles, and, consequently, that supply and demand are distinct, but mirrored, processes oriented around the exchange of products and services between firms and consumers. We believe that, in time, new approaches and tools consistent with a new *experience-based view of economic theory* will emerge. We have identified and summarized some of the key points of departure in Table 3.

The new frame of value creation creates new competitive space for firms. To compete effectively however, managers need to invest in building *new infrastructure capabilities, as well as new functional and governance capabilities*—capabilities that are centered on co-creation through high-quality customer-company interactions and personalized co-creation experiences (see Prahalad & Ramaswamy, 2004). While the building of new capabilities is critical, it is less difficult than changing one's dominant logic. Unless we make a shift from a firm-centric to a co-creation perspective on value creation, co-extraction of economic value by informed, connected, empowered, and active communities of consumers on the one hand and cost pressures wrought by increased competition, competitive discontinuities, and commoditization on the other will only make it harder for companies to develop a sustainable competitive advantage. The future belongs to those that can successfully co-create unique experiences with customers.

IMPLICATIONS FOR INTERACTIVE MARKETING

As we move rapidly to a co-creation experience as the basis of value, the fundamental interaction between the firm and the consumer changes in character and importance. As we have discussed, the interaction becomes the locus of value creation; the interaction can be anywhere in the system, not just at the conventional point of sale or customer service. In the traditional view of marketing, interaction is where the firm markets its offerings to extract economic value from the consumer (based on the value the firm has already created through its value chain). This firm-centric and product-centric view is deep-rooted and manifests itself at all the interfaces and touchpoints between firms and customers. Firms manage customer relationships leaving little room for customers

TABLE 3

The Market as a Target for the Firm's Offerings Versus a Forum for Co-Creation Experiences

THE MARKET AS A TARGET

The firm and the consumer are separate, with distinct predetermined roles.

Supply and demand are matched; price is the clearing mechanism. Demand is forecast for products and services that the firm can supply.

Value is created by the firm in its value chain. Products and services are exchanged with consumers.

Firm disseminates information to consumers.

Firm chooses which consumer segments to serve, and the distribution channels to use for its offerings.

Firms extract consumer surplus. Consumers are "prey," whether as "groups" or "one-to-one." Firms want a 360-degree view of the customer, but remain opaque to customers. Firms want to "own" the customer relationship and lifetime value.

Companies determine, define, and sustain the brand.

THE MARKET AS A FORUM

The firm and the consumer converge; the relative "roles of the moment" cannot be predicted.

Demand and supply are emergent and contextual. Supply is associated with facilitating a unique consumer experience on demand.

Value is co-created at multiple points of interaction. Basis of value is co-creation experience.

Consumers and consumer communities can also initiate a dialogue among themselves.

Consumer chooses the nodal firm and the experience environment to interact with and co-create value. The nodal firm, its products and services, employees, multiple channels, and consumer communities come together seamlessly to constitute the experience environment for individuals to co-construct their own experiences.

Consumers can extract the firm's surplus. Value is co-extracted. Consumers expect a 360-degree view of the experience that is transparent in the consumer's language. Trust and stickiness emerge from compelling experience outcomes. Consumers are competitors in extracting value.

The experience *is* the brand. The brand is co-created and evolves with experiences.

Source: Prahalad & Ramaswamy (2004).

to have a voice, inject their view of how they want to (individually and collectively) interact with firms and consumer communities, and co-create value that customers are, by design, "willing to pay for."

But co-creation demands that both managers and consumers make the necessary adjustments. For example, both must recognize that the interaction between the two—the locus of value creation—must be built on critical building blocks. It must start from access and transparency. Firms have traditionally opposed transparency. The fight against product labeling is well known. Releasing information regarding the likely risks is often mandated. It must become voluntary. Further, transparency and access are of little value if the firms do not create the infrastructure for dialog. This requires investment in technology but more important, investments in socializing managers

and changing managerial practices. How does a firm engage in a dialog? How do you understand the underlying expectations of millions of consumers and their utility functions? The infrastructures and the governance processes that are emerging in a wide range of industries is an indication of implicit negotiations (e.g., Expedia, eBay, Amazon, and others). The system allows for the consumers to inject or state their expectations and their willingness to monetize their own experiences and makes it explicit. The firm also has a way of accepting or rejecting that specific transaction at that time. What is emerging is that dialog requires us to invest time and effort to understand the economics of experience and develop systems to come to agreements rapidly. Finally, firms must recognize that the more educated the consumer, the more likely it is that she will make an intelligent choice and make tradeoffs that are appropriate to her

context. This does not take away the responsibility of the company to deny some choices. As everyone knows, the barman has the obligation to know when to stop serving drinks.

Consumers have to also learn that co-creation is a two-way street. The risks cannot be one sided. They must take some responsibility for the risks they consciously accept. The tobacco company has the obligation to educate consumers on the risks of smoking and develop cessation programs. But if a consumer persists in smoking, he must take responsibility for his own actions. In cases where the consumer is unlikely to have the expertise to make that choice, they must accept the choice made for them by a neutral party such as the Federal Drug Administration. The governance issues that will mediate the interactions and create mutually beneficial results for the consumer and the firm is the goal. This we believe is the next practice of value creation.

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