



How value is created, captured and destroyed

Value created,
captured and
destroyed

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Abstract

Purpose – The purpose of this paper is to address value and the value-creation process. It argues that the firm operating in line with investor interests, acts as both a customer and a supplier of value and considers the internal activities that reflect these motivations.

Design/methodology/approach – A series of propositions are developed regarding the creation, capture and destruction of value.

Findings – It is argued that two types of value-creating activities can be identified. In addition there are activities directed at the maintenance of the firm, and the maintenance of its capital stock, and there are activities that destroy value. Value capture is determined by bargaining relationships between stakeholders and their representatives. The paper concludes with some comments regarding value appropriation.

Originality/value – The paper addresses the critical issue of “value” in the resource-based view (RBV) and specifically begins to develop the RBV away from its neo-classical roots.

Keywords Value analysis, Value chain

Paper type Conceptual paper

Value creation is a central concept in the management and organization literature for both microlevel (individual and group) and macrolevel (organization theory and strategic management) research. Yet there is little consensus on what value creation is or on how it can be achieved (Lepak *et al.*, 2007, p. 180).

This is a surprising comment which has been echoed by those that argue that there is still confusion surrounding various aspects of what is meant by value and the process of value creation (Barney, 2001; Bowman and Ambrosini, 2000, 2007; Makadok and Coff, 2002; Priem, 2007; Priem and Butler, 2001a, b). We believe that part of the problem with the term “value” is that it means different things to different people. Thus, we focus specifically on the following questions: what does value mean to different firm stakeholders? How is value created? And how are value-creation processes sustained over time? We explain value capture as the outcome of a bargaining process, and we also address the issue of value destruction, which we believe is central to any exploration of the processes of value creation within firms.

We suggest that value is not a single phenomenon, it is multi-faceted and in need of some clarification. We propose that value means different things to different stakeholders of the firm, specifically its customers, suppliers, employees and investors. We begin by explaining the terms we use, making a distinction in particular between use value (UV) and exchange value (EV), and between value creation and value capture. We then consider the firm itself in the role of a customer for UVs and supplier of UVs, and



distinguish activities inside the firm that reflect the firm's motivations when these separate roles are performed. Five types of activity can be identified. Two types are involved with the process of value creation: one is concerned with the capture of EV from customers, and another with the capture of UV from suppliers. Two other activity types are directed at the maintenance of the firm, and the maintenance of its capital stock. The final category is activity that destroys value.

We are interested in the attempts to re-position resource-based view (RBV) away from its neo-classical roots (Lippman and Rumelt, 2003b). Consequently, we do not employ the familiar neoclassical concepts of rent and opportunity costs. We view the firm as a going concern, and as a gestalt of interacting UVs. The past prices paid for these UV inputs and their current market value or opportunity cost are not of primary concern here, even if such prices were calculable. We make the following points in the paper:

- We clarify the distinctions between UV and EV.
- We distinguish between separable inputs and human inputs into the productive process and explain that new UV is created solely by human inputs interacting with separable assets and bought in materials.
- We explore the motivations of the primary stakeholders of the firm with respect to UV and EV.
- We suggest that the firm as an economic actor is both a customer for UVs and a supplier of UVs and performs these roles to return a stream of EV to investors.
- We identify activities inside the firm that constitute the value-creation process.
- We explain that the value created by the firm is distributed according to the outcomes of bargaining processes between stakeholders and their representatives.
- We show how resource-endowed firms can nevertheless have below average profitability due to the presence of value destroying activities, or through successful bargaining by resource owners/providers.

Use and exchange values

Before we embark on an explanation of our approach, we need to be clear about our use of value terminology in the following argument. This is necessary as it is:

[...] rather commonplace in the existing RBV of the firm literature for authors to use the term value or even value creation to mean what Bowman and Ambrosini (2000) [date added] call "captured value" or "value capture" (Makadok and Coff, 2002, p. 11).

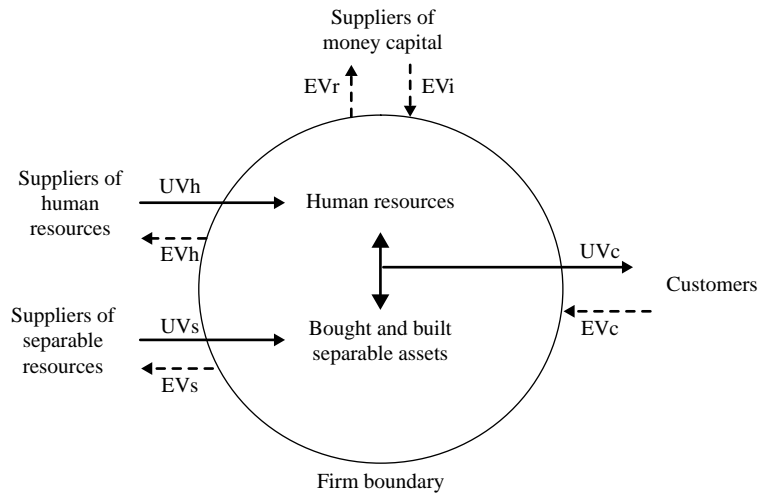
UVs are properties of products and services that provide utility. Inputs into the productive process take the form of separable UVs, e.g. components such as flour or steel and human inputs. Separable inputs are UVs that exist separately from people (Bowman and Swart, 2007). They would include any bought-in materials, and machinery, patents, logos, etc. owned by the firm. Human inputs are UVs in the form of performed services or activities. The peculiarity of human inputs is their ability to create new UVs.

EV is a monetary amount exchanged between the firm and its customers or suppliers when UVs are traded. UVs are converted into EV when they are sold in factor markets or product markets. We assume that firms are established to generate a profit flow for investors and that profit is EV retained within the firm, which may be re-invested or passed on to these equity owners.

The firm contains the processes of UV creation (Figure 1). Within the firm inputted separable UVs like components, ingredients, data, etc. (UVs in Figure 1) are transformed into products and services by employees (UVh). Separable inputs contribute their fixed and usually known UVs to the productive process. These inputs are UVs; they have useful, primarily physical properties, but this stock of UVs cannot self-expand. They cannot of their own volition create more value than they embody. These inputs cannot, therefore be the source of any additional UV, and subsequently of any additional EV accruing to the firm unless they have been transformed in some way (Bowman and Ambrosini, 2000). In summary, then, separable inputs have UV, but they cannot create UV.

Human inputs are different (UVh in Figure 1). They are capable of creating new UVs that generate a revenue stream. Employees working with separable inputs create new value (Lado and Wilson, 1994; Wright *et al.*, 1994). It is the interactions between human inputs and separable inputs and assets that create new UVs.

UVh also includes the enhanced productive capabilities of the employed labour that results from experience and learning (Argote, 1999; Nonaka and Takeuchi, 1995; Senge, 1990). Just as the UV of labour in action is its ability to create new UVs, where human capital is created this is manifested in the enhanced UV creating capability of the employed labour. The contribution is enhanced relative to past levels of performance. This category would include informal networks, and valuable aspects of organisational culture that are embodied and embedded in the workforce (Barney, 1986a; Bartlett and Ghoshal, 1993; Nahapiet and Ghoshal, 1998). Here, we need to recognise that human capital may take the form of teams (Grant, 2000), and “communities of practice” (Lave and Wenger, 1991) and that individuals and teams are likely to be more productive when they are combined with other complementary organisational assets. In all but the simplest firms there will be synergies between employees combined in networks, teams, functions, etc. This definition of human inputs encompasses the notion of social capital (Nahapiet and Ghoshal, 1998; Pennings *et al.*, 1998).



Notes: ← - - - flows of exchange value; → flows of use value

Figure 1.
Flows of UV and EV

The fixed assets of the firm, like buildings and machinery are enduring separable UVs. Once a firm is a going concern additional forms of capital can be created. This would include certain aspects of relational capital like brand awareness, reputation and trust (Amit and Shoemaker, 1993; Brooking, 1997; Edvinsson and Malone, 1997; Sveiby, 1997). It would also comprise internally created separable resources such special equipment or software. These can be regarded as intermediate separable UVs created inside the firm to improve the efficiency and/or effectiveness of the UV creation processes. These may well be RBV resources, that is resources that are simultaneously valuable, rare, non-imitable and non-substitutable and that hence can be sources of sustainable competitive advantage (Barney, 1991, 1995; Wernerfelt, 1984).

The essential difference between intermediate UVs (brands and systems) and the development of human capital described earlier are that the former exist separate from the individuals that may work with them, whereas the latter developments in human capital are embodied in individuals, groups and their routines. These may take the form of tacit knowledge and tacit routines, knowledge assets that are attached to the knower (Nelson and Winter, 1982; Nonaka, 1991; Polanyi, 1962). Clearly if tacit routines were to be made explicit, codified in some way, then this knowledge would exist in a form separate from the individuals or groups. In this case it could become an intermediate UV, able to be deployed into other parts of the firm. Similarly, it may be possible for this created intermediate UV to be sold, so it could potentially be priced. In terms of the RBV organisational and human capital are UVs that have been “built rather than bought” (Teece *et al.*, 1997).

To simplify the exposition we label all these assets as “bought and built separable assets” in Figure 1. However, distinctions between these categories of UV capital are important when we consider issues of competitor imitation of the firm’s assets. Generally within RBV argumentation bought assets like machinery, land, buildings are rarely RBV resources as near identical assets can usually be procured by competitors (Conner, 1994; Quinn, 1992). On the other hand, internally created or “built” assets like special systems, adapted machinery, brands, etc. may well fulfil the criteria for a resource, they are more likely to pass the valuable, rare, imperfectly imitable and imperfectly substitutable tests, be valuable, rare, imperfectly imitable and imperfectly substitutable (Barney, 1991, 1995; Wernerfelt, 1984).

We must however stress that we are making a clear distinction between separable inputs and human inputs. If managers are able to derive new ways of deploying separable inputs to create new forms of value, then it must be highlighted that this process of value creation cannot be attributed to the separable resources re-deployed. These UVs may have greater utility in new deployments, but the act of value creation, the insight to spot the new deployment was a product of human inputs. The UVs of the separable inputs are fixed, any change in their utility can only be effected by people. This argument is not novel in the sense that it emphasises that people matter most in organisations (Pfeffer, 1995; Pfeffer and Veiga, 1999; Felin and Hesterly, 2007). It is also in line with Penrose (1959, p. 25) where she argues that “it is never the resources themselves that are the inputs to the production process, only the services that the resources can render” and that people determine how a particular input will perform a “service” in a productive process not the separable input itself (Kogut and Zander, 1992).

What does “value” mean to stakeholders?

The key stakeholders in the firm are its customers, the suppliers of separable inputs, the suppliers of human inputs and the owners of the firm (Clarkson, 1995; Freeman, 1984) and in what follows we argue that value has a different meaning for each of these stakeholder groups.

When forming our propositions we have employed the term optimise to reflect the fact that it is likely that stakeholders will seek to optimise relationships over time, rather than attempt to maximise or “gouge” other parties for short-term gains. So although we believe the underlying stakeholder motivations are properly reflected in the following propositions, we would not assume entirely opportunistic behaviour on their behalf, particularly if there is a perceived need to maintain relationships over time. We return to these issues later on.

What does “value” mean to customers?

To the customer value can be argued to mean consumer surplus, or colloquially “value for money”. This is a subjective judgement of the UV of the supplied product or service, compared with the price charged for it, its EV. In making these judgements customers factor in their knowledge and evaluations of competing product offers. If we assume the customer is interested in optimising “value for money”, then we could state that the customer would strive to optimise the ratio of UV acquired for EV paid (price):

P1. Customers aim to optimise the ratio of UV acquired for the EV paid.

We have labelled these EVc and UVc in Figure 1. UV, being a subjective assessment, cannot be compared directly with any EV amount. One can however assume that consumers would aim to optimise the amount of UV acquired for a given sum of EV, where amount could refer to a qualitative or a quantitative improvement. If the customers choose to attach a monetary estimate to the perceived UV of the product (\$UVc), which would be an estimate of what they would be prepared to pay for this product, or its “reservation price” (Collis and Montgomery, 1995) then we can suggest that customers are interested in optimising the difference between \$UVc and \$EVc. This “consumer surplus” could be measured as: \$UVc-\$EVc.

In the instance of a monopoly supplier, who is cognisant of the customers’ valuation, and who can price discriminate, the price the customer actually pays will approach the “reservation price” the customer is prepared to pay. There would then be no discernable difference between the customer’s monetary expression of perceived UV (\$UVc) and the price paid (\$EVc) and hence no consumer surplus would result. In all other circumstances, the price paid will be less than the total monetary value perceived by the customer, so there would be positive consumer surplus.

What does “value” mean to suppliers?

Suppliers of separable inputs to the firm have a different view of value. They are not acquiring UVs, rather they are providing them in return for EV. So value to the supplier is the inverse of value to the customer:

P2a. Suppliers of separable inputs aim to optimise the EV received for the UV supplied.



In the case of a supplier of separable inputs the UV supplied is fixed. Moreover, as the point of creating UV is solely as a means of generating EV, the UV of the product to the supplier is probably close to zero (bakers have no personal use for the hundreds of loaves they bake). Thus, it can be argued that supplier EV is increased where the price received for a fixed amount of UV is optimised (optimise EVs:UVs).

Suppliers of human inputs, whether as employees or as service providers, have a different conception of value to that of the supplier of separable inputs to the firm. The UV they supply is their capacity to work. This capacity is the only source of new UV, because as we argued earlier the contribution of separable inputs is fixed. The UV of labour in action combines with separable inputs and built and bought assets to create new UVs.

We might expect the suppliers of human inputs to contract with the firm in the same way as suppliers of separable inputs, seeking to optimise the EV (EVh) they can capture for a given amount of UV, or work, supplied (UVh). This assumption of a calculative involvement with the firm (Etzioni, 1988) may only have limited validity. Great efforts are often made by both employees and firms (which presents itself to employees in the form of hired managers, co-workers, etc.) to shift the nature of the relationship away from this purely calculative involvement. Individual employees may prefer to view their working lives as something more than a simple exchange relationship, and firms may wish to have employees engage more fully with the firm, where they commit not just their hands, but their brains and their hearts too. This suggests that the firm necessarily has a much more complex relationship with these suppliers than it would have with suppliers of separable inputs:

P2b. Suppliers of human inputs aim to optimise the EV received for the UV they supply, an aim that may be moderated by other personal motivations.

What does “value” mean to investors?

The owners of the firm again have a different notion of what value means. Investors supply capital, a monetary sum. This sum is invested on the assumption that more money will flow to the investor, that there will be a “return” on this investment. The investor therefore provides EV, to capture more EV. The investor seeks to optimise return on the capital sum advanced (optimising EVr:EVi):

P3. Investors aim to optimise the EV returned for the EV invested.

There are two primary ways of “investing” in firm. One is to provide equity or risk capital, for a legal claim on the surpluses generated by the firm, which will vary as surpluses vary. The other is to provide debt capital for a fixed claim on these surpluses. In either case it is essential here to emphasise that the investor provides no UVs as such to the firm, and acquires no UVs from the firm. Investors supply a homogenous input: money. The UV of money is its role as a store of value, and its function as a medium of exchange. Money qua money cannot function as capital. The only way money can function as capital is if it is converted from its money form into specific, definite, concrete UVs. Where investors supply cash to establish a firm or to fund specific projects this conversion process is transparent. Where investors acquire stocks or shares there is no addition to the value-creation process. What is being traded here is partial ownership of the firm as a value-creating system. Investors exchange cash for property rights, which then allow investors to capture a proportion of the EV the firm captures from customers.

In short therefore, investors provide no UV to the firm and acquire no UV from the firm, only EV is involved. Note that from an investor perspective a firm may be “valuable” even when it has sold nothing if investors perceive the firm will be profitable in the future, e.g. the trading of shares of many of the dot.com companies at the height of the bubble that had yet to even sell anything.

We have focussed on flows of UV and EV. In any given time period the flow of profits would be $EV_c - (EV_h + EV_s)$. This profit flow could be passed on entirely to the investors such that $EV_r = (EV_c - (EV_h + EV_s))$. If the owners choose to reinvest these surpluses in the development of future assets then, ceteris paribus, their original investment (EV_i) would be augmented ($EV_i + EV_r$). This would be a shift in EVs, but in practice this sum of “retained earnings” would be manifested in UVs, which would hopefully either be represented by enhancements in UV_h (improvements in the quality or additions in the quantity of human resources) or the sums could be invested in improving the stock of separable assets (UV_s).

In summary, we have argued that value means different things to different stakeholders. We have also established that, not only is there an obvious difference between suppliers and customers as to their motivations when contracting with the firm, but also that within the category of suppliers there are three distinct stakeholder types who have particular motivations and relationships with the firm. Suppliers of separable UVs have an “arms length”, primarily calculative involvement with the firm, whereas suppliers of human resources have a qualitatively more intense involvement, and investors have no UV involvement at all.

The question that now needs answering is: what does value mean to the firm?

What does “value” mean to the firm?

The firm as an economic actor and a legal entity is both a customer for UVs and a supplier of UVs. Thus, we would expect the behaviour of the firm to reflect the motivations set out above for these two stakeholder groups. So in acting as a customer, the firm would seek to optimise the UV of inputs acquired, for the minimum EV given up to suppliers. As a customer the firm acts to optimise the firm’s consumer surplus.

As a supplier, we would expect the firm to aim to optimise the EV captured from customers for a given UV supplied. Firms must therefore differentiate their product offerings in ways which are valued by the customer. Firms must deliver more consumer surplus than competitors. This can be achieved by either offering equivalent perceived UV at a lower price, superior UV at equivalent prices to competitors, or indeed a combination of these two. The availability of close substitutes will reduce prices, and thereby increase consumer surplus, but this will reduce the firm’s ability to capture EV.

The firm performs the roles of supplier and customer for an ultimate purpose: to return an expanding stream of EV to investors. In other words, the firm is fundamentally a system for the continual expansion of EV provided by investors. We are privileging therefore the interests of the investor over those of other stakeholders. While this is debatable (Coff, 1999; Makadok, 2003) this assumption is consistent with the RBV tradition that has assumed that within a capitalist economy production is undertaken in the pursuit of profit (Barney, 1986b; Makadok, 2001). Firms that do not make money go out of business:

P4. Firms operate primarily in the interests of the investor, so value for the firm means retained and/or returnable EV.

The expected motivations therefore with respect to the roles of customer and supplier should be in line with the aims of the investor. We would expect that if the firm behaved as a customer and a supplier that the optimum EV would be captured from customers, the minimum EV passed back to suppliers, and thus the optimum profit would be returnable to the owners of the firm. Owing to agency problems resulting from the divorce of ownership from control, information asymmetries, bounded rationality and so forth firm behaviour towards customers and suppliers may not however result in the maximising of profits.

Building on the argument, and viewing the firm as a customer on the one hand and a supplier on the other, we can identify activities inside the firm that are involved in optimising EV capture from customers, and activities directed at optimising UV capture from suppliers. These activities combine to form the “value-creating” activities of the firm. “Value” in this case being value from an investor perspective, i.e. profit flow, the EV captured by the firm.

In the next section, we explore these different types of activities that are involved in the process of value creation.

Value-creating activities

Having explored the issue of what value means to different stakeholders, we can now turn our attention to the question of how value is created. We have already established that separable inputs contribute a fixed and usually known quantity of UV to the productive process. To restate the argument, separable inputs have UV, they cannot self-expand the UV they possess or embody, and new UVs can only be created by the human inputs into the process (UVh). Our argument also indicates that, in line with Priem and Butler (2001a) and Barney (2001) EV is determined by exogenous factors. It is a function of perceived UV acquired and supplied. Moreover, it shows that EV is only realized when a sale takes place. UV is perceived by the customer at a point in time, it is assessed at the point of the decision to purchase. The product at the time of sale has both an EV and a perceived UV.

There are two categories of activity that can have a positive impact on the flow of profits, and three that have a negative impact in the short-term. We first explore activities that reflect the firm as a supplier of new UVs, and our second type of activities are associated with the firm as a customer of UVs. Both these activities can be identified in March’s (1991) terminology as knowledge exploitation.

Activities that capture EV

These activities are involved in the production and sale of products and services, and would include the primary activities of a value chain (Porter, 1985), i.e. inbound logistics, operations, outbound logistics, sales and service. These activities combine to make UVs or provide services that produce a revenue stream to the firm. These activities reflect the firm’s motivation as a supplier as it aims to optimise the sum of EV captured for a given amount of UVs supplied (optimising EVc:UVc). Hence:

- P5. Profit seeking firms will seek to optimise the sum of EV captured for a given amount of UV supplied.

The worth of these activities can only be identified in retrospect as unless the activity leads to a sale, i.e. it ultimately results in the capture of EV from customers, the activity cannot be judged to be productive.

Activities that capture UV

These activities are directed at the capture of UV from input suppliers, i.e. the aim of this activity is to optimise the flow of UVs into the firm for a given amount of EV given up. So, these activities reflect the firm's motives as a customer.

These value capture activities would include procurement, supervision (to capture human UV inputs), as well as activities designed to increase production efficiencies, like process engineering. So these activities aim to optimise the separable UVs and the human inputs procured: optimise UVs:EVs and UVh:EVh. Hence:

P6. Profit seeking firms will optimise the amount of UV captured for a given sum of EV.

The effect of these activities is therefore to moderate the cost flows incurred by all other activities. For instance, artful procurement can result in a cost advantage where the firm pays less than rivals for equivalent UV inputs. Cost advantages in procurement can derive from artful buying, e.g. Makadok's (2001):

[...] resource "picking", or through the exercise of the firm's bargaining power (an economy of scale), or through locational advantages. Also firms can gain procurement cost advantages by having more efficient value creation processes, i.e. they don't use as much material or labour as rival firms.

Note that the acquired separable inputs would only be RBV resources because of the artful way they have been procured. A resource created by "picking" delivers a greater UV:EV ratio than a rival firm's inputs. Also excessive zeal in performing value capture activities can be ultimately counter-productive, for example, if planned maintenance schedules are ignored, or if safety is compromised.

The firm contains the processes of UV creation. The objective of these processes is EV capture which provides an expanding stream profits to the shareholders. The flow of profits is the difference between the flow of revenues (EV_p) and the flow of costs ($EV_s + EV_h$). Whether one treats the returns to the owners (EV_r) as a surplus or as an input cost is the crux of a debate between neo-classical economists and those of a more classical persuasion. As this point does not affect the thrust of our argument we shall note it but not engage with it here.

We now turn our attention to activities that create new capital. These activities can be described as exploratory activities (March, 1991); they are about creating and building the stock of capital.

Capital stock creating activities

These activities can be funded out of current streams of EV captured from customers or they can be funded directly by cash injections from investors, and would include market research, R&D, and training. They help to preserve the capital stock of the firm by, for example, ensuring that the firm adapts to changes in the firm's market environment, and they hopefully extend the capital stock through the creation of new resources.

These activities are intended to generate future streams of firm value. The dilemma is that these activities incur costs today for unknowable future benefits. Hence, in the short-term these activities reduce the EV retained by the firm. However, they help to preserve and expand the stock of human and organisational capital into the future.

These activities can produce intermediate UVs, i.e. UV created by the firm for its own usage and not for exchange, like systems, new product concepts, etc. that can turn into built RBV resources if they are unique, valuable, non-imitable and non-substitutable. They preserve the capital stock by ensuring that the activities are updated and refreshed in line with changes in the firm's environment, and they can expand the firm's capital with the introduction of new value-creating activities. These may be discrete and deliberately managed support activities like R&D (Porter, 1985) or they could be co-produced with ongoing value-creating activities. Co-produced activities would include learning from reflection or from interactions with clients (Argote, 1999; Argyris, 1970; 1990). Some capital creation activities may be undertaken without official sanction from management as individuals experiment with new ideas and approaches to their tasks. Dynamic capabilities directed at the creation of future resources are capital stock creation activities (Eisenhardt and Martin, 2000; Makadok, 2001; Teece *et al.*, 1997). However, these activities are typically vulnerable to short-term pressures to trim costs as the value created by them can only be assessed ex post. Hence:

P7. Expenditure on capital stock creating activities is vulnerable to short-term pressures to cut costs.

Clearly, given that the future behaviour of the market is unknown, persisting with these cost-creating activities is to some extent an act of faith. Managers that choose to devote expenditure to these activities do so based on the assumption that they will generate future profits, and that these profit streams will either add to the current volume of profits, or replace them. Whether these costs can be justified to investors is an empirical question. Some may prefer to have the cash to invest elsewhere, rather than assume that this management team can organise the creation of future profitable schemes within the constraints of this particular firm.

Firm maintenance activities

These activities are necessary for the maintenance of the firm in a particular social context, including infrastructure activities (Porter, 1985) like finance, company secretariat, health and safety, legal, etc. These activities are necessary to conduct business, but they do not contribute to present or future profit streams. They could be viewed as the necessary costs incurred to acquire a "licence" to be allowed to trade in a particular context. Efforts will be made to perform these necessary activities at lowest cost. There are related expenditures, which are not activities, but they have a similar impact. These expenditures include tax, social welfare payments, training levies, etc. Some stakeholders' models of the firm include a catch-all "society" stakeholder category (Clarkson, 1995; Freeman, 1984), and these maintenance expenses could be viewed as payments to society. So it could be argued that maintenance activities, and maintenance expenses are a response to societal pressures, but profit seeking firms will act to reduce the impact of these expenses. Hence:

P8. Profit seeking firms will seek to minimise expenditure on maintenance activities.

Value destroying activity

There are in all firms activities that destroy current value. They do not contribute to the capture of EV or the capture of UVs. These activities also do not have any link to

future profitability nor are they necessary maintenance activities. These inefficiencies are likely to exist because of poor management. They do not add to revenues, nor do they help reduce costs, therefore the expenses they incur actually destroy shareholder value. They may be sources of competitive disadvantage, they are weaknesses and inadequacies within the firm that have a negative effect on competitive advantage (Arend, 2004; Bowman and Ambrosini, 2007; Powell, 2001): “firms may do many things well, but if they do one thing wrong it may negate all the other good” (West and DeCastro, 2001, p. 424). These are liabilities in the true sense of the word. Hence:

P9. Profit seeking firms will seek to eliminate value destroying activities.

We need to point out that although value-destroying activity is a theoretically credible construct, it is unlikely to be present in an obvious or discrete form. If it were we would expect that these problems would be identified and steps would be taken to eliminate them. All value-creating activities are likely to contain some unproductive elements intertwined with their valuable elements. These elements would not necessarily present themselves in straightforward ways, and it may be difficult to eliminate the unproductive elements without having a detrimental impact on the productive aspects of the activity. The presence of value destroying activities may result in a resource-endowed firm earning only average or indeed below average profits:

P10. Owing to the presence of value destroying activities resource-endowed firms may earn below average profits.

Value capture

Thus, far we have focussed on the process of value creation within the firm and hence we have explained how it can optimise profits “by adjusting the ways in which it uses and combines resources and by its purchase and sale of resources” (Lippman and Rumelt, 2003b, p. 924). Recently, Lippman and Rumelt (2003a, b) have set out two important contributions to the RBV, one explaining that all of the firm’s revenues are payments to resources, i.e. EVs, and that within certain parameters the revenues captured by resources are a function of a bargaining process akin to a form of cooperative gaming. For them the bargaining process is not between firms or products, but rather “the individual resources that lie behind them” Lippman and Rumelt (2003a, p. 1070). They explain that:

[...] a resource such as a rich silver mine isn’t “just a factor”, it is the source of wealth in a competitive economy. If it is more productive than other mines, it will receive a larger payment for its services (Lippman and Rumelt, 2003a, p. 1070).

We support this view, but we feel there is a possible danger of reification of separable resources in this line of argument. We have to be careful not to argue that resources capture value, for example. Resource owners might capture value. Moreover, if all revenues are equivalent to costs, there is no “economic” or any other profit or surplus to have to explain, which seems to lead to stakeholders receiving their “just rewards”.

If we assume that Lippman and Rumelt (2003a) are referring to the mine as a separable UV, i.e. as a location of silver bearing ore, then, in this form, the mine creates no value. It has UV, but it creates no more UV than it has. Moreover, “it” cannot receive any payments; “it” is a piece of land. What makes it a valuable piece of land are the past efforts of prospectors and miners. So the mine is valuable, and its value has been created

by human inputs. If I am lucky enough to own this piece of land then I have control over a valuable resource. I could sell it to a mining company and receive a one-off payment, or I could ask someone to use it to build a mining company around it, and I would become its sole shareholder. In both cases I receive payments, or rewards. In the case of the ongoing firm, I will hopefully receive a stream of dividends into the future. What was my contribution to the value-creating process? Physically, I am absent from the process of cutting, crushing, hauling ore, etc. I get a payment for owning the mine, not for creating any new value. The people that do create new value, the miners and other workers, must ergo get less EV than they create, otherwise how else could I be paid my “share”?

We have argued that new UVs, the source of EV, are created solely by the human inputs to the productive process but, as we have seen in the case of the silver mine, some people are able to capture value that they did not help to create. The bargaining perspective that Lippman and Rumelt (2003a) introduce can help us explain this phenomenon. We can also draw on Porter’s (1980) adapted I.O. perspective here, but we focus on the firm, not the industry.

People enter into bargaining relationships, not resources and to paraphrase Coff (1999), resources do not appropriate rent, people do. Their bargaining power is determined as argued by Coff (1999) by the extent to which people are capable of unified action, their access to information, their replacement cost and the opportunities open to people if they were to leave. While some of these determinants are observable and “objective” many aspects of the bargaining power both within the firm and between the firms and its stakeholders are a function of people’s perceived dependence in this exchange. Where one party perceives themselves to be highly dependent they will not bargain strongly, and vice versa. Dependence is subjectively determined, and is likely to be asymmetric in any paired bargaining situation.

So EV created by people making new products/supplying services represents a flow of cash into the firm. How much cash is captured is initially a function of the perceived bargaining relationship between the firm and individual customers. Where the customers perceive themselves to be in a strong relationship (e.g. zero switching costs, many close substitutes), they would have a strong bargaining position and would not tolerate a high price. Alternatively, if a customer is very brand loyal, then the firm may be able to get her to pay a premium; but, more specifically, people inside the firm or working on its behalf, bargain with customers, e.g. the salesman.

There is no connection between the prices emerging from these bargaining relationships with customers on the one hand, and the costs paid out to input suppliers on the other. Input costs are invisible to customers, and they similarly cannot knowingly “reward” suppliers of inputs. Again, people working for the firm enter into bargaining relationships on the firm’s behalf (usually, but we note the agency issues here!) with suppliers of human and separable inputs. And, similarly where the firm is seen to be in a strong bargaining position *vis-à-vis* a supplier it will bargain hard for lower input prices.

What determines perceived dependence for either party are probably the alternatives facing them. For example, if you were a superb computer salesman you may perceive that you have many employment options. If your employer sees it the same way, then you may be able to use this to bargain up your salary, particularly if he/she thinks that you are virtually irreplaceable. Alternatively, if the employer thinks you are pretty useless, and there are plenty of other sales people out there to hire, then he/she has no motive to accede to your demands. So people bargain for a share of the EV created by the

firm (Blyler and Coff, 2003; Coff, 1999; Makadok, 2003). It is possible that poor bargains are struck, from the firm's point of view, so profit opportunities are foregone. For instance, we may overpay for some staff (a footballer who does not fulfil his promise), and we may miss out on capturing EV from customers because we did not bargain hard enough, or we were not aware of their perceived dependence on our offering. We are in a satisficing world, not a maximising one. So it is quite possible that resource-endowed firms may not achieve above average profits if the resource suppliers or owners bargain effectively to increase their share of revenues (Bowman and Ambrosini, 2000; Coff, 1999; Peteraf, 1994).

We have selected the salesman example deliberately insofar as in many instances it is relatively easy to assess the revenue generating contribution of an individual sales person. Moreover, these assessments can be benchmarked over time, internally against other sales staff, and maybe externally too, but the value contributions of most of the other human resources that are sources of firm advantage are far less transparent (Coff, 1999). It is difficult to impute a proportion of a revenue stream to specific groups or individuals. Sensibly, the firm can only be viewed as a going concern, and as a gestalt of inter-locking and interacting human and separable UVs. A firm as an entity can be valued by investors; their valuations being based on expectations (guesses) about future profit streams, but due to, separable alia, internal causal ambiguity in any but the simplest firm it is very difficult to isolate specific contributions to value capture from customers (Blyler and Coff, 2003).

One thing we can assert though is that separable inputs have added nothing to value creation. What UV they contribute to the process is fixed and will likely diminish with use in the case of machinery, or if it is a procured input its UV is incorporated into the product. Similarly, we know that suppliers of money capital, investors or banks, are in no position to add UV, thereby they cannot help capture EV from customers. So how come the investor can nevertheless capture EV? The key here is the requirement for costly separable inputs in many branches of production, combined with a pool of individuals who need to work to live. If I have money capital I can have people procure the required equipment, and hire the requisite staff to work the equipment. I do not have to get involved in the value-creation process. But by owning the money capital, I am in a position to capture some of the value created by the firm.

We conclude this section with two further propositions:

- P11.* The capture of EV is the outcome of a bargaining process between stakeholders based essentially on perceived dependence.
- P12.* Because EV capture is the outcome of bargaining processes it is possible that resource-endowed firms may achieve below average profits where resource owners/suppliers capture a large part of the EV captured from customers.

Conclusion

We have explained that "value" has a different meaning for different stakeholders, and that if the firm operates in line with investor interests, in dealing with external stakeholders the firm itself acts as both customer and supplier, and its motivations will reflect these different roles. We have also argued that there is only one source of new value creation within the firm: human capital. Then, we proposed that five separate types of activity can be discerned within a firm. The two value creating types reflect

the firm's role as supplier and customer. There are activities that are undertaken with the aim of optimising the capture of exchange value from customers, and there are others that aim to optimise the capture UVs from suppliers. The three other categories reduce current investor returns due to their impact on costs combining with no compensating positive impact on the current revenue stream. We have suggested firm attitudes to the five types of activity if we assume the firm operates in the primary interests of investors and we have explained that only people can capture value and the amount they will be able to appropriate depends on their bargaining power.

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Further reading

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