

## VALUE-CREATING CAPABILITIES

**H**ow are strategies created? How do capabilities emerge? These are profound strategic questions that are seldom addressed in the management literature, but are ones that managers have to grapple with on a daily basis. Therefore we will start the reasoning about the new context of management and leadership by presenting a fictional story about a modern Robinson Crusoe becoming an entrepreneur.

In the following story we will see that there are two fundamentally different ways to create a strategy. One is the industrial approach where the instinctive behavior is control and empire building. Another, but perhaps less frequently adopted philosophy, is one of mobilizing external resources and orchestrating an evolving ecosystem. Choosing between these two alternatives will be at hand at a very early stage, even during the evolution of the simplest business, as the case below will show. And very complex decisions arise from quite basic conditions. In the

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following the development path of Robinson Crusoe will be portrayed . . .

Robinson is a survivor from a shipwreck, and lives on an island with only one other inhabitant. He can survive with three ingredients of daily food:

- one portion of water
- one portion of potatoes (five potatoes)
- one portion of oranges (two oranges)

Robinson can fulfill his need for nutrition in the following way:

- To fetch the water he needs to work  $1/2$  a day (water cannot be stored on the island).
- To find five potatoes he needs to work  $3/8$  of a day (potatoes can be stored, but not longer than seven days).
- To find two oranges he needs to work  $1/8$  of a day.

By working the whole day Robinson can thus find the nutrition he needs to stay alive.

After a while Robinson finds out that there is also another survivor on the island, Stevens, who had come to the island earlier.

Stevens has one advantage compared to Robinson: he can find potatoes easier on his land than Robinson can, but on the other hand he cannot find oranges that easily. Stevens gets in touch with Robinson and gives Robinson the following proposal: He would like to exchange oranges and potatoes with Robinson. The conditions would be as follows:

- Stevens would not buy less than two oranges at a time.
- For two oranges he would give Robinson five potatoes.
- For three oranges he would give Robinson five and a half potatoes.
- For four oranges he would give Robinson six potatoes.

If Robinson decides not to trade with Stevens he would have to continue to work all day to get the food he needs. If he wishes to trade, Robinson has several options. If he only wants to work enough to get his daily food he can cut his working time by 25%. He can also build up some stock of potatoes if he cuts his working time by less than 25% and collects additional oranges to trade against potatoes. At this stage an orchestration opportunity has emerged, Stevens contacted Robinson from a traditional, industrial perspective. He wanted to develop a barter arrangement to improve efficiency. However, as we will see, the knowledge perspective provides an additional layer that provides the platform for more opportunities. Whereas Stevens's worldview was restricted to the industrial domain, Robinson saw possibilities not yet identified by Stevens. Robinson thus becomes an orchestrator.

Robinson's choice will depend on how he values his spare time. It might be that he is not interested in the extra return he could get by producing some extra oranges for Stevens. Another question is whether he could use the spare time in order to produce something else, which will give him additional satisfaction with his situation. Answering these questions means for Robinson that he has to have some form of overriding principles, or values, to guide how to prioritize in situations of choice. The values are then about what type of state of existence Robinson considers worth attaining in his life.

*Values are generalized, relatively enduring and consistent priorities of how an actor wants to live.*<sup>1</sup>

The trading agreement suggested by Stevens revealed that Stevens had higher production costs of oranges than Robinson, but lower production costs of potatoes. As long as the trading possibility exists for Robinson one can say that there is a stable market situation. The rational decision for Robinson is to start to trade with Stevens, and this way both will improve their efficiency. This then implies that Robinson will have available spare time.

As Robinson gets additional spare time he decides to use it to develop a new offering. Both he and Stevens are carrying water from the same spring. The amount of work needed for this is the same for them both, half a day. When discussing with Stevens, Robinson finds out that Stevens would be prepared to pay him five potatoes if Robinson would supply him with the daily portion of water.

Robinson invents a jar that can be carried. He can now bring two portions of water from the spring, if he is using this jar. The time needed to bring the two portions is three-quarters of a day. Robinson now has two sellable offerings in his mix: oranges and water. Both offerings include a substantial quantity of service activities, and the water offering is mainly a transport service. From Robinson's point of view the main question is how the offerings affect his spare time, and what can be traded against the offerings.

*An offering is a limited set of focused human activity intended to generate positive customer value and exchange value for the provider of the offering.*<sup>2</sup>

The strategy of a commercial actor is to get the best result out of his resource base. In the case of Robinson this means the

use of his own time. By developing a new offering he has created a situation which further emphasizes the importance of his values, i.e. how he compares spare time with further entrepreneurial development. Robinson decides to develop his business opportunities.

One problem Robinson now meets is that his production capacity is bigger than what his customer can consume. By working seven days Robinson has produced his own food, and at the same time he has increased his stock of potatoes to seven portions, whereby he has to start to eat the oldest ones in order for them not to rot. This means that he does not have to work more than 62% of a day the next week (bringing water and oranges for himself). In a period of two weeks he thus cannot use more than 81% of his production capacity. For Robinson this is unsatisfactory. He therefore decides to use the spare time for innovation.

Robinson has recognized that not very far away from the island there is another island with inhabitants. In his spare time Robinson starts to build a raft. Using the raft he is able to visit this island daily. On the island there are several inhabitants. They are very fond of both oranges and potatoes. For Robinson there are new acquaintances on the island: bananas, grapefruits, and coffee. This creates a quite complicated situation for Robinson: he can offer the inhabitants on The Other Island oranges and potatoes, but he can also bring back some grapefruits, bananas, and coffee to Stevens, and trade these against potatoes. At the same time Robinson has to consider that his time now may suddenly become a constraint for the further development of his business.

One way out of the problem is to start to cooperate with Stevens. He knows that Stevens has a lot of capacity to produce potatoes. Stevens has previously not been very interested in working too much, but he has got very fond of coffee, and is prepared to do some extra work to get more coffee. At the same time, however, Robinson is afraid of giving Stevens too much information about his own business secrets. Perhaps Stevens will

start to build a raft himself, and trade his potatoes directly with the inhabitants on the neighbor island.

The situation Robinson is now facing is to more profoundly define his business model.

*The **business model** defines the value-creation priorities of an actor in respect to the utilization of both internal and external resources. It defines how the actor relates with stakeholders, such as actual and potential customers, employees, unions, suppliers, competitors, and other interest groups. It takes account of situations where the actor's activities may (a) affect the business environment and its own business in ways that could create conflicting interests, or impose risks on the actor; or (b) develop new, previously unpredicted ways of creating value. The business model is in itself subject to continual review as a response to actual and possible changes in perceived business conditions.*<sup>3</sup>

Once Robinson has made up his mind regarding his aspirations he can make the detailed plans for his activities, or processes, and how he will further develop his business model.

*The **aspirations** define how strongly an actor is prepared to act in order to succeed according to his or her values.*

Robinson will suddenly find out that in his relatively restricted environment he already has a quite complicated task in choosing what offerings to focus on and what processes to develop. When we add to this the uncertainty regarding how long his market will be free from invaders from other islands, we see that Robinson from very simple beginnings suddenly will be meeting some very critical decisions with profound implications for the future . . .

## THE ANATOMY OF VALUE CREATION

The Robinson case illustrates that different people have different priorities. Some like oranges, others coffee. Some want to relax and not take on more duties than necessary, whereas others are

driven by an entrepreneurial spirit. Certain individuals are highly occupied with how they can further improve the world around them, like Robinson.

The values and aspirations of individuals are the building blocks for value creation. Without values we could not make choices in situations of ambiguity. And without aspirations we would not direct our energy towards more than the ultimate minimum. Robinson was driven by both his values and aspirations to do more than his neighbor Stevens.

Zetterberg has identified six cardinal values: the pursuit of wealth, order, truth, the sacred, virtue, and beauty. Already Max Weber had identified *Lebensordnungen* (life-orders) and *Wertsphären* (value-spheres). They were the economic, political, intellectual, religious, familial, and erotic life-orders and spheres of life-activity. Zetterberg left out what he calls the microsocio-logical familial and erotic value spheres and added the ethical realm.

When considering the business context one can argue that four of Zetterberg's values are relevant: pursuit of wealth, search for knowledge, civic virtue, and beauty. Order in the original Zetterberg sense would in the business context correspond to level of risk, ultimately expressed as the need to survive. The sacred could be seen broader as a sense of belonging to something, not necessary a religious community. This sense of belonging would then also include the familial sphere suggested by Weber to be one of the cardinal values.

The six cardinal values here adopted would then be: pursuit of wealth, search for knowledge, civic virtue, beauty, survival, and belonging. Robinson has evolved from struggling for his survival to pursue other values as well. It seems that he has an interest in pursuing wealth creation, and that this value for him is of relatively greater importance than is the case of Stevens. Quality of life, or the value of beauty, seems to be more appreciated by Stevens.

There is a cultural bias towards the interpretation of values. They are part of the culture and affect how offerings are used in a society. So for Robinson the first interactions with the inhabitants on the other island should also reveal whether they emphasize different values than those in favor by himself or Stevens.

Value creation is about human activity. The way value creation options opened up for Robinson highlights the interaction between planning and acting, thinking and doing. As the example shows sometimes doing precedes thinking and an external incident may trigger a chain of events that may have profound consequences for an actor, like the appearance of Stevens enabling Robinson not to just work all the time to stay alive. Offerings were defined as a limited set of human activity. The notion of activity was of special interest of the Russian psychologist Lev Vygotsky,<sup>4</sup> who by the time of his death in 1934 at the age of 37 had laid the foundations for a psychology of culture and consciousness. According to Vygotsky activity is the smallest unit of analysis which preserves both the link between mind and society and the coherence of different actions and movements. The concept draws attention to relationships between motives and the contexts of actions. The settings for different activities are not determined by objective, physical features but are provided by those who engage in them. Activities are triggered by some stimuli, but once undertaken the activity in itself starts to change the environment, which also may result in unpredicted implications. So can tools developed to make it easier to do a predefined thing later turn out to have the potential of triggering new events, events that would not otherwise have been possible.

Human activity is principally a continuous process of discovery. Any discovery is a creative achievement, which involves a degree of personal investment; it can only be achieved by active participation. This implies that learning occurs as people do more than they yet know how to do. As they move forward they will retrospectively understand what they actually learnt. The

activities shared by different actors transform the relationships between individuals and communities. The shared activities are thus part of a complex web of mutual interactions. However, activities will not take place without initiators. Activities are triggered by somebody who sees opportunities better than others, an expert. There are different forms of expertise. Becoming an expert is a creative process as people ‘do more than they yet know how to do’. Descriptions of what should be happening are likely to lag behind emerging improvisations.

The origins of expertise lie in different cultures and histories. The tasks that the expert engages in are situated and context based. Experts respond to particular contingencies, using the material, social, and institutional resources available. Expertise is closely related to ambition. Blackler defines expertise as effective activity. Robinson in our example can be considered an expert. He could envision the possibility to expand his scope of activities in order to pursue his own aspirations of wealth creation. To achieve these goals he has had to have a strong involvement, take initiatives, and as the case of motivating Stevens showed, also be flexible. Such skills are needed if the aspirations are high. So aspirations require expertise and skills to become more than empty words.

The tradition of activity studies is organizational. However, activities provide an interesting conceptual framework for analyzing value creation also as a collaborative effort involving a multitude of actors. This will be further highlighted in the next section, which takes a more detailed view on the value creation initiated by Robinson. In Chapter 3 we will bring the discussion one step further and look into how such activities are orchestrated.

The activities carried out by Robinson provided the basis for value creation. We can define value creation as follows:

***Value creation** is the process of co-producing offerings (i.e. products and services) in a mutually beneficial seller/buyer relationship. This relationship may include other actors such as subcontractors and the buyer’s*

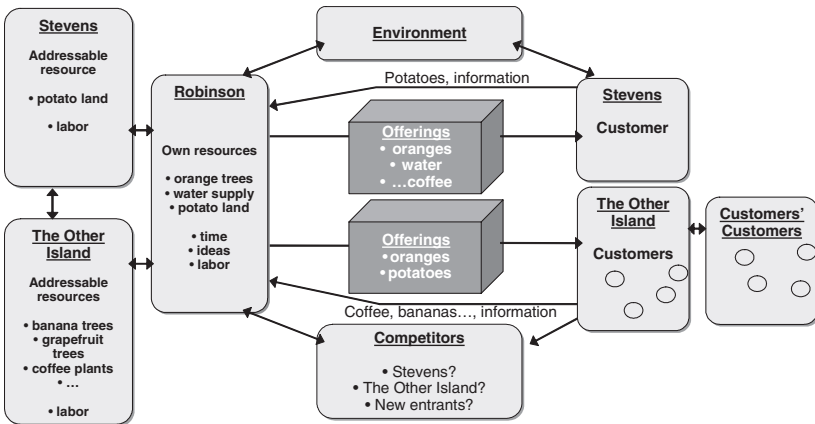


Figure 1.1 The value constellation around Robinson

customers. In this relationship, the parties behave in a symbiotic manner leading to activities that generate positive values for them. The actors brought together to interact in this process of co-producing value form a **value constellation**.<sup>5</sup>

Even if Robinson did not have many actors with whom to interact, the value constellation around him illustrates how value is co-produced. As Figure 1.1 shows, Robinson considers Stevens both as a customer and as an addressable resource, and a potential competitor. In the same way the inhabitants on the other island are also resources (providing coffee). Without coffee Robinson could not motivate Stevens to use some more time to produce additional potatoes that Robinson can trade against other products from the other island.

The notion of value constellation addresses the market for goods and services (the demand) and the resource market (the supply) simultaneously. Value constellations emphasize the symbiotic relationship between actors. More traditional product/market thinking underlines the competitive perspective. In the product/market thinking the focus is on defining the best output strategy of the respective actor. The offering is the output.

Product/market thinking usually separates the resource allocation process to provide the offering from the customer interaction process to sell and deliver the offering. As the Robinson example shows these two processes are not necessarily separable. How well Robinson can motivate Stevens to work depends on what he can trade with the inhabitants on The Other Island. And to pay these inhabitants Robinson needs the potatoes produced by Stevens.

In value constellations actors engage in selling and buying. The starting point of any trading arrangement is the value a customer pays for a particular offering. In the case of Stevens he was considering oranges as valuable. He could package his own resources into something tradable, potatoes, and was thus able to obtain oranges from Robinson.

To understand the value of an offering to a customer, the customer value, we need to know how the good is perceived at the moment of the purchase and what happens to it after the purchase. In the case of Stevens the reason why he was interested in oranges could be called net satisfaction contribution. (The notion of net satisfaction contribution means that if the offering has elements that affect the satisfaction in a negative way (e.g. psychological ‘costs’) these costs are deducted from ‘gross satisfaction contribution’ to get net satisfaction contribution. Perhaps Stevens did not like to peel the oranges, but he was very fond of the taste.)

The nutritional and culinary pleasures attached to the oranges are thus forming the basis for how valuable Stevens considers the offering. However, to achieve the advantages related to oranges Stevens will have to make some sacrifices as well.

Firstly he has to compensate Robinson for the oranges. As he can use potatoes as a trading currency, this means that the work he has to do to find the potatoes is the price for the oranges. This can be called the *initial cost*. But other costs will incur as well.

Stevens may have to pick up the oranges from Robinson. This means some additional work, and could be called *interface costs*.

Once he has the oranges in his possession he will have to prepare the oranges to be able to eat them. This can be called *integration costs*.

Finally, as he has his meal prepared he still has to get rid of the peel of the oranges, again asking for some additional work. This we can call *life-cycle costs*.

All these benefits and costs relate to the physical good, the oranges that Stevens will get. However, when he considers his dealings with Robinson he can potentially get some additional benefits, which depend on the nature of the relationship, not on the offering as such. For instance, during one of his dealings he learned about the possibility to get water from Robinson. This could be called a *learning advantage*.

The relationship with Robinson also may contain some risks: What if Robinson will only provide him with low quality oranges, or if taking a paranoid view, if he tries to poison Stevens? This element is *the relative risk position* related to the offering and the supplier providing the offering. These elements together form the total customer value. The customer value is thus the net satisfaction contribution (NSC) less the costs for the customers to include the offering into his or her own value-creating process including the life-cycle costs, adjusted for possible risk and learning impact.

Co-productive value creation for customers contains two distinct perspectives: the 'single event' transaction and the 'process' relationship over time (which basically consists of a sequence of transactions). Focusing on individual transactions implies that each transaction should cover its own costs plus generate a margin. In the relationship logic, customer relationships are seen as extending over time, and are often conceived of in terms of a 'life cycle'. The relationship logic doesn't solely focus on the profitability of

individual transactions. It also considers the profitability of all the transactions involving one customer – in other words, all of the transactions that take place during the life of the relationship between the supplier and the customer. In such relationships, some up-front seed investments might be needed to generate later revenues. As the case of Stevens and Robinson showed, Stevens could learn things from Robinson that later turned into new value-creating transactions (e.g. the possibility to obtain water from Robinson and pay with potatoes). Current costs, therefore, are not simply expended outlays but are, in part, an investment in lower future costs. In this respect the learning benefits from a customer relationship may prove to be of high value.

Likewise, from the supplier's point of view, current costs to build customer relationships can be regarded as investments in higher future returns. For example, key account management thinking recognizes that relationships evolve over time, with each specific transaction affected by the history of the relationship, and the relationship modified by each specific exchange. Individual transactions are not only affected by market considerations (price and product specifications), but also by relational or process factors, which require different account management strategies to be adopted as the relationship evolves. In this respect Robinson was systematically trying to better understand how Stevens could be an important part of his addressable resource base in addition to being his most important customer.

In a relationship-driven economy, the relative importance of value elements other than the selling/purchasing price is increasing. This applies to the supplier as well. The supplier's exchange value can therefore be defined in a similar way to the customer value. The exchange value is the selling price less the resource costs for the supplier to provide the offering adjusted for possible risk and learning impact and also considering possible goodwill or reference value of the offering and its impact on the future competitive position of the supplier.

How value is perceived depends greatly on the observer. Different customers see products differently. In other words value or the perceived value is not objective but subjective. The value of an offering is contingent, more than subjective. It does not reside 'in' an individual, independent of his actions, or 'in' a good independent of the interactions to which it is subjected.<sup>6</sup>

An offering is therefore not something that exists, independently, in itself. An offering is the output produced by one (or several) actor(s) creating value – the 'producer' or 'supplier' – that becomes an input to another actor (or actors) creating value – the 'customer'. The offering both results from, and contributes to, a bundle of activities that enable the buyer to perform activities in a different way than if the offering had not been acquired. Firms collaborate and compete to make competitive offerings available.<sup>7</sup>

Capabilities in turn consist of the routines by which a firm, or a network, will be able to constantly perform those activities that are needed for the offering to be designed and provided. A capability can be defined as follows:<sup>8</sup>

*A **capability** is the ability of an organization to perform a coordinated set of tasks, utilizing organizational resources, for the purpose of achieving a particular end result.*

Having introduced the basic components of value creation and capability building through the case of Robinson we will further deepen the understanding of the offering as the means of value creation by the example of an auction house.

## **THE OFFERING: THE CASE OF AN AUCTION HOUSE**

The auction business consists of three tasks: (i) solicit goods from a multitude of suppliers; (ii) put them together into attractive auction offerings; and (iii) attract auction buyers to attend the auctions.

Supplier solicitation consists of several activities. Continuous communication with the suppliers is needed. Insurance packages to secure the suppliers from logistics risks have to be developed. Different forms of supplier contact forums have to be established, and here communication using a web portal is an effective means to keep the suppliers updated.

An attractive auction event is based on four pillars: the physical design of the premises; the use of information technology; the expertise and service-mindedness of the personnel; and the availability of third-party services.

The physical layout of the premises has to enable a smooth and efficient working environment for buyers. The auction room, the invoicing, shipping and telecommunication rooms, and the restaurant have to be located centrally within a short distance from each other. The auction center can also host third-party services such as bank offices and travel agents. The availability for restrooms is another advantage. For the biggest buyers there could be the alternative of renting permanent offices within the building. The warehouse has to be designed to make sure that the products are stored and handled in the best possible way.

The information system forms the digital nerve center of any successful auction business. Using the possibilities offered by sophisticated database technology, one can today design and build integrated auction systems. By using satellite technology it is even possible to enable remote bidding from all over the world with video coverage and high-quality sound transmission.

The personnel have to meet the demanding expectations of the international buyers. Great emphasis has therefore to be put on the training of the frontline personnel. Developing a genuine service attitude is paramount. If the personnel are able to respond positively to situations of emergence, this will add to the perceived quality of the auctions. If the customer clearly can see that the service organization understands him and is prepared to listen to him and discuss with him, then he will respect the auction

house as a partner. Quickly addressing and solving emergent problems is the best guarantor of customer satisfaction. Ultimately an auction company is a service company. Demanding auction buyers ask for good service in a multitude of ways:

- efficient auctioning (fast, reliable auctioneers);
- flexible invoicing (in alternative currencies);
- easy pre-auction viewing (well-educated and informed support staff);
- high-class restaurant service (accommodating different tastes and cultures).

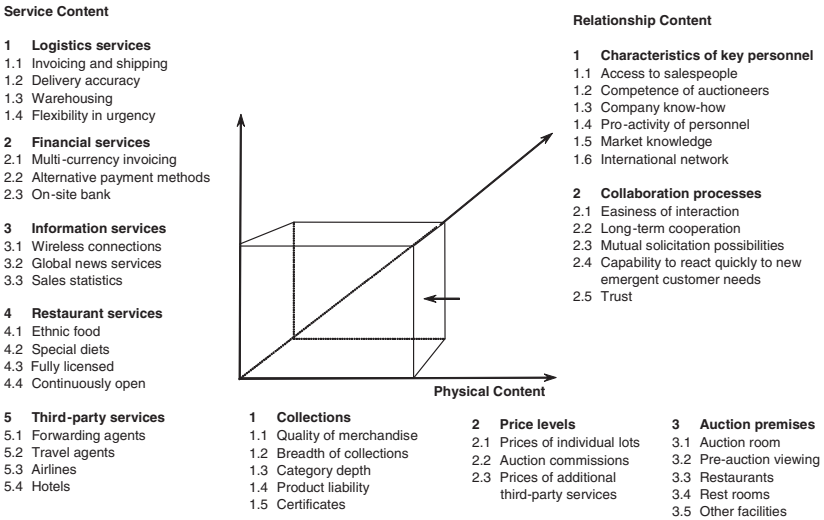
An auction center has to work in close collaboration with airlines, travel agencies, and financial services providers. Shuttle buses connecting the auction center with a number of hotels will further enhance the buyer experience. Correspondingly the auction offering can be described as a package consisting of three dimensions. The three axes of the offering package correspond to the physical, service, and relationship content of the offering.

*The three-dimensional offering consists of hardware, software, and peopleware corresponding to the physical, service, and relationship content of the offering.*

The three-dimensional offering of the auction house is illustrated in Figure 1.2. As the offering only has meaning from the viewpoint of the customer, different customers will appreciate different elements of the offering.

The most important physical elements of the auction house offering are the lots offered for auction. However, the premises are also part of the physical content of the offering.

An auction is a real-time service, and the variety of service elements relating to the offering includes hotel services, transport, shipping, catering, banking, information services, and of course the running of the auction. This represents the service content of the offering.



**Figure 1.2** The three-dimensional offering: auction house case

The service element of the offering is something we get without necessarily reflecting on who is the individual providing the service. Not all services are of this character. Sometimes we look not only for the service activity, but also for the individual relationship. In an auction business the credit approval process is to a large extent something which is handled in this spirit. Established customers expect to discuss their credit limits with certain individuals with whom they feel confident and secure. This part of the offering can be called the people or the relationship dimension. The distinction between the service and the relationship dimension is that the former focuses on the actual service activity, whereas the latter is more occupied with the maintenance of a longer term personal relationship. This relationship then entails the carrying out of the service activity in a confident and trusted atmosphere.

The value-creating potential along each axis of the offering depends on the value-creating process of the customer. What is important is to recognize which are the service elements that are

only hygienic parts, or potential sources of dissatisfaction but not of increased satisfaction, and which parts are those that really provide exceptional satisfaction. For different customers this perception can vary considerably.

## **OPERATIONAL CAPABILITIES**

Value creation stems from a combination of three ideas:<sup>9</sup>

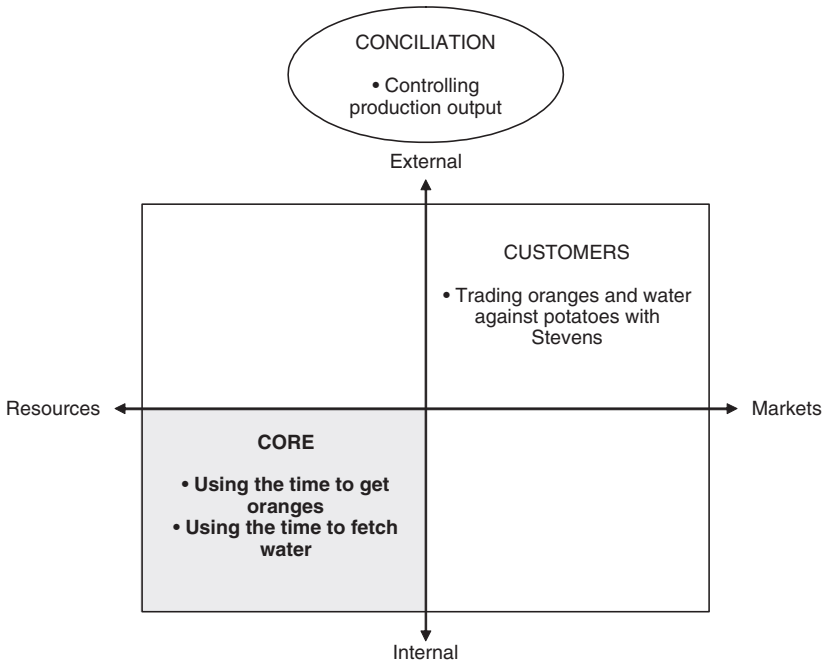
- Discovering a new way of creating value for customers.
- Bringing together a combination of capabilities creating this value.
- Creating uniqueness in this in order to appropriate part of the value created.

To establish a successful auction it is necessary to mobilize a multitude of actors. This network of actors has to collaborate to enable the offering to be provided. So the way of creating value is quite different from the way Robinson as a self-sufficient inhabitant on the island got his first idea of an offering. Robinson was initially fully occupied by securing his daily living. Then Stevens appeared, and a market was established. Robinson and Stevens had some comparative advantages compared to each other. By negotiating a barter arrangement both of them were better off specializing. Each had possession over a scarce resource, which was tradable. The supply was represented by the access to the physical resource. The demand in turn was represented in the form of a single customer: the two men traded with each other. Managing this was quite straightforward. All the elements were known: the supply and demand, the price function, and the limitations on how far the business could be exploited (the limitation of how long potatoes could be stored). So, from the perspective of Robinson, the managerial task was one of control. He should

work as much as possible to exploit the trading opportunities, but he could not work more than he could eat. This resulted in a utilization rate of 81% of Robinson's production capacity.

He used his free capacity to build the raft. This was an entrepreneurial activity. He could not know if there would be any further business opportunities on The Other Island. So in the short term, when he built the raft, this activity was a risky investment for the future. He acquired a strategic option that could turn out to be of value. And so it did. He suddenly became aware of new tasty food alternatives, bananas, grapefruit, and coffee. But now his business model was not adequate any more. He had to figure out on which conditions he would trade different merchandise. Should he pay for bananas, grapefruit, and coffee primarily with potatoes, which could be produced by Stevens? Or should he pay with oranges that he could produce himself? This meant that he had not just to consider his own resources and the customers. He had to genuinely figure out a new offering, or perhaps several offerings. Should he even bring someone from The Other Island to his own island to collect oranges? The challenge was how he could create uniqueness in this offering formula in order to appropriate part of the value created. So transforming the demand into something that would create value for all the involved parties was the primary task. On top of that Robinson now had the opportunity to get a larger part for himself, if he could mobilize the addressable resources appropriately. So besides that he needed to design the offerings he also needed to organize the value constellation. The resource side was not only depending on what he was doing, but also he had to rely on the contribution of both Stevens and the inhabitants of The Other Island to make his new business model successful. The managerial task was now more demanding and he had to coordinate a quite intricate set of activities.

The capabilities required by Robinson during the initial situation, when he was dealing only with Stevens, are depicted



**Figure 1.3** Initial capabilities of Robinson (distinctive capability in bold)

in Figure 1.3. We here introduce the notion of operational capabilities and leadership capabilities. Operational capabilities relate to how the actor is matching supply and demand, separating the internal and external perspectives on the value-creating process. The leadership capabilities relate to how the matching of supply and demand is governed. The leadership capability initially is about how the value-creating process is framed, how Robinson conciliates his own aspirations with the needs and interests of Stevens.

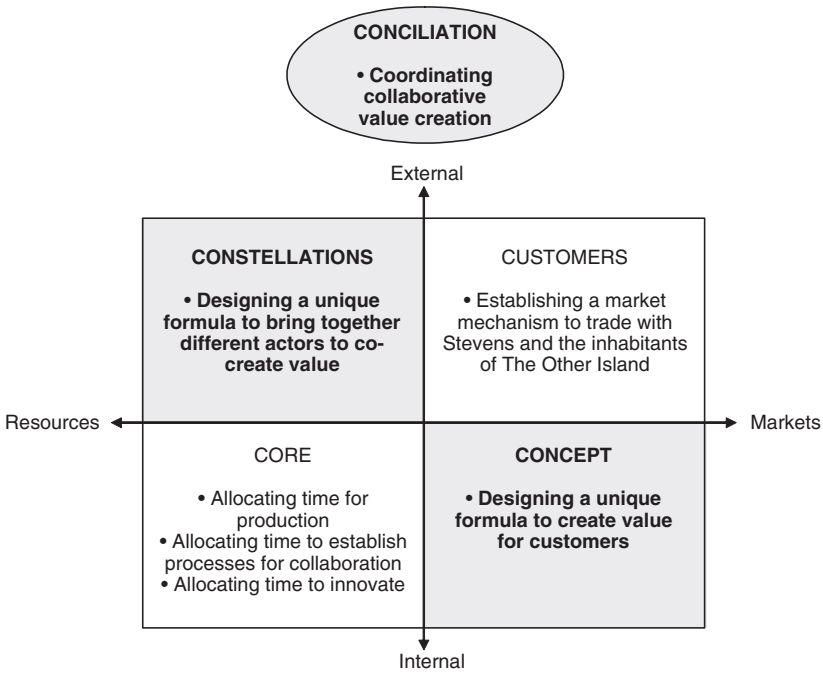
The core based upon which Robinson’s business was formed was his proprietary resources, the access to the orange trees, and how he used his own time. This combination can be called the distinctive capability. A distinctive capability provides the actor with a unique business model and corresponding business success.

The logic of Figure 1.3 is that there are four types of operational capabilities. These capabilities are based on two dimensions, and are related to markets (demand) or resources (supply), and have internal or external focus. The core represents the internal resources that provide the basis for the business, e.g. products, assets, and processes. The customer quadrant represents the way the enterprise interacts with the customers. On top of the operational capabilities is the leadership capability that keeps the operational capabilities together, conciliation.

The early business activities of Robinson asked for the capabilities of an industrial actor. The core was based on access to proprietary resources, the orange trees, and production capacity, i.e. Robinson's own available time. As long as this setting prevailed one could say that Robinson operated in an *industrial mode*.

Once Robinson had his raft ready and could visit The Other Island the context of the value-creating process radically changed. Now he was confronting a much more complex situation. Assuming that Robinson's aspirations still are unchanged, he now has to 'internalize' the demand function, as can be seen from Figure 1.4. He has to understand what different customers want. Based on this he has to transform these customer expectations into offering formulas or concepts. But the offerings will require the mobilization of resources out of his direct control. The same actors that provide the resources, Stevens and the inhabitants of The Other Island, are also the customers to be served. When designing the offerings Robinson will have to simultaneously consider the implications this has on the value constellation.

In Figure 1.4 we have added two more operational capabilities. A concept is the way an enterprise has 'internalized customer needs' and developed ways to provide value to customers. Constellations in turn relate to how the enterprise is able to address external resources for the purpose of complementing own internal resources to create value.



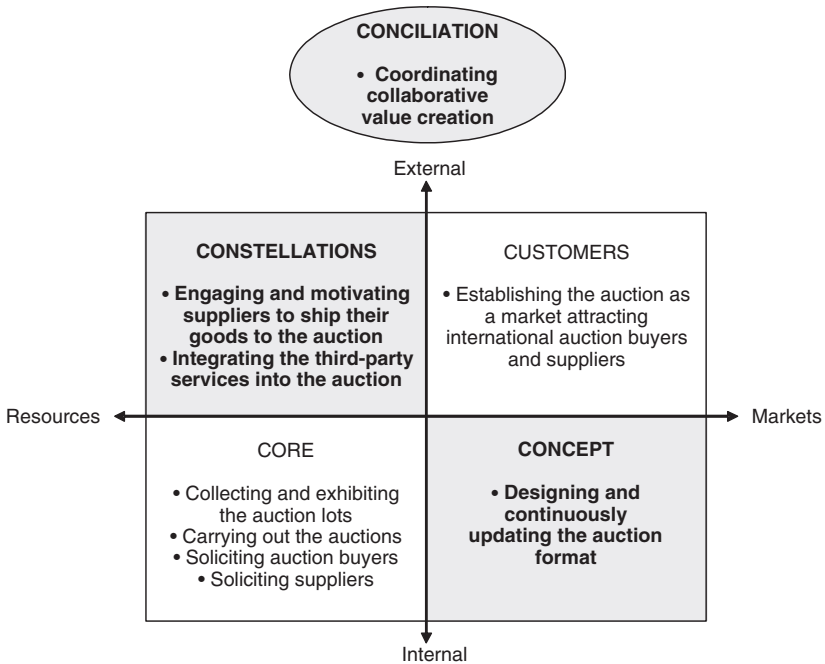
**Figure 1.4** The impact of The Other Island (distinctive capabilities in bold)

Managerially Robinson has to coordinate collaborative value creation, to conciliate this he needs good negotiation and persuasion skills to pursue all participants to agree on the shared agenda. He needs to balance different actors and viewpoints and he cannot enforce the end result. If he is successful the actors will not only comply with whatever suggestions he will come up with. They will also proactively suggest improvements based on their own experiences and insights. Successful framing of the value constellation through his offering design solution will enable Robinson to emerge as the leader within the value constellation. If his values still underline wealth accumulation he could have a good opportunity to appropriate a considerable share of the added value this arrangement will give rise to.

Strictly speaking Robinson develops personal skills and not capabilities. Capabilities are by the definition previously introduced an organizational property. However, for the sake of illustrating the dynamics relating to capability building the Robinson case is used to break down these dynamics into their basic constituents. The scalability of personal skills into organizational capabilities is fully possible. If Robinson and Stevens successfully expand their businesses and form companies, employing new entrants coming to the island, they could form two companies, Robinson Inc. and Stevens Inc. Then the ability to perform the similar duties would reside within organizations. What originally were individual skills would have become organizational capabilities.

To further illustrate how to operationalize capabilities we will revert to the way an auction house functions. Here management has to develop a comprehensive offering to attract international buyers. The auction house cannot independently provide the resources needed for the offering. The lots have to be solicited from suppliers all over the world. The auction offering has to support the motivation of both suppliers and buyers. Successful auctions are the best way to attract both of them. The capabilities needed by an auction house are depicted in Figure 1.5.

The examples provided here have shown that the word ‘offering’ instead of ‘product’ enables a better understanding of the dynamics of collaborative value creation. The notion of offering addresses the issue of value co-production, recognizing that both customers and suppliers can learn through the interaction manifested in the offering. It also highlights the opportunity for one actor to take the leading role to bring a constellation of actors together to pursue collective value creation. Such an actor will here be called an *orchestrator*, and the capabilities to carry out such an orchestrating role will be called *orchestration capabilities*. Chapter 3 will develop a more in-depth definition of orchestration in business.



**Figure 1.5** The capabilities of an auction house (distinctive capabilities in bold)

The next chapter will further discuss the implication of orchestration as a way to create value. The argument is that digital convergence and enhanced possibilities to use information technology to flexibly reconfigure resources and capabilities open up more possibilities for successful orchestration.