Part I

Premises

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1 The service-dominant mindset

> Once destiny was an honest game of cards which followed certain conventions, with a limited number of cards and values. Now the player realizes in amazement that the hand of his future contains cards never seen before and that the rules of the game are modified by each play.
>
> Paul Valéry

Introduction

Part of our nature as humans is to develop belief systems that become handy ways for seeing and understanding the world around us and for ordering our reality. We can refer to these mechanisms as institutional logics.[1] Institutional logics become normative and play a key role in guiding and determining our behavior. Many of these institutional logics arise from our training and education and thus the ordered view of the world from the perspective of an economist is different from that of an accountant, mechanic, sociologist, physicist, fire fighter, or moral philosopher. Regardless, they enable viewing a complex world in what promises to be coherent terms and provide a lens for perceptually separating noise from signal. Thus, they contribute to comfort, understanding, and sense-making.

Just because we are comfortable with our institutional logics does not suggest these logics are always correct or appropriate or do not need to change or evolve. In fact, some institutional logics become so strongly held across individuals that they become paradigmatic and very difficult to shift.[2] It has been found repeatedly throughout history that these paradigms can restrict vision and understanding and scientific advancement. Of course, in business, there are many such "worlds" that need to be understood: cultural, ecological, economic, social, physical, political, technological, and many others. The primary purpose of this book is to contribute to the understanding of the world of economic and social exchange among human actors, both individually and in groups, by proposing an alternative view or perspective, what we call "service-dominant logic" (S-D logic), to the traditional "goods-dominant logic" (G-D logic).

Specialization and exchange

Humans specialize and exchange because they have limited but often advantageous individual abilities. It is noteworthy that it takes more than specialization, since the specialization of one actor must be advantageous to another actor for exchange to occur. By specializing, humans can enhance their abilities but in turn need to exchange their abilities with other actors. This results in systemic interdependencies. Society and, along with it, many institutions, such as language, norms, industries, markets, and organizations (e.g., firms, or enterprises) are created to facilitate this exchange system for efficiency and coordination purposes. While systems of human actors and institutions[3] are complex, theories of marketing, business, and society that deal with them need to be appropriately simple if they are to be broadly generalizable. At the same time, these theories need to be sufficiently representative of the complexity of the world of exchange to serve as the basis of useful, normative applications that they are intended to facilitate.

Problems emerge immediately when constructing simple theories of exchange, business, and society. Arguably, the most difficult of these problems is the dominance of an institutional logic with serious limitations, which is deeply rooted in a discipline and thus monopolizes associated thought processes. One such worldview is G-D logic. This logic frames the world of exchange in terms of *units of output* (goods). Others have referred to it as "old enterprise logic," "manufacturing logic," and other, similarly descriptive tags.

G-D logic views the production and exchange of goods as the central components of business and economics. That is, it frames the purpose of the firm and the function of economic exchange in terms of making and distributing products – units of output, usually tangible. It is closely aligned with neoclassical economics, which views actors as rational, firms as profit-maximizing, customers as

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utility-maximizing, information and resources as flowing easily among economic actors, and markets as equilibrium-seeking – scholars within and outside economics have challenged all these perspectives. For instance, Penrose conceived of the firm as a group of physical and human resources that were deployed in many ways to provide productive services.[4] Richardson, also an economist, built on this idea and introduced the concept of "capabilities" to economics.[5] But the holding power of G-D logic was largely too strong to overcome.

In later chapters, we explain that G-D logic has additional aspects that make it an inappropriate logic for viewing human exchange systems but, for now, we will focus on how G-D logic creates problems for those trying to apply it normatively to the management of firms or public policy. Throughout the book, we propose that a more general and useful understanding of social and economic exchange among human actors, both individually and organizationally, is needed. We offer S-D logic as an alternative.

Goods-dominant logic centricities

There are many problems with G-D logic but some of the most important relate to where it focuses attention. Therefore, before we propose a more useful and robust framework for understanding economic (and, more generally, social) exchange, a brief review of several of the problematic "centricities" of G-D logic and how they misguide academic and practical thought and action, is useful. These centricities are illustrated in Exhibit 1.1 and briefly reviewed in the following sections.

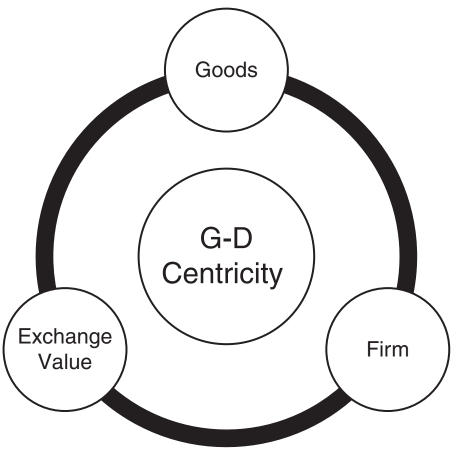

Exhibit 1.1 G-D logic centricities

Goods centricity

Perhaps not surprisingly, the major problem with G-D logic is that it fosters *goods centricity*. As Theodore Levitt suggested fifty years ago, firms produce products but that is not what customers buy.[6] In his vivid examples of the railroad and motion picture industry he proclaims that customers actually want or need transportation and entertainment services, rather than the products – railroad freight and passenger cars and theater seats – that firms often see themselves selling. In brief, customers seek solutions and experiences, not products. To this day, marketing myopia continues; we submit that this is largely attributed to a deeply embedded G-D logic, which has institutionalized it. As we will argue, goods are just vehicles for service provision, usually enabling self-service. They provide a means, rather than represent an "end-product."

Firm centricity

With the G-D model, the firm is central to economic exchange because the firm is seen as the proactive actor: it is viewed as the innovator, developer, producer, distributer, and promoter of goods, and thus is seen as representing the heart of markets and exchange. It also is viewed as central in its role of making major financial commitments, hiring other actors as workers, taking risks, and making a myriad of other decisions. All of this, under the rubric of managerial decision-making, is intended to minimize risks and maximize profitability for the firm, through markets. Markets, on the other hand, are seen as almost passively (i.e., waiting, with unfilled demand) "out there" (i.e., preexisting), and comprising "customers and consumers" from whom the firm profits by producing, selling, and distributing goods.

But just as goods in and of themselves are not the central purpose of exchange, so too firms are not the central actors. Organizations and firms are inventions to help humans solve the problems associated with the exchange of their individual advantageous abilities. Humans are the key actors in the cocreation of their well-being by combining resources from various market-facing (organizations and other actors), private (themselves, friends, family, etc.), and public (government and community institutions, etc.) sources, to continually resolve issues in the context of their own lives. This does not imply or suggest that human actors are not influenced by organizations and other structures. Humans create organizations and structures that in turn influence and control them.

Also, any particular exchange or human action is part of a continuing process that is stitched to other processes and actors that unfolds over time. In this regard, human actors are not end-users at all. Rather they, in turn, contribute both positively and negatively to the well-being of other actors through ongoing market, public, and private exchange. In this more dynamic, actor-centric view of the economy, it follows that there are no fixed, preexisting markets; rather, the "market" is more a representation of the continual quest of human actors for well-being in an ever-changing context. This shift in centrality in no way diminishes the role of the firm in the aggregate, just in the creation of value for other actors. As a result, how the firm thinks about its role in value creation must shift.

Exchange-value centricity

G-D logic is also problematic because of its implicit promotion of *exchange-value centricity*. Scholars have been debating the role of *exchange-value* – what something is worth in exchange – in comparison to *use-value* – the extent to which the use of something contributes to the well-being of some actor – at least since the fourth century BCE, when Aristotle distinguished between the two and discussed them. Generally, they have come down on the side of the primacy and centrality of use-value. For example, the medieval Schoolmen clearly advocated this position in their economic philosophy, based on their views that exchange is motivated by human needs.[7] However, with the development of a more formal economic philosophy, beginning with the work of the "father of economics," Adam Smith, and later extended in the development of economic science, the focus on use value largely diminished, at least temporarily.

Importantly, as discussed in the next chapter, Adam Smith did not set out to be the father of economics; rather his focus was on determining how England could become wealthy through international trade at the time[8] – the early part of the Industrial Revolution. He concluded that the key source of national wealth was the production and the export of surplus tangible goods and reserved the word "productive" only for those activities that contributed to this production and export. Though he acknowledged value-in-use as "real value," given his limited purpose, he used exchange-value as a surrogate, because he felt it was both easier to understand and provided a standardized measurement of wealth. There were several attempts to shift the emphasis back to value-in-use by the economic philosophers who followed Smith, such as Say's introduction of "utility."[9] But, as we will explain in Chapter 2, even that word morphed back into an exchange-value meaning.

The meaning of exchange-value was amplified and institutionalized as economic thought transformed from philosophy to science at a time that "science" meant Newtonian Mechanics – a model that viewed matter as embedded with properties – and thus provided for an easy translation to the concept of a product, or "good," embedded with "utilities" (exchange-value). This, in turn, paved the ground for marginal utility theory,[10] which became the basis of the neoclassical model of economics that, in time, was adopted by other business disciplines.

The early scholars, including Smith in his original analysis of economic exchange, had it right all along: value is created at the point of what we have been calling "consumption" and, more recently, "experience", rather than during production. This latter point is worth pondering. If your house is burning down and you can take one thing (not another person) what would it be? It is likely not something that has a high economic value but something that has meaning to you outside of value-in-exchange. It is something that will be useful to you in continuing experiences that you perceive as valuable. Although the value may not be in exchange, it is also not in the thing *per se* but how you evaluate your connection to or experiences with that thing.

Recap

These centricities, focused on goods, the firm, and exchange-value, are important because, again perhaps ironically, they point firms attempting to "go to market" in the wrong normative directions by blinding them to the purpose and nature of the market, value creation, and the mutual roles of the various actors. They suggest that the firm is the prime mover, that producing goods is its primary purpose, and that this production process embedded goods with value – that goods have intrinsic value. Of course, if this were true, there would be no sales events focused on price reduction and no inventory write-downs. But, even more important, they direct attention away from both the real meaning of value and the way it is created, interactively, in concert with a whole host of actors, singly and collectively (e.g., through organizations, firms), contributing resources that are eventually integrated by other actors to provide service. In short, *value is cocreated*. They also direct attention away from the most important resources being integrated and doing the integration – human actors with their skills, knowledge, and innovative and entrepreneurial abilities. What is needed is a logic that, rather than abandoning goods logic, transcends it, by recognizing the *primacy of human resources applied for the benefit of others* (and ourselves) – *service*.

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Toward transcendence

It is difficult to escape the paradigmatic pull of G-D logic to develop a broad and general view of social and economic exchange. However, it can be helpful to use a sort of "linguistic telescope" to zoom out to a broader view of economic and social exchange for more clarity. Through this telescopic view, we can see social and economic actors exchanging in many different contexts but, as we will argue throughout this book, they are fundamentally always doing three common things: (1) integrating resources from various sources, (2) exchanging service for service, and (3) cocreating value. However, to clearly see this and to fully appreciate its significance and power requires refocusing away from firms and customers to an actor-to-actor (A2A) framework.

The actor-to-actor (A2A) perspective

Arguably, one of the most detrimental conceptualizations of G-D logic is the associated "producer–consumer" distinction. Consider what this implies: some actors (e.g., firms) "produce" (create) value, whereas others (e.g., customers) "consume" (destroy) that value. Exhibit 1.2 illustrates the goods-dominant view of producers and consumers. Let's explore whether that accurately describes what goes on.

We suggest that, to the extent that "production" and "consumption" are appropriately descriptive, they apply to all actors. Consider a professor who

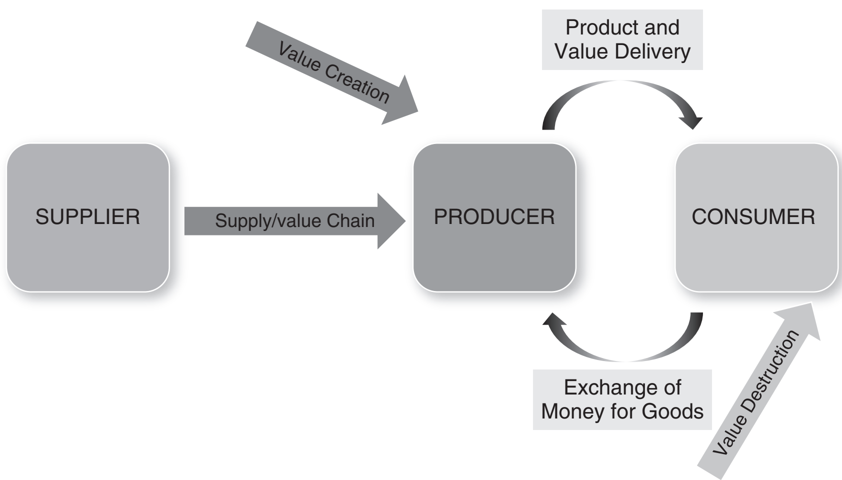

Exhibit 1.2 G-D lens

uses a car, gas, and so on, to go to the university to teach students; is he or she a producer or a consumer? Likewise, consider the students, who take notes so that the professor's insights can be used in their jobs; are they producers or consumers? How about one of the students who is an employee of the car company that makes the car driven by the professor, which, in turn, pays tuition, which provides the university with the resources to pay the professor? Are they producers or consumers? The answer to all of these is "both" and "neither." On the one hand, all economic actors both "produce and consume"; on the other hand, at best, these characterizations do not inform us about anything useful concerning the actors, and, at worst, mislead us about their role in economic exchange in ways that misinform attempts to engage them economically.

For this reason, which will be elaborated on in subsequent chapters, we believe it is important to think about and refer to economic (and social) actors as just that, generic "actors," without introducing (referential) confusion. Fundamentally, all actors (e.g., business firms, nonprofit and government organizations, individuals, and households) have a common purpose: *value cocreation through resource integration and service-for-service exchange*. Therefore, throughout this book, we generally avoid the terms "consumers" and "producers" (except in citations of others) and, wherever possible, the terms "customers" and "firms" (except where needed for relative reference). We use "firm" and "customer" when we need to distinguish between actors, with the firm referring to the provider of direct service or indirect service through a good and the customer referring to the provider of service indirectly, through money. However, we will generally be using an "actor-to-actor" (A2A) notation, replacing "business-to-business" (B2B), "business-to-consumer" (B2C), and "consumer-to-consumer" (C2C)[11] notations, by transcending them. We suggest that economic and social exchange, viewed from a perspective of actors interacting with other actors, as opposed to business exchanging with other businesses or consumers or any combination of these differentiated actors, opens the investigator to a more revealing and transcendent view of the world. An actor-centric versus a firm-, producer-, household-, customer-, or any other role-centric labeling is also less restrictive because it does not predispose differential, single activities, such as "production" and "consumption."

Service-for-service exchange

Just as it is helpful to refocus on the nature of the actors doing the exchanging, it is essential to refocus on what is being exchanged. We often use a discussion of a fisherman and a farmer in our teaching to illustrate alternative conceptualizations.