Relationship Value in

Software Business Models

Work in Progress paper submitted to IMP 2004

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Abstract

The purpose of the study is to research the importance of strategic network partners in different business models. Specifically, the study focuses on the value of relationships with different actors in strategic networks of software businesses. The study describes a conceptual framework to assess the relationship value of strategic partners in a particular software business model. The conceptual framework is composed on the basis of the literature on strategic networks, relationship value and business strategy. The aim is to study business relationship value in connection with business models of software companies in order to gain more thorough understanding of the relation of business strategy and strategic networks.

Introduction

A key question in strategy research is why firms differ in their conduct and profitability (Gulati et al. 2000). The discussions on this question widely rest on the competitive advantage of a firm (Porter 1980). Increasingly, business networks are seen as the source of distinctive competitive advantage to companies (Snow et al. 1992, Möller and Halinen 1999). Concurrently, business model innovation is claimed to be becoming the basis of competitive advantage, and the key to creating successful business models for the knowledge economy lies in understanding the dynamics of business networks of companies (Tapscott et al., 2000; Allee 2002, Timmers 2003). Companies enter complex business relationships in order to exploit and develop their resources, and create and maintain the basis for competitive advantage.

Gadde and Snehota (2000) and Leek et al. (2003) point out that some relationships are more important than others, and stress the emphasis on fewer relationships with greater outcomes. However, the question remains: *Which actors form the vital relationships in a network and how can they be determined?* (Batt and Purchase 2004, Ritter et al 2004). The increasingly diversified role of actors as both customers and suppliers or other types of partners simultaneously makes the assessment of relationship value even more difficult. In addition, it seems logical that, if a business model incorporates vital or key actors, there can be also key networks. Gulati et al. (2000) define strategic networks as stable inter-organizational ties which are strategically important to participating firms. However, this kind of definition does not provide sufficient means to evaluate strategic importance. The literature on networks and business models also does not seem to consider this problem sufficiently. Thus, this study on the importance of actors and relationships can contribute to the research on both business models and networks.

Roehrich et al. (2002) studied the nature of relationship atmosphere and its links with the value of relationships. They point out that relationship importance can be considered as synonymous with the value of the relationship to the parties involved. Relationship value has received increasing attention in the academic discussions of industrial relationships and relational exchange (Wilson and Jantrania 1994, Harvey and Speier 2000, Payne et al. 2001, Tuominen 2004). Indeed, the literature on relationship value seems to provide feasible tools and concepts to analyze the importance of different actors and networks for a business model. This is relevant, as the objectives of this study are to gain a deeper understanding of the importance of relationships from the viewpoint of business models. The initial research questions formulated are *(1) How can the value of relationships and strategic networks of a business be assessed? (2) What are the relationship value implications in software business models? and (3) What are the most important networks and actors in a particular business model?* In order to answer these questions, the study mobilizes conceptual tools and frameworks to analyze relationship value in a particular business model, and aims at integrating business models discussion within the strategic networks discipline.

The strategic networks concept

During the last two decades there has been substantial body of research on business networks Gadde and Mattsson 1987, Håkansson and Johansson 1993, Anderson et al. 1994, Iacobucci 1996, Ford et al. 1998, Möller and Halinen 1999, Ford 2002, Holmen and Pedersen 2002). Research on industrial networks acknowledges that a firm is embedded in a network of ongoing business and non-business relationships, which both enable and constrain its performance (Ritter et al. 2004). Klint and Sjöberg (2003) divide networks into two distinct categories. Organic networks compound of traditional buyer-seller activities resulted in a relationship and a sense of closeness between the actors. The organic network is unplanned and there is no request for a common goal. Strategic networks (Jarillo 1988, Gulati et al. 2000, Möller et al 2004), in turn, are deliberately created, organized cooperation between companies, with the purpose to achieve a common objective. In addition, strategic networks have common goals and actors are known to each other. Based on these definitions, it is logical that both types of networks can incorporate major exchange relationships. However, due to the aspiration for sustainable competitive advantage by firms, it seems illogical that an organic network or its actors can be vital to the company. Thus, this study applies the idea of strategic business networks as the locus of vital relationships.

The partnering strategies of companies are affected by the levels, types and forms of the networks and position in the strategic network play a major role in them (Jarillo 1988, Dyusters et al. 1999, Gulati et al 2000, Barabasi 2002, Möller et al. 2004). Johansson and Mattsson(1992) point out that the position of an actor is described by the characteristics of its exchange relationships. Position also involves the role in value-creating network, which comprises the function accorded by the industrial logic and the relative importance of the actors. Anderson et al. (1994) refer to term strategic network identity that captures the overall perception of the actor's attractiveness as an exchange partner to other firms in its network context. This definition requires a focal point of view, as network context relates to the part of the network within horizon that the actor considers relevant. On the other hand, the term relevant is considerable blurred. This study applies the focal point of view, as assessment of relationship value requires setting the analysis to nets and dyadic relationships of a business.

Business relationships may be formed with any of the types of actors depicted in the value creation, and the range of relationships a firm participates in represents its relationship portfolio. Ritter et al. (2004) identify the types of relationships in the overall portfolio as firm's supplier, customer, complementor and competitor portfolios. Tuominen et al. (2004) point out, that firms establish relationships with those who deliver 'superior customer value'. However, this definition is context dependent and the perceived value can change over time. The change initiates obviously relationship management challenges. Coping in networks incorporates several levels of network management issues (Möller and Halinen 1998, Möller et al. 2004), with various interconnected key themes. Möller et al. (2004) presents the net and relationship portfolio management challenge as what is the potential or future value of the nets and their actors. Therefore, analysis of the relationship value calls for assessment of relationships and their present and potential importance to the network (Möller et al. 2004, Ojasalo 2004).

There is relatively few studies focused on which are the key partners in networks, although multiple studies call for the discussion on the topic (e.g. Batt and Purchase 2004). Different actors may be prioritized according to dimensions such as positive cash flow generation, information, reference value, security, new competences, and new business opportunities (Ojasalo 2004). Beekman and Robinson (2004) use the concept 'critical suppliers' in the sense, that specific suppliers have more relevant effect on the growth of a buyer's business, as well as their own business, as compared with other suppliers. On the other hand, Ojasalo

(2004) introduce the idea of key networks, and recognizes criteria needed to identify suitable members for a key network. The actors in the key network provide relevant capabilities to contribute towards achieving the goals of the key network, and the necessary capabilities and activities of these actors can be controlled by the focal firm. He also points out that since business network is a structure with inherent dynamic features, the goal set by the focal firm, the extent of goal congruence of actors, and the power positions of actors are likely to change over time in key network. A single member that enters, positions, repositions, or exits from the network causes changes to the entire network (Thorelli 1986).

The relationship value concept

In order to assess relationship value it is important to consider the essence of the value concept. Many scholars define value in monetary terms of economic, technical, service, and social benefits a firm receives in exchange for the price it pays for the product/service offering (Anderson and Narus 1999). Some definitions extend this view and consider the time-perspective of economic value through longterm costs and benefits in exchange relations (Gadde and Snehota 2000, Hogan 2001, Hibbard et al. 2003). Other definitions consider the value implications of relationships as changes in firm value (e.g. Wimmer and Mandjak 2002, Park et al. 2004). However, value consists of two interconnected concepts. Value creation involves the creation of customer value, which conbines innovating, producing, and delivering the offering to the market through business networks. On the other hand, value appropriation involves the economic component in appropriating value in the market place, i.e. extracting profits (Brandernburger and Stuart Jr. 1996, Amit and Zott 2001, Mizik and Jacobson 2003, Tuominen 2004). Medlin (2004) points out, that presumption of future between companies is made in order for interaction between firms to occur. However, he points out that discussion of value should consider the fact that there is no certainty of any potential future becoming at present. This study applies the dualistic character and the time-perspective of the value concept.

There are multiple studies focusing on the assessment of relationship value in industrial buyer-seller relationships. A large number of emerging research focuses on the value of customer relationships (Ulaga & Chacour 2001, Roehrich et al. 2002, Ulaga and Eggert 2003, Ulaga 2003), whereas some studies explore the value of supplier relationships (e.g. Gadde and Snehota 2000, Walter et al. 2001). A more holistic approach analyzes the value of buyer-seller relationships from both the customers' and suppliers' perspectives (Hogan 2001, Werani 2001). In these studies, relationship value has been considered more as the sum of total benefits, and less the cost associated with partnerships from the customer point of view, whereas the supplier perspective relates to the understanding of different functions the relationship possesses (Tuominen 2004).

Based on conceptual research, Wilson and Jantrania (1995) develop a three-dimensional categorization of relationship value, including economic, strategic and behavioral value. Ulaga and Eggert (2003) consider relationship value as consisting of the relationship benefits and relationship sacrifices, a conceptualization supported by several scholars (Anderson et al 1993, Wiltron and Jantrania 1995, Ravald and Grönroos 1996, Gwinner et al. 1998, Anderson and Narus 1999, Lapierre 2000, Werani 2001). It suggests that higher value in relationships can come either from increasing the benefits or decreasing the sacrifices (Ravald and Grönroos 1996). This study applies the idea of benefits and sacrifices, considering the time-perspective.

Lapierre (2000) and Ulaga and Eggert (2003) have analyzed relationship value from the customer's perspective as well, and identify several core benefit dimensions (e.g. product, service, and relationship benefits) and sacrifice dimensions (e.g. price and relationship costs). They also suggest that additional dimensions may be necessary to capture value perceptions in particular business market settings, and describe them as contextual dimensions (industry, nature of relationship, and product category). Similarly, Park et al. (2004) claim that the characteristics of business sectors usually determine which resources become critical in order to create competitive advantage and firms' value. They give some examples of characteristics, such as high product homogeneity and resource similarity. Despite heterogeneous conceptualizations, there is a consensus on the fact that value is multidimensional and must be measured as a multi-attribute construct (Ulaga and Chacour 2001, Hogan 2001)

Economic exchange relationships have dominated the theoretical and empirical work on industrial networks. Since the interaction approach confined its attention to buyer-seller dyads there is no clear way to handle notions of non-economic exchanges. However, according to Easton and Araujo (1992), relationships may involve an economic exchange or they may not. Mere economic exchange is expected to become relational exchange in which individual objectives are realized in conjunction with economic goals (Beekman and Robinson 2003). Social exchange is located presently, and the expectation of potential economic exchange in relationships may structure economic interaction in the future (Medlin 2004). Thus, mutuality (mutual benefits) is at the heart of exchange (Easton and Araujo 1992) and the value of relationships can be based on different dimensions.

Roehrich et al. (2002) studied the nature of relationship atmosphere and its links with the value of relationships. They point out that relationship importance can be considered as synonymous with the value of the relationship to the parties involved, and identify four relationship atmosphere constructs. Relationship strength is seen as an indicator of commitment and mutual interest, and relationship fluidity as an indicator of trust and distance. The third element relates to power-conflict settings, and the fourth relationship atmosphere construct is dependence, which is strongly linked to relationship strength. They further analyze the essence of value in relationships, and present four value dimensions: core exchange, downstream, and upstream technical flows, and network link. These dimensions are very similar to the elements presented in the business models literature, putting the emphasis on the value proposition and economic model, resources and relationships in business networks.

The business model concept

The concept of business model refers to the ways of creating value for customers and to the ways a business is capturing opportunities in the market into profit through sets of actors, activities and collaboration. Concepts and issues on business models draw on strategy discussion and provide description of architectural and conceptual layer between business strategy and business processes. The construct of a business model includes elements of business strategy and aims at describing the architecture of business as a manifestation derived from the strategy (Osterwalder and Pigneur 2002, Rajala et al. 2003, Osterwalder 2004, Morris et al. 2004, Tikkanen et al. 2004). In addition, business model has been defined as an abstraction of business (DuBosson-Torbay et al. 2001, Seddon and Lewis 2003), which describes the business-specific characteristics and revenue sources, and specifies where the company is positioned in its value-creating network in a specific business.

The essential elements of different business models are defined in different words by several researchers (e.g. DuBosson-Torbay et al. 2001, Pigneur 2002, Bouwman 2003, Rajala et al. 2003, Hedman and Kalling 2003, Morris et al. 2004, Osterwalder 2004). Many of the studies identify a number of elements characteristic to different business models. To sum up the discussion, three common elements to the studies reviewed are (1) the value propositions or offerings, (2) various assets and capabilities as resources needed to develop and implement a business model, (3) the economic model or revenue logic (including sources of revenue, price quotation principles and cost structures) characteristic to a particular business. In addition to these elements, multiple studies (e.g., in Timmers 2003, Osterwalder 2004, Morris et al. 2004) emphasize relationships. DuBosson-Torbay et al. (2001) and Amit and Zott (2001) define these relationships as network of partners for creating, marketing and delivering value and relationship capital to one or several segments of customers in order to generate profitable and sustainable revenue streams. Therefore relationships compound the value-creating network of a business model, including the network structure, purposes or intentions of the network and actor's roles and relationships.

Amit and Zott (2001) recognize the distinction between value creation and value appropriation in their study. Under these conditions, a business model would depict the architectural configuration of economic exchanges, describing the value-creating network, whereas revenue or earnings model would focus on value appropriation, the specific ways a business model enables revenue generation. However, a following brief review to the elements of business model reveal, that the value-creation and value-appropriation are tightly interconnected, and it is impossible to draw a clear distinction between them.

(1) *Value proposition* relates to an optimal product/service offering of a firm (Tikkanen et al. 2003). Value creation involves the creation of customer value, combined of innovating, producing, and delivering the offering to the market through business networks. On the other hand, value appropriation involves the economic component to extract profits in the market place (Mizik and Jacobson 2003). Value proposition as an offering is the outcome of these two processes, and act as an exchange mean to collect profits from the market (Kothandaraman and Wilson 2001). The development of the offering is based on the competencies and effective and efficient business processes of the firm and its key networks and partners.

(2) Various organizational *resources*, i.e. assets and capabilities, influence value creation and value appropriation (e.g. Hooley et al. 1998). Most resources cannot be exclusively classified as pertaining just to value creation or to value appropriation, but they influence both (Mizik and Jacobson 2003). The value creation process links to core capabilities of firms in networks (Kothandaraman and Wilson 2001). Thus, Möller and Törrönen (2003) propose a selection of indicators of supplier capability for determining the value of the relationship.

(3) *Economic model* comprises of both value proposition related economic benefits, i.e. profits and revenues, and economic sacrifices, i.e. costs. The pricing and revenue antecedents vary in different business models, and are affected by the type of relationships in their network. The prevalence of distribution partners typically hinders collecting profits based on customer-specific work performance, whereas licensing models enable various ways to

capture profit by different actors in a value-creating network. Concurrently, economic benefits may relate to e.g. managing price erosion (Hoover et al. 2001), and clearly represent value appropriation.

(4) *Relationships and networks* as such are vital resources of a company (Gadde and Snehota 2000). Werani (2001) points out that benefits and sacrifices may be considered as building blocks or relationship value, with relationship benefits being the main value driver. Beekman and Robinson (2004) argue that effectiveness of relationships are important for businesses, but point out that a lack of effectiveness may be more important in determining the duration of relationships. Thus, firms are likely to evaluate relationships and to scale back ineffective relationships when their business is not growing. This calls for continuous efforts to aim at effectiveness in relationships. Gadde and Snehota (2000) define relationship benefits as savings in various costs of operations that can be related to collaboration with another actor, and economic consequences of relationships that are related to revenues. Relationship sacrifices include various costs, such as relationship handling costs (Gadde and Snehota 2000) and switching costs (Ojasalo 2004). In such way the relationships are tightly interconnected to other elements of a business models.

This study is founded on the idea that value creation in dyads and business networks reflect in as value appropriation in business models through the elements described above. On the basis of the elements, the next section will construct a framework to analyze the value of relationships, in order to find key relationships and networks in a particular business model.

The construct of a relationship value framework

The study draws on the idea that value of relationships can be approached through how an actor or strategic net can benefit the focal company's business model(s). As business model refers to abstraction of business, i.e. each actor's unique configuration or characteristic way to execute a specified business, we need business model elements to serve as dimensions for relationship value assessment. It is also essential to notice that the strategic partners may be considerable different in various types of business models. One aim of the research project is to explore whether there are differences between key strategic partners in different business model types.

According to Gulati et al. (2000) any strategic network can be decomposed into a variety of dyadic links. However, Gadde and Snehota (2000) point out that the value of relationships and other assets are not absolute but context dependent. Therefore value as economic or other consequences cannot be evaluated only from the content of the particular relationship, but also from the perspective of firm's operations and other relationships. Therefore, the analysis will take action on three levels: *(1) the importance of a dyadic relationship, (2) the importance of strategic network, and (3) identification of the most important strategic actors and networks in the focal company's business model?* These support the initial research questions. The dimensions of analysis are summarized as a framework in Figure 1.

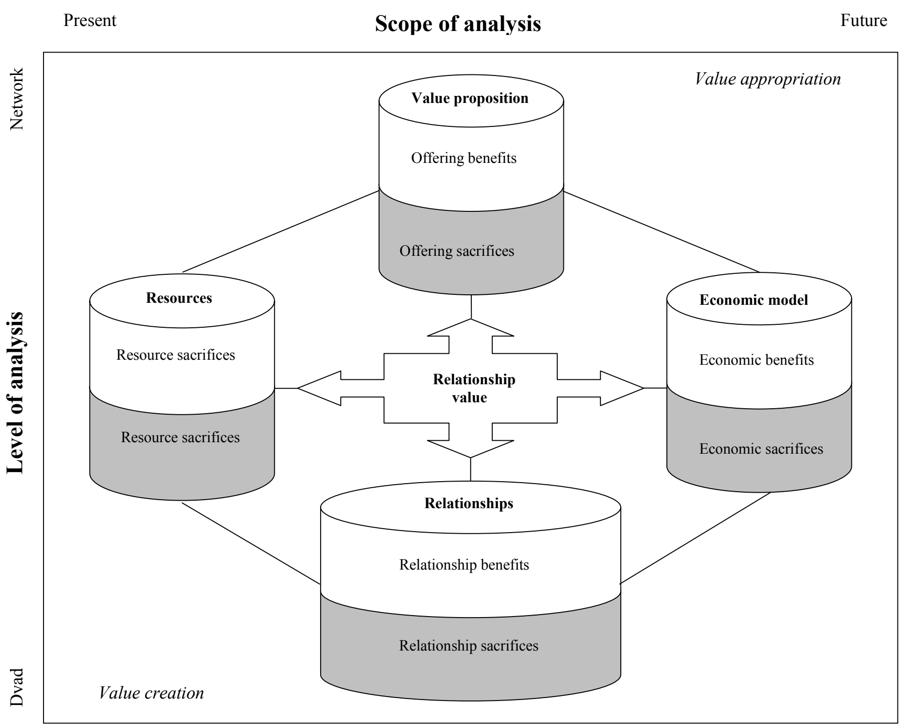

Figure 1 Relationship value analysis and implications on business model.

Implications of relationship value to business model: Each relationship has effects on the business model of a focal company through the elements described in the business model literature. Interaction with particular actor(s) either provides benefits, or demands sacrifices. Thus, the relationship(s) form the focal company's business model, and enables or hinders access to other kinds of business models and opportunities. Interaction between actors spawns an integration of value creation and value appropriation, expressed as a business model of the company.

Scope of analysis: In the analysis of relationship value the essential dimension is observation period. The forms and outcomes the relationship accomplished in the past are not guarantee of the future value. In such way it resembles the traditional dilemmas in the financial market. According to the literature, assessing value of the relationship should consider the net benefits and sacrifices between present and potential/future outcomes.

Level of analysis: Relationships in business models can be analyzed in two levels. The foundational level of analysis is a dyadic relationship, in which the relationship value analysis concentrates on interaction with a specific actor and analyses the gained net benefits and sacrifices in each business model element. The networks as a level of analysis emphasize the importance of nets in the business model of a focal company, and evaluate the benefits and sacrifices related to the business networks involved, and their implications on the focal actors' business model.

Limitations

The analysis of relationship value should take action on many levels. Applying a focal company point of view enables anchoring relationship value to the business models discussion. However, the analysis should also consider the importance of the focal company to the actors and networks in its business model. Therefore, the applied approach does not consider the importance, i.e. relationship value, of the focal company to the participants. It remains an interesting issue, if the presented framework could be extended to perceive aspect.

Methodology

First the study reviews existing literature on related topics to provide basis for framework construction and designing metrics for strategic importance. In order to take a thorough insight of the phenomena, the essence of strategic networks and business models is attempted to capture by qualitative means. Empirical research of the study project will relate to case studies (Yin, 1994) on a group of case studies, and quantitative data acquired through a survey. Results of the empirical research will be disseminated during the study in reports and academic articles.

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