

VALUE IN S-D LOGIC AND ECONOMICS: TOWARDS A COMMON UNDERSTANDING

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ABSTRACT

Traditionally, economics has had a strong influence on marketing theory. The emergence of service-dominant logic (S-D logic) has challenged this position, based on a seemingly fundamental disagreement about the determination and meaning of value. This paper questions the basis of this disagreement and concludes that it is possible to reconcile the meaning of value in S-D logic and economics under the condition of scarce resources.

INTRODUCTION

According to Vargo & Lusch (2004:1), "Marketing inherited a model of exchange from economics, which had a dominant logic based on the exchange of "goods," which usually are manufactured output." They label this model goods-dominant logic (G-D logic). The early contributions to S-D logic include discussions about the differences between S-D logic and G-D logic regarding the determination and meaning of value. Vargo & Lusch (2004:7) state that in S-D logic "Value is perceived and determined by the customer on the basis of "value-in-use". This is compared to G-D logic where "Value is determined by the producer. It is embedded in the *operand resource (good) and is defined in terms of "exchange-value"*" Vargo & Lusch (2004:7). Vargo and Morgan (2005) discuss G-D logic in depth and trace the role of goods and services through economic history. They observe that some early economists, among them Bastiat ([1860] 1996), described a service-centred model of exchange, but that this service-centred model was abstracted away through the development of economic science and replaced by a goods-centred model, i.e. G-D logic, focusing on value-in-exchange. "With utility as an economic unit of analysis, the issue of use value could be ignored; value-in-use had been transformed into an embodied property, essentially equivalent to value in exchange" (Vargo & Morgan 2005:45).

Robbins (1945:16) gives a frequently quoted definition of economics: "Economics is the science which studies human behaviour as a relationship between given ends and scarce means which have alternative uses." Economic theory is deduced from a series of postulates. According to Robbins (ibid.:78-79), the main postulate of

economic value theory "... is the fact that individuals can arrange their preferences in an order, and in fact do so." This postulate is applicable whenever resources are scarce, that is when they are limited in relation to human needs for them. Marketing, on the other hand, is defined by the American Association of Marketing as "... the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large." According to the definition of economics, the activities and processes of marketing are a subject matter of economics inasmuch as they involve the use of scarce resources. Marketing can never be reduced to a matter of economics, but economics is usually considered to be an aspect of marketing. S-D logic could therefore benefit from an extended understanding of the determination and meaning of value in economics.

The purpose of present paper is to extend the understanding of S-D logic by applying economic theory. After a brief review of how value-in-use and value-in-exchange are understood in S-D logic, the determination and meaning of value is discussed from the perspective of economic theory. Finally, the understanding of value-in-use and value-in-exchange in S-D logic is discussed in relation to economic theory.

DETERMINATION AND MEANING OF VALUE IN S-D LOGIC

Vargo and Lusch (2004) reopened the discussion of the nature of value based on the perspectives of G-D logic and S-D logic. Liberation from concepts associated with traditional G-D logic has been important in the process of constructing a conceptual framework for S-D logic. In G-D logic, value is created in the firm's production process and becomes thereby embedded in goods and measured as value-in-exchange. One of the implications of S-D logic for marketing theory is that it shifts the focus from value-in-exchange to value-in-use. According to S-D logic, the value of a service is always uniquely and phenomenologically determined by the customer. The firm cannot deliver value to its customers; it can only make value propositions (Vargo & Lusch 2008a). Vargo and Lusch (2008b:31) explain that "... since service is defined in terms of customer-defined benefit, it is necessarily aligned with value-in-use... Value-in-exchange remains important but it is primarily derived from value-in-use and, like goods, plays an indirect role in value-creation."

Value is related to utility, but the meaning of utility is ambiguous, and so is its relationship to value-in-use and value-in-exchange. Vargo & Lush (2006:48) note that "The term utility has two meanings. The first relates to usefulness, the ability to derive benefit from something.... Utility, as it is more frequently used in marketing, derives from economic science and,

though its original meaning was tied to usefulness, the term has morphed to a connotation, if not a denotation, of an embedded property of matter.” Vargo and Lusch (2008b:30) indicate that utility is an expression of value: “... the early scholastics (*sic*) recognized that value-in-use was a higher order concept than exchange value... But in the subsequent development of economic science, value (utility) became to be understood in terms of value-in-exchange.”

DETERMINATION AND MEANING OF VALUE IN ECONOMICS

Vargo & Morgan (2005) explain that there were two perspectives on economic activity by the end of the nineteenth century, a service-centred model and a goods-centred model. They argue that that the goods-centred paradigm survived and that “... the service-centred model... became a footnote in economic science” (ibid.:46). The literature on S-D logic leaves us with the impression that G-D logic at some stage became inherent to economic theory. In the present paper it is suggested that the goods-centred model rests with the classical economists and that the service-centred model was carried forward by their successors (although some economists, both scholars and practitioners, may have underappreciated this).

With regard to classical economics, the connection between G-D logic and economic theory is quite obvious. Adam Smith ([1776]2001) and other classical economists were concerned with creation of national wealth through production of manufactured goods. Within this context they made a distinction between productive labour and unproductive labour. Productive labour produced manufactured goods, all other labour efforts were unproductive. The value of a product was determined by the relative input of labour (later extended to also other kinds of factor inputs) needed in their production. In this way, value became embedded in the product.

The next generation of economists dismissed the labour theory of value and shifted economic theory to a more service-centred path. Menger ([1871]2007) focused on the ability of goods to satisfy human needs. Jevons ([1871]1957) and Walras ([1874-77]1954) argued that the value of a good was dependent on the utility experienced by the consumer and not the inputs to the production process. Jevons credits Dupuit (1849) with the first perfect comprehension of the theory of utility: “In attempting to frame a precise nature of the utility of public works, he [Dupuit] observed that the utility of a commodity not only varies immensely from one individual to another, but that it is also widely different for the same person according to circumstances” Jevons ([1871]1957:xxviii). From this point value was no longer considered embedded in products. With

Jevons ([1871]1957), Menger ([1871]2007) and Walras ([1874-77]1954) came the breakthrough for the marginalistic approach in economic theory. They made a distinction between (total) utility and marginal utility. Marginal utility is the change in (total) utility caused by the consumption of one more unit of a good. Jevons and Walras believed that both (total) utility and marginal utility was, at least in principal, measurable and that utility could be a subjective measure of happiness. Menger ([1871]2007), on the other hand, focused on the relative importance of goods in satisfying human needs and did not believe in an absolute measure.

Later economists acknowledged the futility of claiming that one object is twice as useful as another. A view similar to Menger's (ibid.) was adopted and the idea of measurability of utility was abandoned. If utility wasn't measurable, then marginal utility wasn't measurable either. Pareto ([1909]1972) and later Hicks and Allan (1934) developed a theory relying only on the postulate that an individual is capable of ordering various situations or experiences according to their importance to him. Utility was now merely a way of describing the preferences of the individual. In comparing two different experiences, the individual will either judge the two experiences to be of equal importance, the first to be more important than the second or the second to be more important than the first. Whether these experiences are connected to a physical good or not is of no importance. They suggested that we could get an expression of how an individual values experience A in relation to experience B by considering how many units of A are needed to compensate for the loss of one unit of B. Contemporary consumer theory rests on this foundation and the exposition in today's textbooks is very similar to the one of Hicks and Allan (ibid.).

Smith ([1776]2001:48) distinguished between value-in-use and value-in-exchange in his much quoted passage: "The things which have the greatest value in use have frequently little or no value in exchange; and, on the contrary, those which have the greatest value in exchange have frequently little or no value in use." At the same time, he introduced the paradox of water and diamonds: water has a high use value, but a low exchange value - diamonds have low use value, but high exchange value. The paradox of the value of diamonds and water was later resolved by Jevons ([1871]1957), Menger ([1871]2007) and Walras ([1874-77]1954), independently of each other. The crucial point was the concept of marginal utility. They explained that although the utility of water is high, in normal situations the marginal utility of water is zero because water is abundant relative to the demand for water. Diamonds may have lower utility than water, but they are scarce relative to demand and their marginal utility is therefore high. From this, it is evident that utility and value are different concepts. Value is a relationship, expressed

by Menger ([1871]2007:120) in this manner: “The value of a good arises from their relationship to our needs, and is not inherent in the goods themselves. With *changes in this relationship*, value arises and disappears. ... Value is thus nothing inherent in goods, no property of them, nor an independent thing existing by itself.” A non-economic good is distinguished from an economic good in that the former is abundant and the latter is scarce. A non-economic good possesses utility only, whereas an economic good possesses both utility and use value. Confusion in this respect had, according to Menger, been an obstacle to the development of economic science, but “At no time has an economizing individual attributed value under ordinary circumstances to a cubic foot of air or, in regions abounding in springs, to a pint of water. The practical man distinguishes very well between the capacity of an object to satisfy ones needs from its value” (ibid.:119).

Menger ([1871]2007:228) explained the difference between use value and exchange value like this; “Use value...is the importance that goods acquire for us because they *directly* assure us the satisfaction of needs that would not be provided for if we did not have the goods at our command. Exchange value is the importance that goods acquire for us because their possession assures the same result *indirectly*.” Value-in-exchange arises in the market as goods actually undergo exchange. Only goods that have value-in-use in the above mentioned sense are exchangeable. A good would lose its exchange value with respect to another good if the other good became useless. The first good would, however, still be scarce and useful (Walras [1874-77]1954). Price and value-in-use will be the criteria employed by the customer when considering engaging in an exchange of goods. An individual will pay for a good as long as value-in-use exceeds the value-in-exchange. According to (Mill [1848]2001:504), “The exchange value of a thing may fall short, to any amount, of its value in use; but that it can ever exceed the value in use, implies a contradiction; it supposes that persons will give, to possess a thing, more than the utmost value which they themselves put upon it as a means of gratifying their inclinations.”

DISCUSSION

From the above review, there seem to be a few points that represent potential dissonance between S-D logic and economics. These points are 1) who creates value, 2) the understanding of value-in-use and 3) the relative importance of value-in-use and value-in-exchange.

S-D logic emphasises that value is uniquely and phenomenologically determined by the consumer. We have seen that early economists believed that value was added in the production process, but that in

contemporary economic theory, value is subjective and based on the fundamental assumption that the individual is able to rank experiences in order of importance to him. Value can therefore not be embedded in a product. There seems to be no contradiction between S-D logic and economic theory at this point. There is no denying that many economists have taken, and some probably still do take, the perspective of G-D logic. Nevertheless, economic theory generally embraces the perspective of S-D logic at this point.

The discussion on the understanding of value-in-use is a bit more subtle and we may start with the ambiguous meaning of utility. Vargo and Lusch (Vargo & Lusch 2006:48) consider utility in the sense of "...usefulness or a benefit derived from something..." compatible with S-D logic. Vargo and Lusch (2008b) state that the customer-defined benefit of a service is "aligned with value-in-use". One possible interpretation of this is that they consider utility equivalent to value-in-use. We saw earlier that Menger ([1871]2007) made a distinction between utility and use value. According to Menger, utility can be experienced regardless of scarcity. Value-in-use, on the other hand, is a concept relevant only to situations involving scarcity. It appears that if S-D logic is interpreted within the context of scarcity, the understanding of value-in-use will be consistent with that concept in economics. The interesting question is then whether the perspective of S-D logic is limited to situations where resources are scarce. The literature on S-D logic does not seem to give an explicit answer to this. On the other hand, Vargo and Lusch (2004) and Vargo and Morgan (2005) find support in the economic theory of Bastiat, who touches on the issue of scarcity when he concludes that "... value must have reference to the efforts made by men in order to secure the satisfaction of their wants" (Bastiat [1860] 1996:5.12).

Vargo and Lusch (2008b) note that in S-D logic, value-in-exchange is derived from value-in-use. This corresponds well to Walras ([1874-77]1954), who states that only goods that have value-in-use will have value-in-exchange, i.e. value-in-use is regarded as a prerequisite for value-in-exchange. Value-in-exchange will then be a function of value-in-use in the sense that circumstances that increase value-in-use also will tend to increase value-in-exchange. The reason is that the customer's willingness to pay for a product increases with value-in-use. A supplier will have an incentive to increase his engagement in customer practises and contribute to increased value-in-use for his customers, as long as his reward exceeds the opportunity cost of his efforts. According to the literature on S-D logic, economics focuses on value-in-exchange, whereas S-D logic focuses on value-in-use. In actual fact, both concepts remain relevant to both disciplines. The issue might be interpreted as a matter of means and ends; where value-in-use is an end in S-D logic but

a mean in economics and value-in-exchange is an end in economics. Widespread support for this interpretation seems to be lacking in economic theory. One would be tempted to regard value-in-use as the end and exchange as a means to this end. The consumer aims to maximise the difference between value-in-use and value-in-exchange. The producer wishes to maximise the difference between value-in-exchange and opportunity cost (the value of foregone alternatives due to resources being tied up elsewhere). Ultimately, this means that the end is to maximise the difference between value-in-use and opportunity cost. Again, there appears to be no contradiction between S-D logic and economics, providing that we operate within the context of scarce resources.

CONCLUSION

This paper has examined the nature of the disparity between S-D logic and economics in understanding the determination and meaning of value. The conclusion is that if the scope of S-D logic is limited to situations with scarce resources, there seems to be no contradiction between the fundamentals of economic theory and the perspective of S-D logic.

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