THE RELATIONSHIP BETWEEN PERCEIVED RISK, PERCEIVED VALUE AND PROJECT COMPETENCIES

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Abstract

Perceived risk and value. The concept of perceived risk has been conceptualised as corresponding to situations when there are potentially negative outcomes. Later studies distinguished between uncertainty before the outcome and the outcome itself, which points to the timing of the perceived risk. This study focuses on how perceived risk impacts perceived value, and further, how risk communication can neutralise the unfavourable impact of perceived risk on value in project transactions.

Perceived risk during projects. The most crucial risk element is the supplier’s performance commitment, which is the responsibility to complete the project successfully in every respect. This risk applies until the project has been completed. From a buyer’s perspective the only relevant aspect is the successful outcome of the project as the buyer lacks the required knowledge to complete the project himself. The uniqueness and performance risk of the project necessitate a very interactive, and problem-oriented partnership from buyer and seller from the beginning to the end of the project. As the project comes to an end the functional risk decreases for the supplier as he was able to finish the project, but the risk of non-payment (by the buyer) still exists and increases. For the buyer non-delivery risk exists in the process, and it might stay constant or it might even increase during the project.

Competencies in projects. Intangible resources (like competences) on both sides can be one of the key determinants of the buyer’s risk perception. Competences provide significant advantages in project development and client service management. The interactive process between buyer and supplier results in value creation, where the exploration of the customer’s value preferences is a key aspect of an active client management. Therefore, the pre- and post-transaction phases are sometimes play a more vital role than the transaction itself. Project buyers are, in general, competent and involved actors in the transactions. Receiving information about the supplier’s competence profile reduces the buyer’s market uncertainty and transaction uncertainty in the implementation phase.

Methodology. In general, projects are 1) time-bound, 2) undertaken by a team and 3) for a specific purpose. This definition allows the inclusion of numerous services. Data was collected by using 180 in-site expert mini-focus group interviews with decision makers in the following industries: ad hoc market research, construction, IT consulting, marketing communication/PR, media agency, finance, consulting, event management, business tourism, business trainings and web development. Equal number of focus groups was conducted with
buyers and suppliers in each context. During the interviews a standard qualitative interview guide was used that consisted of 6 main topics, which are as follows: 1) project uniqueness, 2) problem solving as the supplier’s main competitive advantage, 3) interdependency in projects and its relation to performance risk, 4) the role of presumed competences in decreasing risk perception, 5) the role of risk communication in reducing uncertainty and 6) the role of supplier-buyer relationship in influencing perceived risk. The decision makers were asked to discuss their views on these topics based on their own experiences.

In the paper we present the findings of the qualitative phase and discuss their implications. Based on the findings also a conceptual quantitative model is to be developed.

**Keywords:** performance risk; presumed competence; project transactions

### CONCEPTUAL DEVELOPMENT

#### PERCEIVED RISK

The concept of perceived risk has been around since the 1960s and the domain of consumer behaviour has conceptualised perceived risk as corresponding to situations when there are potentially negative outcomes (Dhalakia, 2001). Therefore, perceived risk is considered as an inhibitor to purchase. Several studies do not distinguish between risk and uncertainty (see e.g. Taylor 1974). Later studies (e.g. Dowling and Staelin 1994) distinguished between uncertainty before the outcome and the outcome itself, which points to the timing of the perceived risk. Risk from the customer’s point of view can be described as the comparison of alternatives (Aqueveque 2006). Jacoby and Kaplan (1972) developed a classification of perceived risk, which includes the following dimensions, such as 1) heterogeneity of offer (Veres 2009c; Guseman 1981; Murray és Schlacter 1990), 2) buyer-supplier interaction, 3) price, 4) company image, 5) personality of decision makers, 6) history of seller-buyer relationship (Ganesan 1994; Sheth és Parvatiyar 1995) and heterogeneity factor. Research on these dimensions shows that transactions that are services at a high price from a company with a poor image (e.g. Havlena és DeSarbo 1991), with a low level of interaction and/or lack of history between the partners result in higher perceived risk. Based on the dimensions of perceived risk developed by Jacoby and Kaplan (1972), this paper focuses on the performance risk in relation to the supplier’s expected performance.

#### PERCEIVED VALUE

Perceived value is usually considered before the transaction, however, its role is more apparent through the entire transaction. In a service-oriented approach delivered value can be derived from dominantly intangible resources – in particular competencies and relationships (Haanes and Fjeldstad 2000). Besides the “is worth what paid for” approach (e.g. Newman 1988), Zeithaml (1988) proposed the trade-off of benefits and sacrifices approach. Similarly to studies in the area of perceived risk, research on perceived value was primarily undertaken in the end-consumer setting, however, there are a few examples in the business-to-business context (e.g. Lapierre 2000). Research has identified various dimensions of value, such as cognitive and affective components (e.g. Anderson and Narus 1990; Sweeney and Soutar 2001), goal performance and financial performance value, and in case of services, the process performance value.
Although both perceived value and risk has been investigated by researchers, no research has focussed on their relationship. Therefore, this study focuses on the interaction of the two concepts and specifically, how perceived risk impacts perceived value, and further, how risk communication can neutralise the unfavourable impact of perceived risk on value. The role of risk communication is extremely important due to the unique nature and high value of projects, however, its role has not been explored in projects.

**PERCEIVED RISK AND VALUE IN PROJECT SETTINGS**

As mentioned in the introduction this study focuses on projects that are usually associated with industrial transactions. These transactions are complex and have a physical (hardware, building) and an intangible component (software, engineering consulting, financial products, production know-how, etc.). In general, projects have the following characteristics: 1) time-bound (it has a start and a finish), 2) undertaken by a team and 3) for a specific purpose. Therefore, this definition allows the inclusion of services, such as engineering consulting, planning, production know-how transfer, ad-hoc market research, management of advertising campaigns, event management, etc).

**THE UNIQUE CHARACTERISTICS OF PROJECTS**

Projects have several unique characteristics (Cova and Salle 1999; Cova, Ghauri and Salle 2002; Veres and Buzás 2006). 1) The most crucial risk element is the supplier’s performance commitment, which is the responsibility to complete the project successfully in every respect. This risk applies until the project has been completed. 2) The project is a unique transaction even for the buyer. 3) The solution to the problem requires system thinking. Hence, project transactions are also referred to as system selling. 4) In the buyer-seller relationship, so-called cooperative risks emerge due to the conflicting interests of the parties. These risks allow each party to leverage the knowledge gaps of the other party (Schmidt–Wagner 1985). 5) Projects have a series of interactions between the parties that can be grouped into phases, such as feasibility study, briefing, supplier selection, project implementation, debriefing, etc. 6) The supplier-buyer relationship is periodic.

Although some projects have a substantial product content, it is unclear which component (product or service) dominates the transaction from the buyer’s point of view. From a buyer’s perspective the only relevant aspect is the successful outcome of the project as the buyer lacks the required knowledge to complete the project himself. (Schmidt and Wagner 1985). In essence, the buyer acquires competence-based expectations of benefits (Page and Siemplenski, 1983), where the knowledge is the major contributor of competitive advantage (Vargo and Lusch 2004). Summarising, projects are discontinuous, unique, complex and phase-specific transactions, where the acronym of the first three characteristics created the DUC model. Although the history of the buyer-seller relationship is an important moderator of risk perception, due to the discontinuity inactive phases can last for long (Mandják and Veres, 1998, Cova, Ghauri and Salle, 2002).

**PERCEIVED RISK DURING PROJECTS**

Cova, Ghauri and Salle (2002) developed a model that describes the process of a project from the planning to the contract from the supplier’s perspective. In this process, the specification of priorities is followed by a project-neutral phase, in which, the supplier prepares for leveraging his functional (core) competences as well as he manages his relational milieu by potentially involving external suppliers. The next phase of the process is the pre-tender phase,
in which the supplier considers the potential demand, and selects the potential buyers in the market. Buyers are selected based on a set of criteria (project screening), whose problems are worth the investment from the supplier’s perspective. The proposal phase includes the delivery of the proposal, the negotiation and the contract.

The uniqueness and performance risk of the project necessitate a very interactive, and problem-oriented partnership from buyer and seller from the beginning to the end of the project (in strong partnerships even beyond). It is to underline at this point that we focus on performance risk, i.e. risk of not keeping promises. In delivery of the needed solution vs. acceptance of the solution delivered. Due to the unique nature of projects there are some strategic considerations to need to be emphasized (Cova and Salle 1996, Engelhardt 1993, Veres 2007, Veres 2009b). 1) The uniqueness of projects does not enable standard solutions, and hence, the project details need to be specified through the interaction of buyer and seller. 2) The process of quality management places a large emphasis on promised competences that can demand a price premium to be paid by the buyer. 3) Due to the lengthy process both parties bear a bilateral risk of the project implementation. As the project comes to an end the functional (technical) risk decreases for the supplier as he was able to finish the project, but the risk of non-payment (by the buyer) still exists and increases. The buyer’s risk perception, however, only starts to increase once the project finishes. Although for the buyer non-delivery risk exists during the process, which might stay constant or it might even increase during the project. This risk perception flow is depicted by risk perception funnel (see Figure 1).

Figure 1. Potential risk flows (Risk perception funnel) for services

The risk perception funnel describes:
a/ the process of risk flows in a project environment (horizontal dimension), which means that risk and risk perception are not independent from the transaction episodes of the project implementation. These episodes might also include access to new market information.
b/ the variability of risk (vertical dimension), which means that as the project progresses the parties reach the ‘point of no return’ and hence, are less likely to abandon the project and seek alternative suppliers. In our view, risk can be managed through effective/targeted risk communication, which can be considered as a marketing competence that is able to increase the buyer’s satisfaction (see Golfetto and Gibbert 2006).
COMPETENCIES IN PROJECTS

Resources can be tangible (e.g. hardware) and intangible (e.g. technology, reputation, alliance, know-how, relationship). The authors hypothesize that the intangible resources (problem solving and relationship/network competences) can be one of the key determinants of the buyer’s risk perception. For instance, a construction company’s most important competence lies in the execution of complex tasks, whereas a consulting company’s main competency revolves around its employees and their relationships with their clients (Sveiby 1997). Competences are classified as epistemic and heuristic competences, where the former represents evidences of previous project successes of the supplier (e.g. references), whereas the latter represents a promise for a reliable and successful delivery (c.f. Grant 1995; Möller 2006).

It has to be mentioned that the Service Dominant (SD) Logic (Vargo and Lusch 2004) provides a useful framework for explaining how competences are used in achieving competitive advantage for the company. According to the SD logic the basic unit of exchange is the competence in use. Value creating problem solving is the key part of any projects, and hence, in order for the firm to create competitive advantage they have to leverage their intangible assets of the company. These intangible assets can manifest themselves in products, technology or management, which develop under competitive pressures. Therefore, competences can be interpreted as the organisation’s learning capability. Competences provide significant advantages in three main areas; in project development, network management and customer service management. The SD logic further states that the supplier only makes a value offer, whereas value creation is the buyer’s task. This interactive process between buyer and supplier results in value creation, where the exploration of the customer’s value preferences is a key aspect in active client management. Therefore, the pre- and post-transaction phases are sometimes play a more vital role than the transaction itself.

A systematic evaluation of competence-based value creation was undertaken by Möller (2006), who concluded that the supplier’s (value) offer can be communicated in three ways. These three aspects are the exchange, relational and proprietary, where the latter two extend the boundaries of the exchange (technological problem solving) competence. The parties usually take a position in the transactional-relational continuum (Veres 2007), hence, these two orientations present a rather mixed orientation than a pure transactional or relational approach.

Figure 2 displays various and highly interrelated aspects of the competencies of the two parties, where aspect 6 represents the basic marketing dimension:
1. Hygiene competencies that are required to offer the service in the industry.
2. The supplier’s perception of his own competencies.
3. The supplier’s evaluation of the buyer’s competencies
4. The buyer’s technological competencies
5. The buyer’s perception of his own competencies.
6. The buyer’s evaluation of the supplier’s competencies.
Project buyers are, in general, competent and involved actors in the transactions (Cova and Salle, 1999, Bettencourt et al., 2002, Axelsson and Wynstra, 2002). The uniqueness of projects contributes to higher uncertainty, which in turn, leads to a higher level of perceived competencies. The authors hypothesize that the supplier’s reputation is the major driver of his perceived competence. Hence, this paper focuses on whether the buyer actually investigates the supplier’s competencies or he might basis his judgment on the supplier’s competence communication. At the start of the project, the buyer’s risk evaluation is most likely to be based on the supplier’s communication, whereas during the project the communication’s role decreases. Receiving information about the supplier’s competence profile reduces the buyer’s market uncertainty (especially in the pre-transaction phase) (Golfetto és Gibbert 2006) and its transaction uncertainty in the implementation phase (Ford 2002). This phenomenon is referred to as the marketing of competencies (Golfetto és Gibbert 2006).

**RESEARCH APPROACH**

In sum special approach of our research can be defined as follows: significant similarities link the research to new orientations of project marketing explored by Jalkala et al (2010 p. 132) like for example increased risk factor, customer-oriented project delivery etc. There are however additional dimensions as compared to the paper mentioned above: the broader, service dominant modelling of project transactions; process orientation; extended project interpretation; co-definition of risks and interactive risk-communication.
METHODOLOGY

Data was collected in 2009 and in 2010 by using in-site expert mini-focus group interviews in the contexts displayed in Table 1.

<table>
<thead>
<tr>
<th>Project activity</th>
<th>Number of mini focus groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ad hoc market research</td>
<td>20</td>
</tr>
<tr>
<td>Construction</td>
<td>12</td>
</tr>
<tr>
<td>IT consulting</td>
<td>20</td>
</tr>
<tr>
<td>Marketing communication/PR</td>
<td>20</td>
</tr>
<tr>
<td>Media projects</td>
<td>12</td>
</tr>
<tr>
<td>Financial (eg loan, insurances) projects</td>
<td>16</td>
</tr>
<tr>
<td>Consulting</td>
<td>16</td>
</tr>
<tr>
<td>Event management</td>
<td>32</td>
</tr>
<tr>
<td>Business tourism</td>
<td>8</td>
</tr>
<tr>
<td>Business education</td>
<td>4</td>
</tr>
<tr>
<td>Web development</td>
<td>12</td>
</tr>
<tr>
<td>Other industrial services</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>180</strong></td>
</tr>
</tbody>
</table>

Equal number of focus groups was conducted with buyers and suppliers in each context, hence 90 buyer and 90 supplier-side interviews were undertaken. Every mini focus group included 2-3 decision makers, such as project experts, business marketers, etc. During the interview a standard qualitative interview guide was used that consisted of 6 main premises, which were as follows: 1) project uniqueness, 2) problem solving as the supplier’s main competitive advantage, 3) interdependency in projects and its relation to performance risk, 4) the role of competences in decreasing risk perception, 5) the role of risk communication in reducing uncertainty and 6) the role of supplier-buyer relationship in influencing perceived risk. These topics aimed to explore the decision makers’ view on the competence-based risk perception. The decision makers who participated in the interviews were asked to discuss their views on these topics based on their own experiences. The interviews were transcribed and the findings will be presented below.

FINDINGS

This section will provide a summary of the findings gained from the interviews according to the following research questions:

RQ 1.: To what extent do project actors perceive the project marketing premises?

The respondents agreed that projects are unique, due especially to the rapid technological and environmental changes. This challenge requires sophisticated service adaptation. Uniqueness makes sales more difficult. Projects are unique systems that coupled with new products represents a knowledge gaps on the supplier side that he needs to fill. Project activity cannot resulted in a semi-product.

“Either we complete it or we fail.“

“When we talk about project selling, we do not mean the sale of a physical thing, but rather that of a future intangible, and hence you have to provide some evidence to the client that we are able to implement the project, and hence he becomes more efficient and will also save some money. “
Uniqueness on the supplier side means a preparatory and a learning phase culminating in the co-definition of the project. That is why so called “kamikaze buyers” - who does not inform supplier before signing the contract for tactical reasons (to achieve better bargaining position) – are so risky for the supplier’s performance.

It can happen that behind the communication/image of a particular competence there is no real content. Therefore, clients, in order to avoid this pitfall, usually look for tangible evidences of competences, such as accreditations (eg. ISO). Competence can be based upon the network of actors, too. The higher the competence level of the client the better they understand the problem, however, if it is missing a third (neutral) party might need to be involved. This phenomenon is commonly referred to as competence-asymmetry, which is high in some sectors (eg. finance), whereas low in others (eg. training), and again in others (eg. business tourism) the client tends to overestimate his competencies.

Long history in the actors’ relationship can considerably reduce risk of uniqueness and the task becomes similar to routine ones. If retention is the goal, then investment into the relationship is vital in order to increase the client’s trust. In sleeping phase the follow-up at successfully completed projects is a must. Dialogue must not cease with valuable reference partners. What is more, free of charge consultancy beyond warranty period can build trust. Suppliers have to visit the client regularly in order to achieve a certain level of trust, which can also be institutionalised by introducing support contracts, which can lead to new projects.

“…if there is no contract like this, then maintaining the relationship is costly, but its return is uncertain.”.

Evaluation of performance depends on the project output. If it cannot be judged at the project closure, an abating phase begins. The final satisfaction level will stabilize later.

RQ 2.: To what extent do project actors perceive the role of time factor in the project process?

Asymmetric competencies represent the biggest challenge in the pre-transaction phase due to client’s need uncertainty, whereas the extent of asymmetry decreases over the course of the project.

Respondents thought that emphasizing trust in the buyer-supplier relationship was commonplace, however, eventually participants agreed that long-term relationships were disadvantageous and did not serve the client’s needs. In several industries supplier changes are carefully planned.

Perception of time factor is significant in case of long projects, where risk perception can vary within the risk space of the “funnel” due to eventual episodes and influences. In the construction industry it is especially relevant.

The trap of the project is evident because of increased switching costs – and bigger tangible content generally means bigger risk perception - even if on buyer side it is not conscious. Possible lost of buyers can be much higher then suppliers non-payment risk. Real defencelessness is on the buyers’ side.

The time can even reduce competence asymmetry between the actors.

RQ 3.: What are the industry-specific features of the investigated premises?

Client side can have several talented managers, who can find solutions for managing their own business processes, however, they do not take responsibility as they cannot influence
other members of their organization. In this respect the governmental and non-profit clients are very different. “Clients who have a set budget have a weak position in negotiations.”

High-tech industries (e.g. telecommunication) take a proactive approach in problem solving, and they might also demand the imitation of a competitor’s innovative system in a short period of time. Nowadays, cost efficiency is part of problem solving. In classical project markets, such as the construction industry, the effective recovery is a key factor. All in all, in some industries the involvement of the client is vital, whereas in some other industries the involvement is not required at all: “The supplier is there so the client can get comfortable.”

In the area of consulting, the client’s professional competencies might outweigh that of the supplier, however, the consultant has higher levels of system and experience competencies. These asymmetries start to disappear as the client gets to know the system and the consultant gets familiar with the company’s business processes. Consultants of buyers act as an extended competence. In case of new selling tasks (e.g. due to high tech investment environment) even suppliers apply consultants as their extended competence.

In certain industries uniqueness can be explained by the continuously changing marketing (e.g. technological, legal etc.) environment. This is the case of standard solution vs. unique conditions.

As an analogy of supplier’s side overpricing a need for overperformance hidden into the flexible contract on buyer side is also exist as a risk reduction solution.

Perception of competence asymmetry is more significant at dominantly intangible services and in case of financial investors in buyers’ position. This latter needs subtle “diplomatic” communication.

RQ 4.: What sort of preventive mechanisms can be applied in risk-handling (risk-communication etc.)?

In order to reduce the buyer’s risk perception complex problems need to be divided into smaller, routine (modularised) tasks, whereas suppliers often make the mistake of developing highly standardised offers.

“...buyers do not want standardised answers... but they expect us to find a solution for them.”

“When the client has a need...the best situation is, when we find out together what this needs it exactly, whereas some clients try to fix every problem in the same way every time irrelevant of the nature of the problem.”

Many companies aim to consciously reduce risk and their processes seems very much standard: continuous project monitoring or setting up milestones (status meetings) and iterations.

“In other words: 90% specified + weekly monitoring + weekly reporting + interactive communication to fill the 10% gap.”

Nevertheless, it is impossible to create a project briefing with flawless specifications as the outcome of the project provides new challenges in terms of its use. Hence, this post-delivery refinement creates a new learning curve for the supplier, which takes a year at least.
Solely communicating the risk factors will certainly increase the level of perceived risk, and thus, risks always have to be presented with the solution in order to decrease the risk perception. Due to the risk communication of the supplier the client’s risk perception changes during the sales process. At the start the client is usually open to various options, but subsequently – as his knowledge and involvement increases its risk perception also increases. Frequent communication between supplier and buyer can, however, lead to a decrease of perceived risk. Project actors should be convinced about not to follow unrealistic objectives.

The value of the relationship is relative, therefore, both orientations (transaction, relationship) are present in the marketplace. Due to high level of trust in the consulting domain, everyone is perceived to be relationship-oriented. Although there are no calculations on the return on relationship (ROR) rather they intuitively manage their relationships with their clients. It is clear that investment into clients is limited above a certain cost level.

“Even if supplier thinks interactive communication as important buyers can refuse it and hide behind the contract.” Interestingly buyer’s involvement in the problem solution is not preferred by all suppliers. As a typical transaction orientation they hide behind the contract.

There are reasonable limits in risk-communication, because psychological factor has to be taken into account, too. It means the aim is a balance between information and uncertainty on buyer’s side. As an important function of interactive communication mutual learning process has to be mentioned. This is to specify the project parameters being left open in the contract.

Competence-based risk communication is in fact a comparison of (supplier) performance and (user) utilization experiences. Even if the competence levels are similar on the two sides, the actors’ point of view is always different.

Finally: “Selection criteria: trust then competence and finally price.”

CONCLUSIONS

The following conclusions can be drawn from this research:

From the data collection it became clear that the size of the company has a significant impact on reducing the client’s risk. This can be explained by the principle of substitution, which means smaller companies have 1 or 2 key people, whom the client interacts with. If they leave the company, this jeopardizes the success of the project. This principle is in contrast with the principle of flexibility, where smaller companies are more flexible in problem solution and project implementation than bigger ones. Subsidiaries of multinational companies can tap into each others’ organizational knowledge and hence experiences through accessing their global databases. However, ample differences (economic, legal, cultural, language, etc.) between contexts can make this knowledge look rather difficult to transfer.

In the interviews a fanatic belief in controllability of tangibles could be observed. The trap in the risk funnel has been associated usually with intangible projects inspite of the fact that in these projects switching costs – hence risks - are significantly smaller.

The interviews further revealed that both parties’ competencies contribute to value creation in projects, however, the competence-asymmetry should also be acknowledged. Most project actors feel that the other side lacks relevant competencies, however, they also assume this asymmetry is of a small extent. The research revealed this asymmetry is mutual and hence
these should be referred to as discrepancies. Clients usually do not learn much from projects and even if they do they do not internalize this knowledge, but rather they rely on creativity and routine at the start of the next project. The project team composition, selection and the human resource management process are of ad-hoc nature rather than systematic on both sides, which is a large risk factor in itself.

Quality assurance and control systems and references clearly communicate competence, and hence reduce the client’s perceived risk, however, these do not work in every context. (eg. event management) Clients work with the same event management companies because in case of a failure the stakes are high, which will result in poor image and thus financial loss. Furthermore, mutual communication and interactivity can decrease risk perception and thus, represent enhanced problem solving capability. Nevertheless, risk communication has to focus on both, the risk factors as well as the solution.

And last but not least this research confirmed that there were more common characteristics across project activities than differences between them. This research aimed to explore some of these characteristics, which can be a significant contribution towards the interrelationship between competences, risk perception and value creation. Further research will be aimed to undertake a quantitative survey to generalise our qualitative findings.

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