

CHALLENGES AND BENEFITS OF DEVELOPING A SERVICE-ORIENTED BUSINESS MODEL IN SMALL FIRMS – A CASE STUDY FROM FINLAND

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Little is known about the benefits, challenges and risks involved in small and medium-sized enterprises (SMEs) becoming more service-oriented. The results of our study that focuses on SMEs from different industries show that a service-oriented business model is a reality in many firms. It is noteworthy, however, that traditional service firms are not necessarily service-oriented. The perceived benefits and challenges vary according to the industry and size of the firm as well as the capabilities of the manager. SMEs pursuing enhanced service orientation should pay close attention especially to management and leadership processes as well as to cooperation and networking with customers and other business partners.

1. Introduction

The globalization of markets, competition from low-cost countries, decreased margins due to commoditization, heightened consumer awareness and increased customer demand promote the shift from product-orientation to service-orientation (Kindström; Kowalkowski, 2009; Lay et al., 2010). However, many manufacturers still see service-oriented business development as focusing on the idea of service add-ons and basic services, such as maintenance and spare parts (Fischer et al., 2010). Often, services are not managed strategically; they are developed ad hoc, added after the product is sold, and not integrated with product development or other business functions (Kindström; Kowalkowski, 2009). Consequently, services are not visible in the firms' financial statements and do not receive managers' attention, although they may have a significant impact on product sales, turnover and profitability (Kindström; Kowalkowski, 2009).

Also, in many service industries, competition has intensified, customer needs and preferences are rapidly changing and, consequently, service firms are looking for ways to profitably differentiate themselves and improve their customer-driven competitiveness (Kim, 2011; Yoon; Choi; Park, 2007). A way to pursue these goals is to become more service-oriented. Prior research has shown that through e.g. employee or job satisfaction, service orientation can enhance the performance of service firms (Yoon; Choi; Park, 2007; Lee; Park; Yoo, 1999).

In prior research, quite a lot of attention has been paid to the process of manufacturing firms transforming from being product-oriented to being more service-oriented and concepts like *servitization* (e.g. Baines et al., 2009) and *service infusion* (e.g. Eloranta; Turunen, 2015) have been introduced to the literature. In fact, the topic of facilitating servitization, service infusion and solutions has been raised as one of the three research priorities in service research (Ostrom et al., 2015). From this perspective, however, the research has mainly concentrated on manufacturers of heavy industrial goods, and more research is needed to study service strategies in a wider range of industries (Gebauer et al., 2012).

This study contributes to the prior literature by examining a broad range of small and medium-sized enterprises (SMEs) that are at different stages of becoming more service-oriented and operate in different industries. While prior literature has focused heavily on manufacturing firms and large enterprises, this study includes also SMEs that could be regarded as traditional service firms. All of the interviewed firms operated in B2B-markets and some of them also in B2C-markets. Thus, the results of this study give a deeper insight into service-oriented business models, and the factors of motivation and hindrance when SMEs are seeking ways to improve their competitiveness through services. Our research questions include the following: What kind of benefits are SMEs looking for when they develop and implement more service-oriented strategies? What are the challenges and risks involved in doing so? As SMEs cannot simply be regarded as miniature versions of their larger counterparts, the benefits, challenges and risks perceived from a service-oriented business model may differ from those of larger firms. These perceptions are important as they affect the way SMEs develop their businesses (Reijonen, 2008).

This paper is constructed as follows: In the literature review, we position the study with regard to different service concepts used in prior literature. Next, we discuss the process or phases of developing a service-oriented business and the related benefits, risks and challenges. After that, we describe the data collection and research methods and then, report the results. Finally, we draw conclusions and provide theoretical and managerial implications.

2. Literature review

2.1. Service concepts

According to Grönroos and Ravald (2011), *service logic* is about the provider supporting its customers' value creation with resources and interactive processes, which may include goods, service activities and information. Service logic differs from goods logic in that while *goods* can be regarded as resources that support value generation for customers, *services* can be considered processes where a firm's resources interact with those of its customers so that value is created or emerges in the customers' processes (Grönroos, 2006). The key notion is that although

customers buy either goods or services, from their point of view, they are both consumed as services (e.g. Grönroos, 2008; Vargo; Lusch, 2004).

Successfully implementing service logic requires firms to be both customer-focused and relational (Grönroos; Gummerus, 2014). Grönroos and Helle (2010) state that for a firm operating in business-to-business markets, adopting servicelogic in fullrequires it to coordinate all its activities and processes relevant to its customers' business with the customers' corresponding activities and processes. In consumer markets, too, the firm must be well informed about the needs and practices of its customers so that its services can support their value creation (Grönroos; Gummerus, 2014).The customer perspective has to be taken into account all the way from service design to service delivery and beyond. Consequently, this kind of service perspective makes customers omnipresent in the firm and highlights the importance of customer management everywhere in the organization (Grönroos; Gummerus, 2014).

Prior literature uses the concept of *service orientation* to reflect the organizational culture (e.g. Gebauer; Edvardsson; Bjurko, 2010) or to describe a business strategy that refers to the extent of how important services are for the firm (Homburg; Hoyer ; Fassnacht, 2002). Homburg, Hoyer and Fassnacht (2002) argue that the more service-oriented the business strategy is, the more actively the firm offers more services to a broader customer base. Service orientation that permeates the whole firm is essential for service success (Raddats; Burton; Ashman, 2015). In a truly service-oriented firm, service is at the center of the strategy because the firm believes that excellent service provides superior value to its customers and, consequently, leads to customer satisfaction, sustainable competitive advantage, business growth and profitability (Lytle; Timmerman, 2006). These benefits are considered to be independent of the firm's sector(Lynn; Lytle; Bobek, 2000).

When discussing the shift from product orientation to service orientation or "adding services," prior literature refers to many different concepts that are used more or less synonymously. In 1988, Vandermerwe and Rada were the first authors to utilize the concept of *servitization* (Baines et al., 2009). Now it is one of the terms most often applied to describe a situation where companies are adding services to their selection of products. Based on how different researchers had defined the concept, Baines et al. (2009) concluded servitization to be the development of organizational capabilities and processes to better create mutual value through a shift from selling products to selling product-service systems. Other terms that describe the same phenomenon include *service addition* (see Matthyssens; Vandenbempt, 2010), *service-based business model* (Kindström, 2010) or *service infusion* (see Eloranta; Turunen, 2015; Witell; Löfgren, 2013). Gebaur et al. (2012) use terms like *service-driven manufacturing* and *service provision*. Fischer et al. (2010) discuss *service-oriented business logic* and describe it as "part of service business development, known in the literature as servitization." These are a few examples of the variety of concepts used to describe the trend of manufacturers becoming more service-oriented (Eloranta; Turunen, 2015). In many articles, most of these terms are used as synonyms for servitization (see Eloranta; Turunen, 2015;

Fischer et al., 2010; Raddats; Burton; Ashman, 2015), and often they are used but not very well described or defined.

Nordin and Kowalkowski (2010) found that researchers use the term *solution* to describe a situation where relatively wide offerings cover most of customers' needs (Nordin; Kowalkowski, 2010). This indicates that *solution* has a wider perspective than *servitization*. "Solution business" refers to customized bundles of products and services involving an ongoing relational process between the customer and the supplier in which the value is co-created (Ryynänen; Pekkarinen; Salminen, 2012). On the other hand, a recent study by Ostrom et al. (2015) combines the concepts of servitization and solution and uses the term service-led and solution-based business when referring to a business model focusing on servitization and solution-oriented offerings. They use the term *service orientation* when referring to a change from product orientation to a service-led and solution-based business. In this study, we understand the basic difference between solution-based and service-oriented businesses to be that solution-based business focuses on co-creating solutions to customers' problems with the customers, while service-oriented business aims to become integrated into the customer's value chain by managing or doing things on behalf of the customer.

In this study, the term *service business* is used interchangeably with *service-oriented business model*. While the majority of the other concepts discussed above (e.g. servitization and service infusion) are mostly used in the context of manufacturing, the idea of service orientation (which can be regarded as an organizational culture and/or strategy) is more easily adopted in different fields of industry. However, in the literature review, we will take a closer look at the prior research on servitization that describes the process of becoming more service-oriented and also the benefits and challenges involved in it.

2.2. Developing a service-oriented business model

Shafer, Smith and Linder (2005, 202) defined a business model as "a representation of a firm's underlying core logic and strategic choices for creating and capturing value within a value network". According to Ristimäki et al. (2014), this definition emphasizes a dynamic and systemic nature of business. Many recent studies of business models describe, but cannot explain, how a comprehensive transformation proceeds because of a lack of empirical evidence on business logic transitions. However, in firms the transformation of business models cause tremendous changes in the logic of value creation and in work practices, as stated by Victor and Boynton (1998). According to findings from Sosna, Treviño-Rodríguez and Velamuri (2010), shifting from one business logic to another takes years or even decades without permanent, "final" solutions.

Hence, from a firm's point of view, it is not very realistic to assume that a shift towards service-oriented business will be quick and straightforward with clear objectives and comprehensive overviews (Kowalkowski et al., 2012). Usually, firms

start with small experiments. Consequently, the process is more likely to be a step-by-step, exploratory one that proceeds by relatively small degrees (Kowalkowski et al., 2012). Moreover, the transition may not be linear as suggested by the product-service continuum, but rather like an expansion of business by the addition of services and the adoption of multiple roles as a supplier (Kowalkowski et al., 2015).

Paiola et al. (2013) described the steps of moving from a product-based strategy to a more service- or solution-based strategy to start with service augmentations that support sales. The next steps include providing after-sales services to repair products or prevent product failure and developing pre-sales services (e.g. consulting) to meet customers' business needs. Finally, the firm provides offerings with which it takes full responsibility for a customer's process.

Gebauer, Paiola and Edvardsson (2012) identified three pathways used in service business development in SMEs. In the first pathway, the focus shifts incrementally from a transaction orientation to a relationship orientation, and services are used to tighten the relationship bonds that serve as barriers against competition. The second pathway emphasizes the role of innovative new services that create a financial contribution. The third pathway is about developing a radical innovation that opens up new business opportunities and a whole new competitive arena.

Homburg, Hoyer and Fassnacht (2002) found that the antecedents of service orientation include the innovativeness of the environment, customer orientation, and how price-conscious the customers are. Antioco et al. (2008) argued that the commitment of managers, service rewards, the use of technology, firm-wide crossfunctional communication, service training and customer treatment are essential in the development of service orientation. In addition, Mathieu (2001) pointed out that the collaboration with customers, service providers and traditional competitors helps to share the risks and to achieve a competitive advantage by providing resources and skills.

2.3. Benefits of service orientation

A general belief is that services create competitive advantage (Eloranta; Turunen, 2015). Many previous studies show that service orientation offers *economic benefits* by increasing revenue, facilitating the sales of goods, and reducing the vulnerability and volatility of cash flow, as well as offering higher shareholder value and profit margins (Mathieu, 2001; Oliva; Kallenberg, 2003; Brax, 2005; Gebauer; Friedli, 2005; Malleret, 2006; Baines et al., 2009; Gebauer; Paiola; Edvardsson, 2012).

Strategic benefits include advantages that relate to competing successfully in the markets. Services are seen as creating growth opportunities in mature markets and increasing the ability to respond to demand (Brax, 2005). In today's markets, the significance of price and product as means of differentiation is diminishing (Gebauer; Paiola; Edvardsson, 2012), and services have taken their place, while simultaneously offering possibilities to create greater barriers of imitation and entry (Mathieu, 2001; Gebauer; Friedli, 2005).

Marketing benefits relate, for example, to customer relationships. Being more service-oriented is seen to increase customer satisfaction (Mathieu, 2001), build customer loyalty (Malleret, 2006), and consequently enhance and lengthen customer relationships (Brax, 2005; Baines et al., 2009). Homburg, Fassnacht and Guenther (2003) found that industrial firms that concentrate on services and design their culture and resource management accordingly perform better, not necessarily due to the direct profits generated by services, but rather due to improved customer relationships. Increased service offerings also augment and make firms' selection more appealing (Mathieu, 2001). Services may also strengthen confidence in the supplier's credibility (Mathieu, 2001) and otherwise reinforce the corporate image (Malleret, 2006).

However, empirical research has shown that the benefits expected from services are not always realized. Lay et al. (2010) found that while a great majority of firms offer services, the turnover they generate is still low because the service strategies are not fully developed. Consequently, they suggest that firms need to fully commit to services and pay attention to the breadth of services as well as to the types of products offered. In addition, it seems that SMEs have a disadvantage in comparison with their larger counterparts with regard to the financial gains from moving towards more service-oriented business. Gebauer, Paiola and Edvardsson (2012) discovered that in the case of an incremental shift, the proportion of service revenue stays below that reported by large companies. Only when small firms make a radical move towards service business (with innovations) are they able to match the financial results gained by their larger counterparts.

2.4. Risks and challenges of becoming service-oriented

Oliva and Kallenberg (2003) argue that challenges with regard to becoming more service-oriented are generated when a firm does not believe in the potential of services, when it does not have the competencies required to offer services, or when it fails to implement a successful service strategy. Fischer et al. (2010) point out that sensing and identifying the need to move towards service-oriented business are limited by managerial cognition. Indeed, the managerial challenge is substantial, as the transition requires changes in organizational principles, structures, processes, business model, capabilities, metrics, incentives, and resource allocation (Oliva; Kallenberg, 2003). Because of this firms should be prepared for resistance, as people are inclined to resist change and sometimes perceive a new service strategy as a threat that it affects their authority, expertise, responsibilities or resources (Mathieu, 2001). Other critical points identified in the transition include refined segmentation, scalability, organizational and relational competences, as well as network competences (Matthyssens; Vendenbempt, 2010). In fact, an effectively organized network could act as a primary source of competition with regard to service infusion (Eloranta; Turunen, 2015).

Brax's (2005) six categories of challenges hindering the servitization of firms include the marketing challenge, production challenge, delivery challenge, product-design

challenge, communication challenge and relationship challenge. In Alghisi and Saccani (2015) the challenges relate to, for example, communicating with and training the network partners and sales personnel, as well as developing service capabilities and processes, the commitment and leadership of senior management, achieving a critical mass of customers, developing scalable offerings, and managing issues relating to brand and supplier competition.

Kindström and Kowalkowski (2009) argue that as customers are often incorporated in the process of service development, this can lead to highly customized and contextual offerings that might be difficult to offer to wider markets. During the sales phase, a frequent challenge is to visualize and show the value created that will generate cost savings and performance enhancements for customers (Kindström; Kowalkowski, 2009). Because selling services or hybrid-offerings requires different proficiencies than selling goods, the successful implementation of service strategy may be in jeopardy due to lack of skills in sales (Ulaga; Loveland, 2014). In the service delivery phase, the risk comes from some services having a long lifetime that require the building of trust and commitment, as well as constantly demonstrating why and how the service is beneficial to customers (Kindström; Kowalkowski, 2009).

According to Witell and Löfgren (2012), the traditional business model in manufacturing firms views the concrete product as the price carrier and services as a cost; thus, many firms have been including free services in their product sales. This development has led to a fundamental problem where customers are not willing to start paying for something that they are used to getting for free, especially where there is an unequal distribution of power (Witell; Löfgren, 2012). Consequently, setting a price for a service may be a salient risk for e.g. some subcontractors or micro-enterprises. Neely (2008) found that although servitized manufacturing firms generate higher revenues than pure manufacturing firms, at the same time they tend to generate lower net profits. He also noted that compared to pure manufacturing firms, considerably more than expected the servitized firms had declared bankruptcy. Overall, the transition to a service-oriented business model calls for new roles for customers, service providers and partners in the value network, in order to make service infusion profitable (Witell; Löfgren, 2012). Kohtamäki et al. (2013) suggest that firms should invest in network capabilities in order to improve sales growth and through that the value creation of services.

Gebauer, Paiola and Edvardsson (2012) found that SMEs in particular face the following challenges and risks: They may not be able to reach the critical mass needed for profitable service business. They may lack the financial means to cover the costs of the investment in service business. They may not have the dynamic capabilities needed to identify and seize service opportunities and reconfigure operations accordingly. Often, they do not have adequate resources, so they need to partner with other firms. Thus, service business often involves other actors besides the customers, such as suppliers, subcontractors, buyers, users, and governmental agencies with varying resources (Hobday, 2000; Cantù et al., 2012). Nevertheless, Gebauer, Paiola and Saccani (2013) note that service business networks do not

emerge; the focal actor must intentionally build them. Furthermore, Epp and Price (2011) argue that the goals of actors in the customer network should also be taken into account as these goals affect customer satisfaction. Therefore, besides the fact that service business in a network requires the coordination of various actors, it also requires coordination outside the lifetime of the service and outside the service production network. In addition, the process of orchestrating a service business network requires coordination between the various actors (Ritala; Hurmelinna-Laukkanen; Nätti, 2012) and balancing the actors' diverging goals, perceptions, power constellations, and cultures (Corsaro et al., 2012). Kowalkowski, Witell and Gustafsson (2013) use the concept of *value constellation* to refer to intentionally created relationships in business networks, with the aim of pursuing repeated enduring exchanges with one another and working deliberately to create value. It can be argued that finding the right value constellation for service provision is crucial for service infusion (Witell; Löfgren, 2012).

3. Data collection and methods

The implementation of this study was tied to the preparation of a development project with the aim of training representatives of firms in Eastern Finland to move towards a service-oriented business model. The goal was to investigate the state of service orientation in these firms and how they viewed the benefits and challenges of introducing service-oriented business, as well as the possible risks of the service-oriented business model. A total of 27 firms of different sizes from the service sector and from manufacturing were selected for interview. The firms were selected to represent typical samples of their industry and scale. The companies interviewed were categorized into sector-specific groups: manufacturing industry (nine companies), subcontractors (four), trade and financing (three), information and communication (five), business services (six). All the interviewed firms operate in B2B-markets and a few of them also in B2C-markets. Other than one firm in the category of trade and financing, all the firms interviewed were small or medium-sized, meaning that they employ less than 250 people or have a turnover less than €50 million (see European Commission). Some of the companies were micro-enterprises with less than ten employees. In the Finnish context, the sample can be regarded as being representative in terms of the firm size.

Most of the interviewees were corporate CEOs; ten of them were members of their company's management team or executive management. The interviews were conducted as thematic interviews where the interviewees were asked to share their views on what they consider service business to be, how the firm would benefit from introducing service business, what dangers and challenges are related to introducing service business, and what the interviewee regards their firm's service business level to be. In cases where interviewees were not familiar with the term "service business," they were first informed about how it is defined in the present study so that

they would be ready for other questions. The interviews were recorded and transcribed.

In the analysis phase, the interviews were first processed as a whole by applying a content analysis method that prepares the empirical data for the interpretation process by repeatedly reading and organizing the data and classifying or thematizing it (Eriksson; Kovalainen 2008). Thereafter, the findings of each interview were compiled into a sector-specific observation matrix. After the sector-specific review, each sector's summaries were compiled into a chart summarizing all of the material, and enabling a better understanding of the differences and similarities between the sectors. Relevant quotations from the interviewees are included in the presentation of the findings in order to understand the perspectives of the respondents and make their interpretation more transparent.

4. Results

4.1. What is service-oriented business

The majority (22 of 27) of the companies interviewed regard service-oriented business as comprehensive, customer-oriented operations where the customer is provided with the company's product and with services, partly through network partners. As a rule, the interviewees were good at defining service business, even though some interviewees still, in practice, mainly provide services themselves to the customer.

Interviewees representing the manufacturing industry frequently used the terms “total service,” “customer processes” and “understanding the customer.”

I7: *“It is everything the company does on behalf of the customer and within the customer processes.”*

Subcontracting firms and ICT companies also consider service-oriented business to be a comprehensive service where the customer is provided with added value through different services. All of the interviewees from the trade and financing sector consider service-oriented business to be modern business thinking and a comprehensive strategy. One of them is of the opinion that all business is ultimately service business:

I15: *“Service business is the only type of business that there is. Even when a company produces metal nuts and sells them to customers, it all comes down to service. It does not matter whether the company is a production company, a retail trade company, or a car shop – all operations are service business.”*

Eleven interviewees mentioned that understanding the customer was at the core of service business. Six emphasized the offering of total service, and two interviewees emphasized account management. Other core themes mentioned included substance competence, service orientation, interaction, accuracy, and flexibility. Of

the 27 companies interviewed, 22 companies are of the opinion that service business will grow in the future, and they consider it to be a future competitive factor in most sectors.

4.2. The level of the development of service-oriented business

Of the companies interviewed, ten have already progressed far in the development of service-oriented business, eleven have started conscious development, and the remaining six do not engage in service-oriented business yet or are not planning to introduce it for a variety of reasons. There are extensive, sector-specific differences among those interviewed, and in general. Trade, financing and ICT can be considered the most progressive sectors among those interviewed. In these three sectors, all the interviewees report that they engage in service-oriented business. This may also be our interpretation as researchers when looking at the activities of these businesses from the outside. In the manufacturing industry, the companies interviewed included a couple of progressive companies; one of them seems to be a pioneer in its sector, even on an international scale. One ICT firm seems to be a pioneer in Finland, in its own narrow business field, in implementing the principle of co-creation required by service-oriented business logic. For their part, subcontractors regard the introduction of service business as more difficult than in the industry in general.

All interviewees identify the significance of business networks in service business, but few of them are at a partnership level in their networks. Network comments emphasize the words “subcontractor” and “outsourcing.” Only a few interviewees commented consistently on partnership and cooperation when referring to their suppliers, but in regard to their relationships with their customers, many pointed out that both parties gain an advantage. Most interviewees do not pay more attention to the members of their supplier network, and no systematic steps have been consciously defined for network development.

4.3. Perceived benefits from service-oriented business model

Long-term customer relationships were considered the most significant benefits of introducing service-oriented business, as was better profitability resulting from bigger deals, which provides a clear competitive advantage. Better customer insight enables better, more comprehensive service, which makes it possible to stand out from competitors and provides new business opportunities.

Long-term customer relationships were the most frequently mentioned (14 interviewees) benefit of service business in the manufacturing industry. These relationships serve to build trust between customers and suppliers, and mutual learning reduces the need to switch suppliers. A service-based approach seeks, and hopefully finds, a competitive edge created through being able to stand out from competitors through services.

According to subcontracting companies, too, the benefits of service business include long-term customer relationships, customer understanding, and a competitive edge based on service business. However, service pricing involves challenges:

I11: *“If the customer relationships are long term and you understand the end product and customer processes, it does give a slight competitive edge, but the price continues to be a challenge.”*

Long-term customer relationships are also specified as a benefit of service-oriented business in the ICT sector. ICT companies usually also emphasize the better profitability and competitive advantage created through individualized service. In addition, long-term customer relationships help to reduce the required amount of resources when operating with the customer, and that leads to lower operating costs.

I21: *“When additional services and additional features and components are developed all the time, you can get a higher price from the same customer, which also improves profitability.”*

4.4. Challenges in developing a service-oriented business model

Factors related to staff competence (17 interviewees) and staff attitude (eight) were highlighted as absolutely the biggest challenge in interviewee comments in regard to introducing service-oriented business model. In technical sectors, in particular, many people underline that sales, developing an additional service, and selling comprehensive solutions require totally different know-how than selling an individual product. Customer encounters and personal customer service are not familiar to many engineers or financial administrators, who are accustomed to working independently and alone. Service-oriented business also requires an understanding of customer needs and the ability to see the big picture.

Pricing and price justification form another important group of challenges. When customers are accustomed to only comparing the price of a concrete core product or service, it is also difficult to persuade them to change their attitudes. In some interviews, finding suitable partners was also regarded as a challenge.

In the manufacturing industry, the major challenge comprises the competence development of internal staff, and sales staff in particular, as one business service representative commented:

I27: *“In many cases, services are related to a person’s competence, which makes them person-bound. In a way, personal competence is about specifying the service as a product and knowing the customer, and this should be successfully transferred to the organization. And perhaps do some organizing, specifying the service model as a product.”*

The attitude shift within the organization and in the customer organization is another challenge that is mentioned in many cases. Sales staff are accustomed to only selling the actual product and justifying the unit price to the customer, which makes it difficult to change their attitude to one of selling total services and justifying a higher price. A representative of a manufacturing firm put it like this:

I5: *“Our people also say that it's a bit funny that our concept results in a scenario where it [Product X] costs the customer more than it does in the hardware store. I said that that's how it is, but the starting point of the entire packaging concept is that we can get a higher price for the product, but we provide the customer with services. We offer unit management and a delivery logistics service, so a higher price is justified.”*

Customer orientation and service competence are also considered to be challenges in the ICT sector:

I21: *“There is always room for development in the attitude of our staff. In the technical sector, it is not easy to encourage everyone to start thinking in a customer-oriented way. Some tend to process things too much through technology and process implementation. Sometimes they forget the customer.”*

Many interviewees in the manufacturing industry pay attention to the fact that introducing service business is largely a management question, i.e. how service orientation can be implemented throughout the organization.

For their part, subcontractors regard the introduction of service-oriented business as more difficult than in the industry in general.

I10: *“We are also living in a reality of very intense competition. When you consider the role of a traditional subcontractor, the customer is often responsible for planning and carefully defining how things should be. And, in a way, subcontractors have a very small chance to innovate, because the customer does not want anything to be changed.”*

As in other sectors, staff competence was regarded as a key challenge in trade and financing. The service sector expressly underlines personal customer service – service encounters are considered to be challenges in all companies interviewed.

H15: *“Regarding customer encounters, the competence pressure is the highest. When new people join and existing ones leave, comprehensively managing customer encounters is pivotal. Regardless of sector, expanding the customer relationship and achieving an emotional connection are a major challenge for all service production companies.”*

All companies regard their own special competence related to the production of products, both physical and intangible, as a core of the business that cannot be outsourced. Many also consider sales work to be an activity that they must retain themselves, because it requires solid customer competence and also provides feedback that helps them better understand their customers. However, understandably, there are also sector-specific differences here.

4.5. Perceived risks involved in the development of service-oriented business

The significance of risks related to service-oriented business implementation varies by sector, but in general, the greatest number of risk factors were linked to network partners (ten interviewees). Network partners may grow and become competitors, or they may copy the service or constitute a quality risk. However, many companies that had progressed far in the development of service-oriented business regarded the risks as manageable, and they emphasized the fact that very detailed contracts need to be signed with partners. The difficulty of pricing services is another, oft-mentioned risk that is extensively underlined in the subcontracting industry. A further risk relates to knowing how to communicate and justify the higher price to customers so that they can compare deals.

In service-oriented business, people may also forget their company's core competence and go astray. Many interviewees specified losing focus as a risk factor, as well as factors related to a lack of competence among staff, which are also linked to a lack of customer understanding and quality assurance issues.

Service pricing is considered to be a risk and a challenge in the manufacturing industry, as is the difficulty in assuring customers that the higher price resulting from the additional services will also provide more value to the customer:

I8: *"Not all costs can be charged at all times, but you always need to show the advantage [the consumer] gains."*

In the manufacturing industry, ensuring service quality is also considered to be a challenge, and poor service is considered to be a risk:

I2: *"Our service product is such that if we fail at it once, it is very likely that the customer will not buy it again. That is, like, where the background of trust is [in quality]."*

The subcontracting industry is based on solid, specialized expertise and competitive pricing, which means that it may be difficult to sell additional services or total solutions. The competition in subcontracting is intense, especially in terms of price. If a competitor is offering a simpler service and the customer fails to understand the difference between the content of the offers, the deal may be lost:

I12: *"Price is always the aspect that ultimately decides everything, and if someone offers a really low price, it is very likely that the customer will go for it."*

Risk factors in the ICT industry include risks related to network partners and staff, focusing on the wrong things, or failure to keep promises to customers. HR risks are related to service production competence and encounters with customers.

I18: *"In service business, the customer is in touch with the person who provides the service. If even one person fails in some aspect of the service, the customer may switch providers."*

Network-related risks include the loss of a partner or a partner being untrustworthy, i.e. they copy the company's product, for example. In addition, there seems to be the risk of committing too many resources to network management. A representative of the business service sector mentioned that one of the service business risks is that a partner providing outsourced services may offer its own service product directly to customers, which would destroy the foundation of the total service provided by the company.

I23: *“Corporate relations, in service business in particular, are largely based on trust, and trust is based on mutual trust between people – In a small town, everyone knows each other, and partners can go and directly offer their product to customers.”*

Service business may also involve the temptation of following customer requests too far:

I21: *“In a way, it is risky if you start going down other paths too much. There should be a focus of some kind. You should keep your eyes on your own product, and you can't implement everything [the customer wants].”*

5. Discussion

Facilitating servitization, service infusion and solutions has been prioritized as one of the top themes in service research (Ostrom et al., 2015). This far, apart from a few studies, e.g. of Gebauer, Paiola and Edvardsson (2012) who examined manufacturing SMEs and their pathways for service business development and Kowalkowski et al. (2013) who studied value constellations used to operationalize different service strategies in SMEs, the research conducted in this area has concentrated heavily on large, manufacturing firms. This study contributes to prior research by examining broad range of SMEs from different industries, including services. Instead of focusing on the *process* of the development of service-oriented business model, the purpose was to investigate the benefits, challenges and risks SMEs perceive to be involved in becoming more service-oriented. These perceptions affect SMEs' decisions on how to develop their businesses (Reijonen, 2008). The results show that the main benefits SMEs perceive in service-oriented business models relate to customer relationships as well as to improved profitability and competitive advantage. On the other hand, main challenges are linked to staff's know-how and attitude as well as pricing matters. In addition to these, SMEs perceive risks in networking and in the inability to focus on the right things. Although the main benefits, challenges and risks seem to be quite consistent between SMEs, on a closer look differences can be detected according to the industry and size of the firm. Next, the results and their implications are discussed in more detail.

The great majority of the interviewees interpret the term *service-oriented business* in the same way as it has been described in the literature, referring to customer orientation, value co-creation, interactive processes with customers, and effective

use of partnerships (e.g. Grönroos; Ravaid, 2011). All representatives of ICT companies, subcontractors, and trade and finance businesses understood the service-oriented business model and were well aware of its potential benefits. This applied also to most of the manufacturing companies as well, independent of the size of the company. Hence, service-oriented business models are already a reality in many of the firms – especially in those involved in international business – but the differences between the sectors are significant. The interviewees in many sectors (e.g. trade and financing, ICT) see it as difficult for firms to compete on the core product or service attributes or prices, which means that service is the only competitive factor available. This is a common finding also in the prior literature (see e.g. Eloranta; Turunen, 2015). The majority of the interviewees from the other sectors seem to perceive the benefits and importance of service-oriented business model on a general level, but have different kinds of challenges and obstacles in transforming to this business model in their own businesses. Subcontractors in particular understand the benefits for their side, but they feel that their customers are not ready for the business model, as for most of them, price is the major factor affecting their decisions.

Nevertheless, in this dataset, an interesting notion was that part of the traditional business-to-business services sector (representing e.g. advertising agencies and business consultants) did not identify the existence of the service-oriented business model in the market, or did not perceive any benefits from it after the interviewer had explained the meaning of the concept. One of the manufacturers interviewed could see the benefits for other fields of industry but could not imagine the business model for his firm. These firms were micro-enterprises and firms that were led by older managers who did not seem to be growth-oriented. They did not see the benefits of a service-oriented business model, and they were not keen to develop their businesses in areas other than their specific core competences. They also seemed to want to keep matters in their own hands. Consequently, they did not recognize the potential in networking and outsourcing. For them, partnering could mean a loss of control, which they were not prepared to accept. There were also firms that could not see the benefits of stakeholder relationships beyond direct customers and suppliers. Consequently, they overlooked possibilities to develop with other stakeholders value-adding services that influence customer's buying decisions, although SMEs often need partners to complement their resources and abilities to identify and seize service opportunities as well as to reconfigure their operations accordingly (Gebauer; Paiola; Edvardsson, 2012). One manufacturer did not recognize the concept, however, when describing the marketing approach of the company, this interviewee seemed to have applied the business model without being conscious of it. Often small firms pay only little attention to plans and strategies, the main focus being on the needs of the moment (Stokes, 2000).

The differences identifying and implementing service-oriented business models between the companies could partly be attributed to the size of the company and to the personalities or capabilities of the managers, and especially to their attitudes

towards outsourcing, networking and partnerships, in other words their collaborative orientation. As McCartan-Quinn and Carson (2003) have argued, the attitudes of owner-managers of small firms, their experience and expertise are essentially those of the firm itself. Consequently, the recognized need to move towards a service-oriented business model is limited by managerial cognition (Fischer et al., 2010) and that is why it is important to identify the perceptions owner-managers attach to becoming more service-oriented.

The major challenges in developing a service-oriented business model identified in this study were similar to those reported in prior literature and related to the competencies of the personnel (e.g. Alghisi ; Saccani, 2015), as well as the management and leadership of the process, i.e. how service orientation can be implemented throughout the organization (e.g. Alghisi ; Saccani, 2015; Brax, 2005). An attitudinal change from products to service-led solutions requires a lot of training at all levels of the organization, and especially in the sales of technical solutions, which in Finland are, in most cases, in the hands of engineers, whose approach is often focused on the technical attributes of the equipment, not the customer value of the solution. According to the interviewees, capabilities for customer-oriented thinking may also be limited. The transformation requires a change in organizational culture, which is often a project that spans several years. The goal of value co-creation is to comprehensively, yet profitably, provide value to customers, in cooperation with them and with other partners of the company. Several interviewees also note, especially in the subcontracting field, that there is also a need for a change in attitudes on the customer side; it should be possible to shift from a focus on price to a focus on value of the entire solution. As Brax (2005) puts it, it is important for both suppliers and customers to fully understand the concept of the service.

The role of networks in service business is found to be substantial, especially for SMEs who need complementary value-creating capabilities (Hobday, 2000; Cantù et al., 2012). However, according to the results, networks are also seen as a major source of risk. Managing networks and negotiations with partners may bind resources and time, which are limited commodities in SMEs. Thus, focusing resources on functions and tasks that may not pay off is a risk for SMEs. Creating a networking strategy that defines criteria for partners, for example, offers a tool that can be used to find suitable partners, evaluate them and their behavior, and determine when it is time to end the partnership. Yet, the absence of these kinds of plans and strategies are a challenge for SMEs (Reijonen, 2010). The trustworthiness of partners is, therefore, emphasized strongly, and it is recommended that this risk is managed through rigorous and detailed contracts. All in all, the findings indicate that finding suitable partners and managing networks seems to be a major challenge for companies taking their first steps on the transformation to a service-oriented business model.

Regardless of the level of service orientation in their operations, most of the interviewees were able to perceive several benefits in the transformation to and

implementation of a service-oriented business model. The benefits of long-term customer relationships were recognized most often, including those who were not yet acting in a service-oriented way. Among those who were familiar with the service-oriented business model in practice, better profitability was also mentioned. Homburg, Fassnacht and Guenther (2003) have pointed out that becoming more service-oriented helps firms to perform better – not necessarily by generating direct profits, but due to improved customer relationships. Eventually, improved customer relationships are expected to show in the profitability of the firm.

To conclude, traditional service firms are not necessarily service-oriented. An inability to identify the opportunities of partnerships, perhaps stemming from mistrust or bad experiences, may lead a firm to try to deliver all the services the customer might need on its own. As Gebauer, Paiola and Edvardsson (2012) note, small firms need partners, as the set of required capabilities for a service-led and solution-based business model is extensive, and small firms cannot gain all possible knowledge and skills.

From a managerial perspective, the results show that there are a multitude of things that small firm owner-managers consider when they develop their businesses towards service orientation. Most likely they weigh the benefits with risks and challenges and see which side comes out the heaviest. There are many uncertainties to take into account. For example, SMEs recognize the risks and challenges related to the staff, at the same time, being labor intensive investing in services means often also investing in recruiting new employees which in turn affects the financial outcome. Networking is deemed to be important, but building, developing and coordinating a profitable network takes expertise, time and other resources that are usually quite limited in SMEs. Finally, the transition from a business logic to another takes years and even decades (Sosna; Trevinyo-Rodriguez; Velamuri, 2010) and a lot can happen in between. However, here SMEs may benefit from their tendency not to make strict plans and strategies (Stokes, 2000) and nimbly change the course when needed and experiment new ways of utilizing services in the quest of better competitive advantage. Further studies are needed to examine, for example, the impact of the staff and networking to the development of service-oriented business models in SMEs. Longitudinal studies on dynamic capabilities and strategic development in SMEs would also shed new light to the matter.

This study has some limitations. This is a case study implemented in a regional context. Although the aim is to introduce a representative collection of companies, the sample is still small and limited to one region. However, we believe that it represents quite a good picture of companies acting outside of the capitol region. The aim is not to generalize but put forward the topic in a small business context which has been neglected, although the majority still is small and micro business, which, in many cases operate more close to their customers (McCartan-Quinn; Carson, 2003) than the large companies.

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