Customer relationships and the small software firm
A framework for understanding challenges faced in marketing

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Received 10 December 1998; received in revised form 3 March 1999; accepted 9 August 1999

Abstract

This paper identifies the major marketing challenges small software firms face during their growth and internationalization processes. It starts with an analysis of small software company activities along a continuum from ‘project business’ to ‘product business.’ This is followed by a brief analysis of the two major schools of thought in marketing, in which there is a paradigm shift from the traditional notion of marketing-mix management towards ‘relationship marketing’ is discernible. Finally, the discussion is summarized in a framework for identifying the major marketing challenges facing software company managers at the beginning of the next millenium. © 2000 Elsevier Science B.V. All rights reserved.

Keywords: Marketing; Customer relationships; SMEs; Software industry; Internationalization

1. The managerial challenge of growth and internationalization for small software firms

During the 1990s, the software industry has grown and internationalized. At the end of the decade, we are facing a situation in which there is a large and growing international market worth over 100 billion US$ per annum for different software products, including embedded software, packaged software and tailored systems [28]. However, the rapid growth of the industry has not been generally recognized. For instance, it is little known that the software industry in the US nowadays ranks third among its largest industries, and amounts for approximately 75 percent of the world software market.

The dominance of large US software companies, such as Microsoft and Oracle, is so evident that one seldom thinks that the global market share of European software producers is currently ca. 20 percent and that it is growing steadily. Most European software firms are relatively small and concentrated almost solely on serving their home markets. For instance, there are approximately 2000 software companies in Finland and only 10 percent have regular export activities. However, today software is increasingly needed, both for new products as well as in various development and manufacturing processes. Smaller firms can also benefit from the growth of the industry through increased internationalization:
for example, Finnish software producers have increased their exports by more than 40 percent annually since the mid-1990s [17]. Internationalization and ‘productization’ can be seen as the key prerequisites for continued growth in the software business. In the context of the software industry, productization typically includes a shift from unique service-intensive customer projects towards tangible standardized products aimed at international mass markets. We argue that this shift from local to international product business calls for a major mindset change in understanding and managing growing software companies. This is especially relevant for small Nordic software firms, because of the openness and small size of their home markets. On the other hand, the Nordic countries are at the forefront of IT development and use, which offers software firms a unique opportunity to gain competitive advantage in international markets. For instance, the penetration rate of cellular phones and the use of the Internet per household in Finland are the highest in the world.

The purpose of this paper is to identify the major marketing challenges that small software firms face during their growth and internationalization. It has been argued that managerial competence, especially in marketing, currently remains at a rather premature stage in many software companies where technology development has traditionally been the central area of interest among managers [12,24]. Furthermore, probably due to the newness of the industry, academic discussion on the management of the software business has been scarce: only a few contributions exist that specifically tackle the management of small software companies [4,5,6,7]. One of the main conclusions in these studies is the ever-growing importance of marketing in the development of software firms. We would argue that there is currently a clear need for software industry-sensitive management and marketing concepts. On the other hand, the software industry also offers an interesting arena for the development of management theory in a dynamic setting.

Firstly, we analyse small software company activities along a continuum from ‘project business’ to ‘product business.’ Secondly, we briefly analyse the two major traditions or schools of thought in marketing in which a paradigm shift from the traditional notion of marketing mix management towards ‘relationship marketing’ is discernible. Finally, we summarize our discussion in a framework for identifying the major managerial challenges faced by software company managers at the beginning of the next millennium.

We have cooperated extensively with dozens of small Finnish software firms in the collection of information for the study reported here. Numerous qualitative in-depth interviews were conducted, complemented by several group discussions with managers during seminars arranged by the University of Oulu, etc. Thus, the arguments represent our understanding of the typical situation faced by small firms in the software industry.

2. Software business in the late 1990s — from tailored systems to packaged products?

We are a small company concentrated heavily on tailored software systems. Our customer relationships are long-term oriented and based on mutual trust. Actually, we do not perform any specific marketing activities, and thus we do not have much professional marketing experience either.

Senior Executive, Small Software Firm in the Oulu Region

As this quotation highlights, small European software producers generally do business in the tailored software segment in their own home country within established customer relationships, without performing activities that resemble those described as marketing in well-known, traditionally oriented textbooks. However, many small software companies nowadays intend to enter the international packaged software market, which naturally functions in accordance with a business logic very different from the familiar local context.

Table 1 compares tailored software-systems business with packaged-software business, along the key dimensions differentiating these two areas. Despite the dichotomized presentation in our table, we see ‘project business’ and ‘product business’ as the extreme polar opposites along a continuum highlighting changes in business logic when moving from tailored systems towards increased productization.

Larger players in the international market for packaged software already act in accordance with the
transactional logic labelled ‘product business’. On the other hand, small and locally operating companies typically follow the relational logic connected to more or less unique project deliveries, the ‘project business’. The objective of many small companies to enter the more transactional product business can be seen as paradoxical from the marketing theory point of view that currently puts emphasis on the development of intensive long-term customer relationships. From an entrepreneurial viewpoint, however, this desire is not surprising. Bill Gates did not get rich through selling tailor-made, labour-intensive systems; he productized his expertise in operating systems and eventually achieved a huge world-wide mass-marketing success.

### 3. Marketing thinking in the late 1990s

There has been constant discussion on the differences and similarities of different research traditions or schools-of-thought in marketing since the early 1970s. For instance, Hunt [14] and Sheth et al. [26], have presented their widely-known typologies. Furthermore, Möller [19] and Grönroos [9] have identified slightly different traditions, based on a European perspective. In the late 1990s, however, there seemed to be widespread consensus that the traditional marketing mix management paradigm and different relational approaches form the basic two alternative approaches to marketing [22,27].

Several authors (e.g. [30]) have also proposed that different business relationships vary along a ‘marketing-strategy continuum’ or a ‘range of marketing relationships.’ At one end of the continuum is the purely transactional relationship, in which the customer and the seller focus on the short-term exchange of basic products in a highly competitive market. This approach is identical to the traditional notion of marketing mix management. At the other end is the purely collaborative relationship, or even a hierarchy in the form of vertical integration, in which the customer and the supplier organizations form strong social, economic, technical, and legal bonds over time in order to achieve mutual benefit. The second approach has its primary theoretical underpinnings in International Marketing and Purchasing Group (IMP) interaction/network research [8,15,16] and the so-called Nordic School of Services and Relationship Marketing [10].

The emergence of the marketing mix approach dates back to the late 1940s, when the marketer was conceptualized as a ‘mixer of ingredients’. Since then the managerial school of thought has virtually become the universal model for marketing among both academicians and practitioners. The marketing mix management approach can be characterized as tackling the following problem: How to develop an opti-
mal marketing mix consisting of product, price, place and promotion decisions for competing for the preferences of the chosen target segment of consumers or organizational buyers.

Much research has been conducted on business relationships and networks. The earliest studies concentrated mostly on understanding the nature of dyadic relationships based on the observation that both customer and supplier are active [29]. In the next phase, the focus changed towards understanding the dynamic development of dyadic relationships. One of the main conclusions of the IMP Group studies was that a dyadic relationship has to be considered in the context of a larger set of inter-firm relationships forming the business context of the focal dyad. The underlying rationale was to understand the actions of the buyer and seller, and the longitudinal development of their relationship. This network perspective has recently attracted considerable. [1,3,21,30].

Table 2 compares the central tenets of the two polar opposites along a continuum from transaction to relationship marketing. However, it should be remembered that we have summarized the two approaches in a somewhat pointed way in order clarify their major philosophical differences.

It could be argued that many small software companies seem to perceive marketing mix management as the ‘true’ way of doing marketing. Thus, they may regard its adoption as the key for entering the international market for packaged software: they do not consider the development of their present long-term customer relationships as ‘marketing.’ The management of an internationalizing software company may believe that it is facing a completely new phenomenon, requiring the adoption of more ‘professional’ marketing techniques such as the 4Ps. Some recent academic contributions that argue that the marketing mix approach is best suited for getting new customers and that relationship marketing is best for the retention of existing customers might even give theoretical support to this idea [18].

4. A framework for identifying major managerial challenges in the software business

It is now possible to sketch the framework that is illustrated in Table 3. Through positioning themselves in accordance with their dominant business logic on the one hand and their primary marketing approaches on the other, companies can identify managerial challenges during their growth and internationalization processes. The matrix describes four different situations companies may face. Cell (1) depicts the typical situation, in which a company operates in project business within established customer relationships.

Table 2
A comparison of the major theoretical approaches to marketing

<table>
<thead>
<tr>
<th></th>
<th>The marketing mix approach</th>
<th>The relational marketing approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>World view</td>
<td>Managing a company’s product portfolio, setting and modifying marketing mix-parameters to achieve optimal 4P configuration</td>
<td>Managing a company’s customer portfolio, building long-term business relationships</td>
</tr>
<tr>
<td>Key concepts</td>
<td>4 Ps, segmentation, branding etc.</td>
<td>Interaction, relationships and networks</td>
</tr>
<tr>
<td>Foreign market entry</td>
<td>The choice of a product/market, defining the goals in the target market, the choice of entry mode, developing the marketing plan for penetration, the creation of control systems for monitoring</td>
<td>Focuses on the character and number of business relationships developed with other firms in the foreign network as well as with the actors that are active in the development of these relationships</td>
</tr>
<tr>
<td>Market interaction</td>
<td>One-way communication, formal market studies, the seller is the active counterpart</td>
<td>Interactive communication, mutual learning and adaptations, all interaction parties active</td>
</tr>
<tr>
<td>Differentiation</td>
<td>Product differentiation</td>
<td>Relationship differentiation</td>
</tr>
<tr>
<td>Negotiations</td>
<td>Not seen as important</td>
<td>Crucial</td>
</tr>
<tr>
<td>Promotion</td>
<td>Non-personal advertising, brand and image management</td>
<td>Through personal interaction, developing identity as a reliable supplier in a network</td>
</tr>
<tr>
<td>Mutuality</td>
<td>Not seen as important, own short-term goals and market opportunism are the central focus</td>
<td>Seen as very important, own long-term goals are achieved through concessions in short-term goals</td>
</tr>
</tbody>
</table>
with a relational marketing approach. On the other hand, Cell (4) depicts the objective of many software companies in internationalization: following the marketing mix approach. Cell (2) depicts some kind of intermediate form between ‘pure’ relational project and international mass-product business. It is questionable whether Cell (3) — project business in accordance with the marketing mix approach — will ever be a feasible alternative.

While moving from Cell (1) to cells (2) and (4), an important issue is managing the risk perceived by small software companies’ foreign partners and customers. Risks related to the acquisition of software can generally be divided into the following components: those related to the unfamiliar product and those related to an unknown supplier (cf. [25]). Productization reduces the risk related to the product, since the buyer can test its functionality before the purchase decision is made; this is not possible when buying tailored systems. On the other hand, small software companies must establish credibility as reliable suppliers when entering foreign markets. This cannot be done without developing mutually oriented relationships with cooperative partners in target markets.

Thus, productization combined with internationalization does not necessarily imply unilateral movement from relationship development to more traditional marketing mix-based product marketing. The internationalization process essentially involves the incremental creation of personal relationships with foreign customers, that is, building a basis of trust. This is directly connected to the reduction of the uncertainty and risk perceived by the customers. Moreover, brand building basically aims at the same objective. In fact, branding is close to the long-term development of customer relationships, since it can be seen as an important element in building customer loyalty.

This might lead us to conclude that the critical question in the internationalization of a small software company is not whether to adopt the 4Ps/marketing mix approach or whether to rely solely on relationship marketing (cf. [20]), but to identify actions which decrease the uncertainty and risks perceived by foreign customers. This typically calls for the simultaneous adoption of some features from both marketing approaches. The desire expressed by numerous entrepreneurs to shift from Cell (1) to Cell (4) is, therefore, seen to be overly simplistic. On the other hand, the recent determination of marketing academics to emphasize relational concepts in almost all business settings also proves to be unrealistic in the setting that small software companies face when growing and internationalizing.

We argue that the most important managerial challenges that small software companies are facing involve how to ‘enter’ cells (2) and (4), which demand a new business logic, while maintaining traditional way of doing business. The most important managerial questions will then probably revolve around the questions:

1. How can we develop strategic and operational capabilities in product business to complement capabilities in the traditional project business?
2. How can we simultaneously manage several businesses with differing logics, for example, cells (1), (2) and (4)?
3. How can we form and simultaneously manage profitable product and customer portfolios?

<table>
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<tr>
<th>Table 3</th>
<th>A framework for identifying major managerial challenges in the software business</th>
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<tbody>
<tr>
<td></td>
<td>The relational marketing approach</td>
</tr>
<tr>
<td>Project business</td>
<td>(1) The typical situation faced by most small software companies: unique tailored projects within long-term customer relationships</td>
</tr>
<tr>
<td>Product business</td>
<td>(2) Product business within long-term -oriented customer relationships. Productization of learning from projects.</td>
</tr>
<tr>
<td></td>
<td>(3) An impossible situation. Tailoring is not currently possible without cooperation with the customer</td>
</tr>
<tr>
<td></td>
<td>(4) Traditional mass marketer functioning in atomistic, competitive markets. Product development mainly through formal market research and immediate sales response.</td>
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5. Conclusions

In the near future, the emerging phenomena of Electronic Commerce and Internet Marketing should also be added to our framework. Electronic Commerce as a form of doing software business on the Internet will clearly involve a new business logic — different from the more traditional project and product businesses. Furthermore, parallel ‘Internet Marketing’ will also require a restructuring of marketing practice and theory. Since software products and support services can now easily be offered through the Internet, significant changes are already occurring in business practices in many industries [2,13]. In this sense, it is legitimate to ask whether the slow, evolutionary, and incremental view of SME internationalization remains valid when Internet technology provides small software companies with a rapid, low-cost gateway to foreign markets (cf. [11,23]).

References

Kimmo Alajoutsijärvi is a Professor of Industrial Marketing at the University of Oulu. He holds an M.Sc. in Accounting and Ph.D. in Marketing from the University of Jyväskylä. He has published articles in marketing and management on many topics including the management of customers relationships and industrial networks, core competence, business cycles and sponsorship in journals such as European Journal of Marketing, Journal of Business-to-Business Marketing, Advances in Business Marketing and Purchasing, Journal of International Selling and Sales Management, Journal of International Marketing and Marketing Research, Corporate Communications – An International Journal, and Pulp and Paper International. He is also author and co-author of several research monographs on marketing and management.

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