

Differentiation strategies
of small service firms
under the impact of customer interaction

Hung Pham



Center for Entrepreneurship
Faculty of Mathematics and Natural Sciences

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Author: Hung Pham

<http://www.duo.uio.no>

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Abstract

Background: Small service businesses face the challenge of differentiating themselves in increasingly competitive markets, such as Norway. While customers are always important to any business, how do the firms act differently under the impact of customer interactions?

Objective: Assess the differentiation strategies that entrepreneurs in small service firms in Norway apply, under the impact of customer interaction.

Method: A qualitative case study on Norwegian small service firms. The study assessed the ways entrepreneurs act in different circumstances based on feedback from customer interaction activities.

Results: Ten entrepreneurs were interviewed in this study. The interviews were conducted with open-ended questions in a semi-structured format. Analysis of the interviews identified the following strategies: being the first mover on a new market, and focus on customer satisfaction on an equilibrium market. In addition, no matter how long the firms have been established, the entrepreneurs tend to apply effectuation principles, even they do not know about that in first-hand experiences. Effectuation principles help the entrepreneurs have quicker actions, adapt better the customers' needs and thereby make them different.

Conclusion: The study showed that all entrepreneurs paid strong attention to customer interaction, they invited customers join from the first stages of service development to make sure that they could control the outcomes. The study also revealed that many Norwegian entrepreneurs did not pursue a low cost strategy. Instead, they focused on service values and quality for increasing customer satisfaction. However, the empirical data did not show clearly the ability of entrepreneurs to exploit contingencies since none of the companies studied appear to take this action.

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1 Introduction

1.1 Small business in service sector

During the past years, the service sector and its peculiarities concerning innovation into the center of economic policy research (Hipp and Grupp, 2005) are getting more and more attention from business executives. Undeniably, the service sector has become an important part of the economy. In Norway and other OECD countries, the number of employees in service sector has grown, while that number in manufacturing decreased in the past few decades (Norwegian-government, 2001). The majority of service firms exist in the form of small businesses. Added to that, those firms are not only growing in any particular country, but also spreading all over the world. It is predicted that the number of global small businesses will be in the millions with service providers representing the majority (Priestley, 2011).

On the positive side, there are good things with small business. Many great ideas appear in small businesses which tend to be more innovative than larger enterprises (Audretsch et al., 1999). Governments all over the world are providing more and more support for innovation in their countries, not only in technologies, but also in policies and management. Taking Norway as an example, the natural resource industries such as oil, gas or fishing have been boosting the Norwegian economy for many years. However, these resources are limited, and the government sees a need for improved productivity. In a report from Nordic Innovation Publication, Napier et al. (2012) indicates that entrepreneurship in Norway is growing strongly. Many improvements have been implemented in various forms. Innovation Norway, the national innovation support agency, gets funding directly from the government and uses it to support companies in developing their advantages. The banking system has also been improved for easier usage. Most business forms are now accessible online at anytime which has led to the rise in number of companies in Norway. There are almost 550,000 companies in Norway as of January 01, 2015. That is a 3.9% percent increase, compared to 2014 (SSB, 2015). The starting a business index of Norway has increased from 30th to 22nd, following assessment from Wordbank (2015). Although 80% of firms have less than five employees, the enterprises' overall innovation expenditure for developing new products or processes rose from NOK 29 billion in 2010 to NOK 34.5 billion in 2012. During the three-year period from

2010 to 2012, the value of product and service innovations was worth 13.7% of the product innovators' turnover in 2012 (SSB, 2015).

On the other hand, it raises an issue of competition between firms for entrepreneurs. Considering the total population of Norway only around 5,1 million citizens (SSB, 2015), one business serves approximately nine people. The local market seems very small when compared with the number of businesses being developed in the country. Despite that, the Nordic Entrepreneurship Survey from EY (2015) shows that more than 56% of Norwegian entrepreneurs want to stay local and become a nationally important player. Around 82% Norwegian entrepreneurs' revenue comes from the home market. Therefore, with such a competitive market, how can Norwegian entrepreneurs maintain and keep expanding the market for their businesses. Finding the way to differentiate themselves from their competitors or creating a new market is critical for a business.

1.2 Differentiation and customer interaction

In increasingly competitive markets, differentiation is an important part of any business in the market. It not only helps firms differentiate themselves from other competitors, but also improve their products or services. Being in a market, where considerable differentiation exists, is much better than being in a commodity market where differentiation between products is impossible (Sharp and Dawes, 2001). The question for any entrepreneur is how to differentiate themselves from competitors while still serving the appropriate customer segments in a suitable market?

There are ways to do that. For example, based on new technologies, the firm can develop and offer a new product or service thereby becoming the first mover on market. Alternatively, the firm can pursue different pricing strategies in different markets. One critical part, however, is that other factors can affect an entrepreneur's differentiation strategies. These factors can include internal factors such as management, human capital; or external factors such as government policies, working environment or customer interaction. It is not easy, or even possible, to say which factors are more important. This thesis only evaluates connection between differentiation and customer interaction and its impact on entrepreneurs' differentiation strategies.

1.3 Research question

Based on the above reasons, the following research question is posed:

- How do entrepreneurs in small service businesses in Norway differentiate themselves under the impact of customer interaction?

Multiple cases of Norwegian entrepreneurs were examined to answer this question. Two sub-research questions also emerged from the literature review and from the evidences from the data. The sub-research questions are:

- RQ1: To what extent do entrepreneurs use effectual processes to create new services based on interactions with customers?
- RQ2: To what extent do entrepreneurs focus on building high quality service and customer satisfaction rather than low cost between different competitive strategies?

1.4 Rationale for the topic

Via an extensive search in several databases of the English-speaking literature, Alam (2002) concluded that user involvement in product and service development is quite a new research area. There is a general lack of literature on new service development compared to the richness of the new tangible product development literature (Alam, 2002). At the time of this thesis, a quick search on the library portal, University of Oslo¹, with keyword “*product differentiation*”, returns 55,804 results. Comparing with keyword “*service differentiation*”, the number of results is 15,607, also on Google Scholar. Undoubtedly, service marketing is different from tangible product marketing. New service development process is significantly different than the development process of tangible products (Alam, 2002). Those differences leads to a desire to have more research in this area (Alam, 2002). This study is bringing a contribution to that trend.

Added to that, the numbers of small companies in Norway is continuously increasing, despite the competitive market. Norway is ranked as a moderate performer in entrepreneurship (Napier et al., 2012) and not the best in either the Nordic area or in the OECD. There is obviously room for improvement. Therefore, this empirical study will help entrepreneurs to have some insights about how Norwegian firms differentiate from their competitors.

¹ The library portal at University of Oslo is a powerful tool, which is linked to multiple research

1.5 Thesis structure

Following the introduction, chapter 2 discusses the differentiation strategy, effectuation and customer interaction literature. Chapter 3 describes the case study methodology used in this study. Chapter 4 shows the findings from empirical studies. The results are discussed in chapter 5 along with some limitations of the study, suggestions for future research and implications for practitioners. The conclusion is summarized in the final chapter.

2 Literature review

In this section, I first discuss the literature on service differentiation and customer interaction and then discuss how these two topics tie together. In addition, Sarasvathy's effectuation framework is introduced as the lens that is used for examining the relationship between service differentiation and customer interaction. Finally, I discuss how the company's development stage affects differentiation and customer interaction.

2.1 What is differentiation?

The term *differentiation* is an old concept, and it can relate much to product or service features, market segmentation, marketing strategy, etc. (Smith, 1956, Sharp and Dawes, 2001). There is no formal definition for that term, people can use it in business generally, or in a narrow segment with different alternative definitions (Sharp and Dawes, 2001). With an empirical study with 36 Australia manufacturing industries, Caves and Williamson (1985) tried to answer the question: *What is product differentiation, really?* They suggested "product differentiation has structural bases in the technology of production and consumption and in the information costs those condition buyers' choices among competing products."

Sharp and Dawes (2001) went further, listing multiple definitions and explanations for the link between differentiation and profitability from different researchers. The basic definition of differentiation was also raised: "differentiation exists when a firm's offering is preferred on some buying occasions (or by some customers all of the time) over rival firms' offerings." Theoretically, differentiation can make the firm's products:

- Desirable, which can lead to higher sales and helps build brand loyalty that allow the firm defense existing customers and influence new customers.
- Unique, which can help the firm to sell products at higher prices.

However, Sharp and Dawes (2001) also disagree on some points. Differentiation does not always have the same meaning with manufactured product feature differences. Differentiation is not always synonymous with either premium price or high costs, and it is not the pre-requisite for the firm earning more profits. They did conclude, nonetheless, that on the real competitive markets "*differentiation is a pervasive and almost unavoidable*

aspect". Both customers and firms gain benefits from differentiation in a competitive market. Customers can not only use better services but can also see the weakness of each firm via the firm's competitor sales pitches and then have better information when purchasing services. From a firm's perspective, a firm can be more competitive if it can analyze competitors performance, imitate competitor's strengths or from that, being differentiation (Li and Calantone, 1998).

Although the above findings seem to indicate similarities between product and service differentiation, there are differences between them. For instance, for a new tangible product to succeed the most important factor is the quality of an innovation. However, for a new service to succeed, there are other important factors such as human resources, teamwork, and user collaboration that the firm should focus on (Alam, 2002). From that perspective, doing product differentiation might focus more on technologies and on the final products while service differentiation will emphasize processes more.

Differentiation deployment is not an easy process. It requires the firm to deliver something different from the offerings of competitors. Developing and implementing a differentiation strategy requires considerable information and knowledge. Even though such information and knowledge are usually available, the firm needs to acquire them through different sources such as market research or customer interaction (Svendsen et al., 2009).

However, each market stage has different characteristics. Therefore, differentiation can also be distinctive. And from that viewpoint, the ways that entrepreneurs conduct differentiation strategy are also diversified. In this paper, I will review the differentiation strategies in two market stages. The first stage is before and during the period that a new product is introduced to sell on a new market. The second stage is when market is more mature and approaching equilibrium. These two stages are not linear but more of a continuous circle. The market needs time for developing customers and completing product features. When the market becomes more mature, there will be a need for creating a new service or product to create a new market stage. It is similar to the concepts of exploration and exploitation (O'Reilly and Tushman, 2008). Exploration creates the base for exploitation activities but exploitation also provides tools for exploration to search for new resources and enhance resource usage. Exploration relates to actions such as searching, risk taking, experimenting, playing, discovering the flexibility, and innovating. Utilizing exploration, entrepreneurs conduct

market research and try to find out what customers need before deploying into products. Exploitation, on the other hand, includes such things as refinement, choice, production, efficiency, selection, implementation and execution (March, 1991). In exploitation, entrepreneurs use existing assets and try to improve the efficiency to increase productivity. This creates different ways to communicate with customers in conducting the differentiation strategy. The circle operates continuously and leads to the transformation of both resources and outcomes (Sarasvathy and Dew, 2005).

But first, the basic information about effectuation framework will be introduced as the lens for assessing the differentiation strategy later.

2.2 Effectuation and Causation

Recently, Professor Saras D. Sarasvathy has built a new entrepreneurship framework for addressing the issues how entrepreneurs deal with uncertainties. Via a study of 27 founders of companies ranging in size from \$200 million to \$6.5 billion, the framework has built two logics of thinking: causation and effectuation. Both connect to customers, but from different approaches.

Following the causation logic, entrepreneurs usually start with some extensive market research and carefully consider different market segments. Based on the information they collect, entrepreneurs develop a product that is expected to bring them more profits. In the opposite way, effectual entrepreneurs might or might not start with any opportunity. They might not have a specific goal. They start with the concepts (means) of who they are, what they know and whom they know. Using these means, the entrepreneurs begin to imagine and implement possible products that they will bring to markets later. The markets then can be very different in disparate industries. Utilizing different methods requires having different actions and it might lead to different results.

Causal reasoning is close to the planning school of strategy (Wiltbank et al., 2006). Entrepreneurs have specific goals and with the given means, they try to achieve that pre-determined goals. They emphasize competitive analysis, focusing on exploiting pre-existing knowledge and trying to predict an uncertain future (Perry et al., 2012). In any activity, causal-logic entrepreneurs look for an expected return based on their predictions.

Categories of Differentiation	Causation Processes	Effectuation Processes
Givens	Effect is given	Only some means or tools are given
Decision-making selection criteria	Help choose between means to achieve the given effect Selection criteria based on expected return Effect dependent: Choice of means is driven by characteristics of the effect the decision maker wants to create and his or her knowledge of possible means	Help choose between possible effects that can be created with given means Selection criteria based on affordable loss or acceptable risk Actor dependent: Given specific means, choice of effect is driven by characteristics of the actor and his or her ability to discover and use contingencies
Competencies employed	Excellent at exploiting knowledge	Excellent at exploiting contingencies
Context of relevance	More ubiquitous in nature More useful in static, linear, and independent environments	More ubiquitous in human action Explicit assumption of dynamic, nonlinear, and ecological environments
Nature of unknowns	Focus on the predictable aspects of an uncertain future	Focus on the controllable aspects of an unpredictable future
Underlying logic	To the extent we can predict future, we can control it	To the extent we can control future, we do not need to predict it
Outcomes	Market share in existent markets through competitive strategies	New markets created through alliances and other cooperative strategies

Table 1. Contrasting Causation and Effectuation (Sarasvathy, 2001b)

On the other hand, effectual reasoning, instead of predicting the future, emphasizes what is controllable. Beginning with a given set of means, entrepreneurs focus on affordable loss and exploit contingencies. Since entrepreneurs have identified how much they can afford to lose, they no longer need to pay much attention to the competitive analysis and instead emphasize what they can do. They build strategic partnerships, a network of stakeholders who can contribute to the development process and utilize partnerships as resources, in an attempt to control an unpredictable future (Perry et al., 2012) and convert uncertainties to opportunities from an existing knowledge base. Because entrepreneurs now control all resources and processes, the process outputs can be different depending on how entrepreneurs use those

resources. In her study, Sarasvathy (2001a) showed that starting with exactly the same product, entrepreneurs ended up creating companies in 18 completely disparate industries.

In effectuation, there are three categories of *means* that are emphasized from the beginning. They are identity (who they are), knowledge (what they know), and networks (whom they know) (Wiltbank et al., 2006). Entrepreneurs begin with these means and imagine things they can accomplish. The result is that entrepreneurs can control the future events, rather than predict what is happening. When developing a new service, they reach out the people who can somehow participate in the service development process at any level. Those people can become potential stakeholders. The key here is the pre-commitments from those potential stakeholders: they *commit* to the development process, with what can be their *affordable loss*. The commitments are not the stakeholders' fit into the firm but the complementary parts of the coming service. In that way, entrepreneurs can adjust the service development strategy following the new conditions while they can still control the whole process.

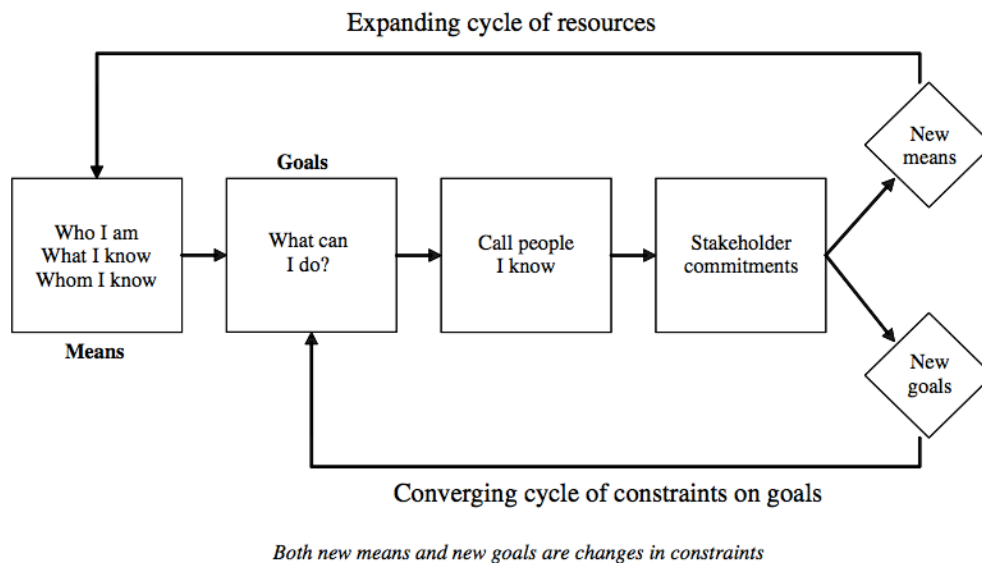


Figure 1. The effectual process (Wiltbank et al., 2006)

Using partnerships as resources is also bringing another advantage for the firm. Since the commitments from partners contribute in creating the new products, different partners can build different coming products. Entrepreneurs then do not need to spend company resources on competitive analysis, which usually takes significant time and effort. This is especially a good condition for small businesses since small firms often lack resources at the beginning

for developing and commercializing new products in-house (Vrande et al., 2008). Furthermore, with new resources (means, commitments from stakeholders), the outcomes can be a better product to create additional markets or can be a completely different product. From that new product, a new market with a new business goal can also be created.

Effectuation principles can apply to entrepreneurs' actions, in both exploring and exploiting activities. In the next sections, effectuation framework will be used as the lens for assessing entrepreneurs' actions when exploring new opportunities and exploiting current markets when pursuing a differentiation strategy.

2.3 How does customer interaction affect service differentiation?

Firstly, we need to assess the customer characteristics because different types of customer need to have different way to interact. Gruner and Homburg (2000) defined four types of customer characteristics: technically attractive customers; financially attractive customers; customers who have close relationship with the firm; and lead users who present strong needs that become general in a marketplace months or years in the future (Hippel, 1986). Each type of customers has different characteristics and therefore, the way they interact with each of them is different too. Within this paper, only lead-user customer type is studied. They can be customers, or potential customers, who have needs that are advanced compared to other market members and who expect to benefit significantly from a solution to those needs (Hippel, 1986). From now on, the term customer will refer to lead user.

Like the term *differentiation*, the term *customer interaction* is used generally too. Theoretically, it can refer to other terms such as *customer involvement* or *customer partnerships* which are used in different research papers (Carbonell et al., 2009). In different situations, it can be distinct too. For example, when linked to service innovation, the term refers to “the interactions between service producers and the representative(s) of one or more customer firms at various stages of a new service development process” (Alam, 2002).

Obviously, developing a new product or service based on a new technology is costly. It can cost the firm more if doing an inappropriate process. In case of small firms, it might collapse the whole business. Focusing on a wrong customer segment will waste the firm's resources.

Involving customers into the product and service differentiation process might not help to reduce resources expenses but can use resources more effectively. Information on customer needs and user experiences will give entrepreneurs a clear view about their products. Cooperation with customers can be considered as a bridging strategy to secure access to the critical resource of information on customer needs (Carbonell et al., 2009). Moreover, from that, entrepreneurs can have accurate strategies for the next circle of product development. Reviewing number of previous research, Svendsen et al. (2009) showed that a key success factor for product development projects is external communication with key customers. It is also agreed by Carbonell et al. (2009) that customer involvement has long been considered important for successful product and service development. It explains for a popular example: beta testing stage. Almost every software companies nowadays invite their existing and potential customers join to multiple beta tests before releasing the final software version.

As mentioned, product and service differentiation have similar points, but there are also differences. The role of customer interaction in those differentiation processes is distinct too. After reviewing a range of research papers in both product and service development fields, Alam and Perry (2002) commented that customer input and involvement in the service innovation process may be more useful than in tangible products. Service firms tend to involve customers in their service delivery and customers tend to purchase the service with longer commitments. In many firms nowadays, monthly subscription is the way to maintain repeated sales, for example Red Hat Linux. Thus, customer orientation plays a more important role in service firms than tangible product manufacturing firms. In most cases, customers' input in form of needed information and instruction to service provider is essential. In some special cases, the service cannot be created without customers' input because of their active working in the service co-producing process (Dadfar et al., 2013).

The information entrepreneurs receive back from customers can be in the form of either complaints or suggestions (Brockhoff, 2003). Both can be considered a valuable and inexpensive source for either improving current products or offering suggestions for the new product development (Brockhoff, 2003). If entrepreneurs can process this information correctly, customer involvement will have a positive impact on new service performance (Carbonell et al., 2009).

Depending on the market stage that the firm is working in, the information from customer interactions can have a different impact on the firm's differentiation strategy. The next section will review the impacts of customer interaction to the firm's differentiation strategies in different market stages.

2.3.1 The developing stage

In this stage, a firm's differentiation strategy could be to become a first-mover, which is the first to sell a new product or service category (Schilling, 2009). A firm can achieve the first-mover status in multiple ways. The firm can produce a totally new product, enter a new market, utilize a new service process, or it can be significantly improve on a current product that the firm can claim the distinction (Kerin et al., 1992).

"Entrepreneurs create ex nihilo, through the forward-looking process of imagining that allows them to 'think outside the box', where the 'box' is defined largely by the limits of knowledge rooted in interpretations of the past... They exploit opportunities by continuously combining and recombining intermediate goods to produce consumer goods" (Chiles et al., 2007).

As the first-mover, the firm can gain multiple advantages such as brand loyalty, sustainable leadership in technology, preemption of scarce assets and switching costs or buyer choice under uncertainty. It can help the firm to remain more profitable than later entrants (Lieberman and Montgomery, 1988).

However, developing innovative products or being the first-mover with a new product concept is not easy and it is also the most risky development strategy. The firm has to face to multiple uncertainties such as technological standards, the needs for new product opportunities and buyer resistance to innovation (Slater and Narver, 1996). Being the first-mover does not guarantee a success for the new product.

Additionally, at this point, there is no reference on the market. If they are following a causal logic, an entrepreneur needs to plan carefully with his or her predictions based on their expectations. Because expectations are oriented to an unknown and unknowable future,

entrepreneurs must imagine possible futures and choose from among these subjective mental creations (Chiles et al., 2007). With those predictions, the firm needs to go out and conduct extensive market research. The customer interaction appears here in the form of suggestions. Research participants answer given questions and those answers are expected to confirm the entrepreneur's expectations or not. Analyzing responses from the research participants, who can be potential customers, an entrepreneur then decides the target market or even decides to create a product or not. This method is the common way to develop businesses, known as the STP process: segmentation, targeting and positioning. However, the process would involve considerable amounts of time and analytical effort (Sarasvathy, 2001b).

Since production, consumption, and customer's experience of the a service often happen at the same time of interaction between a service provider and its users, it is difficult to obtain feedbacks from customers in advance which is different from a tangible (Dadfar et al., 2013). All the questions and answers in the market research at this stage are based on predictions and expectations. When entrepreneurs sets research questions and expected answers, they have already given a consistent set of preferences (Cohen and March, 1986), which is the assumed existence of the central artifacts and contexts of business within which the decisions take place (Sarasvathy, 2001b). The questions and answers have been framed. What happens if the questions are not correct? This is similar to one issue that Alam (2006) addressed: the style of customer questioning in customer interaction strategy. The firm representatives do not know how to interact with customers and obtain input from them correctly. A simple case, which can happen, is that a participant is not sure if his preset set of values is the set of values in terms of which he wants to act (Cohen and March, 1986). So, that kind of research does not guarantee the success of coming product.

There is a possibility that established firm has provided an existed product for a while already. Entrepreneurs can collect customer feedbacks based on current product usage. They then can build imagination of future possibilities and try their best efforts to bring those possibilities to the market. This approach emphasizes high control and high prediction (Wiltbank et al., 2006). One example is Microsoft Windows. When Microsoft first introduced Microsoft Windows as the desktop operation system in 1985, they based on the information they already had from MSDOS and the amount of customers who had been using CLI (command line interface). They predicted that the GUI (graphic user interface) would be the next step. With the relationship with IBM at that time, and the big financial support from

investors when the firm became public in 1986, Microsoft had the power to control the effort required to bring their product to market as committed. Several scholars have researched this approach too as summarized by Wiltbank et al. (2006). To gain market leadership, the firm needs to have a commitment to a clear vision, a unique view of how things could be in the future, and a commitment to financial and reputational resources. The commitment needs to be supported by strategic projections, where consistency between the communication and resource commitments are in line with the organization's vision. Those strategic projections are critical to increased reputation and a desire by others to support that organization's particular visionary efforts.

However, this raises a question. Since the firm still relies heavily on predictions while they still need to control the efforts to convert these predictions to products and bring to market, does it require having a significant amount of resources, especially financial and human resources? Is this a barrier for small firms when again, most of the time, they have limited resources at their disposal (Vrande et al., 2008)? At the same time, multinational enterprises have the resources almost available all the time but are unable to innovate as well as small firms.

Conversely, if using effectual logic, entrepreneurs can start with who they are, what they know, and whom they know. Based on their own means, they create a new product. Entrepreneurs can then try to convince people around them to use their new product and give their feedback. Customer interaction occurs at the very first stage of product development. An example of this is Amazon back in 1995. Before officially introduced their first website version, Jeff Bezos and Paul Barton-Davis invited 300 friends and potential customers, many of whom became Amazon employees later, to join a beta test for the order process. Although the entrepreneurs had already addressed most issues, the test was still very helpful. They identified two ways to process an order and it turned out that the entrepreneurs had chosen the worse way. In this case, the customer inputs were contributing to process innovation.

Clearly, it is beneficial for firms to treat customers with particular characteristics, such as detail-oriented and sophistication, as partners in new service development. As partners, their role in new service development is much broader than just voicing their needs. Moreover, as lead users they often attempt to fill the need they experience (Hippel, 1986) and therefore

will be keen to help crystallize product concepts and critically evaluate product designs and final outcomes (Li and Calantone, 1998).

Once again, the important aspect of differentiation, both products and services differentiation, is to bring something unique that is valuable to buyers. Customer suggestions from the first rounds will allow entrepreneurs know what they are missing and what is valuable for those customers. Entrepreneurs do not need to guess or predict what is beneficial for their buyers. They now know what they need to do and what they can do. The results might be different from the original plans, but the new plan is likely more focused on exactly what customers need. It can actually help to boost business performances. Via an empirical study with 807 Spanish service firms, Carbonell et al. (2009) confirmed that customer involvement has a positive impact on technical quality and innovation speed.

Note that using effectual logic, entrepreneurs do not just wait for the *right* people. Besides continually striving to attract the *right* people, entrepreneurs learn also to nurture and grow those right people naturally (Sarasvathy, 2001a). Each of those people is treated as a partner, a stakeholder who commits only what he or she can afford to lose and comes on board to drive what the goals of the firm will be and what the new market opportunity will eventually turn out to be (Sarasvathy and Dew, 2008). Paying attention to this kind of customer involvement does not guarantee the success of new product either. However, it avoids a big issue with causal logic. Via interactions with customers, entrepreneurs can know sooner whether the intended product will be successful or not. It prevents time, effort, and money issues especially in case of small businesses. Combining with feedbacks from customers, entrepreneurs can even change the original plan completely to a new direction.

From a buyer's perspective, customers also face significant uncertainty in this market stage because of a lack of relevant experience with the newly introduced product (Heide and Weiss, 1995). Joining the product development process from the beginning will reduce much of uncertainty for customers. From a certain point, that is the foundation for trust. When there is trust between the firm and customers, customers have more confidence to experiment (Sinek, 2013) and may even spread the product information to other people in their networks. Trust is important and is a key factor in the development of brand loyalty (Lau and Lee, 1999) which is also one aspect of differentiation. This effectual interaction brings a win-win relation between a service vendor and their customers.

In summary, in the developing stage of market, being the first-mover can be a differentiation strategy. For achieving that position, the firm can involve potential customers into the service development process at the very beginning phases. This helps the firm save resources while still controlling the development process for identifying customers' needs.

Based on that, the first sub-research question is raised below:

- RQ1: To what extent do entrepreneurs use effectual processes to create new services based on interactions with customers?

2.3.2 Equilibrium stage

The second stage is when the market becomes mature. Functional differences between brands are unusual because most functional differences can be copied (Sharp and Dawes, 2001). Mansfield (1985) pointed out that the technology imitation could happen quite rapidly. The important information concerning development decisions is generally in the hands of rivals within about 12 to 18 months on average. At this market stage, product or service standardization is more likely (Song and Adams, 1993). Late entrants can become free-riders and benefit from the pioneering firm's investments in R&D, buyer education, and infrastructure development (Lieberman and Montgomery, 1988). Unlike the first-mover situation, differentiation can now occur without product feature differences between brands. In this stage, products become mature on a competitive market, and entrepreneurs need to find out different strategies for maintaining their position. Purchase preference undoubtedly exists. However, rather than product differences between the brands, it is often a function of *salience* (which means some brands can be known better than others), *habit* (when each buyer usually purchase some brands than others) and/or *availability* (which brand is ready when each buyer needs) (Sharp and Dawes, 2001). The firm, instead of devoting effort to acquire new customers, needs to focus more on defending their customer base (Fornell, 1992). Clearly, customer interaction is even becoming more important for the firm and has a bigger impact on entrepreneur's differentiation strategy. There are two popular differentiation perspectives: cost perspective and service development perspective (Song and Adams, 1993).

Cost perspective

The first differentiation perspective is related to a firm's pricing scheme. Following the technology imitation issue, the firm might lose other advantages from the first mover position, such as price sensitivity. An increasingly competitive market puts even more pressure on a firm's pricing strategy (Fornell, 1992) especially if customers value the firm's offer less than other competing offers (Sharp and Dawes, 2001). When a firm is in the first-mover position, its products or services can have a unique bundle of features, which will have some customers who are willing to pay a high price for it (Sharp and Dawes, 2001). However, as there is not much difference in technical features now, it is hard to convince customers to pay more for something they could purchase at lower price from other competitors. The result is that many firms choose to lower their price for maintaining the current customer base, especially if the firm did not have a clear differentiation advantage leading to premium prices or did not have a clear cost advantage (Sharp and Dawes, 2001).

Cost is not always the first priority factor for both service consumers and providers. From the buyers' perspective, service consumers seem to pay greater attention to the quality of a service than they do to the costs associated with its acquisition (J. Joseph Cronin et al., 2000). On the firm side, Boulding et al. (1994) concluded that the firm's price elasticity provides a direct measure of their degree of differentiation. The research results imply that for firms pricing above the industry average current advertising and sales force activities help to increase the firm's differentiation in the future in parallel with decreasing future price competition whereas current promotion activities will decrease the firm's differentiation and increase future price competition. Therefore, changing the monetary cost of acquisition (price) is just one of the many routes to differentiation (Sharp and Dawes, 2001). The entrepreneur tasks become harder since they must find a way to bring something unique to the market that is valuable to buyers beyond simply offering a low price (Porter, 1985).

Service development perspective

Secondly, opposite to reducing price method, entrepreneurs can manage to maintain the current prices by continuously developing the service, which includes supporting service and service features. This perspective is based on the theory that firms that provide high customer

satisfaction are less vulnerable to competition and have higher proportion of repeat business (*for example, the monthly subscription as an important factor in service industry*) and higher gross margins (Fornell, 1992). For instance, American airline programs are usually designed not through superior service or passenger satisfaction but by providing an economic incentive for the customer. European airlines, however, rely more on customer satisfaction to secure repeat business (Fornell, 1992). In a mature market, customers have experienced with the firm's services already, as well as have more chances for using services from different vendors, and they can then compare between vendors. Based on the total purchases and consumption experiences over time, the firm's services are evaluated by cumulative customer satisfaction (Anderson et al., 1994), including both service quality and service value (J. Joseph Cronin et al., 2000). Pursuing a customer satisfaction strategy can make the firm stand out on a market where other companies compete by price. A big question for entrepreneurs is how to keep and continue increasing customer satisfaction.

Fornell (1992) considered that switching barriers and customer satisfaction are two forms of a firm's defensive strategy. However, I would not merge them together in all circumstances. The firm can increase switching costs by making customers satisfied. That actually inherits from an advantage existing from when the firm was in a first-mover position. Alternatively, the firm can manage to increase switching costs, making it difficult and expensive enough to prevent customers from switch to another vendor. From a customer's point of view, it is not a bad thing because buyers can have a better supporting service and continuously get more service value that other vendors still cannot provide.

One sensitive aspect in customer satisfaction is handling complaints. Many customers complain to their service vendor even though the mistakes do not belong to the vendor. Researchers have shown that customers themselves can cause one-third of all service problems (Kotler and Keller, 2011, p.363). If the firm cannot handle complaints well, besides decreasing customer satisfaction, these unknowledgeable customers may also have a negative effect on service process and quality (Dadfar et al., 2013). On the other hand, when the firm is in a monopoly position, it might not pay much attention to customer satisfaction than in competitive market structures. Instead of making use of customer complaints, the firm behaves dysfunctionally, even though the fact is that good complaint handling can turn a dissatisfied customer to a loyal one (Fornell, 1992).

However, there might be a risk for the firm. As mentioned, service features can be imitated. If customers of a service firm keep requiring new features, and/or if they involve to the firm's production process, the variance in their demands can create uncertainties for the firm (Skaggs and Youndt, 2004). In the service sector, customers' ideas might be not only more innovative than professional service developers but also harder for converting into commercial services (Gillig and Sailer, 2012). When dealing with customer requests, entrepreneurs need to keep that in mind.

However, entrepreneurs should not be too careful with customer requests either. In entrepreneurship theories, the adaptive or learning school suggests that the firm can learn from feedback from the market. The firm then experiments the feedbacks and needs to quickly capture new opportunities (Wiltbank et al., 2006). Opposite to tangible product manufacturing, especially in the Internet age, the windows of opportunities close very fast (Gillig and Sailer, 2012). Combined with information from customers, in the form of both *complaints* and *suggestions*, entrepreneurs now can recognize what their customers' need, instead of trying to predict them. The challenge for entrepreneurs is that based on customers' feedbacks, how do they capture opportunities on time and process these opportunities correctly.

Back to the example of Microsoft Windows, nowadays it needs to fight with other products from FOSS/Linux, such as Ubuntu. Both Microsoft and Ubuntu know what users need. Microsoft Windows and Ubuntu OS have the same features. However, who adapt the needs from customers better? Obviously, Ubuntu, since it integrates many other open-source applications into its OS when compared to the closed-source programs from Microsoft. That explains why Linux has between seven to 21 million users worldwide, with a 200% annual growth rate (Lerner and Tirole, 2002). Not only that, it is also backed by millions of developers around the world, who are working around the clock to push features to users quickly, to patch security holes promptly. That fast adaptation is helping Ubuntu expand its market share.

This adaptive approach seems better than a planning approach. However, it depends a lot on the dynamic of entrepreneurs. If the entrepreneurs are too rigid and try to stick with the

original predictions instead of adapting the changes based on facts from customer interaction activities, it might lock the firm into planned strategies, even though they acknowledge huge challenges in justifying those predictions. In this case, entrepreneurs might not be able to adapt the changes effectively, even if they can see clearly the need to make changes to the original plan (Wiltbank et al., 2006).

Another market approach is called transformative strategy. It inherits the fluid features of an adaptive method while emphasizing control. Again, entrepreneurs learn from the market via customer interaction and use the resources they already have for controlling what is going to happen. In this transformative approach, the lead user role has big impact. Since lead users are familiar with conditions which lie in the future for most others, they can play a big role in the firm's marketing research while still keeping an important position in suggesting service features (Hippel, 1986). In addition, because entrepreneurs do not try to predict the future, in this rapidly moving world, they rely heavily on interactions with customers who have real life experiences to process opportunities on time and correctly (Hippel, 1986). While manufacturing firms look to customers to help reduce the uncertainties of technology investments (Lin and Germain, 2004), entrepreneurs in service firms utilize information from customers for *transforming* customers' knowledge into a new service offer. Entrepreneurs can always change the original plan to a new one, to make differentiate their services. "*They do not tie themselves to any theorized or pre-conceived market or strategic universe for their idea*" (Sarasvathy, 2001a).

Furthermore, the transformative strategy also reveals the ability of entrepreneurs to be ambidextrous (O'Reilly and Tushman, 2008). By adopting feedback from customers while still emphasizing control by their knowledge, entrepreneurs can simultaneously conduct both new market exploration and existing market exploitation activities. The key to the process is not selecting between alternatives but transforming existing realities into the new alternatives through a growing chain of effectual commitments (Sarasvathy and Dew, 2005).

Generally, the firm can effectually leverage information from customer interaction and build service values based on that. Service quality can also be improved via processing complaints and suggestions from customers. Feedbacks from customers are also the base for entrepreneurs to transform to new realities, not tying themselves to any specific plan.

The second sub-research question is thus raised:

- RQ2: To what extent do entrepreneurs focus on building high quality service and customer satisfaction rather than low cost between different competitive strategies?

2.3.3 The gap in literature

Many research papers show the important link between customer interactions and a firm's differentiation process in the service sector. However, most of them were conducted with large firms. In a market where the majority of firms are small, the relationship might, or might not, be different. Is it true that large firms compete by differentiation strategy, while small firms utilize focus strategy (Wright, 1987)? Which differentiation strategies should small service firms apply under the impact of customer interaction? The study will be continue by examining small service firms in Norway, to find out answer for the research question.

3 Methodology

3.1 Research design

Yin (2003) defined case study research as an empirical enquiry that investigates a contemporary phenomenon within its real-life context, especially when the boundaries between phenomenon and context are not evident. Differentiation in the small service business sector with the impact of customer interaction clearly falls into this circumstance.

In addition, I, as the investigator, have no control (Yin, 2009, p.13) on the studied firms and entrepreneurs. Therefore, I have chosen a qualitative approach, employing a descriptive research design with *how* research question. The research has been designed as a multiple case study with the unit of analysis as entrepreneurs in small service firms. The literature review above is used as a guide and helped me develop a sharper and more insightful research question (Yin, 2009, p.14).

3.2 Data reliability & validity

Reliability concerns the stability and consistency of measured results (Wilson, 2014, p.116). To improve data reliability, the following practices were followed.

- *Using multiple sources of evidence*: ten interviews with different entrepreneurs were conducted and used as primary data. In addition, a number of documents and information from the companies' websites are used as secondary data.
- *Establishing the chain of evidence*: All interviews were digitally recorded with interviewees' permission. However, the transcripts are not published here due to privacy concerns. The interview guide used in this study is attached in the appendix. Moreover, all documents cited in the study are reported in the references section at the end of the thesis. This is done to help the reader follow the derivation of any evidence from initial research questions to ultimate case study conclusions (Yin, 2009, p.122).
- Besides the use of data triangulation (multiple sources of evidence) and a chain of evidence, a *case study database* was developed for increasing the reliability of the data. During the interviews, important points were noted down and used as additional tool when the interview transcripts were analyzed. After each interview, these notes and interview information were also added to the case study database.

Furthermore, these practices also need to maintain external and internal validity (Wilson, 2014). External validity concerns generalization, using results from this research to make predictions to the entire population. With the tight relationship between customer interaction and differentiation in the service sector, combining the literature review from big enterprises and empirical findings from small service firms in Norway, a conclusion can be generalized for the firms in Norway. However, further studies are still needed to confirm the results. More details will be presented in the limitations and recommendations for future research section. There are other factors that can affect differentiation strategy, but within this study, the principle of cause and effect between customer involvement and service differentiation is clear. There are several methods that have been applied in this research, as recommended from May and Pope (2000):

- *Data triangulation.* As mentioned above, independent interviews with different entrepreneurs were conducted. Besides, data from companies' websites and public discussion portal were collected for comparing.
- *Clear exposition of data collection and analysis.* The cases selection, data collections and analysis can be found in the next sections.
- *Reflexivity.* This concerns to the sensitivity to the ways that researcher bias may shape the collected data. In this study, all interviewees were asked with open-ended questions and were able to talk freely upon the subjects.

3.3 Cases selection

While European-Commission (2003) defines small businesses are the firms having less than 50 employees and having a turnover or balance sheet total less than 10 million euros, the accepted definition of Norwegian small and medium-sized enterprises use the number of employees as the key (Iversen, 2003):

- Small = 1 – 19
- Medium-sized = 20 – 99
- Large = 100+

Combining the conditions, the companies chosen in this study met the following criteria:

- Norwegian startups. One characteristic of the Norwegian market is specialization or service focused. Most companies concentrate in their expertise and outsource other parts

such as administration, accounting. In that kind of market, customer input into the product development is very important. Through its customer-value oriented activities, the market-oriented business is well positioned to develop products and ancillary services that cost effectively satisfy customer need (Slater and Narver, 1996).

- Working in service industries. The Information Technology (IT) sector was chosen based on my familiarity with the companies.
- The number of employees is less than 20.
- Sales volume is less than 10 million kroner per year. The Proff² database is used for checking companies' turnover.
- In addition, entrepreneurs have startup experiences of at least five years.

3.4 Data collection

Fourteen selected companies were contacted and invited to participate. Twelve entrepreneurs replied. Out of twelve, two of them denied the request due to privacy concerns. There were ten entrepreneurs who agreed to take part in the research. The interviews were conducted by meeting face-to-face or via Skype. All the interviews were digitally recorded and transcribed later. Each focused interview (Yin, 2009, p.107) with entrepreneurs lasted on average between 30 and 90 minutes. All the interviews were semi-structured with the option of going deeper into specific topics during the conversations. The interviewee could talk freely with the given questions. The interview guide can be founded in the appendix section of this thesis. In some cases, interviewees were followed up via phone, or email to clarify specific details.

² <http://www.proff.no/>

4 Analyzing the empirical data

From the literature review, many papers show the positive impacts of customer interaction on the differentiation processes. However, these studies were conducted on large enterprises. In service-focused markets with many small businesses like that found in Norway, the results might be different. As a reminder, I will restate the main research question and its two sub questions to make the analysis and discussion easier to follow.

The main research question:

- How do entrepreneurs in small service businesses in Norway differentiate themselves under the impact of customer interaction?

The sub research questions as below:

- RQ1: To what extent do entrepreneurs use effectual processes to create new services based on interactions with customers?
- RQ2: To what extent do entrepreneurs focus on building high quality service and customer satisfaction rather than low cost between different competitive strategies?

Yin (2009) suggested that all empirical research studies, including case studies, should have a story to tell. That story is the evidence for findings from literature; and there is a need for a strategy for analyzing the evidence. The strategy will help researcher to treat the evidence fairly, produce compelling analytic conclusions, and rule out alternative interpretations.

The strategy used in this research relies on theoretical propositions (Yin, 2009, p.130). The propositions, here in the form of sub-research questions, help to focus attention on certain data and to ignore other data. The proposition also helps to organize the entire case study and to define alternative explanations to be examined. Therefore, theoretical propositions stemming from "how" and "why" questions can be extremely useful in guiding case study analysis in this manner.

The first part in this section introduces the companies studied. The second part of this section will present the *raw* data, with quotes from the interviews with the entrepreneurs.

4.1 Cases introduction

Ardoq AS

Established in 2013, Ardoq AS aims to bring a completed solution for customers to document and visualize dependencies in large business systems. It can be computer systems, requirements or business flows, KPIs, or even a part related to some other parts of systems. It took 1.5 years for the entrepreneurs at Ardoq AS to complete the first version of their software and they had few customers for external validating. The success of the company can be understood via the fact that they still work closely with their first customer. Customers grow with the Ardoq service in place and it becomes an indispensable part of their business.

Eliksir AS

Established as a proprietary firm in 2002, the company was created as a hobby of two high school students who wanted to build websites and needed to have a company for invoicing customers. Eliksir's founders had been working together to provide web design service and computer hardware reselling to their customers. However, too much competition and low margin in reselling computer hardware made them decide to stop. Based on requires from their customers and realizing the potential of the market, the entrepreneurs have dedicated their time and effort to building a new product, a newsletter system offered as SaaS – software as a service. With this kind of online services, the entrepreneurs can try to get international customers. However, they want to focus on the Norwegian market, continue improving their product quality and become an important player in the local market.

GG Media

GG Media is a proprietary firm that provides online services for small and medium-size companies in Norway. It seems the rise in number of small companies in Norway is not a big challenge for the entrepreneur. He actually converts that situation into a business opportunity when he finds that many small company owners do not know much about online services. *“They use Facebook, they know Facebook, but they do not know how to use that channel for generate interests to the services, products they are offering.”* Because the source for getting

new customers is from word-of-mouth, customer service is very important for GG Media. It is also considered as the information source for improving product quality and completing the company services offer.

iSee Communications AS

With expertise on Joomla and WordPress content management system, the entrepreneur has established iSee Communications AS since 2000. The company builds websites for small and medium size business clients in Norway many of whom are located in Horten due to the location of iSee Communications's office. The entrepreneur does not believe much on paid advertising, so he has not paid much on marketing his brand. Customers come from referrals.

Mums Mean Business AS

Mums Mean Business AS is a new Norwegian startup. The company was established at the end of 2013 and provides a crowdfunding platform focusing on female entrepreneurs. It has already had some successful campaigns. However, issues with their crowdfunding platform were also revealed that required the entrepreneur to rebuild the system. The company founder has paid much attention to building partner relationships with other women as well as other entrepreneur organizations over the world to help expand the business. Recently, based on feedback from customers, investors and through expanding partnerships the firm is moving slowly to a new platform that can serve customers better.

Rayon AS

Rayon AS was established in Oslo in 2006. The company calls itself *a full-service design agency, specializing in increasing brand awareness through relevant differentiation*. The services include brand concept, strategy, visual identity, web design, and developments. The company owner comments that the Norwegian market is boring with no *wow* media campaigns anymore and he is looking for chances to *wow* the market again. The company was started as a graphic design service, which then expanded into media on multiple digital platforms.

Steelcyber Scientific

Information security is always a hot issue, especially in the Internet age. With more than a decade of experiences working in data centers environment, entrepreneurs at Steelcyber Scientific focus on a narrow market by offering a digital forensic service. Due to the fact that they always need to access their customer's sensitive information, building trust and personal relationships between the firm and customers are very important. Steelcyber Scientific aims to provide a complete solution for customers from their core service, digital forensics, and other complementary services by using an ecosystem with other partners over the world.

UX Lab AS

Seeing the importance of UX – User Experiences, two entrepreneurs in Oslo decided to establish UX Lab where they are heavily involved in how users experience digital services. The commitment that the entrepreneurs bring to customers is a great user experience and designing a user interface that is simple and effective in use. They focus on a *user-centered design philosophy* where users within current target included in the design process in various ways. The entrepreneurs believe that the best way to improve user experiences is interacting with the potential customers and the real users. The entrepreneurs listen to them and let them decide all the designs and functions to increase value. *“Do not sit in an internal workshop, guess what customers need. Go and talk with customers, and find out what their needs are.”*

Vian Consulting Norge

Established in 2013 in Norway, Vian Consulting Norge is a NUF – Norwegian Registered Foreign Company. The firm provides web development service, focusing on value-added services for web hosting. Since opening in Norway, they have been developing a new service for supporting immigrants. The entrepreneur also intends to expand that service to other European countries where he has connections and sees big immigrant communities there.

YAY Media AS

The entrepreneurs at YAY Media AS was denied funding at their first pitching to investors but they decided to establish the firm anyway. It turned out that it is the best decision they

made. Nowadays, the firm has customers around the world but still focus primarily on the Norwegian and USA markets. Not only providing high quality photos, YAY Media AS focuses on photo legal review service that protects both the firm and its customers from lawsuits, which have been happening with other big photo services.

4.2 Being the first mover

- **The first sub research question RQ1:** To what extent do entrepreneurs use effectual processes to create new services based on interactions with customers?

Out of ten companies, three chose to be the first mover in their markets. That includes Ardoq, Steelcyber Scientific and YAY Media. All entrepreneurial ideas started from communication with potential customers. For instance, the entrepreneur at YAY Media AS said:

“Most of our customers are in the US and Norway, and they are very concerned that the images should have high quality, but also be legal. No other online photo service has a professional legal review program.”

In addition, three of the studied entrepreneurs converted customer suggestions into commercial services and became first-movers in their working sector. For instance, when the entrepreneurs at Elikvir AS decided to build their MailMojo platform, there was no service like that available in Norway. There have been some other competitors in USA such as BaseCamp but they were not reaching the Norwegian market. Elikvir became the first company offering an e-newsletter service for Norwegian firms. The decision to build this product was made based on requests from customers.

“That was based on requests from two clients of us, separatedly but nearly at the same times, that if we could make something like that for them. We thought it’s also something other people could use too, but no other company in Norway offered similar service at that time.”

(Founder / Elikvir AS)

Similarly, when the entrepreneur at Mums Mean Business AS started offering crowdfunding service, there were other big companies in the sector such as Indiegogo and Kickstarter. However, after five customer campaigns and numbers of conversations at women focused business conferences, the entrepreneur upgraded her platform to not only provide crowd funding services but also to provide crowd services for human capital.

”If you just bring money, do you know how those entrepreneurs do with money if their campaigns are successful? If you just provide mentoring sessions, all other women organizations provide mentoring and supporting already. All the services already exist, but separately. We put all together into our powerful platform. That makes our platform differentiation. That makes it hard for coming people to copy. We prepare this platform for more than one year, and it even can take much longer time and effort for others to become the same level with us.”

(Founder / Mums Mean Business AS)

The new service of iSee Communications AS was also created from the need of a single customer but the entrepreneur decided to commercialize it.

“We built it first time for one client here in the city. Then I recognized that there are other building owners who might want to use this too. So, why not package it as a Joomla component and sell it to new customers?”

(Founder / iSee Communications AS)

Although the first version of service might be not completed, the entrepreneurs did not spend much time and effort on market research. They started building the product right away and focused on developing the new service and testing it with customers and strategic partners. Entrepreneurs in Ardoq AS, Elikvir AS and iSee Communications AS are experienced developers, so it was easy for them to start and validate their business idea with their first customers. It took 1.5 years for Ardoq AS to bring the first version of their product to customers but it was much shorter in the case of Elikvir AS:

“We did the first version to those two customers, just in a day. But it just likes a prototype thing and get it work with basic functions, no real database, just files-database. But then when we brought to customers, thought that we need to do it for

different customers, then we needed to do it better, with a real database system, put it into a server, make better design, security, etc.”

(Founder / Elixir AS)

Even though she does not have technological background, it did not make the entrepreneur at Mums Mean Business AS delay her plan. Instead of doing everything herself, she looked for other people who could deal with technical details.

“I asked myself, who could build the new platform for me. I have no clue, but I know some very good companies. So, I pitch my idea to one of them. I described the idea of platform. The company CEO ended up with interest at my idea, and instead of asking me to pay as a usual customer, he asked if they could join to the board. So, we have a great partner on board with their expertises, and I do not need to worry about capability for expanding in the future anymore.”

(Founder / Mums Mean Business AS)

In case of the first group in the first-mover firms, the business ideas come from potential customers. In the second group, entrepreneurs in Elixir, iSee Communications and Mums Mean Business have been actively working with their existing clients. The new means and goals effectually appear during their interactions with customers. When opportunities happen, the entrepreneurs quickly grasp those opportunities, and bring them to reality.

“People keep asking us to do the same things, so why not streamline them. That are what we are doing anyway. Automating the tasks would help both us and our customers.”

(Founder – Steelcyber Scientific)

4.3 Focusing on service values and quality

- **The second sub research question RQ2:** To what extent do entrepreneurs focus on building high quality service and customer satisfaction rather than low cost between different competitive strategies?

4.3.1 Low cost strategy

Out of ten, there are two entrepreneurs pursuing a low cost strategy: GG Media and YAY Media. However, it is not only lowering service price but also the important requirement of a high quality of service and personal relationship with customers. The entrepreneur at GG Media emphasized it much:

"I also notice the customers moving from bigger companies to us, because of the service charge. Those big companies they can be fancy, they have big offices, salesman, calling systems... I do not have them. But big companies cannot go too much lower because of their costs. So, they go for volume, I go for smaller volume but quality. Quality of service and personal relationship are still the key. Cannot just lower price and lower the quality too. I will lose customers then, instead of getting new ones."

The other entrepreneurs had similar decisions to keep prices in higher levels and focus on their service quality. They did not mention short- or long-term customers but they all agreed that low price is not the key. The critical point is the quality of service, and it might, or might not, come with low price strategy.

"Lowering prices will kill our business. Instead, we focus on what we can do with our assets: people, knowledge, and networking, current customers and partners. In communication world, I believe that price is not the key. It is an important factor when negotiating, but if you can bring on table a really good concept, you will be surprised how much you can charge the client. A good campaign will show who you are to the whole market, and customers will come to you."

(CEO / Rayon AS)

In the case of Eliksir AS, they even tried to increase their prices when they found their price policy was not good enough for growing their business. Since customers were happy with the quality of services in the past, they accepted the price change.

“We actually increased our price. And our income increased a lot. At the beginning, we only launched the new version to new customers, but in 2011, we started to rephrase all customers to the new version. Luckily we did not lose any customers because of the price change. They are still happy with the service quality that we bring to them.”

4.3.2 Exceptional quality of service

All entrepreneurs studied emphasized customer service. They contact customers frequently, try their best to solve any issue that customers might face. Unlike employees in other *big* companies in Norway, these entrepreneurs can work late at night, weekends or holidays. Keeping customers happy and building personal relationships is the key differentiation in each of their working sectors. For example, customers can contact Vian Consulting Norge anytime if they have troubles.

“After I completed a work for a company, if they need extra things, they would come to me again, because I was helping them a lot, even in holidays or weekends. In some cases, they do have in-house developers, but then when there are holidays in the country, those developers are not working either.”

(Founder / Vian Consulting Norge)

Of course, availability is just one aspect. Customers also consider the quality of the firm’s supporting service. Each of the entrepreneurs might have their preferred method when working with customers but aim for the same goal, which is completely resolving issues for customers. One illustration comes from iSee Communications AS:

“I talk to them, ask them questions, and try to solve their problems. When people have problem, and I can fix it for them, they see that I have ability to see what the problem is, and I show them that I have knowledge and experiences in doing this.”

In some cases, the entrepreneurs even go further, and join to the customer’s projects to make sure that they understand customer correctly so that they can help them in the right way. They effectively become a business advisor for their customers.

“Sometimes I have clients call and ask they are going to offer this and that service, and how I think about that. They take me into their business like an advisor. That’s something coming from customer relationship.”

(Founder / iSee Communications AS)

Even though the company sizes are different, entrepreneurs always try to keep personal relationships with their customers. They build customer satisfaction upon those relationships. Entrepreneurs consider that the trust between them and customers helps the firm to compete with the big companies and makes the firm different from other competitors in the service sector. In addition, it not only helps them maintain the customer base but also gets them new customers.

“Mostly, my business is based very much on the personal relationship with clients. People are happy with what they get. I provide services for them years after years. They know that my business is reliable. They trust me, and refer me to other people.”

(Founder / iSee Communications AS)

From close relations with customers, entrepreneurs build networks and spread the firm’s brand in their networks. Trust from customers is critical, because it allows customers to introduce the firm to other people in their personal networks. It makes the firm’s brand more *salient, habitual and available* (Sharp and Dawes, 2001). It gives entrepreneurs a workable segment profile (Sarasvathy, 2001b) for the firm.

“You can have the same prices, the same product features on the same services. Might be somebody can be better or worse in some ways, but who are the people that customers trust. When customers trust me, they go in the deal. Then from my experiences, they also suggest me to others who are in the same situation.”

(Founder / GG Media)

4.3.3 Service values & customer satisfaction

Not only do entrepreneurs provide extraordinary support service to customers, they also continuously develop the features of their service. Customers here can play the role of advisors. Through their requests, customers give entrepreneurs ideas for offering more features. This can happen in both when the entrepreneurs starts developing the service and during business operation. Examples from Ardoq AS and GG Media clearly show this:

“We have an early customer from the day one. They grow with our product. They have a lot of product features requests, they really need us to figure out which part is important and how to improve the UX.”

(Co-founder – Ardoq AS)

”We are offering extra components since starting. Customers kept asking us about this and that. The extra services make customers happy, and help our services a bit more completed. That is why working with more customers, identifying their problems, is important to us. With our expertises, we are working with them, offering them what they are missing, and they help us to complete our services offering.”

(Founder / GG Media)

Added to that, service firms can also differentiate themselves in the competitive marketplace by customizing their service for individual customers (Skaggs and Youndt, 2004). Because each customer has their own characteristics, the requests from them are unique too. Entrepreneurs in Elik sir AS and Rayon AS adapt to this very well. They own their services, which allow them to customize them for customers. It is obviously a very good strategy to defend their customer base in a competitive market. The founder of Elik sir AS stated:

“We want to have full control of the software, so we develop our systems ourselves in Norway. If you want a new feature, it is easier to work with us, a small company in Norway than talking to an international big company. We love to work with stuff, work with customers over time to make good products. We often talk to our customers about what they want, how they feel about the service concept, that sounds an interesting one or not.”

In the cases of Steelcyber Scientific and Ardoq AS, not only can they customize their service for different requests but they also go further by allowing customers to access to their API so that they can freely build add-ons to meet their needs.

“When we receive customer request, we will judge if we can do it and apply to other customers too, or the customer can do themselves by using our API.”

(Co-founder – Ardoq AS)

“We offer API components under open source licenses, that customers can use for developing. The components can connect transparently to our core.”

(Founder – Steelcyber Scientific)

The value of services is also different from the value of tangible products. The value of a service can come from new features, helping customers save time, or helping customers be more productive.

“A lot of systems built with the mindset of what features system has. OK, here are the features, but how the customers use them? Well... we need to guide them, we have them in training, etc., that can make people feel frustrating. On Scandinavia market, we do have some competitors, but again, it's complex and expensive. That's why simplicity is the first criteria in our service.”

(Founder / Elixir AS)

“It is hard to tell customers what they need, if they do not understand themselves. We help our customers understand their needs.”

(Co-founder – UX Lab AS)

5 Discussion

The empirical study was set out to answer the research question: *How do entrepreneurs in small service businesses in Norway differentiate themselves under the impact of customer interaction?* In attempting to do that, two sub-questions were identified that helped focus the analysis:

- RQ1: To what extent do entrepreneurs use effectual processes to create new services based on interactions with customers?
- RQ2: To what extent do entrepreneurs focus on building high-quality service and customer satisfaction rather than low cost between different competitive strategies?

Based on the data, I found that entrepreneurs focus on means-driven strategy and building strategic partnerships, even with competitors. Based on their affordable loss and pre-commitments to customers, entrepreneurs are able to increase their quality of service and bring more value to customers. Through this increased service and value they are able to increase customer satisfaction and differentiate themselves from their competitors.

5.1 Means driven

Sarasvathy (2001a) suggests entrepreneurs begin with three categories of means: who they are, what they know, whom they know. Entrepreneurs can start small with the means that they already have. The empirical data provides evidence that all studied entrepreneurs have started their firms based on their backgrounds and their networks. Entrepreneurs then execute possible actions based on their means with the logic that *“to the extent that we can control the future, we do not need to predict it”* (Sarasvathy, 2001a). The first product versions can be rustic, but shows that the product actually works. Quick actions can help to improve the innovation speed and technical quality of the firm (Carbonell et al., 2009). In the meantime, those actions also help the firm move faster to adapt to rapidly changing environments (Sarasvathy, 2001a). These important factors help differentiate the firm on the market. The case of iSee Communications AS is a good example. They started with their owned content management system but then moved to Joomla and WordPress platforms due to more requests from customers. Now, their customers are demanding mobile-friendly websites. In

the case of Rayon AS, when the entrepreneur needs to decide to adapt new Internet technologies for creating new communication campaign based on screen size.

“Well... cannot refuse that customers have a big impact on the services we are offering now. We started with graphic design in printing period, but nowadays, everything moves to digital. People depend a lot on telecommunication, digital channels, or screen-based media. There are more requests in showing media on different sizes of screens: desktop, mobile, and tablet. We need to adapt that too.”

(CEO / Rayon AS)

The entrepreneurs do not stop at their original means. Through the interaction with customers, new means and new goals appear. Entrepreneurs then adapt those means and goals to fit their business. That can help the firm differentiate itself from its competitors as well as build business partner relationships.

5.2 Strategic partnership vs. competitive analyses

The common logic of these entrepreneurs is that when entrepreneurs see opportunities, within their means, they start building the new services immediately; they do not need to wait. Using strategic partnerships (Sarasvathy, 2001a) with external actors “*whose strategies are driven by other types of identity, knowledge, and networks*” (Wiltbank et al., 2006), entrepreneurs build an ecosystem and use it to expanding the capabilities (Chandler et al., 2009) of the firm. This principle is shown clearly in Steelcyber. The firm provides disaster-recovery service in multiple locations over the world. It does not have human capital in every place neither have billion dollars for building infrastructure in multiple countries. That is why the entrepreneur chooses to create strategic alliances with other data center firms, which allow the firm meet the customers’ needs. Another example is the entrepreneurs at UX Lab AS who want to focus on UX service only. When they have development requests from customers, they co-operate with other firms to complete the jobs. They do not hire developers for doing development tasks themselves, which can lead to competing with other IT firms. At the same time, some graphic design companies lack UX designers and UX Lab can collaborate with them to provide those capabilities. This creates a stable alliance with effectual processes.

Similarly, other entrepreneurs focus on partnerships building from the beginning (Sarasvathy, 2001a). For completing the legal photo review, the entrepreneurs at YAY Media AS needed to co-operate with other professional in law areas, where they are not familiar. The entrepreneur at Mums Mean Business AS pitched her plan to some other business organizations to get experts join the board as advisors. She is also working with other web development firms to get designers and coders to develop the new platform. In those cases, the firms need to create strategic partnerships. And these partnerships sometimes help the firms be the first-movers on the market.

Obviously, either being the first-mover or not, customers are important. That is why entrepreneurs cannot neglect customer service. The next section will discuss why commitment to customers is so important.

5.3 Pre-commitments & affordable loss

The data also shows that entrepreneurs should devote effort to service value and quality while manipulating the price strategy in a flexible way to increase customer satisfaction. From a customer's perspective, price is only one aspect of purchasing and/or consumption. Other factors include delivery, ease of use, and after sales service (Sharp and Dawes, 2001). That means differentiation by low price is not always necessary. Instead, entrepreneurs must understand customer needs. They need to pre-commit their time and effort to interact with their customers. This pre-commitment is actually helping the firm to reduce uncertainties and to erect entry barriers to the late entrants (Sarasvathy, 2001b). Not only that but pre-commitments from the firm are the foundation for developing innovative solutions and providing superior values to customers (Slater and Narver, 1998). Those conceptualizations are supported from the empirical findings in this study. The collected data shows all entrepreneurs are concerned with service value and quality. Even when two of them have chosen a low-cost strategy at first, they also put substantial effort into customer service and thereby increasing the service value. The other seven entrepreneurs keep their service charge at a *fair* level, equivalent to the quality that they provide to customers. The entrepreneurs consider customers as business partners and take part in customers' projects. They put themselves into customers' shoes and walk in customers' feet. Especially in the case of Elik sir AS where the entrepreneurs decided to increase service price. They thought they might lose some customers. The fact was they maintained their entire customer base. They

built their service based on customers' requests. They committed their effort to the service development as well as the supporting service. That builds trust between the firms and their customers. The trust is the best link between the firms and their customers, not any contract or agreement.

"I do not want them to stay with me, because they have to. I want them to stay with me, because they want to. Many other companies try to lock their clients to stay with them. That is unsustainable model."

(Founder – iSee Communications AS)

The pre-commitments here are not just promises. The entrepreneurs accepted that they might lose money, time and effort when starting a new venture. The entrepreneurs at YAY Media AS did not stop after being denied by investors. Having financial support from investors was a good sign, but without it, the entrepreneurs could still start the firm. They accepted the need to run the business with their own funds and considered that an affordable loss. Through communications with potential customers, they knew that their customers needed a legal photo review service and that none existed at that time. That was also their commitment to their customers, that they would bring a completely new legal service to customers. In the case of Ardoq AS, the entrepreneurs accepted changing from working in enterprise environments to startups and focused on experimenting as much as possible with their first clients (Sarasvathy, 2001b). Those entrepreneurs knew their customer's needs but they did not know if they would be successful or not. Instead of expecting returns, they emphasized the downside of the business, on the affordable loss, and tried the best they could and experimented with customers. From these experimentations, more service features can be created in the future, which bring more values to customers. Those features and values make the firm different.

5.4 Contingencies vs. pre-existing knowledge

While effectuation theory emphasized the exploitation of contingencies rather than pre-existing knowledge (Sarasvathy, 2001b), from the empirical data in this study, contingency exploitation is not that strong. Most entrepreneurs have a technical background and they utilize their expertise in each working field for creating more value. Only the entrepreneur at Mums Mean Business AS did not have first-hands knowledge about what she is offering

now. In regards to exploiting contingencies, most of the firms use more of a causation model rather than an effectuation model.

5.5 Effectuation vs. causation

One interesting finding is the way entrepreneurs apply effectual or causal logic. Sarasvathy (2009) comments that entrepreneurs are capable of both logics and the fact that they can apply both effectuation and causation well into their businesses. But entrepreneurs prefer effectual logic of thinking over causation in the early stages of a new venture. When the firm is more mature, it moves more to the causation model. In this study, half of the companies are quite new, established in 2013. However, the rest are older than five years and three of them are older than ten years. The entrepreneurs in those firms are expected to utilize more causation processes. However, data from the interviews indicate that all entrepreneurs in small service firms in Norway seem to be applying effectuation in their differentiation process even though they do not know about effectuation theory.

In general, the data from this empirical study show to a great extent that entrepreneurs use effectual processes with feedbacks from customer interaction activities for creating new services, offering more service values and increasing service quality for gaining satisfaction from customers.

5.6 Limitations and future research

As other studies, in my research, there are some limitations because of the research design and resource constraints. These limitations can give suggestions to areas for future research.

Firstly, the service industry is huge. It includes multiple different service types. This study only focused on companies working in the IT service sector. More particular, even inside the IT sector, cloud computing, managed data center infrastructure, and information security are hot trends with different features. Therefore, it is possible to have different patterns of findings in each specific service area.

Secondly, the characteristics of customers are also important. Within this thesis, I only focused on the lead users type. Due to the importance of customer interaction, I suggest that future researchers can address other types of customers. There are several interesting cases in

the IT world. For example, within four years, Digital Ocean has become the second largest hosting company in the world. They have been focusing on developers, who can be technically attractive customers. Or Endurance International Group owns multiple Internet brands that most of them emphasize on low-cost strategy with financially attractive customers. Deep research in those cases with different types of customers might reveal exciting results.

Thirdly, market characteristics are another factor that can affect to the results of research. Within this research, the data was collected within Norway, primarily in Oslo, which is considered one of the most expensive places in the world. The expenses in Norway are usually higher than other places. That makes big impact to customer suggestions as well as the firm's pricing strategy. Conducting research in other countries might lead to different results. While the research results are good for entrepreneurs working in Norwegian conditions, it is a limitation when generalizing the results to all small service firms in other countries.

5.7 Implication for practice

Obviously, customers are important for any business. However, the results from this study suggest entrepreneurs in the service sector may benefit more from interaction with customers from the beginning of a new venture or a new product line. For Norway, in particular, the results are important, where most small service companies have less than five employees and employee salaries and business are high. Combining effectuation principles and customer interaction will help entrepreneurs start with a small financial outlay while still working effectively on a differentiation strategy. An effective differentiation strategy will help expand their choice of activities so that they might end up with offering different products or services on a new market.

On the other hand, entrepreneurs need to be assertive when processing requests from customers. Saying *yes* to all feature requests from customers will make the product or service overloaded. From the interviews, multiple entrepreneurs mentioned to that problem. In many cases, technical people from customer's organizations thought that they had responsibility to ask for new features, even those they were not actually using. Entrepreneurs in this study have chosen to keep their products easy to use.

Added to that, entrepreneurs can become strained too. They think at the beginning that they could do everything but eventually they cannot continue to work this way and that circumstance can lead to drops in customer satisfaction, which harms the firm in the end.

“That is why we need to say no some times to customers. We need to know if they are willing to use that or not.”

(Co-founder – Ardoq AS)

“When customers want to have a new feature, we ask back: why you need that.”

(Co-founder – Elikvir AS)

6 Conclusion

I started out trying to understand how small service firms can compete with other rivals on an increasingly competitive market. From the collected data, I have showed that entrepreneurs in small service firms in Norway leverage information from customer interaction activities go creating new services and thereby being the first mover on the market. Alternatively, some entrepreneurs work towards improve service quality and providing more value to customers. In any case, the entrepreneur accepts the affordable loss, emphasize on effectual activities for improving services for customers.

The study has reached both goals: contributing to literature about service differentiation and providing insights about differentiation strategies in small service firms in Norway. In addition, the empirical evidences show that differentiation strategies can be applied not only in big enterprises but also in small service firms. Entrepreneurs in new ventures or mature companies can do and do well with differentiation strategies. However, due to the lack of literature in this topic, there might need more studies for confirming the results.

Appendix

The interview guide

Each interview is conducted with open questions in semi-constructed type. Therefore, there are some guided questions that I used to keep the interviews on track. There are three main themes for the interviews.

First, the basic information about entrepreneur and company:

- Can you tell me about your background?
- Can you introduce your company, the services that you are offering to customers?
- How did you come up with the idea to create the company?

Second, the service differentiation:

- How do you differentiate yourself from competitors?
- What were the main reasons for you to offer this service?
- Why did you decide to develop this new service for this new market, when you were working in the old market for a while and knew about it clearly?
- You offered a different service before, why did not continue with that? Why have you decided to develop a new service? What make you think that you will be successful with this new service?
- There is a strategy with lower price for getting customers. How do you think about this? How do your customers think about your pricing scheme?

Third, the customer interaction:

- How did you customers respond to your service when the first time they used it?
- How do you deal with the customer feedbacks about your service offering?
- How do your customers contact you?

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