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# Business Models and Foreign Entry Mode Strategies of Digital Service Providers

## Introduction

In this chapter, we demonstrate how a business model applied by a digital service provider might impact the selection and usage of a foreign entry model. By using the term “digital service providers”, we refer to firms who develop, market, and sell digital services that are based on software or digital data, and their services are available in digital format (see Gabriellsson et al. 2021). Compared to physical objects (artifacts), digital artifacts can be easily distributed over the Internet to customers, irrespective of physical location (Kallinikos et al. 2013; Ojala et al. 2020). That is, the distribution of the digital service itself tends not to be problematic. However, a more challenging task faced by digital service providers is how to identify and connect with potential foreign customers and how to provide support for customers located around the globe. These are important issues for both managers innovating new business models for digital services, and international business (IB) scholars searching for more theoretical understanding of the topic.

The existing literature on digital service providers’ internationalization focuses mainly on internationalization strategies (Chen and Wang 2010; Su 2013), the selection of foreign entry modes (e.g., Erramilli 1992; Brouthers 1995; Bell et al. 2001; Blomstermo et al. 2006), and applicability of existing IB theories to digital context (Wentrup et al. 2019; Wittkop et al. 2018). This literature can be used to develop a basic understanding of how digital service providers select their foreign markets, how they employ different strategies to enter these markets, and which factors are affecting their entry mode selections for target countries. However, the existing literature does not adequately explain how digital service providers ~~move~~-internationalize their business model (Brouthers et al. 2016) and how they should adjust their international entry mode strategies after the initial entry into a foreign market (Canabal and White 2008). Furthermore, digital service providers may opt for different strategies based on the characteristics of the digital service (Gabriellsson et al. 2021). For firms offering customized services for business to business (B2B) markets, the international entry mode strategy may differ considerably from those ~~of~~ firms providing more standardized services for ~~business to~~ consumers (B2C). The research question here is: How thea business model applied by a digital service provider impacts ~~on~~ the entry mode strategies?

To fill this gap, this chapter integrates insights from IB and information systems (IS) literatures, considering different types of business models applied by digital service providers in the international context. In the field of IB, different frameworks have been applied to explain how firms select their entry modes to operate in foreign markets. However, these frameworks have not been adequately applied to explain the entry mode strategies in the context of different digital service offerings. The chapter contributes to the IS and IB literatures by examining how different business models of digital service providers may lead to different entry mode strategies to serve foreign clients and to maximize the reach of their service. Further, this chapter develops a theoretical understanding on the topic by explaining how a business model affects distribution strategies and how the ~~studiedse~~ firms organize their strategies to serve foreign clients.

## Literature Review

### *Foreign Entry Modes*

Entry modes have long been a focus of IB research (e.g., Shaver 2013; Hennart and Slangen 2015). The main research question in entry mode studies has dealt with the way in which firms choose to operate in a foreign country (Canabal and White 2008; Shaver 2013), and numerous different aspects have been addressed, including differentiation among entry modes (e.g., Anderson and Gatignon 1986), determinants of entry mode choice (e.g., Brouthers 2002), performance outcomes of different entry modes (e.g., Shaver 1998), target market selection (e.g., Agarwal and Ramaswami 1992), and risks related to particular entry modes (e.g., Zahra et al. 2000).

The innovation-related internationalization model (the I-model), related to the stages model of internationalization (Andersen 1993; Hadjikhani et al. 2014; Welch and Paavilainen-Mäntymäki 2014) is particularly applicable to the study of how digital service providers approach international markets, as it sees the foreign entry process as resembling the innovation adoption process, such as the adoption process of new software based services. In the I-model, each stage represents a foreign entry mode; the stages are arranged to represent increased commitment on the part of the internationalizing firm, in the form of higher involvement and strategic commitment to the target market. Table 1 summarizes the I-model, with higher-numbered stages representing higher market commitment.

<b>Entry modes in the I-model stages</b>	<b>Authors</b>
Stage 1: Exporting based on unsolicited orders	Wortzel and Wortzel 1981; Varaldo,1987; Rao and Naidu 1992
Stage 2: Direct exporting activities operated from the domestic country	Bilkey and Tesar 1977; Cavuşgil 1980; Reid 1981; Czinkota 1982; Rao and Naidu 1992; Crick 1995; Petersen and Welch 2002
Stage 3: Exporting through domestic agent agreements	Fina and Rugman 1996; Petersen and Welch 2002
Stage 4: Exporting through foreign agent agreements	Johanson and Wiedersheim-Paul 1975; Fina and Rugman 1996
Stage 5: Establishment of a firm's own foreign sales office in the target country	Johanson and Wiedersheim-Paul 1975
Stage 6: Establishment of cooperative production with a foreign representative	Fina and Rugman 1996
Stage 7: Establishment of a foreign manufacturing subsidiary in the target market	Johanson and Wiedersheim-Paul 1975; Luostarinen and Welch 1990; Fina and Rugman 1996

**Table 1. A synthesis of existing entry modes (adapted from Paavilainen-Mäntymäki 2009)**

In a literature review focusing solely on entry modes, Canabal and White (2008) found that digital services like software was among the most frequently-studied industries. Their review revealed that the focus in studies published between 1980 and 2006 was often on the antecedents of entry mode choices, but seldom on the consequences of such strategies, i.e., the actual content of the choice and its effects on further entry strategies. According to Canabal and White (2008, 271), “Studies linking internationalization theory and entry modes have been focused on transferability and distribution in international business units..., and host market characteristics on expanding firm entry mode choice...”. This paper attempts to address these implications by looking at the foreign entry mode strategies of digital service providers and the organization of business models within the firms, particularly examining the relationship between the characteristics of the digital service and the selected entry mode strategies.

### ***Business Models and Foreign Entry Mode Choice***

Business models can be defined in several ways (see e.g., Foss and Saebi 2018). In this chapter, we define a business model based on the characteristics of a firm’s service offering and its business logic (Baber et al. 2019; Ojala 2016). Business models of digital service providers might vary greatly based on their service offerings (Nambisan 2001, 2017; Ojala 2016). Hoch et al. (1999) divide business models that digital service providers commonly apply as follows: 1) professional services (B2B), 2) enterprise solutions (B2B), and 3) packaged mass-market (B2C). Firms applying professional service -business model have very low level of productization, and the business model is based on one-to-one relationships with customers. These firms applying this model focus on winning customers’ faith and trust, by solving specific problems for the client. The second business model, enterprise solutions – model, focuses on the development of digital services that require some customization for a customer’s specific environment. Thus, the cost to the customer might be much lower than the comparable cost of the one-off customization associated with professional services. The third business model focuses on mass-markets with digital services that are highly standardized. In these cases, localization of customization needs is very low, and customers commonly download or stream the digital service without need for help from a provider side.

Although the different business models presented by Hoch et al. (1999) provide a detailed categorization of digital services and their offerings, other literature considers digital service providers to be either digital service or digital product providers (Alajoutsijärvi et al. 2000; Cusumano 2004, 2008; Nambisan 2001). In the digital product business model, the software or a digital artifact (see Kallinikos et al. 2013) is highly standardized and is easy to install and put into use without help of third parties. In a digital product business model, legal protection of the digital product, continuous upgrades, and complementary products/services are critical to maintaining competitiveness in the market and the uniqueness of the offering (Nambisan 2001). In this business model, the aim is to develop software or other digital artifacts to suit a wide variety of situations by decreasing or removing context-specific elements from the product (Alajoutsijärvi et al. 2000; Nambisan 2001). This categorization corresponds closely to mass-market business model by Hoch et al. (1999).

In contrast, digital service firms focus on customized digital artifacts that are largely tailored for customers’ specific requirements. That is, their business model is based on customization,

and provisioning strategy advice, training, integration, consultation, technical support, and maintenance work (Cusumano 2004; Rajala et al. 2003; Valtakoski and Rönkkö 2010). These firms focus on the development of unique digital solutions in close cooperation with customers (Alajoutsijärvi et al. 2000); the close cooperation makes knowledge of customers' idiosyncrasies a very important asset (Nambisan 2001). These firms are generally involved in project-driven businesses, in which the customer base is relatively narrow, and customers tend to be technologically unsophisticated (Alajoutsijärvi et al. 2000; Nambisan 2001). Projects are likely to be very unique and labor-intensive, requiring the digital service providers to have very subject-specific knowledge (Cusumano 2004).

These distinctions with the business model in respect to the nature of the digital product and digital service provided have important implications for how digital service providers approach international markets. While several studies have investigated the entry mode choices of firms providing digital artifacts like software, they have tended to focus on other aspects such as the internationalization process (Bell 1995; Loane et al. 2004), psychic distance (Ojala 2008), etc. To date, the interaction between the business model applied (that is, the type of digital service and product) and the foreign entry mode strategy has received limited attention. However, the existing literature can be used to form a basis for a more in-depth consideration.

For example, Bell (1995) found that providers of customized services tend to utilize their own staff in dealing with end-users, whereas providers of more standardized services were likely to use agents or distributors. This is consistent with Loane et al. (2004), who indicated that customized software is more likely to be sold via the firm's own sales staff, as the service component critical to the solution makes it difficult for the complete service to be provided via indirect entry modes such as agents or distributors. McNaughton (1996) argued that the provision of customized services is associated with the use of foreign sales subsidiaries, which represent much higher commitment to international markets than exporting. This is supported by Ojala and Tyrväinen (2006) and Ojala (2008), who indicated that providers of customized digital services used sales subsidiaries because of the need for after-sales support and marketing. Brouthers et al. (1996) also noted that firms developing customized digital services tend to prefer more integrated entry modes, such as sales subsidiaries.

While the extant literature offers some clues about ~~the role that~~ how the nature of the digital service offer impacts on digital service providers' foreign entry mode strategy, a more detailed consideration is needed. Using an in-depth, qualitative approach, this study attempts to understand more about the connection between the nature of the firm's business model and its internationalization strategy. Does the business model – standardized service vs. customized service – make the firm more inclined to adopt a higher- or lower-commitment approach to pursuing sales outside of its home country? For these purposes, the I-model, with its entry mode stages, combined with a more nuanced categorization of digital service provider's business model, provides a clear basis on which to conduct the analysis. ~~A~~ The more detailed assessment of the relationship between the type of digital service and foreign entry mode sheds ~~some~~ light on the nature of foreign entry mode strategies within digital-based firms that rely on international sales for survival and growth.

## **Research Method**

Given the goal of understanding the nature of digital service providers' strategy processes and capturing cause-and-effect relationships, the methodological approach adopted for this study needed to enable an in-depth investigation of complex phenomena. This led to the selection of a case study approach (Darke et al. 1998; Yin 2009). The qualitative case-study method allows for the collection of detailed and empirically rich data (Eisenhardt and Graebner 2007) to investigate a complex phenomenon such as the development of an international entry mode strategy.

The case firms for this study were selected using a theoretical rationale, as advised by Eisenhardt (1989). The selected firms, described in Table 2, complied with the following criteria: (i) the firms had international operations; (ii) the firms were independent software providers (that is, they were developing their own software, rather than selling third-party software); and (iii) the firms in the sample differed in the nature of their product and service offerings, so that the sample covered the range of software providers from very standardized software to very customized software offerings. All of the firms in the study are based in Finland, a small and open economy (SMOPEC) that provides strong push for firms to expand internationally due to the limited market size at home.

The data for this study were collected between 2010 and 2019, from three different projects focusing on (i) internationalization of digital service providers' firms, (ii) business models of digital service providers, and (iii) international service strategies of software firms. Altogether, 71 interviews were conducted for this study, with each interview lasting from 30 to -90 minutes. All of the interviews were recorded and transcribed verbatim, using a word processing program. Thereafter, the complete transcripts were sent back to the interviewees for review. For the most part, the interviewees accepted the transcripts in the form in which they were sent. Most of the interviews were conducted in-person; however, six telephone interviews and one Skype interview were undertaken because of difficulties in finding a suitable time for a face-to-face interview.

<b>Firm</b>	<b>Service business model</b>	<b>Digital service</b>	<b>Target industry</b>	<b>Number of Interviews</b>
Firm A	-Standardized service (B2C)	-Antivirus software	-Consumers and diverse industries	2
Firm B	-Standardized service (B2B and B2C)	-Cloud gaming solution	-Network operators and consumers	16
Firm C	-Standardized service (B2B and B2C)	-Firewall service	-Diverse industries	2
Firm D	-Standardized service (B2B and B2C)	-Mobile games and gaming solution	-Mobile operators	3
Firm E	-Semi-standardized service (B2B)	-Data-in-transit security service	-Diverse industries	3
Firm F	-Semi-standardized	-3D modeling software	-Building and construction	4

	service (B2B)		industry	
Firm G	-Semi-standardized service (B2B)	-Network analysis service	-Mobile phone manufacturers and network operators	4
Firm H	-Semi-standardized service (B2B)	-3D modeling platform	-Furniture industry	12
Firm I	-Customized service (B2B)	-Risk management software	-Financial sector	7
Firm J	-Customized service (B2B)	-Identity and access management solution	-Diverse industries	5
Firm K	-Customized service (B2B)	-Virtual design and modeling software	-Mobile phone manufacturers, mobile operators	3
Firm L	-Customized service (B2B)	-Video codec software	-Mobile phone manufacturers	10

**Table 2. Overview of the case firms and the number of interviews**

Content analysis was employed to analyze the interview data. The analytical approach consisted of three concurrent flows of activity (Miles and Huberman 1994): (i) data reduction, (ii) data displays, and (iii) conclusion-drawing/verification. In the data reduction phase, the data were given focus and simplified through a compilation of a detailed case history for each firm. This is in line with Pettigrew (1990), who suggested that organizing complex aspects in chronological order is an important step for understanding the causal links between events. In the data display phase, the relevant data drawn from the case descriptions were arranged in new tables, aimed at facilitating the identification of patterns and themes. The conclusion-drawing and verification phase included the identification of cross-case aspects that appeared to have significance for this study. At this stage, regularities, patterns, explanations, and potential causal relationships related to the phenomena of interest were identified and explored.

### Findings

Based on their business model, the case firms can be divided into providers of standardized digital services (A, B, C, and D), providers of semi-standardized digital services (E, F, G, and H), and providers of customized digital services (I, J, K, and L). Firms providing standardized digital services had no requirements for customization of their products, and localization needs were minimal. Customers were able to integrate and implement the service by themselves without support from the providers. In the case of semi-standardized digital service providers, while localization and customization work were needed, it was undertaken by a combination of collaboration with the provider and the distributors. Similar to the situation for standardized digital service providers, customers were often able to integrate and implement the service with

minimal ongoing support. In contrast, firms providing customized digital services took care of most of these activities themselves, as the service was very complex and required the ~~firms'~~ providers' involvement in all of the phases of the processes associated with sales, installation, and ongoing support.

### ***Entry Mode Strategies for Providers of Standardized Services***

The providers of standardized digital services – firms A, B, C, and D – used both distributors (exporting via Stages 3 and 4 of the I-model) and subsidiaries<sup>1</sup> (foreign direct investment, generally Stage 5 of the I-model) to enter foreign markets. High levels of standardization made the service relatively less complicated to market and sell to customers outside of the home country ~~of Finland~~, as the functionalities of the digital service were easy to understand, especially among the target group of customers. In addition, customers were generally able to handle, if needed, the required integration and implementation works by themselves. Because the usage of the service was simple to learn, distributors were able to give after-sales support for end-users when needed. However, in the most complex situations, after-sales support was provided in conjunction with either the Finland-based firm or its subsidiary in the customer's market.

~~Located~~Sitting toward the middle of the range in the I-model, the ~~providers of~~ standardized digital service providers used their subsidiaries mainly for (i) promoting the service within the foreign market region, (ii) finding new distributors to market, and (iii) supporting distributors (and, in some extreme cases, end-users). The establishment and location of subsidiaries was based mainly on the market potential in the location of interest. Thus, these firms had subsidiaries in the main markets for their products, and the service was targeted to relatively wide customer segment. Interestingly, the firms providing standardized digital services employed a strategy in which distributors handled all of the sales activities, even in the markets in which the firm had established a subsidiary. The General Manager of Firm C highlighted this strategic decision as follows:

*We are not selling directly from subsidiaries; all software goes through our distributors. It's a strategic decision. We are using subsidiaries only for promoting the software and finding new distributors.*

### ***Entry Mode Strategies for Providers of Semi-Standardized Software***

The firms providing semi-standardized digital services (E, F, G, and H) also made use of both distributors and subsidiaries to access foreign markets, but in somewhat different ways. While these firms provided digital services that were relatively easy to integrate and put into use, customers were likely to require some training or assistance during the initial installation process. Common to all of these providers of semi-standardized digital services was the strategy that both distributors and subsidiaries were involved in the sales process in foreign markets. In addition, both distributors and subsidiaries undertook localization and customization of the

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<sup>1</sup> The term "subsidiary" is used here in a broad sense, and includes "offices", "representative offices", and formal foreign business units, on the basis that the reported activities associated with these variations of foreign-based establishments were identical.

service necessary for the target market in general and for specific local customers, with the head office in Finland only attending to major changes or specific requirements ~~attended to by the head office in Finland~~. The foreign entry modes were organized similarly to providers of standardized digital services, with subsidiaries established in the main markets and distributors utilized in markets with lower demand for the firms' service. After-sales support was organized so that distributors supported their own customers and subsidiaries gave support to their direct customers. The Executive Vice President of Firm F commented on the entry mode arrangement as follows:

*Each subsidiary and distributor has exactly the same tasks. Our R&D is in Finland, but each foreign unit takes care of the localization for their customers. They all have an employee who works as a product manager, so we have local product management in each country.*

### **Entry Mode Strategies for Providers of Customized Software**

Three of the four providers of customized digital services (I, J, and K) also entered and served international markets using both subsidiaries and distributors. Again, though, the approach employed by these firms differed from those providing less-customized digital services. Firms I, J, and K used distributors only for marketing and sales purposes; that is, the main responsibility of the distributors was to get the word out about the software and to identify potential customers. Unlike the earlier examples, these firms employed distributors in countries in which the largest numbers of potential customers were located. However, the complexity of the fully-customized services made it difficult for distributors to provide after-sales support. In the case of Firm K, distributors were used only for marketing, and the firm handled the sales process. For Firms I and J, distributors were able to sell the digital service, but the firm was also involved in the sales process, in terms of specifying key requirements for the service.

In addition to the distributors, these three firms used subsidiaries, mainly for marketing and after-sales support. Subsidiary locations were selected based on the size of the target industries in specific countries. Having subsidiaries established in the markets in which main customers were located allowed the digital services providers to offer rapid and effective after-sales support when needed. For instance, Firm J established subsidiaries in the same countries in which they had distributors. While the distributors were marketing the product, the headquarters handled the sales process, and the subsidiary took care of after-sales support. The CEO of Firm J explained the need for high-commitment wholly owned subsidiaries to be co-located with distributors:

*We have to have our own employees supporting distributors because our product is technically so complex. They know the technical requirements; distributors can focus on the sales.*

Firm L adopted a different strategy, using only direct investment via subsidiaries. This was the result of the nature of Firm L's digital service, a particularly complex service demanding time-consuming analysis of user requirements, integration, and implementation, all in close liaison with a customer. The specific knowledge that was required to undertake all of this in a successful manner meant that Firm L was unable to identify distributors that would be able to take care of the marketing and/or sales of the service. The Vice President of Firm L offered the following description:

*We have evaluated some potential distributors. However, in our case, it does not work well as the product is so complex, making the sales process very difficult and time consuming.*

## Discussion

The interview data showed that most of the Finnish digital service providers in the study used a combination of exporting (distributors) and foreign direct investment (subsidiaries) as their entry modes for international markets. Thus, focusing solely on the presence of particular entry modes would reveal little variation among the firms. However, more detailed investigation regarding the roles assigned to the entry modes reveals a more subtle set of strategies, in which single entry modes are employed for different activities. Analysis of the qualitative data revealed a clear connection between internationalization strategies and the business model used.

Table 3 summarizes how different activities were allocated between the two key foreign entry modes, based on the type of the business model used. It should be noted, though, that these categorizations do not represent ~~fully distinct grouping a strict typology~~; rather, these firms represent points on a continuum in which Firm A has the most standardized digital service and Firm L the most customized digital service.

Service business model	Exporting (Distributor)	Foreign Direct Investment (Subsidiary)
Standardized service (firms A, B, C, and D)	-Sales and marketing -After-sales support	-Marketing -Find new distributors -Support to existing distributors
Semi-standardized service (firms E, F, G, and H)	-Sales and marketing -Localization and customization -After-sales support	-Sales and marketing -Localization and customization -After-sales support
Customized service (firms I, J, K, and L)	-Sales and/or marketing	-Technical support for distributors -After-sales support -Sales and marketing

**Table 3. Type of the software and the activities within the entry modes**

These findings suggest that firms using standardized -service business model are likely to outsource sales and after-sales activities to distributors, whereas subsidiaries take care of marketing, acquiring new distributors, and giving support to distributors when needed. The high level of standardization makes the digital service relatively easy to understand, integrate into existing systems, and implement. Thus, distributors and customers can take care of most of the activities without help from the software provider.

In the case of firms using semi-standardized -service business model, interviewees reported even ~~more-greater~~ split between activities undertaken by distributors and subsidiaries. Both took care of sales and marketing, localization/customization, and after-sales support. Semi-standardized

services required, in most cases, localization and customization, and support or training during the implementation phase. However, the distributors were able to handle these activities, following extensive training from the digital service providers.

Firms applying customized service -business model used distributors solely for marketing and sales activities purposes, whereas subsidiaries provided technical support to distributors and end-users. In some cases, subsidiaries took care of sales and marketing, but firms seemed more likely to undertake these activities from the headquarters in Finland.

## Conclusions

This study has explored the connection between digital service providers' internationalization strategies and business models. While the Finnish digital service providers used very similar foreign entry modes, in the mid-~~dle~~-range of the I-model, the roles and tasks of the foreign entry modes varied considerably based on the type of the software provided. Hence, the business models applied are clearly related to the firm's foreign entry mode strategy, ~~driving-dictating~~ what types of activities distributors and subsidiaries are able to undertake in foreign markets.

These results contribute to the business model literature by demonstrating the interplay between business model and firms' approach to accessing international markets. Although previous literature in the field has shown how the business models are related to product and service development (Nambisan 2001; Cusumano 2008) and marketing (Alajoutsijärvi et al. 2000), the connection between business model and strategies related to foreign entry mode has not received much attention.

Further, this study reveals the importance of developing a deep understanding of the nature of the firm's business model when considering potential entry mode strategies. This is particularly important in the context of digital service providers seeking to internationalize, as demonstrated by the case firms. While the entry mode choices of digital service providers have attracted some interest among IB scholars (Brouthers et al. 1996; McNaughton 1996; Ojala and Tyrväinen 2006; Ojala 2008), previous studies have not focused on the nature of the firms' digital service; the results of this study demonstrate that a more nuanced understanding of international strategy, especially for digital services firms, demands such a consideration. In addition, this study responds to the call for more studies to investigate how firms make use of and develop their entry mode strategies beyond their first entry into a foreign market (Canabal and White 2008).

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