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Strategy competence: a successful approach to international market entry

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Abstract *This article presents a study of the link between strategy competence and performance in the context of international market entry. The concept of strategy competence encompasses international market entry and business relatedness. It is assumed that efforts of a firm to establish a business in a market where the firm encounters limited entry barriers, and where the local business belongs to the corporate core, lead to high performance in the local business. The empirical findings are based on a study of 173 Swedish ventures in Germany and indicate that limited customer access problems lead to high performance. At the same time, high relatedness between the core business and the local business, in terms of similar requirements for management skills and similar brand recognition, leads to high performance of the local business. In light of the findings, management would be well advised to leverage key management skills such as brand management from the core to the local business and to continuously evaluate ways to achieve customer access.*

Introduction

The question of what drives the performance of a firm is a central issue in contemporary research on international strategy that applies the resource-based view of strategy (see, for example, Barney, 2001; Farjoun, 1998). In earlier publications (Pehrsson, 2000, 2001) I have proposed that strategy competence is a key driver of performance. The term "strategy competence" is composed of two dimensions: the international market experience of the firm; and relatedness among the businesses of the firm. International market experience is manifest, for example, in a firm's perceptions of local entry barriers. Awareness of entry barriers is certainly practically crucial as this to a large extent decides the freedom of action of the firm. As regards business relatedness, the exploitation of similarities has been singled out as a major determinant of performance (e.g. Palich *et al.*, 2000).

In light of the proposition, it is pertinent to assume that efforts to establish a local business where the firm encounters limited market entry barriers, and where the local business is highly related to the core business of a firm, are likely to lead to high performance. But will an empirical study of management perceptions detect differences between low and high performing firms and, thus, establish the relationship? Answers to this question will contribute to our body of knowledge on what really drives sustainable competitive advantage and performance.

The purpose of the study presented in this article is, thus, to explore the relationship between strategy competence and the performance of the firm's local business.

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Perceptual data were obtained from 173 ventures of Swedish manufacturing firms operating in the German market and statistical techniques were applied to detect significant relationships. The article presents the research design, a discussion of the findings, conclusions and implications.

The concept of strategy competence

Strategy competence is a central driver of firm performance (Pehrsson, 2000, 2001). The concept is primarily an outgrowth of the resource-based view of strategy (e.g. Barney, 1991, 2001; Grant, 1991). In this view, resources essentially are said to confer competitive advantage to the extent that the resources must be difficult to create, buy, substitute, or imitate (Barney, 1991; Lippman and Rumelt, 1982). In line with this, strategy competence is considered to be a crucial source of heterogeneity that enables the firm to achieve competitive advantage and generate high performance. Moreover, much recent research from the resource school has shifted from focusing on tangible assets as a source of competitive advantage to include intangible assets, such as competence and experience. No matter what asset is the focus, the rationale is that key resource advantages lead to high performance.

International market experience and business relatedness

The concept of strategy competence comprises an international market experience dimension. High familiarity with international market conditions particularly strengthens the competence and the possibility of finding sustainable positions in local markets. Local market conditions may be specified by aspects such as market entry barriers (e.g. Porter, 1980; Robinson and McDougall, 2001), the behaviour of competitors in the market (Bengtsson, 1998; Pehrsson, 1990), consumer behaviour in the market (Rumbo, 2002), and local preferences for technology and choice of suppliers (Makadok, 1998; Pehrsson, 1985). Familiarity with international market conditions might be acquired through any sequence of market entry or any way of searching knowledge on the conditions external to the firm.

Besides international market experience, the overall strategy competence for a particular firm is due to the position of its businesses in relation to the core business of the corporation. This is manifest in the *business relatedness* dimension of the concept. It means, for example, that high relatedness enables accumulation of related and relatively homogeneous knowledge on products and markets, and that efforts to establish a business that belongs to the corporate core business hypothetically possess strong potential for success (Palich *et al.*, 2000; Rumelt, 1982). The opposite is valid for a unit less related to the core.

Rumelt's "related-core" term relies on the definition of a core competence which comprises the core business. Here, core competences are meant to be: the collective learning within the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies; the organization of work and the delivery of value to the customers; and a guide to patterns of diversification and market entry (Prahalad and Hamel, 1990). In general, at least three tests can be applied to identify core competences of a company. First, a core competence provides potential access to a wide variety of markets. Second, a core competence should make a significant contribution to the perceived customer benefits of the end product. Finally, a core competence is the kind of competence that is difficult for competitors to imitate.

Market entry barriers and associated relatedness issues

The match between a firm's perceptions of barriers to entering local markets and associated relatedness issues is a central feature of the strategy competence concept. The reason is that the exploitation of advantages stemming from the relatedness between the core business and the local business is a central way to overcome the barriers. If we pay attention to incumbents in local markets, much of their competitive strategy focuses on how to create and sustain barriers that make it difficult for new entrants to succeed (Marsh, 1998). A strategy that promotes the development of proprietary knowledge or brand loyalty or that controls sources of supply, for example, focuses on the market factors that create barriers and the potential to generate profits. These barriers are thus of different character and importance, depending on firm perceptions. Porter (1980) discusses six major types of entry barriers that emerge from industry competition:

(1) Loyalties among buyers and sellers established previously.

(2) Customers' switching costs (any customer who wants to switch from one supplier to another faces varying costs).

(3) Access to distribution channels (available channels might not be imagineable or they may be controlled by competitors).

(4) Scale effects (the entrant may need large volumes and low costs).

(5) Extensive need for resources (e.g. management capacity and capital) in order to be firmly established.

(6) Important costs independent of scale.

As Table I shows, I recognize these barriers and underscore the fact that costs of local technology adaptation is an important local entry barrier that is independent of scale. I refer to existing loyalties, switching costs and distribution difficulties as "customer access problems". Moreover, I think it is crucial to realize that entrants perceive barriers and also to consider how entrants' capabilities allow them to reduce the barriers they face. Entrance barriers, in fact, are perceived differently from company to company and from one individual to another (Pehrsson, 1985, 1990).

Table I illustrates my view that each barrier is associated with certain issues concerning the relatedness between the core business and the local business. To start with, any decision on technology adaptation would be matched to customer

Key local entry barriers	Relatedness issues
Technology needs to be locally adapted	Are customer requirements familiar? Are products designed as the core products? Can technical core skills be leveraged?
Customer access problems: Existing loyalties are too extensive Customers' switching costs are too high Distribution channels are occupied	Are end customer types the same as for the core? Is local brand recognition similar to core recognition?
Large volumes and low costs	Is the pricing policy the same as for the core?
Extensive need for resources to get established (management capacity and capital)	Can management core skills be leveraged?

Table I.
Local entry barriers and issues of relatedness

requirements. If these are familiar, then knowledge from the core business might be leveraged to the local business. Further, any similarities in product design would encourage the exploitation of relatedness advantages. This approach is also valid for the intangible resource of technical core skills (Farjoun, 1998) such as knowledge of designing key components that are central to the core business.

Perceived customer access problems would most probably be limited if the local end customer types are familiar, implying that previously accumulated knowledge on customer access might be exploited. This also applies to brand recognition: Keller (1998) and Tsai (2000) convincingly argue that brand recognition represents customers' associations with the brand, including customer loyalty. That is, if similarity in brand recognition between the core business and the local business is achieved, then relatedness advantages would be captured on the basis of the intangible brand resource.

A local need for large volumes and low costs may be efficiently treated if the pricing policy is similar to the core business policy. There are, in essence, two alternative ways of treating this barrier: either the firm faces the low cost competitors by reducing its own prices, or the firm differentiates itself (Porter, 1980), offering higher prices and putting forward other competitive advantages.

Finally, the leverage of management core skills, such as general management skills and brand management skills, is a way to overcome an extensive need for management capacity in order to be firmly established in the local market. Variants of managerial skills have, in fact, commonly been applied as intangible resource attributes of business relatedness (Farjoun, 1998; Ilinitch and Zeithaml, 1995; Sharma, 1998). In particular, Farjoun found in his empirical study that management core skills seem to be particularly important in the context of relatedness.

Strategy competence and international market entry: some hypotheses

The underlying assumption of this article is that strategy competence is a key driver of firm performance. In this section of the article, two hypotheses are put forward regarding links between strategy competence and performance in international contexts.

Market entry barriers and performance of the local business

Familiarity with local market conditions strengthens strategy competence and, hence, the possibility of finding sustainable competitive advantages in the market in question. However, one of the most serious tensions in strategy research is the debate about this sustainability. Within the resource-based view of strategy, several authors have focused on articulating the necessary conditions for achieving this goal of sustainability (e.g. Barney, 1997). But is it, for example, possible for a firm to create sustainable advantages through its decision about when to enter a market?

An extensive empirical literature attempts to measure the magnitude of first-mover and early-mover advantages (see, for example, Lambkin, 1992; Makadok, 1998). Makadok (1998) studied the money market mutual fund industry, because it offers an ideal setting for a truly severe test of the sustainability perspective. It is a young and highly fragmented industry where new product innovations are easily imitated. If entry-order advantages are not unsustainable here, then where are they unsustainable?

The results of Makadok's (1998) study underscore the significance of familiarity with local market entry barriers. Thus, the entry-timing advantages of first- and early-movers are resistant to erosion by the entry of additional competitors in the focused industry. Once a new competitor has entered the local industry, it is difficult to match the performance of the pre-existing incumbents due to extensive customer loyalties established previously. For the new entrants this creates severe problems of access to customers. On the basis of this discussion we are now able to formulate the first hypothesis:

H1. Efforts to internationally establish a business by a firm that perceives limited barriers to local market entry lead to high performance.

Business relatedness and performance of the local business

Efforts to establish a business that is highly related to the corporate core business can be assumed to possess the best possibility of success. This is supported by previous research (e.g. Palich *et al.*, 2000) showing that firms having a strategy of growing primarily into areas that draw on some common core skill or resource generally exhibit the highest level of profitability.

But why is the related strategy superior? One reason is that the building of competence is a cumulative activity that is facilitated by concentrating it in areas of prior knowledge accumulation. For example, the competence to innovate in a particular domain follows consistent investments to develop the facilities, personnel, intellectual property, interorganizational relations, and tacit knowledge to successfully innovate in that product or technological area (Teece, 1988). This means that the knowledge stock a firm has accumulated in a technological subfield conditions its returns to research and development investments in that subfield. Therefore, it is natural to expect that strategy development related to the core business will produce superior results when research, development, and market investments are concentrated in areas of a firm's established competencies.

However, when radical environmental developments shift the basis of competition, the path-dependent nature of a firm's capabilities prevents them from responding quickly. Importantly, such observations strongly imply that a firm's technical developments do not follow sudden and unanticipated changes (Stuart and Podolny, 1996).

Current research, moreover, acknowledges multiple and interacting bases of relatedness (Farjoun, 1998; Stimpert and Duhaime, 1997) where physical and resource attributes can appropriately be employed in studying relatedness and its effects on performance. The physical base concerns apparent product characteristics, whereas the resource base pays attention to skills and other key resources. On this basis, it is pertinent to further explore both bases of relatedness, and we are now able to formulate the second hypothesis:

H2. Efforts to internationally establish a business that belongs to the corporate core business lead to high performance.

Method of the study

This section of the article presents the operationalization of the central terms, the definition of the sample for the empirical study, and the method of collecting data on which the hypotheses are tested.

Variables

Perceptual measures of market entry barriers, similarities between core businesses and local businesses, and financial performance are central to this study. The theoretical components presented in Table I define the 13 independent variables of the questionnaire (see the Appendix).

In order to capture data on perceptions of market barriers, statements are put forward which correspond to the barriers defined in Table I. Furthermore, the second hypothesis involves measurements of perceived similarities between the core business and the local business. In this study, similarities will be assessed along those product and resource attributes indicated by the relatedness issues presented in the Table I.

Financial performance dominates performance measures in strategy research (Pehrsson, 2001), and it is financial performance that is the focus of this study. Typical of this approach would be to examine indicators such as sales growth, profitabilty, earnings per share, and so forth. A broader conceptualization of performance would include emphasis on indicators of operational or organizational performance as well, i.e. non-financial performance. These measures focus on the factors of success that might lead to high financial performance.

However, there are a number of difficulties in interpreting objective performance measures. Companies, for example, frequently define such measures in different ways, and transactions within company groups constitute a source of uncertainty as regards estimations of the extent to which the performance of a single company should be regarded as "real" performance. Accordingly, it was found more appropriate in this study to consider respondents' judgements of the overall financial performance of the local businesses in relation to industry average in the market in question.

Sample and data collection

The sample comprises all the 218 Swedish manufacturing firms represented in Germany in 2003, according to The Export Directory of the Swedish Export Council. The firms were represented either by offices or subsidiaries of their own, or by other firms acting as middlemen. The reason for focusing on Swedish firms only is twofold. As these companies are generally easily accessible, it is possible to capture information for research purposes. Moreover, an investigation of companies of a single country of origin implies that management values can be expected to be relatively homogeneous. As Germany is a very important market for Swedish companies, and competition on that market is severe, it is of crucial importance for companies to be aware of market entry barriers and relatedness issues.

Given the relatively large number of firms in the sample, mail questionnaires were used in the first step of the data collection. The questionnaires were answered by the presidents of the firms, or by managers responsible for foreign operations. After a telephoned reminder a total of 173 questionnaires were completed, representing an 80 per cent response rate. An analysis of firms that did not answer indicated that they did not differ systematically from responding companies as regards character of businesses, or other relevant premises. The median turnover of the firms in 2002 was 111 million SEK, and the mean export share was 63 per cent. Furthermore, the median firm was represented in 8 countries, and had been present in Germany since 15 years. Moreover, a seminar was held with a group of managers representing the responding firms in order to further confirm the validity of the results; the results were presented and discussed, thereby yielding enhanced interpretation.

Test of hypotheses

Table II shows the data for "high performers" and "low performers" on the 13 independent variables. Ninety-three firms stated that, compared to industry average in this market, the financial performance of their German activities was very low, low, or just medium. These firms are called "low performers". Those 80 firms that demonstrated high or very high financial performance are called "high performers".

Chi-square tests showed three statistically significant differences between the two performance groups at the 95 per cent confidence level, and one at the 99 per cent level. In the two differences referring to perceived entry barriers (existing customer loyalties and availability of distribution channels), high performers demonstrate lower mean values, which is equal to limited customer access problems for high performers. As for the two differences which are valid for relatedness between the core business and the German business (similarities in brand recognition and requirements on management skills), high performers demonstrate higher mean values. This means more extensive similarities of the businesses of the high performers with regard to the resources of brand recognition and management skills.

If we now turn to the hypotheses, statistics offer indications to believe both hypotheses are right. This means that two kinds of relationships between strategy competence and performance apply to the study sample:

(1) Efforts to internationally establish a business by a firm that perceives limited customer access problems in the local market lead to high performance.

Variables	Low performers ($n = 93$) Means	SD	High performers ($n = 80$) Means	SD
Perceived entry barriers				
Local technology adaptations	2.66	1.46	2.59	1.44
Customer loyalties*	3.65	1.29	3.21	1.24
Switching costs	3.48	1.14	3.38	1.11
Channels occupied*	3.01	1.22	2.65	1.31
Scale effects	3.15	1.28	2.75	1.33
Resource need	2.88	1.22	3.01	1.33
Business relatedness				
Customer requirements	4.39	0.94	4.16	1.12
Products' design	4.65	0.90	4.65	0.83
Requirements on technical skills	4.30	1.10	4.28	1.07
End customer types	4.43	1.04	4.39	1.04
Brand recognition**	3.54	1.30	4.11	1.06
Pricing policy	3.80	1.25	3.84	1.24
Requirements on management skills*	3.98	1.11	4.29	1.03

Notes: * Difference is significant at the 0.05 level (two-sided); ** difference is significant at the 0.01 level (two-sided)

Table II.
Data on perceived barriers and business relatedness of high and low performers

(2) Efforts to internationally establish a business that belongs to the corporate core business, where degrees of similarities refer to brand recognition and need for management skills, lead to high performance.

Discussion of findings

We are now able to state that high strategy competence in the context of international market establishments is generally associated with high performance of the entrant business. In this statement, extensive market experience is manifested by an ability to limit customer access problems, while extensive relatedness between the firm's core business and the entrant business is manifested in high similarities concerning the intangible resources of brand recognition and management skills (Figure 1).

A closer look at characteristics of the low performers and high performers respectively reveals no systematic differences in the character of businesses, turnover, number of countries penetrated, or number of years in Germany. However, export shares differ significantly at the 95 per cent confidence level. The mean value of low performers is 59 per cent (SD = 25 per cent) and the corresponding value of the high performers is 68 per cent (SD = 21 per cent). A general experience of international operations is, hence, a reasonable explanation of success, even in Germany.

Thus, an ability to effectively approach customers seems particularly important for success, according to the findings of this study. As similarities between local brand recognition and core recognition is a central relatedness issue that may be further exploited in order to firmly overcome the customer access problems (Table I), it is reasonable to assume that high performers are able to leverage branding skills from the core to the local business. A capability of achieving close links between core competence, core products, end products, core values, and brand identity generally encourage this process of leverage (Pehrsson, 2001). Of course, it requires particular

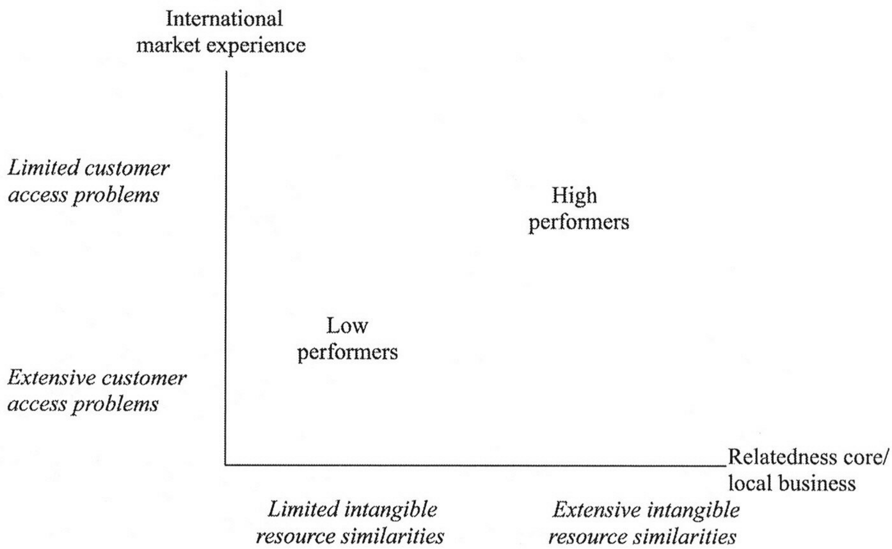

Figure 1. International market experience, relatedness and performance of market establishments

internal and external communication investments but these obviously pay off and similar brand recognition frequently turn out to be an intangible strategic asset (Markides and Williamson, 1994; Tsai, 2000) that provide valuable input into the building of sustainable competitive advantage.

Branding skills are at the centre of management skills. But why is extensive leverage of management core skills important to success? An ability to treat requirements for management which are similar as regards the core business and a local business in general benefit from a capability of management to apply routines and competences derived from the core business. This capability is, in fact, consistent with a management capability of expanding effectively and exploiting synergy (Galbraith and Kazanjian, 1986; Ilinitch and Zeithaml, 1995). The capability of applying management routines across businesses underscores the values of intangible resources, particularly at the corporate level where different businesses are treated, and management skills essentially need to be leveraged. However, as Ilinitch and Zeithaml implicitly emphasize, achieving a related-core portfolio of a corporation may prove more difficult and time-consuming than changing business level strategies, because it generally involves rebalancing the existing business mix. Managerial relatedness is, thus, certainly a key resource that is difficult to create, buy, substitute, or imitate (Barney, 1991; Lippman and Rumelt, 1982), and is therefore a basis for sustainable competitive advantage.

Concluding remarks

On the basis of the findings of this study, it is pertinent to state that efforts of a firm to internationally establish a business where the firm has an ability to efficiently reach customers and to leverage key management skills, including brand management skills, are likely to lead to high performance. In light of this, we can now add to the body of strategy knowledge that strategy competence is a key resource driving sustainable competitive advantage and performance. This means that a firm's competitiveness and performance is largely a function of the firm's pace, efficiency, and the extent to which strategy competence is acquired.

However, there is a need to further test the significance of strategy competence in the context of market establishments conducted by other firms operating in other countries. There is also a need to specifically explore the learning process involved in the perceptions of entry barriers, and the capability of taking actions based on the perceptions.

As the possibility of becoming firmly established in a market to such a large extent relies on possessing the relevant strategy competence, management would be well advised to focus on acquiring this intangible resource. Building strategy competence, thus, requires a focus on managerial relatedness and a drive towards exploiting management skills and leveraging routines that are applied in the core business. The chances of reaching high performance in the local business will also increase if the need for investments in market communication is taken seriously, and where there is an explicit ambition to achieve similarity in brand recognition through efficient brand management. This implies that the international firm has to evaluate the difficult question of balancing standardization and adaptation of communication messages between different markets in relation to the internal process of brand building, covering links among core competence, core products, end products, core values and brand identity. Anyway, an efficient branding process will facilitate the break through of existing customer loyalties and the search for appropriate distribution channels.

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Appendix. Questionnaire to top executives in Swedish manufacturing firms

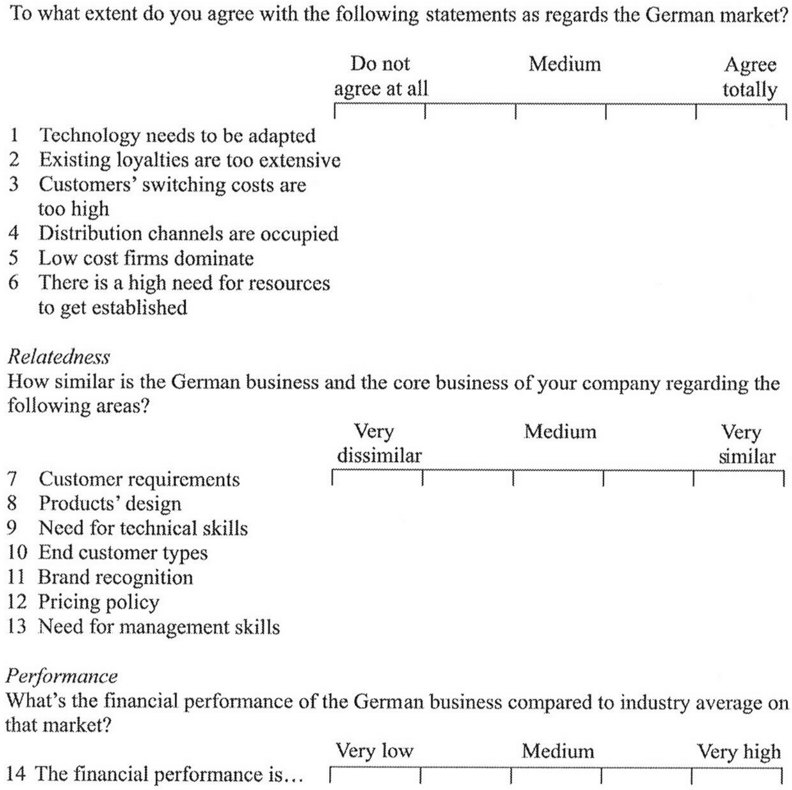

Figure A1.
Perceived entry barriers