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Role of Parent Control of International Joint Venture in Gaining Competitive Advantage

Nguyen Huu Le (Corresponding author)
University of Vaasa, Finland
PO Box 700, 65101 Vaasa, Finland
Tel: 358-6-324-5289 E-mail: nghl@uwasa.fi
Do Nhu
University of Vaasa, Finland
PO Box 700, 65101 Vaasa, Finland
Tel: 358-6-324-8257 E-mail: dtqn@uwasa.fi

Abstract

This article aims to investigate role of foreign parent control of international joint ventures (IJVs) in gaining sustainable competitive advantages from partnership with local firm through achieving 1) accesses to local firm's proprietary resources, 2) promoting knowledge and skills acquisition, 3) economies of scale and scope, 4) market position. Foreign parent firm control is conceptualized across three dimensions including the control mechanism, the control focus, and the extent of control. As foundation theories, resource dependent theory and organizational learning theory are employed. Our empirical evidence is based on the survey data collected from Finnish firms that established IJVs with local firms in the 1990s. The empirical evidence shows that in order to achieve successfully competitive advantages when entering IJVs, foreign parent firms need to have comparable IJV control structures which fit with their intended specific competitive advantages.

Keywords: Parent control, International joint ventures, Competitive advantage, Resource dependent theory, Organizational learning theory

1. Introduction

In the last decades, establishment of IJVs has become a major strategy for firms entering international markets (Ding, 1997; Duan, 2007; Dunning, 1995; Li, 2003; Meschi & Riccio, 2008). The rationale behind the formation IJVs is often related to the increasing speed of technological change and the rapidly growing competitiveness in global markets (Huaning, Colin & Barry, 2008), and to maximize profits through growth or improvement of competitive positions. Partners establish IJVs in order to diversify risks inherent in developing new technologies or to take advantage of the complementary of each partner's developmental skills (Hergert & Morris, 1988). The new partnerships can also provide essential economies of scale and market power to withstand a dominant competitor whom neither partner can challenge individually (Huaning, Colin & Barry, 2008). Such a functional classification of IJVs, however, does not say much about their competitive context. Porter and Fuller (1986) point out that coalitions represent an important strategic option in international competition. Firms in a weak position may defend themselves against dominant players through coalition (Child & Faulkner, 1998). A challenger may form an alliance to obtain necessary resources, technology, market access, or other strengths to fight again an industry leader (Porter, 1985, 1998). Despite the fact that there are many studies focus on IJV, most studies have focused on partner selection, ownership, cross cultural management, technology transfer, motives, and performance. Previous researchers suggested that the strategic motives of parent firms determine their control in IJVs (e.g. Calantone & Zhao, 2001; Chalos & O'Connor, 1998). The issue of the relationship between parent firm's motive of achieving competitive advantage through IJVs and parent control has been ignored. This study is to fill this gap. Using resources dependent theory and organizational learning as foundations theories, this study aims to discuss *how parent firms can achieve their competitive advantage through proper control of their IJVs*.

In this study, an IJV is regarded as a separate entity formed by a multinational company (MNC) or multinational companies and a local firm or local firms either through greenfield investment or partial acquisitions. According to Harrigan (1985), foreign parent firms form IJVs to generate internal benefits, competitive benefits, and strategic benefits.

The resources contributed to a partnership usually are land, equipment, labor, money, or patents. Both the contribution and withdrawal of resources are explicit and thus relatively simple to control. In contrast, competencies are fundamentally information based invisible assets (Itami, 1987) that cannot be readily purchased and their market value

is difficult to ascertain such as management and organizational skills, knowledge of the market, or technological capability. Invisible assets are embodied in people within the organization. These assets represent a tacit knowledge that is difficult to understand and that can only be appropriated over time, if at all (Teece, 1986).

This study focuses on how parent firms can achieve competitive advantages such as gaining *skills*, *assesses* from local firms, achieve *economies of scale and scope*, and *market position* when entering into IJVs because these gains are seen as the foundation for a sustainable competitive advantage (Aaker, 1988; Day, 1990; Dunning, 1995; Porter, 1985). In the following sections, we conceptualize the IJV control. Then, we elaborate foundation theories for our analysis. After that we analyze how parent firms can achieve competitive advantages through exercising proper control over their IJVs. We conclude the study by pointing out the implications for researchers and managers, and indicate some opportunities for future research.

2. Conceptualization of IJV control

In the organizational literature, management control means the process by which an organization influences its members and units to work in ways that meet the organizational objectives (Glaister & Buckley, 1998). According to Child et al. (2005: 15), control is a central aspect of management, and essential in any system that holds managers accountable for their actions and decisions. The main purpose of control is to attain predictability and critical information on IJV operation through some regulatory means (Makhija & Ganesh, 1997), and thus to safeguard the parent firm's interests. In the present study, the control of IJVs is defined as the influence of the foreign parent firms on the operations of the IJVs (Ding, 1997). Furthermore, researchers have acknowledged that control systems are complex and multidimension (see e.g Das & Teng, 1998; Geringer & Hebert, 1989; Lu & Hebert, 2005). Unfortunately, existing research tends to focus on only one dimension. To be able to capture the dynamic nature of IJV and conduct IJV control research thoroughly, this study adopts the multidimensional approach of control (mechanism, focus, and extent) advocated by Geringer and Hebert's (1989). In this section, these control dimensions are elaborated upon.

2.1 Control mechanisms

Control mechanisms are structural arrangements deployed to determine and influence what an organization's members do (Geringer & Hebert, 1989). Control mechanisms consist of a variety of mechanisms including formal and social controls that are available for firms exercising effective control to protect their interests in IJVs (Geringer &Hebert, 1989; Groot & Merchant, 2000). *Formal control* depends on hierarchies, standards, codified rules, procedures, goals, and regulations that specify desirable *patterns of behavior* (Das & Teng, 1998) aimed directly at protecting the assets of parent firms (Fryxell et al., 2002). Formal control mechanisms help to decrease the potential for opportunisms by controlling the assets through hierarchical means (Mjoen & Tallman, 1997). *Social control* is designed to promote expectations and mutual commitments through which the IJV managers learn to share the common attitudes and knowledge of the parent organization. Social control refers to mechanisms such as personal relations, informal communication, information exchange and training, mentoring, and development of a common organizational culture that foster shared values and norms without explicitly restricting the behavior of the targeted people by those social controls (Schaan, 1983; Das & Teng, 1998; Fryxell et al., 2002).

2.2 Control focus

Regarding the control focus, partners can choose to have a *broad control* focus and attempt to exercise control over the entire range of the IJV's activity, or they can have a *narrow control* that focuses on only one or two areas in IJV activities which they consider the most critical (Geringer & Hebert, 1989; Groot & Merchant, 2000). The most critical areas in IJVs are often: 1) Marketing, sales, and distribution; 2) Procurement; 3) General management and operation; 4) Finance and accounting; 5) R & D; 6) Production and quality; and 7) Human resources (Glaister et al., 2005). Depending on factors such as the parent firm's competencies and the goals of IJV activities, parent firms may focus their control on technology-related or market related activities (Child et al., 2005).

2.3 Control extent

Control extent refers to the tightness of control which is exercised (Geringer & Hebert, 1989). Tightly controlled organizations tend to be strict with respect to their employee's punctuality, and detail oriented, and precise in operation. Tight control can be effected through any mechanism that provides a partner with a high degree of certainty that personnel in the IJV will act as the given partner wishes. According to Child et al. (2005), the tightness of control is reflected in frequent and precise reporting. Controls can be tightened by more intensive training of IJV employees in production and management techniques. These dimensions of IJV control will be used as the IJV control structure when we discuss how foreign parent firms strategies determine the IJV control structure in the following section.

3. Foundation theories

3.1 Resource dependence theory (RDT)

RDT was developed by Emerson (1963) and further progressed by Pfeffer and Salancik (1978), who proposed that control over critical resources by one organization can make other firm dependence on it. Critical resources often are

technology, management know how, global service support, local knowledge, product distribution, material procurement, and equity share (Yan & Gray, 2001). Resource dependence theory assumes that even operating in the same industry, firms are heterogeneous in terms of their resources and capabilities. In addition, in competitive environments, to survive, organizations are dependence on each other for critical resources. By controlling resources, a firm can minimize the dependence on other firms and maximize the dependence of other firms on it. (Pfeffer & Salancik, 1978)

The resource dependence theory has viewed an IJV as a combination of parent firm resources, tangible and intangible, which create competitive advantages. Resource dependence theory is appropriate for examining IJVs because parent firms use IJVs to access valuable resources that they do not own (Chen & Chen, 2003). The power that from the resources the dependent parties needed can help the other parties to negotiate for higher level of control over IJV activities (Mjoen & Tallman, 1997). In addition, Emerson (1962) argued that power is a property of social relationships. The power among partners could be balanced if each depends on other in similar manner but not necessarily in the same things. In IJVs, power is needed to reduce uncertainty in partner's behavior and expected resource contributions. Besides, if resources are not exchanged as stated in IJV contracts, then IJV performance may not be as expected. Besides, withholding information is likely to result in inappropriate resource allocations, thus threatening and futile the relationship. As a result, where there is a great the dependence between partners, there is the need for information to be freely exchange parties (Guidice, 2001). Partners in IJVs want to control and maintain uninterrupted supply of the resources and information that they can not afford or are unable to procure on their own (Pfeffer & Salancik, 1978).

Resource dependence theory has emerged as an important explanation for the persistent firm level performance by emphasizing firm's ability to create and sustain competitive advantage by acquiring defending advantageous resources positions (Leiblein, 2003). In an IJV, the existing of resources of the firm is expanded by the resources of the other parent. Resource dependence theory assumes that firms within the same industry are heterogeneous in terms of their resources and capabilities; all assets can not be bought or sold in markets; decision makers are subject to bounded rationality; and strategy is used to achieve a competitive advantage (Peteraf, 1993). The competitive advantage of a firm is the result of a strategy that utilizes its unique resources and skills. The application of resource dependence theory will, therefore, deepen our understanding of what resources parent firms prefer to control and how they control them.

3.2 Organizational learning perspective

Organizational learning perspective is important in IJV literature (Guidice, 2001). Learning or knowledge acquisition is a way to achieve competitive advantage and enhance organizational performance (Leventhal & March, 1993). Fiol and Lyles (1985: 811) defined organization learning as the development of insights, knowledge between past actions, the effectiveness of those actions and the future actions. Regarding to learning in IJVs, Child & Yan (2003) pointed out three aspects of learning including learning from experience, formation learning, and operational learning. Learning from experience is a transfer relevant knowledge from previous experience of IJVs by parent firms. Formation learning take places when parent firms seeking and negotiating terms with new partners. Operational learning is learning how to work effectively with local parent firms in subsequent operation of an IJV. (Child & Yan, 2003: 287-288). Entering to new market through IJVs, the foreign parent firms certainly spend great amount of time to learn about their local partners. In their learning process from identifying suitable partners to forming process of IJVs, the foreign parent firms face with certain international barriers to work and make IJVs success with the local parents. In sum, each theory has it own limitations and the use of one single theory in previous research about IJV control and performance has produced conflicting results. Thus an integration of multiple approaches to enhance better understanding of IJV control and firm's competitive strategy necessary (see e.g. Yan & Gray, 1994; Kogut, 2002). As Parkhe (1996: 451) states: "While each theory provides a useful lens, no theory alone is sufficient to encompass the complexity of JVs". Therefore, in the present study resource dependence theory and organizational learning theory are applied to investigate thoroughly relationship between parent control strategies in their obtaining competitive advantage.

4. Parent firm control strategies in obtaining competitive advantage

4.1 Parent control strategy in IJVs to obtain competitive advantages by gaining skills through knowledge acquisition from local firms

IJVs involve the contribution and leverage of both resources and skills. The traditional management focus is concentrated on acquiring and control visible assets. In IJVs, lack of attention to the accumulation of skill may erode the competitive advantage derived from the venture. Removing the organizational obstacles to learning by loosening control is strategic priorities of parent control and its involvement in the design and management IJVs. Narrow control is essential for learning and knowledge acquisition to take place (Inkpen & Culllen, 2004; Mona & Usha, 1997). Inkpen and Cullen (2004) point out that social controls that involve interactions between partners and personal friendship between managers create the opportunities for firms to learn about each other's skills. Lyles and Salk (1996) found that IJVs with equally shared ownership control had significantly higher levels of knowledge acquisition than majority controlled IJVs. Social control promotes inter-organizational learning by enhancing partner's trust and providing

medium through which knowledge can be transferred (Lyles, Doanh, & Barden, 2000). Makhija and Ganesh (1997) maintain that social control promotes social interactions through informal communication, team meeting, and training. Parent control, in addition, needs to focus on personnel exchange so that it can have a positive impact on the amount of accumulated knowledge.

Proposition 1: Parent firms entering into IJVs to achieve competitive advantage through gaining skills from local firms are more likely to use a narrow, social, and loose form of control over the IJV.

4.2 Parent control strategy in IJVs to obtain competitive advantage by gaining access to local firms

The primary motive for foreign parent firms forming IJV is to *gain access* to a local firm's proprietary resources including both firm-specific knowledge and country specific knowledge. Whilst, local firms may lack management know-how and technology (Luo et al., 2001), they often contribute their country specific knowledge, land, and manufacturing facilities (Killing, 1983). According to resource dependency theory, if the access that local parent firms contributing to the IJVs have is critical to the IJVs success, the local parent firms have a better position from which to negotiate for more control over IJVs (Mjoen & Tallman, 1997). Thus, they leave foreign firms less control in the IJVs. Foreign firms, as a result, acquire their control through *social control* and by concentrating their control on the areas where they contribute most to the IJVs. Thus we propose:

Proposition 2: Parent firms entering into IJVs to achieve competitive advantage by gaining access from local firms proprietary resources are more likely to use a narrow, social, and loose form of control over the IJV.

4.3 Parent control strategy in IJVs to obtain competitive advantage by gaining economics of scale and scope

Another way for a foreign parent firm to enter IJVs with local firms is to achieving competitive advantage through *gain economies of scale and scope.* For this purpose, foreign parent firms are often manufacturing firms and they just expect the local parent firms to merely supply them with cheap labor, and existing facilities such as land and/or a factory (Killing, 1983). This contribution by local parent firms can simply help to reduce the production costs of the IJVs (Kogut, 1988). For foreign parent firms entering into IJVs with this motive, the most important issue is the quality of the product of the IJV (Chalos & O'Connor, 1998). In addition, the success of a joint venture depends on the fit between the parent criteria for success and how well the parent control specific activities related to its criteria for success (Schaan, 1983). Thus, foreign parent firms may narrow down their control to focus on the quality issue of the IJVs' output. Furthermore, by focusing their control on some specific activities and loosening control over the rest of the IJV activities for local parent firms, foreign parent firms give incentives for local parent firms more chance to involve in and contribute to the activities of the IJVs. Giving up overall control and maintaining formal control in just some key areas of the IJV also helps to reduce the costs associated with excessive control. This may help to reduce the level of conflict and increase the cooperation between foreign and local parent firms. As a result, we propose:

Hypothesis 3: Foreign parent firms entering to IJVs to achieve competitive advantage by gaining economies of scale and scope are likely to exercise formal, narrow, and loose control over their IJVs.

4.4 Parent control strategy in IJVs to obtain competitive advantage by to gaining market position

As aiming for achieving market position in the countries where IJVs operate, commitment and cooperation from the local partners are more important. Because foreign parent firms are probably not familiar with local tastes and local unique customer needs. The knowledge of the host environment provided by the local partners may enable suitable adaptation; and bring advantages to the IJVs (Johnston, 2005). Previous research also points out that less control from the foreign parent firms, and more influence of the local parents, are factors necessary for better performance of IJVs (Li, 2003). This is especially important in those countries such as China where the local governments play an important role in joint venture activities (Beamish, 1993). Information about the local economy, politics, culture and business customs, consumer's demands and tastes, the labor force, infrastructure, raw materials, and other factors required for the operation of joint ventures are likely to be delegated to the local partner (Makino & Delios, 1996).

In addition, Bai, Tao, and Wu (2003) found that if the sales of the IJVs' products are mainly focused on local markets, the control of the foreign parent firms decreases with the need for local marketing knowledge of their products. This is because the IJVs in the countries like China are often a marriage of foreign technologies and local markets. In this context, the marketing expertise for local markets is often an important contribution of the local partners, while the technological sophistication is an equivalent provided by the foreign partners. Therefore, the foreign parents oriented towards the local markets are likely to exercise less control over the IJVs because the resources important to them are obtained with the help of the local partners (Calantone & Zhao, 2001). As a result, we propose:

Hypothesis 4 To achieve competitive advantage through gaining market position in the countries where IJVs operate, foreign parent firms prefer to exercise a narrow, loose, and social control over the IJVs.

5. Methodology

5.1 Method and measurement

This study adopted a survey research design to fit with the exploratory nature of the research. In the survey, the

questions about joint venture control and components of competitive advantage were collected directly from those involved in IJV operations. Furthermore, to be able to generalize conclusions about the joint venture control, a large number of IJVs is needed to be examined. This made direct interviews very costly in terms of time and money and impractical so that to achieve the desired sample size. The measure of variables is based on a 5 point-scare. Concerning control measurement, a list of different control mechanisms, focused on areas of IJV activities were provided, the respondents were asked to evaluate their control with 1= always used to 5= never used. The methodologies used in this study to analyze the data are description statistics and the Chi-square test. The purpose of the methods is to determine how well an observed set of data fits an expected set of hypotheses. These methods are used to examine the differences with categorical variables. The method is particularly useful to find out whether an IJV control structure which is made by different elements of IJV control dimensions (formal, social, broad, narrow, tight, and loose) has a normal distribution or there is particular structure forming to promote foreign parent firms to achieve competitive advantages.

5.2 Sample description

The study herein is a part of an on-going research project focusing on IJV behavior, strategies, partner selection, control structure, and performance of Finnish firms. The target firms and investments were identified as follows 1) the FDI data base collected by the project leader starting from late 1980s based on press releases regarding IJVs published on leading business magazines and newspapers and 2) annual reports and websites of the 250 largest Finnish firms from the leading magazines; 3) based on the earlier surveys focusing on IJVs and WOS by Finnish firms conducted by the project leader. From the resources, we identified 340 IJVs qualifying for our study; they were founded by 200 Finnish parent firms since 1988 and in operation at least until 2002. Among these 200 firms, several firms were very difficult to contact either because they had been restructured or gone out of business. While researching for informants, we found that in some firms there was no longer anyone with sufficient knowledge required for the study. This left a total of 161 Finnish parent firms. Given the time and cost constraints a postal questionnaire and online web survey were used to gather the data. The participants were those managers who were directly involved into the IJV's establishment and operations.

To enhance the quality of the data, the respondents were contacted by phone in December 2006 to explain the key points of the study and the questionnaires. In exchange for their participation in the study and to ensure accurate responses, the respondents were assured of their anonymity and were promised a summary report of the findings and participated in a draw for three gifts. After one reminder at the end of January 2007, at the end of February, 54 questionnaires were returned from which 5 questionnaires were not usable. Thus, the final sample was 49 IJVs including 40 Finnish parent firms. The response rate was 24.84%, which is relatively similar to that of earlier respective studies in Finland (see Larimo & Rumpunen, 2006). The sample was carefully examined for any systematic response bias using t-tests. Respondents and non respondents were compared across their age, size, international experience, and IJV experience. No statistically significant difference was found. Thus, there was not response bias to be found in the final sample. Among the 49 IJVs of the final sample, 45% were established in 1988-1995, 55% in 1996-2006; 53 % through acquisitions, 47% through greenfields, 76 % were with 2 partners and 24 % with 3 partners; 61% with indefinite duration, 22% with less than 5 years, 17 % more than 5 years; 41 % with 10%-49% Finnish ownership, 10% with equal ownership, 49 % with Finnish major ownership at establishment; 71% located in emerging economies, and 29% in developed economies; 63% with industrial products, 27 % with consumer products, 10 % with both consumer and industrial products. The summary of the operationalization of the key variables of the study is presented in the appendix.

6. Results

The empirical data has been analyzed based both on descriptive statistics and on testing statistics. The results are shown in table 1.

6.1 Parent control strategy in IJVs to obtain competitive advantage by gaining skills through knowledge acquisition from local firms

When asked to consider their intent to obtain competitive advantage in IJVs, 33 respondents mentioned that they intent to gain skills through knowledge acquisition from local firms. Of these 33 responses, almost 76% of the companies concerned exercised social control, and about 69% were found to exercise narrow and loose control over their IJVs. In addition, based on the chi-square test, x^2= 13.15 the result was significant at $p<0.05$ (df=5) (see table 1.). Thus, the results support hypothesis 1 by both description statistics and chi-square test.

6.2 Parent control strategy in IJVs to obtain competitive advantage by gaining access to local firms

Of 49 respondents, 18 mentioned their main strategic motive in entering to IJVs to obtain competitive advantage by gaining access to local firms. Of these 18 respondents, almost 90% exercised narrow control, over 80% exercised loose control, and almost 80% exercised social control over their IJVs. In addition, table 1 shows statistically positive relation between this gaining access strategy and narrow, social, and loose control structures. Thus, the result supports the hypothesis 2.

6.3 Parent control strategy in IJVs to obtain competitive advantage by gaining economics of scale and scope

There were 31 firms who mentioned their intention of entering IJVs to obtain competitive advantage by gaining economies of scale and scope. Of these 31 firms, more than 80% of foreign parent firms used formal control, and about 70 % of parent firms used narrow and loose control with their IJVs. Table 1 also shows statistically positive relation between foreign parent firms' intention to gain economies of scale and scope in IJVs and their control structure: narrow, formal, and loose control. Thus, the result supports hypothesis 3.

6.4 Parent control strategy in IJVs to obtain competitive advantage by to gaining market position,

There were 23 respondents mentioned their focus on is to gain market position in local partners' markets. Among these, 19 (82%) exercised formal control, 16 (70%) employed narrow control, and 14 (61%) used loose control in their IJVs. Based on the chi-square test, x^2= 15.74 the result was significant at $p<0.01$ (df=5) (see table 1.). Thus, the results support hypothesis 4 by both description statistics and chi-square test.

Insert Table 1 Here

7. Conclusion

The present study offers a valuable insight into how to achieve competitive advantages through the use of proper control structure by the foreign firms. The presented set of hypotheses may prove very useful, since the ability to adapt control strategy of parent firms toward subsidiary task, strategic motive: the creation of their competitive advantages has become critical (Chalos & O'Connor, 1998; Feldman, 2004; Govindarajan & Fisher, 1990; Johnston, 2005). The aim of this study was to find out *how parent firms configure the control structure in their IJVs to gain competitive advantage.*

The results show that to achieve competitive advantages through IJVs, foreign parent firms need to narrow down and loosen their control to some key areas of IJV operations such as human resources control, effective communication control. In addition parent strategic control agenda for IJVs must be centered on the process of learning and acquiring new skills and resources. In cases of aiming to achieving competitive advantages through accessing local firm ´s resources, and to acquiring local skills and knowledge, foreign parent need to exercise social control mechanisms over their IJVs. In contrast, in cases of aiming to achieving competitive advantage through gaining economies of scale and scope, and through gaining market position, foreign parent firms need to exercise formal control mechanisms over their IJVs. The present study concludes that, in order to achieve successfully competitive advantages such as acquiring new skills, accesses to local firms resources, gaining economies of scales and scope, and gaining market position in foreign countries, the foreign parent firms need to have comparable IJV control structures that fit with their intended competitive advantages that they want to achieve when entering IJVs. This study is believed to contribute significantly to IJV theory since it is the first to attempt to link parent firms control and competitive advantages obtaining. Or in other words, this study is the first to examine how parent firm can realize their competitive advantages through exercising proper control structures over their IJVs.

We also acknowledge several limitations to our study. First, the sample size of the study is rather small and only from Finnish IJVs. For further studies, researchers could use the framework of the present work with a bigger sample size and foreign parent firms from several countries. In addition, because IJVs evolve overtime, further studies are also needed to investigate the dynamic of the parent control over IJVs to achieve competitive advantages along the IJV's life cycle. Furthermore, qualitative study such as case study which allows researchers to investigate the issue more deeply insight is great of interest. Finally, when discuss about the control of IJVs, the present study exclude the role of local firms. However, control of IJVs is an agreement between foreign firms and local firms, thus future study may include the role of local firm control of IJVs in creation of competitive advantages.

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Table 1. The results of the study based on the chi-square test

Hypotheses		X^2	**DF**	**Results**
Competitive advantage component	**Control structure**			
H1 Accesses to local resources	Narrow, Social, Loose	13.15	5	significant at 0.05
H2 Acquiring local knowledge	Narrow, Social, Loose	17.73	5	Significant at 0.01
H3 Economies of scale & scope	Narrow, Formal, Loose	12.70	5	significant at 0.05
H4 Market position	Narrow, Formal, Loose	15.74	5	Significant ar 0.01