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Reshaping Our Understanding of Unrelated Diversification Strategies:
Lessons from Small Entrepreneurial Ventures in the Agri-Tourism Industry

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ABSTRACT: This paper draws upon a cased-based empirical study that examined the success of small wineries that have pursued growth options that combined manufacturing (wine production) and service (lodging). Twenty-six case studies have been completed to date. Contrary to what the extant strategy literature predicts, this innovative combination of unrelated industries is achieving significant success and growth. We highlight the numerous management actions taken to achieve integration success and provide data and pattern analysis. We combine this with comments from the owner/managers to suggest future management research opportunities as it pertains to small, entrepreneurial oriented firms and their respective growth options.

Keywords: New management approaches; innovation and change

INTRODUCTION AND SCOPE

Through an empirical examination of twenty six firms that have combined on site wine production with tourist lodging, we examine how these disparate and largely resource-independent units can be managed and integrated to achieve a synergy. As a consequence, these firms simultaneously achieve higher product sales and customer brand loyalty for the manufacturing outputs and a superior service experience on the service side. Corporate strategy researchers would classify such a firm’s strategy as pursuing unrelated diversification – a strategy that is almost universally considered in the extant literature as likely to underperform or fail. Our empirical research challenges this received wisdom.

Our work does, however, indicate significant challenges to achieving success, including the need for multiple integrating mechanisms and the ultimate creation of a “hybrid” firm identity that is neither well understood nor well researched in the corporate strategy domain. Our work also provides empirical evidence that extends Cohen and Zysman’s (1987) concept that “manufacturing matters”, even in a post-industrial society (Bell 1973), through “tight linkages” (Cohen and Zysman 1987, p. 16). We find that these “tight linkages” do not exist in their own right but, rather, are actively and purposefully created and managed to achieve a synergistic purpose.
This is an exploratory study. We use a case study approach that examines the planned, purposeful development and integrating mechanisms for a combined winery operation (manufacturing – wine producer SIC 2084) and resort accommodation (service – lodging SIC 7011). Contrary to normative expectations, a few firms are experimenting with a novel approach of leveraging off each separate strategic business unit to create unique and distinctive customer experiences and to enhance product sales through a combined winery/lodging entity. Twenty six very specific locations were identified and visited to assess the wine production facility (volumes, prices, development timelines and growth) and the lodging component (number of rooms, prices, physical evidence, development timelines and growth). Sites were located in Canada (British Columbia and Ontario) and the United States (Oregon, Washington State and California). Future research (prior to the ANZAM Conference) will include similar wine and lodging combinations located in France and Spain to provide an “old world winery” versus “new world winery” comparison. While not a large number, use of this new model of wine/agri tourism” is growing rapidly with additional wine and lodging combinations known to be in the active planning and expansion stages. The general concept also has significant potential extensions beyond our “wine tourism” focus.

Research data gathered included historical records and timelines, photos, experiential site visits and interviews with managers and customers using standardized protocols. The scale of operation, both in terms of guest rooms and wine production, varied dramatically across the sites. Likewise, the relative financial importance of wine and lodging within each firm varied dramatically as did efforts to integrate the business units. And the path that each firm followed in development of the lodging facility and winery operation varied. Nonetheless, common patterns emerged, integrating mechanisms were documented and propositions for future research were derived. Given the firm sizes, the results and conclusions may be most germane for our understanding of how small firms can compete effectively in a competitive environment by successfully bridging the domain between service and manufacturing.

The paper is structured as follows. First, we review the extant literature from a Corporate Strategy perspective. We then detail the research approach and summarize the data derived from the field
visits. We then extract commonalities and patterns that point to a number of conclusions, suggestions and propositions for a more generalized research approach. Finally, we explore the study’s research and managerial implications including the need for alternative views of what unrelated diversification means in a service based economy.

CORPORATE STRATEGY AND DIVERSIFICATION

The strategy literature in diversification has a long and rich history (Wrigley 1970; Rumelt 1974) and provides a useful context for our study as it illuminates why we were so intrigued by our field observations of an emerging trend in the winery and lodging sector. Much has been written in Corporate Strategy on the relative success and failure of related versus unrelated diversification (Bettis 1981; Dobrev 2007; Galan and Sanchez-Bueno 2009; Gary 2005; Goranova et al 2007; Grant 1996; Hodgkinson and Healey 2011; Kor and Leblebici 2005; Markides and Williamson 1994; Pehrsson 2006; Peteraf and Shanley 1997; Rawley 2010; Robins and Wiersema 1995, 2003; Rumelt 1974, Tanriverdi and Venkatraman 2005; Wrigley 1970; Zhou 2011) as well as how diversification is managed over time (Helfat and Eisenhardt 2004). Three dominant theories drive this research: transaction cost economics (TCE) (e.g. Williamson 1981, 1992, 2002), resource based views (RBV) (e.g. Prahalad and Hamel 1990) and knowledge based competition (e.g. Grant 1996).

From an overall perspective, Palich et al.’s (2000) meta analysis reviewed over 55 studies on diversification that were quantitatively based and concluded that the inverted U shape for the diversification-performance linkage was clearly evident but cautioned that most prior studies have generally failed to control for firm size and industry effects, such as industry concentration (Montgomery 1979), which might mask true relationships.

To address a potential gap in prior studies, specifically the root causes of diversification inefficiencies, Rawley (2010) examined related diversification in the taxicab and limousine service industry subsequent to legal changes in 1993 that made joint ownership of such firms in the United States feasible. The change in the legal environment allowed firms to jointly manage bookings, auto and fleet purchases, licensing costs and driver assignments to provide transportation service that was
“qualitatively” similar (p.877) but differentiated by price. The legislative change also permitted the 
author to use an event study approach. The author concludes that there are significant productivity 
debates from following a diversification strategy as a consequence of organizational rigidities. New 
diversified entrants fare better as these rigidities do not exist a priori, although these firms still
significantly underperform the purists.

An equally divisive issue in the strategy domain relates to measures of diversification - what defines 
related and unrelated diversification and who is best positioned to judge what represents the degree of 
diversification. By far the most common objective (external) measure has its roots in the Herfindahl, 
Berry-Herfindahl and Entropy index of diversification, approaches that, in one form or the other, 
utilize SIC codes and relative sales in each business category (Van Kranenburg et al 2004). Studies
that compare and contrast firms within a narrowly defined range of SIC codes tend to provide clearer 
results (St. John and Harrison 1999). But there is by no means universal acceptance of these
“objective” measures, both from a content validity perspective (Robins and Wiersema 2003; Bryce 
and Winter 2009) and from those in the resource and knowledge based strategy camps. Many
researchers argue that, since strategy execution is a key element in success, there is a difference 
between “potential” diversification, as evaluated using external objective measures, and “actual” 
(subjective and achieved) diversification as viewed and implemented by the firm’s managers.

The difference in researcher views, as summarized by Nayyar (1992), continues to this day. For 
example, Rumelt’s original groundbreaking work focused on similarities between products, markets
and technologies as the basis for assessing diversification strategy and relatedness, an approach that
was subsequently verified as being highly consistent with the SIC code measures. More recently, 
Pehrsson’s (2006) study attempted to measure the degree of relatedness using three key factors
associated with perceived relatedness (Stimpert and Duhaime 1997) including: product-market
attributes (Miller 1987), resource attributes (Lemelin 1982) and value chain attributes (St. John and
Harrison 1999, Tsai (2000). Product-market attributes include competitors, product use, product
 design, product technology, and end customer types. Resource attributes include management,
technical and administrative skills as well as market knowledge and brand identity. Value chain
attributes include commonalities in supply and sales channel types as well as after sales service and suppliers. Pehrsson surveyed 124 Swedish manufacturing firms to gauge the manager’s self reported views of their business units’ relatedness along the three major dimensions. Interestingly, the author excluded service firms from the study as the author anticipated that “relatedness in service firms may manifest itself along other dimensions” and “that it is not appropriate to evaluate, for example, similarities pertaining to value chains” for service firms (p.269).

Neffke and Henning’s (2013) recent study of skill relatedness and inter-industry employment flows, even though it is single mindedly focused on labour and skill level transferability between industries, does suggest that the old classification system as a basis for measuring diversification may be misleading. Tanriverdi and Venkatraman (2005) point to some significant challenges associated with the operationalization of resource relatedness and suggest that focusing on inter-industry technology flows and occupational profiles, while an improvement on previous measures, still fails to fully address, at the firm level, the more subtle but perhaps more important concept of knowledge relatedness. They also point out that prior studies have almost exclusively been conducted in the manufacturing sector and caution that applicability in the service sector is questionable. The authors surveyed Fortune 1000 firms with a healthy balance of respondents from the manufacturing and service sectors. Focusing exclusively on self reported “knowledge relatedness”, the authors conclude that product knowledge, customer knowledge and managerial knowledge can provide a useful basis for assessing the overall degree of diversification relatedness at the firm level and that such a measurement approach may be more robust, offering the potential for use in both manufacturing and service sectors.

In summary, there are several constant themes from the extensive extant research on diversification.

1. Regardless of how it is measured, unrelated diversification is an unwise strategy to follow, as an inverted U shaped diversification-performance link is consistently demonstrated.
2. The conclusions from prior studies, which almost universally rely on publicly available large firm financial data, may not apply to smaller firms where “general” managers and enhanced and informal communication flows may be more prevalent.

3. The applicability of measures and findings to service settings may be somewhat limited and certainly hasn’t been exhaustively researched.

4. While St. John and Harrison (1999) focused on tight linkages between manufacturing business units (e.g. resource and activity similarities), there are no known studies that specifically look at diversification that combines service and manufacturing business units.

Contrary to the extant strategy literature and normative expectations, we have observed an emerging, growing and successful trend in the wine industry that combines a service firm (tourist lodging - SIC 7011) and a manufacturing firm (wine producer - SIC 2084) to achieve synergistic objectives. Initially, we were intrigued by several locally based diversification examples and our interest was heightened as we expanded our search horizons to find this trend to be much broader based geographically. While wineries have been routinely known to add tasting rooms for product sampling, there is a growing trend to add on-site lodging (e.g. inns, villas, guest suites, etc.) as part of an innovative approach to growth. Our interest was in exploring these anomalies of unrelated diversification to better understand how these firms successfully integrated their business units.

Having reviewed the corporate strategy diversification literature, we conclude that there is almost no established and recognizable common basis for “marrying” these two businesses. Apart from being co-located, the skill set and expertise, knowledge, technology, processes, marketing channels, products, distribution systems and components of success for a winery and for a lodge are fundamentally different. One business is quite capital and technology intensive, involves a good deal of science (oenology) and results in a physical product as the output that can be inventoried and shipped. The other is very much a high contact service which is labour intensive and delivers a customer service experience (Pine and Gilmore 1999, 2007). And from an academic perspective, differences in SIC codes have been used extensively in prior research as a gauge of such relatedness.
(e.g. Robins and Wiersema 1995, 2003; Rawley 2010; Goranova 2007) while others have used psychometric data to measure product knowledge relatedness, customer knowledge relatedness and managerial knowledge relatedness (e.g. Tanriverdi and Venkatraman 2005). Whether we use a perspective grounded in reality, the Herfindahl entropy measure, SIC codes or perceived measures of relatedness, these two industries are dramatically different from each other and readily qualify as “unrelated”.

These industries are extremely important in North American economies. Recent figures indicate the lodging industry in the U.S. consists of over 52,000 hotels with room revenues exceeding $42 billion. And there are over 7,000 wineries in the U.S. representing direct production value in excess of $14 billion. The combined total of these two industries are financially significant and growing. Most industry participants, however, have operated as separate entities trying to achieve financial and corporate success in an extremely competitive and crowded arena. A few, however, are experimenting with a novel approach of leveraging off each strategic business unit to create unique and distinctive customer experiences and to enhance product sales, combining the winery and the lodging offerings into a single and, to varying degrees, integrated entity.

Twenty six very specific locations were identified and visited to assess the wine production facility (volumes, prices, development timelines and growth strategy) and the lodging component (number of rooms, prices, physical evidence, development timelines and growth strategies). Sites were located in Canada (British Columbia and Ontario) and the United States (Oregon, Washington State and California). Additionally, this new model of “wine tourism” is growing rapidly and there are a number of additional wine and lodging combinations known to be in the active planning stages or with expansion plans in place for existing operations, as was the case at two of the sites visited. We are also aware of many more such examples in other regions of the world (e.g. other US States, Australasia and Europe).

We chose this combination of wine and lodging as an example of unrelated diversification and integration principally because of convenience (our home region is a principal wine growing region in
the country) and a growing sense that wine production is increasingly being associated with wine/agri
tourism as an expanded destination marketing approach. This is partly a matter of necessity – small
wineries face significant challenges in terms of a sustainable business model: suitable vineyard land is
increasingly expensive, there are significant capital expenditures involved in the wine making process
and wine differentiation is challenging. From the winery perspective, most firms in the business have
introduced wine tasting (product sampling), wine clubs and shipping service (ease of purchase) and,
increasingly, on-site restaurants as a marketing mechanism for wine and food pairing (wine
appreciation). However, a very select few have chosen to introduce accommodation as part of the
service experience, using the winery as a mechanism to sell more “room nights” in the hotel/inn and
to have the hotel lodging experience drive interest in the winery and, ultimately, the purchase of more
wine in the long term.

The research is considered exploratory as we are examining empirical examples that conflict with the
received wisdom on diversification strategy (Eisenhardt 1989). In order to achieve the necessary
degree of understanding and given the reasonable geographical convenience and number of sites, we
chose a case study approach. Our objective was to identify those firms that had pursued this specific
combination, to visit the site for experiential purpose, and to interview the owner/visionary founder to
gain a better understanding of how and why the decision was made, what key challenges were faced
and, of particular importance, what mechanisms are employed to achieve integration and synergy
between the two distinct operations. Likewise, we discussed with customers their impressions of and
satisfaction with the service experience, with a particular focus on the degree to which the winery and
lodging components had been synthesized into a memorable experience.

RESULTS

Research data gathered included historical records and timelines, photos, experiential site visits and
interviews with managers and customers using standardized protocols. The scale of operation, both in
terms of guest rooms and wine production, varied dramatically across the twenty six sites. Likewise,
the relative financial importance of wine and lodging within each firm, a measure in the strategy
literature considered as a key indicator of relative business unit importance and also used as a measure
of the degree of diversification, varied dramatically. And the path that each firm followed in development of the lodging facility and winery operation varied. Most often, the wine and winery were the starting points but there were examples of both the inn being the starting point as well as concurrent development. Nonetheless, common patterns emerged, integrating mechanisms were compiled and propositions for future research were derived. There were enough cases that the phenomena became somewhat predictable and theoretical saturation was achieved (Glaser and Strauss 1967). For our analysis, four sites were eliminated because the wine production facility was not co-located with the lodging facility and therefore did not represent an appropriate sample.

Our on site analysis revealed the use of a number of integrating mechanisms that were used to build linkages between the separate business units (e.g. tours, visible cues, plant centrality, special privileges, landscaping). Each firm’s integration efforts were rated based on a composite score of three components: winery site location (1= remote, 3=central), integrating mechanism usage (1=infrequent, 3= numerous) and cross promotional efforts (1=limited, 3=extensive). Composite scores could vary, therefore, between 3 and 9. And increased integration efforts yielded positive financial outcomes. As one owner put it, “there is a very high degree of correspondence between occupancy rates in the lodge and case sales at our winery” while another mentioned that wine inventory was depleted every year through loyal on-line sales to previous lodging visitors. .

We used the composite score in two ways. First, we suspected that there might be a relationship between relative financial dependency and the efforts to integrate. We used the absolute difference between the firm’s ratio of winery to lodging revenues and the value 1.0 (a ratio of 1.0 would represent a perfect balance between the two business segments). The resulting pearson correlation is -0.41, indicating that as the business revenues deviate from a perfect balance, there is a corresponding decline in the degree of integration observed. The integration scores and financial dependency ratios for each winery are shown in Table 1.

Insert Table 1 about here
The variations in the composite integration score along with interview comments were also used to explore patterns of a more subjective nature that related to relative success and failure. For example, we noted that firm size appears to have little explanatory value, the operational management of the lodging and winery components is best handled by respective experts, decentralization of the wine production facility significantly discourages customer engagement and that management commitment to integration drives the extent of integration efforts and intensity. As one owner put it “the biggest challenge is getting the hotel and restaurant staff to fully embrace the winery’s presence and value and for the winery experts to appreciate the importance of the lodging”. Nayyar (1992, p224) used a term that relationships between distinct business units need to be “actively managed” in order that integration and synergy can be achieved. Some of the most innovative examples included: hotel flooring using wine barrel pieces, creative landscaping using vines and wine barrels, rooms labeled after wine varietals, branded and wine-shaped room keys and restaurant table reservation signs in the form of bottles. Some of these integrating mechanisms can be classified as macro (e.g. location of the production plant, vineyard presentation) while others were more micro level and quite often sublime (e.g. wine label room keys, artwork using wine barrel rings). Without more detailed research to identify the relative importance of each technique, our results presented in Table 1 are based on the premise that the greater the number of integrating techniques used, the more synergy was achieved between these distinct and unrelated offerings.

Interestingly, wine quality did not even register with customers in terms of an association with integration success. While many of the firms have won winery awards at various competitions, wine quality is considered a “qualifier”, not an “order winner” (Hill 1983, 1985). The total experience is much more driven by the lodging (i.e. the place), the accessibility of the winery operation for tours, constant sensory stimulation and the efforts taken to integrate the winery and the lodging.

**CONCLUSIONS AND FUTURE RESEARCH**

The firms we visited that had successfully integrated the wine production with the tourist lodging represent a novel and innovative approach to small firm growth. Rather than operate as completely independent entities, they chose to leverage off each business unit to achieve
synergy through reduced marketing expenditures and enhanced top line revenue. To do so, they continually innovated in the use of subtle integrating mechanisms to continuously remind customers of the other part of the business. As a consequence of this continued psychological reinforcement, customers left with a lasting impression of the place and product they experienced. The end result was a greater propensity to sell out the wine production and to enjoy greater occupancy rates in the lodging facility. This successful new management practice has a number of implications for both researchers and managers of small firms seeking to grow in highly competitive environments.

As a starting point, the extant literature on unrelated diversification may need significant rethinking and refinement. Combining service firms with manufacturing firms may offer integrative opportunities that challenge well established theories that were largely based on a manufacturing dominant era. At the very least, differences in SIC codes (and its subsequent classification system of NACIS codes) may be a very misleading measure of relatedness in an advanced, service based economy. Successful diversification in smaller firms may have much more to do with simply identifying customer-oriented common interests and themes than previous used classification schema. Likewise, with few exceptions, prior models have used large firms to test relationships. Given the continued growth in the number of small firms and their importance in a post industrial service based economy (Bell 1973), we, as researchers, do a disservice to society and the academy by focusing exclusively on large corporate entities.

Specific to our current industry in wine tourism and the combination of lodging and winery operations, while we suspect that integration commitment and integrating mechanisms are of central importance, only future research would be able to verify our proposition. More detailed and controlled experimental market research is called for to identify those techniques that provide the most impact on achieving integration and those that might be somewhat
superficial. The management commitment construct may be much more complicated to assess. Based on our data, one key component that could drive integration commitment is the relative balance in financial importance of the two business units. But we also suspect that, given comments from owners interviewed, commitment may also be driven by a sense of vision. Many that we interviewed reminisced about previous great experiences in Europe and California that combined wine and place. These memories guided them to offer clientele the opportunity to experience the wine, its production and an outstanding lodging facility simultaneously. Past experiences, therefore, may be a root cause of why owners believed that such an integrated offering would be successful.

Lodging and winery features as well as accessibility (broadly defined) to the plant operations was critical for achieving integration success – sensory stimulation through the sights, sounds, and smells associated with product manufacturing leaves a very lasting and positive impression. Many of these elements fall into the category of “product design” and there is much to be learned in better understanding the link between sensory stimulation, impact on memory and subsequently repurchase decision making.

Finally, given the success of firms combing wine production and lodging, managers of other small firms might reconsider their hesitancy in combining and integrating across a variety of disparate endeavours. This is likely to be most relevant for smaller firms where a certain degree of using the “visible hand” to ensure synergy can be achieved. Much of the agri-tourism industry plays to a harmony between the place where food is produced and this could easily be combined with a number of tourist activities to make the experience more complete and memorable.
References


Table 1: Winery Integration Efforts and Relative Financial Dependency

<table>
<thead>
<tr>
<th>Winery</th>
<th>Plant (Location)</th>
<th>Sensory (Cues)</th>
<th>Marketing</th>
<th>Total Score</th>
<th>Financial Integration ratio</th>
<th>Difference From Balance</th>
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<tbody>
<tr>
<td>black walnut</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>7</td>
<td>0.23</td>
<td>0.77</td>
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<td>Per Cazo/Creekside</td>
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<td>2</td>
<td>2</td>
<td>7</td>
<td>7.56</td>
<td>6.56</td>
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<td>asuncion</td>
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<td>3</td>
<td>3</td>
<td>9</td>
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Pearson Correlation of Total Integration Score and Absolute Deviation From Balanced = -0.41