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note on the design and management of international joint ventures

Professor Paul W. Beamish wrote this note solely to provide material for class discussion. The author does not intend to provide legal, tax, accounting or other professional advice. Such advice should be obtained from a qualified professional.

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An international joint venture is a company that is owned by two or more ﬁrms of different nationalities. International joint ventures may be formed from a starting (or greenﬁeld) basis or may be the result of several established companies deciding to merge existing divisions. However they are formed, the purpose of most international joint ventures is to allow partners to pool resources and coordinate their efforts to achieve results that neither could obtain acting alone.

A broad range of strategic alliances exists. They vary widely in terms of the level of interaction and type. Most of the commentary in this reading focuses on equity joint ventures—the alliance form usually requiring the greatest level of interaction, cooperation, and investment. While the discussion that follows generally considers a two-party joint venture, it is worth noting that many joint ventures have three or more partners.

Joint ventures have moved from being a way to enter foreign markets of peripheral interest and have become a part of mainstream corporate activity. Virtually all multinational enterprises (MNEs) now use international joint ventures, many as a key element of their corporate strategies. For example, General Motors’ (GM) longstanding joint venture partnership in China with Shanghai Automotive Industry Corp. manufactures about 40 per cent of all GM vehicles and contributed over $2 billion[[1]](#footnote-1) to GM’s 2016 profits. It has also expanded to include operations in Latin America and India. Similarly, GM has facilitated its decade-long foray into the Russian automotive marketplace through the continuing growth of its joint venture partnership with the Russian firm AvtoVAZ. Even ﬁrms that have traditionally operated independently around the world are increasingly turning to joint ventures.

The popularity and use of international joint ventures and cooperative alliances has remained strong. The rate of joint venture use does not change much from year to year. In general, joint ventures are the mode of choice about 30 per cent of the time by both U.S. and Japanese multinationals.

The popularity of alliances has continued despite their reputation for being difﬁcult to manage. Failures exist and are usually widely publicized. For example, the 2007 joint venture announced between Tiffany & Co. (Tiffany) and Swatch Group S.A. (Swatch), which was intended to grow into a decades-long partnership, devolved into a legal battle in which Swatch sued Tiffany for lost profits (estimated at $4.2 billion) and Tiffany filed a $590 million counter-claim. Also, after Lucent Technologies’ (Lucent) joint venture in wireless handsets with Philips Electronics ended, Lucent took a $100 million charge when it sold its consumer phone equipment business. Similarly, HealthMatics, a joint venture between GlaxoSmithKline and Physician Computer Network Inc., shut down after losing more than $50 million.

While early surveys suggested that as many as half the companies with international joint ventures were dissatisﬁed with their ventures’ performance, there is reason to believe that some of the earlier concern has now be ameliorated. This is primarily because there is far greater alliance experience and insight to draw from. There is now widespread appreciation that joint ventures are not necessarily transitional organizational forms that are shorter-lived or less proﬁtable. For many organizations, they are the mode of choice, given the recognition that they may survive just as long as wholly owned subsidiaries. Consider Cereal Partners Worldwide, a 50/50 joint venture between General Mills and Nestlé. It markets breakfast cereals in 130 countries and began operations over 25 years ago.

There now also exists an Association of Strategic Alliance Professionals. It was created to support the professional development of alliance managers and executives to advance state-of-the-art alliance formation and management and to provide a forum for sharing alliance best practices, resources, and opportunities to help companies improve their alliance management capabilities.

Why do managers keep creating new joint ventures? The reasons are presented in the remainder of this reading, as are some guidelines for international joint venture success.

WHY COMPANIES CREATE INTERNATIONAL JOINT VENTURES

International joint ventures can be used to achieve one of four basic purposes. These are as follows: to strengthen a ﬁrm’s existing business, to take the ﬁrm’s existing products into new markets, to obtain new products that can be sold in the ﬁrm’s existing markets, and to diversify into a new business (see Exhibit 1).

Companies using joint ventures for each of these purposes will have different concerns and will be looking for partners with different characteristics. Firms wanting to strengthen their existing business, for example, will most likely be looking for partners among their current competitors, while those wanting to enter new geographical markets will be looking for overseas ﬁrms in related businesses with good local market knowledge. Although often treated as a single category of business activity, international joint ventures are remarkably diverse, as the following descriptions indicate.

Strengthening the Existing Business

International joint ventures are used in a variety of ways by ﬁrms wishing to strengthen or protect their existing business. Among the most important are joint ventures formed to achieve economies of scale, joint ventures that allow ﬁrms to acquire needed technology and know-how, and ventures that reduce the ﬁnancial risk of major projects. Joint ventures formed for the latter two reasons may have the added beneﬁt of eliminating a potential competitor from a particular product or market area.

Achieving Economies of Scale

Firms often use joint ventures to attempt to match the economies of scale achieved by their larger competitors. Joint ventures have been used to give their parents economies of scale in raw material and component supply, in research and development, and in marketing and distribution. Joint ventures have also been used as a vehicle for carrying out divisional mergers, which yield economies across the full spectrum of business activity.

Very small entrepreneurial ﬁrms are more likely to participate in a network than an equity joint venture in order to strengthen their business through economies of scale. Small ﬁrms may form a network to reduce the costs and increase the potential of foreign market entry or to meet some other focused objective. Most of these networks tend to have relatively low barriers to entry and exit, a loose structure, and require a limited investment (primarily time, as they might be self-ﬁnancing through fees). International equity joint ventures by very small ﬁrms are unusual because such ﬁrms must typically overcome some combination of liabilities of size, newness, foreignness, and relational orientation (often the small ﬁrms were initially successful because of their single-minded, do-it-themselves orientation).

Raw Material and Component Supply

In many industries, the smaller ﬁrms create joint ventures to obtain raw materials or jointly manufacture components. Automakers, for instance, may develop a jointly owned engine plant to supply certain low-volume engines to each company. Producing engines for the parents provides economies of scale, with each company receiving engines at a lower cost than it could obtain if it were to produce them itself.

The managers involved in such ventures are quick to point out that these ﬁnancial savings do not come without a cost. Design changes in jointly produced engines, for example, tend to be slow because all partners have to agree on them. In fact, one joint venture that produced computer printers fell seriously behind the state of the art in printer design because the parents could not agree on the features they wanted in the jointly designed printer. Because all of the venture’s output was sold to the parents, the joint venture personnel had no direct contact with end customers and could not resolve the dispute.

Transfer pricing is another issue that arises in joint ventures that supply their parents. A low transfer price on products shipped from the venture to the parents, for instance, means that whichever parent buys the most product obtains the most beneﬁt. Many higher-volume-taking parents claim that this is fair, as it is their volume that plays an important role in making the joint venture viable. On the other hand, some parents argue for a higher transfer price, which means that the economic beneﬁts are captured in the venture and will ﬂow, most likely via dividends, to the parents in proportion to their shareholdings in the venture. As the shareholdings generally reﬂect the original asset contributions to the venture and not the volumes taken out every year, this means that different parents will do well under this arrangement. Clearly, the potential for transfer price disputes is signiﬁcant.

Research and Development

Shared research and development efforts are increasingly common. The rationale for such programs is that participating ﬁrms can save both time and money by collaborating and may, by combining the efforts of the participating companies’ scientists, come up with results that would otherwise be impossible. The choice facing ﬁrms wishing to carry out collaborative research is whether to simply coordinate their efforts and share costs or to actually set up a jointly owned company. Hundreds of multi-company research programs are not joint ventures. Typically, scientists from the participating companies agree on the research objectives and the most likely avenues of exploration to achieve those objectives. If there are, say, four promising ways to attack a particular problem, each of four participating companies would be assigned one route and told to pursue it. Meetings would be held, perhaps quarterly, to share results and approaches taken and when (hopefully) one route proved to be successful, all ﬁrms would be fully informed of the new techniques and technology.

The alternative way to carry out collaborative research is to establish a jointly owned company and to provide it with staff, a budget, and a physical location. Yet even here, problems may occur. In the United States, the president of a joint research company established by a dozen U.S. computer ﬁrms discovered that the participating companies were not sending their best people to the new company. He ended up hiring more than 200 of the joint venture’s 330 scientists from the outside.

A sensitive issue for ﬁrms engaging in collaborative research, whether through joint ventures or not, is how far the collaboration should extend. Because the partners are usually competitors, the often expressed ideal is that the joint effort will focus only on “precompetitive” basic research and not, for example, on product development work. This is often a difﬁcult line to draw.

Marketing and Distribution

Many international joint ventures involve shared research, development, and production but stop short of joint marketing. GM and South Korea’s LG Corp. (LG) announced a joint venture to develop electric and hybrid vehicles by combining GM’s strength as an automaker with LG’s leadership in electronics and lithium-ion battery technologies. Under the terms of the joint venture, LG is authorized to market any technologies that it co-develops with GM to other companies. In 2015, this partnership was broadened, making it one of the most extensive between a U.S. automaker and an overseas supplier. More of the development and production costs will be shifted to LG, which has considerable technical expertise.

Antitrust concerns play a role in the decision to keep marketing activities separate, but so does the partners’ intrinsic desire to maintain separate brand identities and increase their own market share. These cooperating ﬁrms have not forgotten that they are competitors.

There are, nevertheless, some ventures formed for the express purpose of achieving economies in marketing and distribution. Here, each ﬁrm is hoping for wider market coverage at a lower cost. The trade-off is a loss of direct control over the salesforce, potentially slower decision making, and a possible loss of direct contact with the customer.

Somewhat similar in intent are cooperative marketing agreements, which are not joint ventures but agreements by two ﬁrms with related product lines to sell one another’s products. Here companies end up with a more complete line to sell, without the managerial complications of a joint venture. Sometimes the cooperative marketing agreement can in fact entail joint branding.

Divisional Mergers

Multinational companies with subsidiaries that they have concluded are too small to be practical have sometimes chosen to create a joint venture by combining their “too-small” operations with those of a competitor. Fiat and Peugeot, for example, merged their automobile operations in Argentina, where both companies were doing poorly. The new joint venture started life with a market share of 35 per cent and a chance for greatly improved economies in design, production, and marketing. Faced with similar pressures, Ford Motor Company (Ford) and Volkswagen did the same thing in Brazil, creating a jointly owned company called Auto Latina. A divisional merger can also allow a ﬁrm to gracefully exit from a business in which it is no longer interested.

Acquiring Technology in the Core Business

Firms that have wanted to acquire technology in their core business areas have traditionally done so through licence agreements or by developing the technology themselves. Increasingly, however, companies are turning to joint ventures for this purpose, because developing technology in-house is seen as taking too long, and licence agreements, while giving the ﬁrm access to patent rights and engineers’ ideas, may not provide much in the way of shop-ﬂoor know-how. The power of a joint venture is that a ﬁrm may be able to have its employees working shoulder to shoulder with those of its partner, trying to solve the same problems. For example, General Motors’ New United Motor Manufacturing, Inc. (NUMMI) joint venture with Toyota provided an opportunity for GM to obtain a source of low-cost small cars and to watch ﬁrst-hand how Toyota managers, who had operational control of the venture, were able to produce high-quality automobiles at a low cost. Some observers even concluded that the opportunity for GM to learn new production techniques was potentially more valuable—if absorbed—than the supply of cars coming from the venture. General Motors’ joint venture arrangement with LG has been designed to position GM to co-develop battery-powered vehicles more quickly than its competitors, as auto manufacturers race to develop vehicles that will comply with new fuel economy regulations in the United States.

Reducing Financial Risk

Some projects are too big or too risky for ﬁrms to tackle alone. This is why oil companies use joint ventures to split the costs of searching for new oilﬁelds and why the aircraft industry is increasingly using joint ventures and “risk-sharing subcontractors” to put up some of the funds required to develop new aircraft and engines. When GM announced its joint venture to develop battery-powered vehicles with LG Corp., GM then–vice chairman Steve Girsky was quoted as saying, “We don’t know how big this market is going to be. This is a way to go at it in an efficient way that doesn’t risk the company.”

Do such joint ventures make sense? For the oil companies, the answer is a clear *yes*. In these ventures, one partner takes a lead role and manages the venture on a day-to-day basis. Management complexity, a major potential drawback of joint ventures, is kept to a minimum. If the venture ﬁnds oil, transfer prices are not a problem—the rewards of the venture are easy to divide between the partners. In situations like this, forming a joint venture is an efﬁcient and sensible way of sharing risk.

It is not as obvious that some other industry ventures are a good idea, at least not for industry leaders. Their partners are not entering these ventures simply in the hopes of earning an attractive return on their investment. They are gearing up to produce, sooner or later, their own product. Why would a company be willing to train potential competitors? For many ﬁrms, it is the realization that their partner is going to hook up with someone anyway—so better to have a portion of a smaller future pie than none at all, even if it means you may be eventually competing against yourself. This is consistent with the old adage “Keep your friends close, and your enemies [competitors] even closer.”

Taking Products to Foreign Markets

Firms with domestic products that they believe will be successful in foreign markets face a choice. They can produce the product at home and export it, license the technology to local ﬁrms around the world, establish wholly owned subsidiaries in foreign countries, or form joint ventures with local partners. Many ﬁrms conclude that exporting is unlikely to lead to signiﬁcant market penetration, that building wholly owned subsidiaries is too slow and requires too many resources, and that licensing does not offer an adequate ﬁnancial return. The result is that an international joint venture, while seldom seen as an ideal choice, is often the most attractive compromise.

Moving into foreign markets entails a degree of risk, and most ﬁrms that decide to form a joint venture with a local ﬁrm are doing so to reduce the risk associated with their new market entry. Very often, they look for a partner that deals with a related product line and, thus, has a good feel for the local market. As a further risk-reducing measure, the joint venture may begin life as simply a sales and marketing operation, until the product begins to sell well and volumes rise. Then a “screwdriver” assembly plant may be set up to assemble components shipped from the foreign parent. Eventually, the venture may modify or redesign the product to better suit the local market and may establish complete local manufacturing, sourcing raw materials and components locally. The objective is to withhold major investment until the market uncertainty is reduced.

Following Customers to Foreign Markets

Another way to reduce the risk of a foreign market entry is to follow ﬁrms that are already customers at home. Thus, many Japanese automobile suppliers have followed Honda Motor Corp., Toyota Motor Corporation, and Nissan Nissan Motor Corporation as they set up new plants in North America and Europe. Very often these suppliers, uncertain of their ability to operate in a foreign environment, decide to form a joint venture with a local partner. There are, for example, a great many automobile supplier joint ventures in the United States originally formed between Japanese and American automobile suppliers to supply the Japanese “transplant” automobile manufacturers. For the Americans, such ventures provide a way to learn Japanese manufacturing techniques and to tap into a growing market. Additionally, some joint ventures are established to satisfy legal requirements in order to permit a firm to follow its customers abroad. The Chinese air transport industry is regulated by laws that limit foreign ownership. NetJets Inc., a Berkshire Hathaway subsidiary that specializes in private jet management, indicated that demand from existing customers in the United States and Europe, in addition to demand from prospective Chinese customers, motivated its entry into a joint venture with a consortium of Chinese investors to provide private aircraft management services within China to both corporate and individual clients.

Investing in “Markets of the Future”

Some joint ventures are established by ﬁrms taking an early position in what they see as emerging markets. These areas offer very large untapped markets as well as a possible source of low-cost raw materials and labour. The major problems faced by Western ﬁrms in penetrating such markets are their unfamiliarity with the local culture, difficulty in establishing Western attitudes toward quality, and, in some areas, difficulty in repatriating earnings in hard currency. The solution (sometimes imposed by local governments) has often been the creation of joint ventures with local partners who “know the ropes” and can deal with the local bureaucracy.

Bringing Foreign Products to Local Markets

For every ﬁrm that uses an international joint venture to take its product to a foreign market, a local company sees the joint venture as an attractive way to bring foreign products to its existing market. It is, of course, this complementarity of interests that makes the joint venture possible. For example, Starbucks entered India through a 50/50 joint venture agreement with Tata Global Beverages. While India has been traditionally regarded as a tea-drinking nation, consuming more than 800,000 metric tons of tea, both Starbucks Corporation and Tata Sons Ltd., were optimistic that the country’s more modest but increasing consumption of coffee (approximately 100,000 metric tons in 2010) would position the joint venture to succeed in developing the coffee chain’s retail presence in India. As of 2016, the joint venture operates 83 stores in India with over 1,200 employees. It has expanded its partnership to benefit both companies beyond the initial joint venture to include offering Indian coffee to U.S. customers, increasing roasting capacity at the Indian plant, establishing an exclusive partnership with Vistara airlines, extending the Starbucks Teavana tea brand to India, introducing Tata’s Himalayan Natural Mineral Water to Starbucks stores outside India, and committing to help underprivileged youth in India.

Local partners enter joint ventures to get better utilization of existing plants or distribution channels, to protect themselves against threatening new technology, or simply as an impetus for new growth. Typically, the ﬁnancial rewards that the local partner receives from a venture are different from those accruing to the foreign partner:

* Many foreign partners make a proﬁt shipping ﬁnished products and components to their joint ventures. These proﬁts are particularly attractive because they are in hard currency, which may not be true of the venture’s proﬁts, and because the foreign partner captures 100 per cent of them, not just a share.
* Many foreign partners receive a technology fee, which is a ﬁxed percentage of the sales volume of the joint venture. The local partner may or may not receive a management fee of a similar amount.
* Foreign partners typically pay a withholding tax on dividends remitted to them from the venture. Local ﬁrms do not.

As a result of these differences, the local partner is often far more concerned with the venture’s bottom line earnings and dividend payout than the foreign partner. This means the foreign partner is likely to be happier to keep the venture as simply a marketing or assembly operation, as previously described, than to develop it to the point where it buys less imported material.

Although this logic is understandable, such thinking is short-sighted. The best example of the beneﬁts that can come back to a parent from a powerful joint venture is Fuji Xerox, a venture begun in Japan in 1962 between Xerox Corporation (Xerox) and Fujifilm Corporation (Fuji). This is among the best-known American–Japanese joint ventures in Japan.

For the ﬁrst 10 years of its life, Fuji Xerox was strictly a marketing organization. It did its best to sell Xerox copiers in the Japanese market, even though the U.S. company had done nothing to adapt the machine to the Japanese market. For example, to reach the print button on one model, Japanese secretaries had to stand on a box. After 10 years of operation, Fuji Xerox began to manufacture its own machines, and by 1975 it was redesigning U.S. equipment for the Japanese market. Soon thereafter, with the encouragement of Fuji Photo, and in spite of the resistance of Xerox engineers in the United States, the ﬁrm began to design its own copier equipment. Its goal was to design and build a copier in half the time and at half the cost of previous machines. When this was accomplished, the ﬁrm set its sights on winning the Deming Prize, a highly coveted Japanese award for excellence in total quality control. Fuji Xerox won the award in 1980.

It was also in 1980 that Xerox, reeling under the impact of intense competition from Japanese copier companies, ﬁnally began to pay attention to the lessons that it could learn from Fuji Xerox. Adopting the Japanese joint venture’s manufacturing techniques and quality programs, the parent company fought its way back to health in the mid-1980s. By 1991, Xerox International Partners was established as a joint venture between Fuji Xerox and Xerox Corporation to sell low-end printers in North America and Europe. In 1998, exports to the United States grew substantially with digital colour copiers. In 2000, Xerox Corporation transferred its China/Hong Kong operations to Fuji Xerox, and Fujifilm raised its stake in the venture to 75 per cent in 2001. By 2015, Fuji Xerox Co. Ltd. employed over 45,000 people, had nearly $10 billion in revenues, was responsible for the design and manufacture of many digital colour copiers and printers for Xerox worldwide, and was an active partner in research and development. Both the lessons learned from Fuji Xerox and the contributions Fuji Xerox has made to Xerox have inevitably helped Xerox prosper as an independent company.

Using Joint Ventures for Diversiﬁcation

As the previous examples illustrate, many joint ventures take products that one parent knows well into a market that the other knows well. However, some break new ground and move one or both parents into products and markets that are new to them.

Arranging to acquire the skills necessary to compete in a new business is a long-term proposition, but one that some ﬁrms are willing to undertake. Given the fact that most acquisitions of unrelated businesses do not succeed, and that trying to enter a new business without help is extremely difﬁcult, choosing partners who will help you learn the business may not be a bad strategy if you are already familiar with the partner. However, to enter a new market with a new product and a new partner—even when the probability of success for each is 80 per cent—leaves one with an overall probability of success of (0.8 × 0.8 × 0.8) about 50 per cent!

Joint ventures can also be viewed as vehicles for learning. Here, the modes of learning go beyond knowledge transfer (i.e., existing know-how) to include transformation and harvesting. In practice, most international joint venture partners engage in the transfer of existing knowledge, but stop short of knowledge transformation or harvesting. Although many multinational enterprises have very large numbers of international equity joint ventures and alliances, only a small percentage dedicate resources explicitly to learning about the alliance process. Few organizations go to the trouble of inventorying/cataloguing the corporate experience with joint ventures, let alone how the accumulated knowledge might be transferred within or between divisions. This oversight will be increasingly costly for ﬁrms, especially as some bilateral alliances become part of multilateral networks.

Requirements for International Joint Venture Success

The checklist in Exhibit 2 presents many of the items that a manager should consider when establishing an international joint venture. Each of these is discussed in the following sections.

Testing the Strategic Logic

The decision to enter a joint venture should not be taken lightly. As mentioned earlier, joint ventures require a great deal of management attention, and, in spite of the care and attention they receive, many prove unsatisfactory to their parents.

Firms considering entering a joint venture should satisfy themselves that there is not a simpler way, such as a non-equity alliance, to get what they need. They should also carefully consider the time period for which they are likely to need help. Some joint ventures have been labelled “permanent solutions to temporary problems” by ﬁrms that entered a venture to get help with some aspect of their business; then, when they no longer needed the help, they were still stuck with the joint venture.

The same tough questions a ﬁrm may ask itself before forming a joint venture need to be asked of its partner(s). How long will the partner(s) need it? Is the added potential payoff high enough to each partner to compensate for the increased coordination/communication costs that go with the formation of a joint venture?

A major issue in the discussion of strategic logic is to determine whether congruent measures of performance exist. As Exhibit 3 suggests, in many joint ventures, incongruity exists. In this example, the foreign partner was looking for a joint venture that would generate a 20 per cent return on sales in a one-to-two-year period and would require a limited amount of senior management time. The local partner, in turn, was seeking a joint venture that would be quickly proﬁtable and able to justify some high-paying salaried positions (for the local partner and several family members/friends). While each partner’s performance objectives seem defensible, this venture would need to resolve several major problem areas in order to succeed. First, each partner did not make explicit all its primary performance objectives. Implicit measures (those below the dotted line in Exhibit 3) are a source of latent disagreement and misunderstanding. Second, the explicit versus implicit measures of each partner were internally inconsistent. The foreign partner wanted high profitability while using little senior management time and old technology. The local partner wanted quick proﬁts but high-paying local salaries.

Congruity is not just an inter-partner issue. From an intra-partner perspective, it is also essential that the internal managers speak and act from a common platform.

Partnership and Fit

Joint ventures are sometimes formed to satisfy complementary needs, but when one partner acquires (learns) another’s capabilities, the joint venture becomes unstable. The acquisition of a partner’s capabilities means that the partner is no longer needed. If partner capabilities are only accessed rather than acquired, the joint venture is more stable. It is not easy, before a venture begins, to determine many of the things a manager would most like to know about a potential partner, like the true extent of its capabilities, what its objectives are in forming the venture, and whether it will be easy to work with. A hasty answer to such questions may lead a ﬁrm into a bad relationship or cause it to pass up a good opportunity.

For these reasons, it is often best if companies begin a relationship in a small way, with a simple agreement that is important but not a matter of life and death to either parent. As conﬁdence between the ﬁrms grows, the scope of the business activities can broaden.

A good example is provided by Corning Inc., which in 1970 made a major breakthrough in the development of optical ﬁbres that could be used for telecommunication applications, replacing traditional copper wire or coaxial cable. The most likely customers of this ﬁbre outside the United States were European national telecoms, which were well known to be very nationalistic purchasers. To gain access to these customers, Corning set up development agreements with companies in England, France, Germany, and Italy that were already suppliers to the telecoms. These agreements called for the European ﬁrms to develop the technology necessary to combine the ﬁbres into cables, while Corning itself continued to develop the optical ﬁbres. Soon, the partners began to import ﬁbre from Corning and cable it locally. Then, when the partners were comfortable with each other and each market was ready, Corning and the partners set up joint ventures to produce optical ﬁbre locally. These ventures worked well.

When assessing issues around partnership and fit, it is useful to consider whether the partner not only shares the same objectives for the venture but also has a similar appetite for risk. In practice, this often results in joint ventures having parents of roughly comparable size. It is difﬁcult for parent firms of very different sizes to establish sustainable joint ventures because of varying resource sets, payback period requirements, and corporate cultures.

Corporate culture similarity—or compatibility— can be a make-or-break issue in many joint ventures. It is not enough to ﬁnd a partner with the necessary skills; you need to be able to get access to them and to be compatible. Managers are constantly told that they should choose a joint venture partner they trust. As these examples suggest, however, trust between partners is something that can only be developed over time as a result of shared experiences. You cannot start with trust.

Shape and Design

In the excitement of setting up a new operation in a foreign country or getting access to technology provided by an overseas partner, it is important not to lose sight of the basic strategic requirements that must be met if a joint venture is to be successful. The questions that must be addressed are the same when any new business is proposed: Is the market attractive? How strong is the competition? How will the new company compete? Will it have the required resources? And so on.

In addition to these concerns, three others are particularly relevant to joint venture design. One is the question of strategic freedom, which has to do with the relationship between the venture and its parents. How much freedom will the venture be given to do as it wishes with respect to choosing suppliers, a product line, and customers? In a Dow Chemical Company (Dow) joint venture, a dispute between the partners centred on the requirement that the venture buy materials at what the Koreans believed to be an inﬂated price from Dow’s new wholly owned Korean plant. Clearly, the American and Korean visions of the amount of strategic freedom open to the venture were rather different.

The second issue of importance is that the joint venture be a win–win situation. This means that the payoff to each parent if the venture is successful should be a big one, because this will keep both parents working for the success of the venture when times are tough. If the strategic analysis suggests that the return to either parent over time will be marginal, the venture should be restructured or abandoned.

Finally, it is critical to decide on the management roles that each parent company will play. The venture will be easier to manage if one parent plays a dominant role and has a lot of inﬂuence over both the strategic and the day-to-day operations of the venture, or if one parent plays a lead role in the day-to-day operations of the joint venture. More difﬁcult to manage are shared management ventures, in which both parents have signiﬁcant input into both strategic decisions and the everyday operations of the venture. A middle ground is split management decision making, where each partner has primary inﬂuence over those functional areas where it is most qualiﬁed. This is the most common and arguably most effective form.

In some ventures, the partners place too much emphasis on competing with each other about which one will have management control. They lose sight of the fact that the intent of the joint venture is to capture complementary beneﬁts from two partners that will allow the venture (not one of the partners) to compete in the market better than would be possible by either going it alone.

The objective of most joint ventures is superior performance. Thus, the fact that dominant-parent ventures are easier to manage than shared-management ventures does not mean they are the appropriate type of venture to establish. Dominant-parent ventures are most likely to be effective when one partner has the knowledge and skill to make the venture a success and the other party is contributing simply money, a trademark, or perhaps a one-time transfer of technology. Such a venture, however, begs the question, “What are the unique continuing contributions of the partner?” Shared-management ventures are necessary when the venture needs active consultation between members of each parent company, as when deciding how to modify a product supplied by one parent for the local market that is well known by the other, or to modify a production process designed by one parent to be suitable for a workforce and working conditions well known by the other.

A joint venture is headed for trouble when a parent tries to take a larger role in its management than makes sense. An American company with a joint venture in Japan, for instance, insisted that one of its people be the executive vice-president of the venture. This was not reasonable, because the manager had nothing to bring to the management of the venture. He simply served as a constant reminder to the Japanese that the American partner did not trust them. The Americans were pushing for a shared-management venture when it was more logical to allow the Japanese, who certainly had all the necessary skills, to be the dominant or at least the leading ﬁrm. The major American contribution to the venture was to allow it to use its world-famous trademarks and brand names.

A second example, also in Japan, involved a French ﬁrm. This company was bringing complex technology to the venture that needed to be modiﬁed for the Japanese market. It was clear that the French ﬁrm required a signiﬁcant say in the management of the venture. On the other hand, the French had no knowledge of the Japanese market and, thus, the Japanese also needed a signiﬁcant role in the venture. The logical solution would have been a shared-management venture and equal inﬂuence in decisions made at the board level. Unfortunately, both companies wanted to play a dominant role, and the venture collapsed in a decision-making stalemate.

Finally, every joint venture must resolve how much of the joint venture will be owned by each of the partners. Some ﬁrms equate ownership with control, assuming more is always better. Such an assumption is incorrect. Research has shown that once a foreign ﬁrm has about a 40 per cent equity stake, there is little difference in the survivability of that subsidiary versus if they had, for example, an 80 per cent stake (see Exhibit 4).

Doing the Deal

Experienced managers argue that it is the relationship between the partners that is of key importance in a joint venture, not the legal agreement that binds them together. Nevertheless, most are careful to ensure that they have a good agreement in place—one that they understand and are comfortable with.

Most of the principal elements of a joint venture agreement are straightforward. One item that often goes undiscussed is the termination of the venture.

Although some managers balk at discussing termination during the getting-acquainted period, it is important to work out a method of terminating the venture in the event of a serious disagreement, and to do this at a time when heads are cool and goodwill abounds. The usual technique is to use a shotgun clause, which allows either party to name a price at which it will buy the other’s shares in the venture. However, once this provision is activated and the ﬁrst company has named a price, the second ﬁrm has the option of selling at this price or buying the ﬁrst company’s shares at the same price. This ensures that only fair offers are made, at least as long as both parents are large enough to be capable of buying each other out.

Making the Venture Work

Joint ventures need close and continuing attention, particularly in their early months. In addition to establishing a healthy working relationship between the parents and the venture general manager, and appropriate metrics, managers should be on the lookout for the impact that cultural differences may be having on the venture and for the emergence of unforeseen inequities.

International joint ventures, like any type of international activity, require that managers of different national cultures work together. This requires the selection of capable people in key roles. Unless managers have been sensitized to the characteristics of the culture that they are dealing with, this can lead to misunderstandings and serious problems. Many Western managers, for instance, are frustrated by the slow, consensus-oriented decision-making style of the Japanese. Equally, the Japanese ﬁnd American individualistic decision making to be surprising, as the decisions are made so quickly, but the implementation is often so slow. Firms that are sophisticated in the use of international joint ventures are well aware of such problems and have taken action to minimize them. Ford, for example, has put more than 1,500 managers through courses to improve their ability to work with Japanese and Korean managers.

It is important to remember that cultural differences do not just arise from differences in nationality. Below are some examples:

* Small ﬁrms working with large partners are often surprised and dismayed by the fact that it can take months, rather than days, to get approval of a new project. In some cases, the cultural differences appear to be greater between small and large ﬁrms of the same nationality than, say, between multinationals of different nationalities, particularly if the multinationals are in the same industry.
* Firms working with two partners from the same country have been surprised to ﬁnd how different the companies are in cultural habits. A Japanese automobile ﬁrm headquartered in rural Japan may be a very different company from one run from Tokyo.
* Cultural differences between managers working in different functional areas may be greater than those between managers in the same function in different ﬁrms. One group of European engineers, for example, discovered when discussing a potential joint venture with an American partner that they had more in common with the American engineers than with the marketing people in their own company.

A very common joint venture problem is that the objectives of the parents, which coincide when the venture is formed, diverge over time. This divergence can be brought on by changes in the marketplace. For example, when the 50/50 joint venture between Sony Corporation (Sony) and Ericsson was formed in 2001, both firms sought to improve their position in the growing high-end mobile handset market. Ten years later, with Apple dominating the premium end of the mobile handset market, Ericsson began to shift its focus to the supply of mobile and wireless networks, while Sony chose to focus its efforts on content delivery to personal computing devices such as tablets, PCs, and mobile phones. Consequently, Sony acquired Ericsson’s share of the joint venture, in order to facilitate Sony’s efforts to capture a greater market share in content delivery. Such divergences can also be brought on by changes in the fortunes of the partners. This was the case in the breakup of the General Motors–Daewoo joint venture in Korea. Relations between the partners were already strained due to GM’s unwillingness to put further equity into the venture, in spite of a debt-to-equity ratio of more than 8:1, when, faced with rapidly declining market share, the Korean parent decided that the venture should pursue growth and maximize market share. In contrast, GM, itself in a poor ﬁnancial position at the time, insisted that the emphasis be on current proﬁtability. When Daewoo, without telling GM, introduced a concessionary ﬁnancing program for the joint venture’s customers, the relationship was damaged, never to recover.

A ﬁnal note concerns the unintended inequities that may arise during the life of a venture. Due to an unforeseen circumstance, one parent may be winning from the venture while the other is losing. A venture established in the late 1990s between Indonesian and American parents, for instance, was buying components from the American parent at prices based in dollars. As the rupiah declined in value, the Indonesian partner could afford fewer components in each shipment. The advice of many experienced venture managers is that, in such a situation, a change in the original agreement should be made, so the hardship is shared between the parents. That was done in this case, and the venture is surviving, although it is not as proﬁtable as originally anticipated.

In reviewing any checklist of the things to be considered when forming a joint venture, it is important to recognize that such a list will vary somewhat depending on where the international joint venture is established. The characteristics of joint ventures will vary according to whether they are established in developed versus emerging markets.

Most of the descriptions of the characteristics considered are self-explanatory, yet more ﬁne-grained analyses are always possible. For example, the discussion in this reading has generally taken as its subject a traditional equity joint venture, one focused between two ﬁrms from two different countries. However, other types of equity joint ventures exist, including those between ﬁrms from two different countries that set up operations in a third country (i.e., tri-national), those formed between subsidiaries of the same MNE (i.e., intra-ﬁrm), and those formed with companies of the same nationality but located in a different country (i.e., cross-national domestic joint ventures). Further, many joint ventures have more than two partners. Interestingly, traditional joint ventures (at least those formed by Japanese MNEs) tend simultaneously to be more proﬁtable and to have a higher termination rate than the alternative structures available.

Summary

International joint ventures are an increasingly important part of the strategy of many ﬁrms. They are, however, sometimes difﬁcult to design and manage well, in part because some organizations do not treat them as “true” “joint” ventures (see Exhibit 5). The fact that some ventures are performing below management’s expectations should not be an excuse for ﬁrms to avoid such ventures. In many industries, the winners are going to be the companies that most quickly learn to manage international ventures effectively. The losers will be the managers who throw up their hands and say that joint ventures are too difﬁcult and that they had better go it alone.

In the future, will we see more or fewer international joint ventures? Certainly, the reduction in investment regulations in many countries, coupled with increased international experience by many ﬁrms, suggests that there may be fewer joint ventures. Yet other countervailing pressures exist. With shortening product lifecycles, it is increasingly difﬁcult to go it alone. And with the increase in the number of MNEs from emerging markets, both the supply and demand of potential partners will likely escalate.

Exhibit 1: Motives for International Joint Venture Formation

|  |  |  |
| --- | --- | --- |
|  | **Existing Products** | **New Products** |
| **New Markets** | To take existing products to foreign markets | To diversify into a new business |
| **Existing Markets** | To strengthen the existing business | To bring foreign products to local markets |

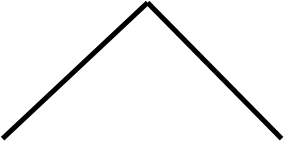
Source: Paul W. Beamish, *Joint Venturing* (Charlotte, NC: Information Age Publishing, 2008), 25.

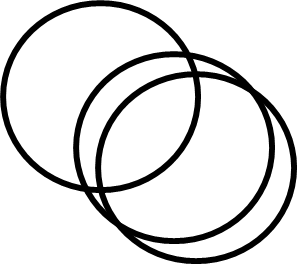
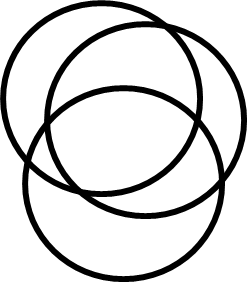
Exhibit 2: Joint Venture Checklist

|  |
| --- |
| 1. Test the strategic logic.  * Do you really need a partner? For how long? Does your partner? * How big is the payoff for both parties? How likely is success? * Is a joint venture the best option? * Do congruent performance measures exist?  1. Ensure partnership and ﬁt.  * Does the partner share your objectives for the venture? * Does the partner have the necessary skills and resources? Will you get access to them? * Will you be compatible? * Can you arrange an “engagement period”? * Is there a comfort versus competence trade-off?  1. Determine shape and design.  * Deﬁne the venture’s scope of activity and its strategic freedom vis-à-vis its parents. * Lay out each parent’s duties and payoffs to create a win–win situation. Ensure that there are comparable contributions over time. * Establish the managerial role of each partner.  1. Do the deal.  * How much paperwork is enough? Trust versus legal considerations? * Agree on an endgame.  1. Make the venture work.  * Give the venture continuing top management attention. * Manage cultural differences. * Watch out for inequities. * Be ﬂexible. |

Source: Case author.

Exhibit 3: Measuring joint venture Performance: The Search for Congruity

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Foreign Partner Local Partner

1. Profitability: 20% Return 1. Profitability

on sales (within 9–12 months)

(within 12–24 months)

1. Require limited senior 2. High-paying salaried

management time positions

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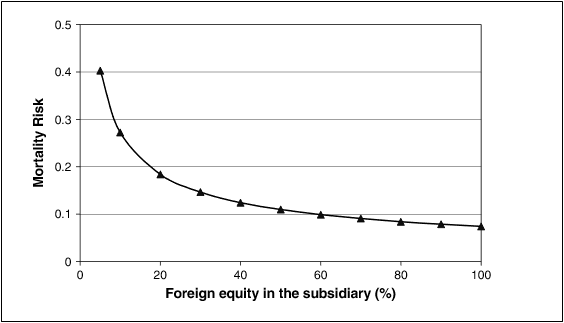
3. Maximize local sales 3. Opportunity to export

4. Exploit peripheral or 4. Obtain newest technology

mature technology

Source:Paul W. Beamish, *Joint Venturing* (Charlotte, NC: Information Age Publishing, 2008),36.

Exhibit 4: Effect of Foreign Equity HoldingS on Subsidiary Mortality Risk



Source*:* Charles Dhanaraj and Paul W. Beamish, “Effect of Equity Ownership on the Survival of International Joint Ventures,” *Strategic Management Journal* 25, no. 3 (2004): 295–305*.* doi:10.1002/smj.372.

Exhibit 5: The True Joint Venture versus the Pseudo Joint Venture

|  |  |  |
| --- | --- | --- |
|  | **The True Alliance** | **The Pseudo Alliance** |
| **Planned level of parent input and involvement** | Continuing | One-time |
| **Distribution of risks/rewards** | Roughly even | Uneven |
| **Parent attitude toward the JV** | A unique organization with unique needs | One more subsidiary |
| **The formal JV agreement** | Flexible guidelines | Frequently referenced rulebook |
| **Performance objectives** | Clearly specified and congruent | Partially overlapping/ambiguous |

Source: Note author.

1. All currency in U.S. dollars unless specified otherwise. [↑](#footnote-ref-1)