A SCRUTINY OF LITERATURE ON INTERNATIONAL JOINT VENTURES

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Abstract: Corporates aspire to expand their business activities by diversifying either product lines or markets. There are variety of expansion strategies available for corporates in this globalized era. IJV is one among those which is a commercial enterprise undertaken jointly by two or more parties from different countries wherein all the promoters as well as the newly formed firm can enjoy their distinct corporate entity. This particular study aims at understanding the contribution of earlier researchers in the field of IJV and the researcher tries to bring light on developments in the arena of IJV considering different phases of its life. Our extensive review has identified many potential researchable areas in case of International Joint Ventures. The study helped in understanding the practical as well as theoretical implications of the works done in the past in a way that will help to further review and bring developments in the existing body of knowledge in the subject matter.

Index Terms - International Joint Venture, Announcement Effect, Ownership Pattern, Performance

I. INTRODUCTION

Corporates aspire to expand their business activities by diversifying to either related or unrelated product lines or markets so that they are efficiently utilizing their resources. They use different expansion strategies to accomplish their expansion endeavors. Such expansion might aim at reaching foreign markets also. Strategies used to accomplish such ambitious expansion endeavours may be viewed under three different classifications with the firm either retaining full control over operations and property of the foreign entity or merely possessing contractual control over activities of the foreign entity as two extremes while there is an intermediary mode whereby firms shall possess partial ownership and limited contractual control over the foreign entity (Harrigan, 1985)

In the first extreme, companies can fulfill their global expansion aspiration through a wholly owned subsidiary unit and this can be best accomplished by merging or acquiring established foreign firms or by internally venturing into foreign markets. These strategies can result in the firm having full ownership of property of foreign entity and the authority to fully control the foreign firm's operations as well as the responsibility of shouldering the entire element of risk. In the second extreme strategy, companies do not have any control over the operations and property of the foreign entity as they merely have contractual control. In the case of the intermediary strategy, companies enjoy partial ownership and control over the assets and activities of foreign entity. Joint Venture fall under this intermediary category of corporate expansion strategy (Mangwengwende, 2012).

1.1 Joint Venture

A Joint Venture is a distinct corporate entity incorporated by two or more distinct corporate entities with all the parent corporates and the newly formed company retaining their distinct corporate entity. The company newly formed as an outcome of the Joint Venture will enable the parent corporate firms to fulfil their common objectives and goals through persistent involvement and control. Though Joint Venture companies display hybrid characteristics, they possess distinct legal entity, empowering them to possess discrete business structures, managerial staff, monetary and non-monetary dealings and work processes and practices. They can maintain their own assets and liabilities and be distinctly assessed for corporate tax as per the guiding principles and legal framework of the country in which they are located. Hence, an international joint venture can be advantageous if the foreign company is taxed at a higher rate than the rate at which the joint venture is taxed at the country of location.

1.2 International Joint venture

An international joint venture (IJV) is said to be struck when the partner firms to the IJV arrangement belong to different countries. IJV fulfills the aspiration of a company to enter foreign market without assuming the accountability of trading beyond borders as it can forge an alliance with a local firm and start a new business entity with agreed proportion of share of ownership and control. IJV is a quasi-distinct legal entity, given birth to by two or more distinct legal entities of different countries, which are referred to as parent partner firms in a Joint Venture arrangement. It is easier and faster for foreign companies to penetrate a foreign market through IJV while by forging an alliance with local company can result in a drastic reduction in risk and cost for the foreign company as the local company usually shall assume the financial risk involved in the arrangement. Similarly, companies can venture into foreign markets through IJV by overcoming trade barriers which might be prevalent in foreign countries. IJV arrangements also result in the creation of good synergies and sharing of technologies and potentials among companies of different countries. In sectors involving technology explosion at rapid pace, IJV deals are struck largely to gain better technological synergies and innovate at a good pace, minimizing cost and risk associated with research and development and optimum utilization of resources. However, in the case of labor and capital-intensive industries such as the FMCG (Fast
Moving Consumer Goods) industry, IJV partner can offer valuable resources to fortify technological potentials, thereby grow rapidly towards generation of better products with high earned values.

I. Aim of the study

This particular study aims at understanding the contribution of earlier researchers in the field of IJV. The researcher tries to bring light on developments in the arena of IJV considering different phases of its life. Generally, IJV has three major phases as a distinct business entity; First, the announcement of the deal, Second, the formation of the new Company and finally the performance of the new company. The market reaction on the announcement of the strategic investment decision by the partners involved, sharing of ownership for the new firm and integrated and dynamic approach to functioning for common objectives of partners would be the prime consideration respectively in the three stages mentioned earlier. These dimensions of IJV have gained importance in the current global business scenario. The present study focuses on available literature on these three aspects of IJV and in turn, tries to generate knowledge which can be seen as a reference for future research.

II. Announcement effect of IJVs

Many studies have been conducted to unearth the impact of IJV announcements on stock market. These studies have hypothesized that investors are precise in detecting and encoding public corporate announcements such as IJVs, appraise the corporate strategy deals using generally accepted and proven norms and the resultant value creation of the strategic move is governed by the environment under which the announcement has been made (Ozcan & Overby, 2008).

Arend (2004) opined that IJV announcements provide information spike to the stock market which can be utilized by investors to conduct a thorough scrutiny of the impact the announcement is likely to exert on value of the firm.

IJV announcement is considered by corporate as spur, prompting investors to make a re-assessment of returns accruing from their investment in securities of the company which may be done in the light of information furnished in a transparent manner about details of the IJV deal (Madhavan et al., 1998; Zajac and Westphal, 2004). Investors will make a scrutiny of pros and cons associated with IJV deal such as transaction cost, resultant knowledge and skill enrichment to the organization, etc. Usually, alliances resulting in value creation for firms will also result in better market returns for securities of the firm (Ozcan & Overby, 2008).

a. Impact of IJV Announcement on Shareholders Wealth

Almost all studies have reported accrual of positive abnormal returns to firms announcing domestic joint venture deals, resulting in shareholders of these firms maximizing wealth. However, studies on abnormal returns resulting due to IJV announcements have yielded mixed results. Some studies have reported that IJV announcements result in significant value addition to firms announcing IJV deals while some other studies have reported the accrual of negative returns to shareholders of firms making IJV announcements while some more studies have reported absence of any significant impact of IJV announcements of firms on their value (Liu, Aston, & Acquaye, 2014). Acquaye et al. (2014) have found that IJV announcements generally create value which however, is not long-lasting. This value creation is also influenced by the industry type and location of the firms while there was a significant difference in abnormal returns accruing to the firms during the pre and post financial crisis period with firms reaping positive abnormal returns during the pre-crisis period.

Brooke & Oliver, (2005) have established that abnormal returns accrue to shareholders of firms striking IJV deals on the announcement and the cumulative abnormal returns persist for the firms for a maximum window period of three days and not beyond.

Larry J. Prather and Jae Hoon Min (1998) have established that shareholders usually derive small but significant positive returns on the IJV announcement date to the tune of four percent.

Marcikaityte, Roskelley, & Wang, (2009) have unearthed that IJV announcements of firms engaged in financial services attracts positive reaction from the stock market on the announcement date only and no abnormal returns get cumulated since the announcement date.

Jones & Danbolt,(2004) utilized market-adjusted return method to assess the impact of some 158 IJV announcements on market value of firms and found that positive abnormal returns accrue to shareholders on the date of IJV announcement only.

Merchant & Schendel, (2000) scrutinized IJV deals of US firms and found that value creation due to IJV announcement is influenced by factors such as relatedness among partner firms in the venture and partner firms and the outcome company, size measured in terms of market capitalization and prior experience of the partner firms, political environment prevalent in the country where the IJV is to be located and distinctiveness of organizational culture among the partner companies.

Chiou & White, (2005) studied joint venture deals of Japanese firms engaged in financial sector and found that such deals resulted in enhancement of value of the promoting companies. The study also exposed the wider spreading of returns from joint venture deals among the promoters and better returns for smaller firms and inter-group venture deals while there is no significant difference in returns from domestic and international joint venture deals.

Lee, Cho, Cheong, & Kim, (2013) observed yielding of significant cumulative abnormal returns to Korean firms venturing into IJV while there was an inverse relationship between value of the firms and their size. Type of strategic alliance (whether equity or non-equity) and nationality of the foreign firms seem to cast a significant impact on value creation from the IJV announcement.

Amici, Fiordelisi, Masala, Ricci, & Sist, (2013) studied IJV in banking and financial sectors of Europe and US and found that IJV deals of banks with non-financial firms entitled the banks to access foreign markets, resulting in positive value creation to them. However, firms striking IJV deals with multiple foreign firms suffer adversely in terms of value creation.

H. Chen et al., (1991) studied 88 IJV deals of US firms with China and found that the US firms enjoyed significant positive abnormal returns during the announcement date. Hence, efforts of US firms to venture into Chinese market resulted in wealth enhancement for investors.
Hanvanich & Tamer, (2001) established that IJV announcements led to positive market reaction which spanned across for a few days prior to the announcement date.

The Information Technology and electronic media can play a significant part in transforming a market efficient in receiving information and reacting accordingly.

Owen & Yawson, (2015) unearthed that returns generated from international alliance is greater than domestic alliances. They also found that the cumulative abnormal returns is largely influenced by Research and Development initiative of firm taking the initiative for the alliance.

Talay et al., (2010) have propagated that IJV deals are more beneficial for larger firms and has supported the result with the argument that IJV deals will lead to appreciation of value while huge financial strength is needed to combat the extensive competition prevalent in the host country and shoulder the mounting marketing cost which can be neutralized only by reaping benefits of large-scale economies by dealing in large scale. The point that marketing intensity of US firms striking IJV deal exerts significant positive impact on cumulative abnormal returns serves as testimony to their claim that large sized firms reap higher benefits from IJV deals.

Khanna, (2000) studied almost 2000 IJV and Licensing arrangements and found that management of joint ventures involved greater learning experiences while licensing contracts did not involve such things.

Chou, Ou, & Tsai, (2014) assessed the influence of strategic alliances on bond market and established that alliances have their influence spread over beyond the equity market and result in firms procuring borrowed funds at lower cost. In a similar study, later (2015) established that financial synergy and operational synergy were the major factors determining wealth of bond-holders in the case of joint venture and strategic alliances deals respectively.

The arrangement of bond contract play a significant part in establishing the link between synergy and accrual of abnormal returns to bond-holders (Chen, King & Wen, 2015).

To summaries, past studies focusing on corporates expanding using joint venture arrangements to gain better networking yield gaining of positive wealth for shareholders and bond-holders. Studies on IJV arrangements with reference to accrual of positive abnormal cumulative returns have yielded diverse results as they have not concentrated on assessing the positive expansion effect in the light of various contemporary issues which include market efficiency, economic scenario of the country to which host IJV partner belong and other IJV specific factors.

b. Determinants of Abnormal Returns Accruing from IJV Announcements

Many studies have concentrated on evaluating the announcement effect of IJV as well as to clarify the sources from which such effect has accrued. A gist of such studies focusing on determinants of abnormal cumulative returns accruing due to IJV announcements is presented in the forthcoming paragraphs.

i. Firm specific factors

Qualities and special traits of partner companies to an IJV deal having a bearing on creating value for the companies due to such deals constitute the firm specific factors.

Size of company is the most important firm specific factor having a bearing on accrual of positive abnormal returns to shareholders of partner companies to IJV arrangement. Larger partner firms to the IJV arrangement try to get benefit of innovative capabilities of the smaller partner firms (Das et al., 1998). Relative comparative position of partner firms also plays a significant role in accrual of positive abnormal returns (Dussauge&Garrette, 1995). Such relative comparative position of partner firms to an IJV arrangement is usually attributed to by the firm’s financial position (Gulati, 1998).

Merchant, (2005) found that US firms got good benefit from their IJV deals due to their proportionate equity participation in the IJV, regardless of other features such as location of their partner firms. The US firms gained a lot from their IJV deals with firms in developing zone if they concentrated on firm specific factors of their partner companies while they gained lesser due to IJV arrangements with firms belonging to NICs while Jones & Danbolt, (2004) established that UK firms undertaking IJV consider size of projects as important criteria for effectiveness of the venture while there seemed to exist a negative relation between market adjusted returns and market capitalization.

Hoon & Prather, (2001) unearthed that Tobin’s q and Cash flows were the important factors having a significant bearing on creating wealth from IJV announcements while Lai & Chen, (2014) established that corporate governance initiatives played a significant role in affecting accrual of creating wealth from IJV arrangements.

ii. Country specific factors

Acquaah (2009) investigated 76 IJV deals and established that the country to which partner firms belong to has a large say on business strategy of such an IJV, thereby exerting a significant impact on success of such an IJV arrangement. Acquaah (2009) advocated that IJV arrangements involving partner firm from developed nations should concentrate on product/service differentiation strategy while if the IJV arrangement has got partner firms from developing nations, the concentration should be on efficiency. Hence, strategy formulation as a part of IJV deal should take into account, the economic character of country to which partner firms belong.

García-Canal, (2015) and Parkhe, (1998) have unearthed that cultural distance between the partner firms, political risk associated with distinct political and legal environments prevalent among countries to which the partner firms belong to and economic scenario of the countries to which the partner firms belong to have significant bearing on success of an IJV deal.

H. Chen et al., (1991) reported that US companies enjoy greater wealth creation out of their IJV deals with Chinese firms while Joseph E. Finnerty, (1986) have hinted that even smaller sized US firms reap larger abnormal returns from their IJV deals.

Hanvanich, Miller, Richards, & Cavusgil, (2003) have found that financial markets yielded good returns to firms striking cross-border joint venture deals involving establishment of an IJV by partners from distinct nations in a totally new country.

Prather & Min, (1998) have found that US firms gain significantly from IJV arrangements involving partner firms in lesser developed nations while they fail to make any significant gain out of IJV arrangements involving partner firms in better
industrialised nations. However, US firms tend to make better gains out of expansion arrangements involving partner firms in the local area. Hence, it shall be interesting to assess whether it is advisable for firms to venture into an IJV with partner firms belonging to countries which are lesser developed economically in order to make greater gains in terms of announcement effect.

III. Equity Ownership and its determinants

Recent IJV arrangements involve equity participation from the partner companies resulting in direct participation of the partners in the IJV. Aguir & Misra, (2017) have authenticated that equal participation by partners in an IJV deal will yield better results and value creation process shall be determined by ownership pattern, IJV type, firm-specific features and country-specific features of the foreign partner firm. Smaller firms with less exposure to foreign market conditions may take away significant gains from IJV arrangements. They have also pointed out that legal environment prevalent in the foreign country in which the IJV is to be established play a crucial role in ownership pattern and dominating the ownership is a significant determinant of creating value for the firm.

Pan, (2002) have established that firms from a country with stronger currency, lower interest rate, minimum uncertainties and good export performance can gain better ownership participation in an IJV arrangement. Jung, Beamish, & Goerzen, (2010) have established that liberal Foreign Direct Investment and technological advancements in the country offers good bargain for the firms in negotiating an IJV deal.

Chang, (1996) and Greenwood and Hingling’s (1996) have pointed out that internal and external environmental factors have a significant bearing on deciding their ownership pattern in an IJV.

a. Ownership Balance in IJVs

While striking an IJV, the initial equity balance is most important as it decides the level of authority for the partner firms in the IJV (Steenema & Lyles, 2000, Young-Ybarra & Wiersema, 1999).

A balanced equity position for the IJV partners give them sense of equality, which will facilitate future cardinal relationship (Blodgett, 1992). An imbalance in the initial equity ownership among partners of an IJV deal will result in firms striving for a reversal of pattern of equity ownership which may result in some friction in the IJV arrangement (Iriyama, Shi, & Prescott, 2014). Despite the issue of initial equity ownership balance in IJVs have attracted many researchers, literature does not contain studies on unearthing reasons for discrepancies in ownership pattern.

IV. Dynamic capability and performance of IJVs

Dynamic capability is defined as a routine organizing and strategy devising skill of managers in procuring and applying resources by suitably modifying their resource base, integrating the resources and work out new combinations and permutations of mobilized resources to arrive at strategies targeting value creation for the firm (Grant, 1996, Pisano, 2018).

Ewosiida Osisioma, Ngozi Nzewi, & Charity Mgbemena, (2016) recommended that managers should adopt a flexible approach wherein they should utilize their core potentials according to changing environmental conditions and ensure utilization of such potentials to foresee and recognize probable threats and opportunities which might emerge for their business in future and accordingly draft strategies to meet any eventualities. Similarly, Zhan, Chen, Erramilli, & Nguyen, (2009) advocated that IJV established in a developing nation perform better on competitive and confidentiality grounds if they possess greater potential to rationally utilize the resources granted by the parent companies and keep upgrading and developing novel capabilities which is more likely when the IJV is functioning in a dynamic environment. Similarly, under a congenial environment of strong cooperation among the partner firms, potential utilization will significantly result in boosting performance.

Zhan & Chen, (2013) further reiterated that IJV managers should possess competencies in acquiring potentials from parent firms as well as from other sources in external and internal environment and reconfigure current and acquired potentials and utilize them to gain utmost operational efficiency.

A big matter of concern for researchers has been to evolve a methodology to measure the performance of IJV. Financial parameters such as cost, profitability and growth have been utilized by many scholars to establish the performance of IJV (Dang, 1977; Leecraw, 1983). Other subjective factors have been used by different scholars such as continued existence of the IJV (Killing, 1982; Geringer, 1990), period of existence of the IJV (Harrigan, 1985, Kogut, 1988), unstable ownership pattern of the IJV (Franko, 1971; Gomes-Casseres, 1987), and periodicity of negotiations and re-negotiations of the IJV agreement (Blodgett, 1987). However, the underlying fact is that scholars have not settled down to an operationalized methodology to assess the performance of an IJV (Geringer & Hebert, 1989).

Despite such limitations, studies have utilized both objective and subjective methods of measuring performance depending upon prevalent conditions and appropriateness of the methodology. Since financial data about IJVs is very much limited in India, the better methodology to assess performance of the venture shall be survey method wherein higher level managers shall provide self-assessment about performance of their IJV.

V. Directions for future research

a. Value effect of IJV announcement in Emerging countries like India

Past studies have concentrated largely on IJVs resulting in creation of value for firm and wealth for shareholders in respect of firms in developed nations, especially US and Europe. There is a dearth in studies on IJV leading to value creation in the case of firms belonging to developing nations. Such firms are subject to entirely different economic conditions and it is essential to study the value creation of such firms also.

At times, IJV deals might be misused by dominant firms to exploit the firms in lesser developed nations. Hence, it becomes imperative to assess whether IJV deals involving Indian and other firms have resulted in Indian firms gaining or losing in terms of market value.

In addition, past studies on IJVs have yielded conflicting results regarding accrual of positive or negative value effect of IJV announcements. Some studies have reported accrual of significant positive returns while others have hinted upon accrual of
significant negative returns while some other studies have concluded that IJV announcements did not exert any impact on value of parent firms. For instance, two different studies on US firms have reported accrual of positive returns in one case and accrual of negative returns in a second case to US firms. Since there are conflicting results in prior studies, the researcher got attracted to assess the announcement effect of IJVs on Indian firms.

b. Determinants of value effect of IJV in Indian scenario

Many research studies have assessed the announcement effect of IJV in terms of boosting of value of the firm located in developed countries. Studies have concentrated on economic status of countries which partner firms belong while some studies have focused on effect of cultural background of countries to which IJV partners belong. Studies on assessing differences in announcement effect on Indian firms undertaking IJV deals with different background such as nature of industry, size, etc. and operating under different internal and external conditions has not been undertaken.

c. Pattern of ownership and drivers of such pattern

Firms undertaking any strategic move must be in a position to evaluate the positives and negatives of such a move. Rights over cash flows, rational utilization of resources and residual control along with balanced ownership pattern are the secrets of success of IJV deals. Similarly, country specific factors are also important determinants of successful IJV deals. However, the subject has not been extensively researched. The fact is that details about ownership of Indian IJVs has not been documented at all.

d. Capabilities and Performance

There might be number of plans and strategic initiatives. Ultimately, these moves should result in a boost of performance of the firms. During the execution stage of IJV, it is indispensable to ensure that the deal has resulted in the IJV gaining good dynamic capability and competitive advantage, ultimately leading to better performance. No study has been conducted under Indian context to explore whether Indian IJVs have gained dynamic capabilities from their parent companies and the resultant outcome of such gain.

VI. CONCLUSION

Our extensive review has identified many potential researchable areas in case of International Joint Ventures. The study helped in understanding the practical as well as theoretical implications of the works done in the past in a way that will help to further review and bring developments in the existing body of knowledge in the subject matter.

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