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# The effect of foreign partner network embeddedness on international joint venture failure: Evidence from European firms' investments in emerging economies

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## ABSTRACT

Access to trusted information about potential local partners is a critical factor for international joint venture (IJV) stability and success in emerging economies. We build on social network theory and examine how foreign investors can benefit from their alliance networks in accessing reliable information on the availability, resources, and behavior of potential local IJV partners. More specifically, we examine positional embeddedness in networks and network density and how these factors help foreign firms mitigate behavioral uncertainty in IJVs and thus reduce the likelihood of failure. We use data on 349 IJVs formed by 132 European firms in emerging economies during the 1995–1997 period and event history analysis to test our hypotheses. Our findings indicate that having an alliance network is a necessary but insufficient condition to mitigate behavioral uncertainty of local partners. We find that only densely tied networks offer benefits of reliable information on potential local partners that ensure the longevity of IJVs and that a central position in an alliance network translates into lower IJV failure.

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## 1. Introduction

Joint ventures (JVs), i.e. separate organizational entities formed and managed by two or more independent partners (Kogut, 1988, 1989), are a common device for entering into emerging economies (Luo, Shenkar, & Nyaw, 2001; Meschi & Riccio, 2008; Yan, 1998). From a foreign investor's perspective, a key concern in international joint ventures (IJVs) is the mitigation of collaboration hazards related to the unpredictability of the local IJV partner's behavior after the formation phase (Burgers & Padgett, 2009; Das & Teng, 1999; Parkhe, 1993).

IJVs in emerging economies are particularly challenging because the turbulent political, institutional, and economic conditions increase the likelihood of such collaboration hazards (Burgers & Padgett, 2009; Fang & Zhou, 2010; Yan, 1998) and negatively affect an IJV's transaction costs, stability, and outcome (Gulati, 1995b). Often, enforcement of restrictive local regulations on foreign direct investment, greater risks of government expropriation, or more government corruption increase the bargaining power of local IJV partners and likelihood of negative IJV outcomes such as termination before goal achievement, sell-off to the local partner, or buy out by a third party (Hennart, Kim, & Zeng, 1998; Makino, Chan, Isobe, & Beamish, 2007; Meschi & Riccio, 2008; Valdés-Llaneza & García-Canal, 2006).

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Alliance networks can help mitigating partner related collaboration hazards because they represent a reliable source for information on potential IJV partners (Gulati & Gargiulo, 1999; Walker, Kogut, & Shan, 1997). Research that has focused on the role of alliance networks in providing such information has predominantly examined the role of industry-level alliance networks (i.e., alliances among firms in one industry) during the alliance formation phase. Firms' positional embeddedness in such networks and the underlying network structure are key antecedents for alliance formation because they enable information exchange concerning potential partnering opportunities and firms' behavioral track records (Ahuja, 2000; Gulati, 1995a, 1995b, 1999; Gulati & Gargiulo, 1999; Gulati, Nohria, & Zaheer, 2000; Kogut, Shan, & Walker, 1992).

When it comes to understanding alliance failure, however, research on the role of alliance networks has been surprisingly absent. Most research focusing on failure has taken the individual alliance as the unit of analysis and has examined antecedents such as the equity distribution between the partners, partner asymmetries, inter-partner trust, organizational complementarity, cross-cultural differences, alliance scope, rivalry between the partners, and governance structures (Geringer & Hebert, 1989; Gulati, 1995b; Hennart & Zeng, 2002; Nakamura, 2005; Park & Russo, 1996; Park & Ungson, 1997; Parkhe, 1993; Yamin & Golesorkhi, 2010). Only recent research has taken a first step in investigating the effect of industry-level networks on JV dissolution by analyzing the impact of the asymmetry in JV partners' positional embeddedness (Polidoro, Ahuja, & Mitchell, 2011).

The approach of taking industry participation as the key criterion for network boundary definition and network actor inclusion, however, excludes certain relationships and thus limits the generalizability of what we know about the role that alliance networks play. While this approach is suitable for explaining issues such as industry dynamics, competition, and performance heterogeneity (Bae & Gargiulo, 2004; Baum, Calabrese, & Silverman, 2000; Yang, Lin, & Peng, 2011), it is less so for examining a network of alliances between a set of firms that share attributes relevant from an international business and foreign market entry perspective, such as for example the same region of origin or cultural background. Such a perspective is indeed relevant because foreign investors from the same geographic region frequently enter the same foreign markets, partner with the same local firms, and are facing the same regulatory constraints (Goerzen & Beamish, 2005) and thus may take similar benefits from embeddedness in an alliance network. Moreover, the industry-level alliance network perspective ignores that in today's business landscape most firms maintain alliance networks comprised of multiple simultaneous ties to partners from various industries (Wassmer, 2010). An industry perspective, therefore, falls short of capturing interfirm ties beyond the focal industry and thus provides an incomplete picture of how alliance network embeddedness affects alliance outcomes such as dissolution (Goerzen & Beamish, 2005; Rowley, Behrens, & Krackhardt, 2000; Zaheer, Gözübüyük, & Milanov, 2010). For that reason, the alliance network boundary definition in this study takes an extended IJV ego-network perspective (Goerzen & Beamish, 2005; Reuer, Park, & Zollo, 2002; Reuer & Ragozzino, 2006) and includes all direct and indirect ties between foreign investors from the same region of origin (i.e., European Union).

The objective of this study is to extend the prior literature and examine the link between the network of alliances among a set of foreign investors that share the same region of origin and IJV failure. Our study focuses explicitly on IJV failure as the outcome although IJVs may come to an end for other reasons than failure (Lunnan & Haugland, 2008; Makino et al., 2007; Meschi, 2005; Reuer & Zollo, 2005).<sup>2</sup> In line with prior research, we view IJV failure as dissolution or sell-off because both outcomes represent a corrective response to business failure (Geringer & Hebert, 1989; Park & Russo, 1996; Polidoro et al., 2011). Two research questions guide our study: *does a foreign investor's positional alliance network embeddedness affect the failure rate of its future IJVs in emerging economies? What is the impact of alliance network density on the failure rate of IJVs formed in emerging economies by embedded partners?* The crux of our argument is that alliance network embeddedness and network structure specific features provide foreign investors with reliable and useful information not only concerning the availability of potential local partners but also about their reputation, quality of resources, and past behavior (Polidoro et al., 2011). Such information helps to reduce uncertainty and mitigate collaboration hazards (Kogut, 1989; Park & Russo, 1996; Uzzi, 1996) and thus is likely to reduce IJV failure.

In this research, we aim to make three contributions to the literature focusing on the link between alliance networks and IJV failure. First, by applying an alliance network perspective we move beyond the research taking the individual IJV as the unit of analysis and examine how foreign investors' central network positions and specific network structure features can mitigate collaboration hazards with local partners. Second, we move beyond existing industry-level alliance network research that has focused on the relationship between positional embeddedness, network density and alliance failure by examining the network of alliance relationships between foreign investors sharing the same region of origin. Lastly, we provide new empirical evidence of IJVs in the specific context of emerging economies. Examining the role of interorganizational networks as mechanisms to obtain partner information and mitigate collaboration hazards in emerging economies is particularly useful because, in comparison with developed countries, these environments are characterized by additional external uncertainty and a greater likelihood of IJV failure (Burgers & Padgett, 2009; Fang & Zhou, 2010; Yan, 1998). Network embeddedness can help foreign investors mitigate this uncertainty and the hazards related to collaborations with partners for which information is hard to obtain.

The remainder of this paper is organized as follows. In the next section, we develop theory linking alliance network embeddedness, network density, and network position to the likelihood of IJV failure. We then test our theory by using event history analysis and data on 349 IJVs formed by 132 European firms in various emerging economies during the time period

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