How do CEOs matter? The moderating effects of CEO compensation and tenure on equity ownership in international joint ventures

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Abstract

We propose that CEO compensation and tenure moderate the relationship between multinational corporations’ (MNCs) R&D intensities and their percentages of equity ownership in international joint ventures (IJVs). Transaction cost economics (TCE) suggests a positive relationship between MNC R&D intensity and IJV equity ownership, but this relationship has not been confirmed consistently in prior research. We examine the moderating effects of CEO compensation and tenure on the relationship between MNC R&D intensity and IJV equity ownership, thereby bringing more nuanced explanations from agency theory and upper echelons theory into the discussion. Our proposed relationships were tested using a sample of 202 IJVs formed between U.S. MNCs and foreign partners in high-tech industries for the period 1993 to 2003. We found an overall positive relationship between MNC R&D intensity and the percentage of equity ownership in IJVs. Moreover, CEO tenure and bonus compensation each weaken the positive R&D intensity-equity ownership relationship in our sample, while CEO stock options compensation amplifies it. These findings indicate that CEO compensation and tenure influence decision making about equity ownership in IJVs, suggesting that scholars and boards of directors should consider these CEO-related factors when evaluating strategic decisions regarding IJVs.

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1. Introduction

Equity ownership is a major strategic decision when MNCs use IJVs as an entry mode (Hill et al., 1990; Malhotra et al., 2011; Slangen and Hennart, 2008). Much of the research on the determinants of IJV equity ownership has followed a TCE approach (e.g., Buckley and Casson, 1976; Hennart, 1982), finding that firms take ownership strategies that are appropriate for minimizing expropriation risks when deploying IJV assets in foreign countries (Blodgett, 1991; Delios and Henisz, 2000; Gatignon and Anderson, 1988; Geringer and Hebert, 1989; Williamson, 1996). This research has contributed greatly to knowledge of ownership choices in foreign market entry.

A central focus of TCE-based IJV equity ownership research has been to examine the relationship between the R&D intensity of an MNC and its equity ownership in IJVs, because equity ownership is a mechanism that can prevent both potential technological leakage and the hazard of free riding on brand name and reputation (Delios and Henisz, 2000; Pisano, 1990). The findings of this research have been equivocal, however (e.g., Brouthers, 2002; Delios and Henisz, 2000; Hennart, 1991). Inconsistencies in the empirical findings

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concerning the effect of MNC R&D intensity on IJV equity ownership may be due, in part, to implicit assumptions that CEOs have limited influence on the choice of IJV ownership levels, and that any CEO effects that do occur are likely similar across firms and stable over time.

The relative neglect to date of CEO effects may be preventing researchers from more fully understanding the determinants of IJV equity ownership. Indeed, prior empirical findings in closely related areas indicate that, for example, CEO characteristics—such as experiences, backgrounds and succession events—do influence MNCs’ choices of foreign market entry mode (Athanassiou and Nigh, 1999; Herrmann and Datta, 2002, 2006; Liang et al., 2009; Nielsen and Nielsen, 2011; Tihanyi et al., 2000). Moreover, several scholars have found an association of top executives’ or board of directors’ attributes with the choice of full control versus shared control (Datta et al., 2009; Herrmann and Datta, 2002; Lai et al., 2012; Musteen et al., 2009). These findings of CEO effects on IJV characteristics should not be surprising, because according to upper echelons theory top managers’ values, beliefs and experiences combine with organizational situations in determining managers’ interpretations, choices and strategies, and thereby organizational outcomes (Hambrick and Mason, 1984).

Our study makes three major contributions to theory and practice. First, we integrate agency theory, upper echelons theory and TCE in the context of decisions regarding IJV equity ownership percentages. Most conceptual and empirical research using TCE regarding JIVs has focused on strategies or actions that can be undertaken to protect against knowledge leakage or partners’ opportunism, while neglecting the effects of top managers on those actions. Hence, when facing those hazards, the extent to which CEOs with different compensation mixes or tenures actually make decisions or take actions aligned with the interests of their MNCs is still largely an unanswered empirical question. Second, we extend upper echelons theory into a new setting. Most upper echelons research has focused either on the characteristics of top managers (Carpenter and Fredrickson, 2001; Thomas et al., 1991) or on their implications for firm performance (Halebian et al., 2006; Herrmann and Datta, 2002). To date, however, there has been relatively little research that explores the impact of CEO compensation and tenure on the choice of equity ownership percentages in international joint ventures (IJVs). Third, our study provides practical implications concerning how to design optimal compensation packages that best motivate different CEOs to make strategic IJV choices that benefit long-term organizational growth and development.

In sum, we take a step toward reconciling inconsistent empirical findings on the relationship between MNC R&D intensity and IJV equity ownership percentage, by building more nuanced theory regarding CEO effects. Our study examines the moderating effects of CEO compensation and tenure in determining MNCs’ equity ownership in IJVs by integrating agency theory, upper echelons theory and transaction cost theory. Specifically, we investigate how CEO compensation and tenure moderate the well-studied relationship between R&D intensity and equity ownership in IJVs in high-tech industries. By investigating these issues, we strive to provide new insights into the determinants of equity ownership levels in IJVs. For example, are CEOs’ interests always aligned with their MNCs’ interests? If not, are CEOs with certain compensation and tenure characteristics more willing to forgo high ownership in IJVs, despite situations where their MNC may risk losing intellectual property? Put another way, how could these CEO factors contribute to a misalignment in the interests of CEOs and their MNCs in the context of IJV equity ownership? We turn to theory development for these issues next.

2. Theories and hypotheses development

2.1. R&D intensity and IJV ownership

Considerable research has focused on the importance of using IJV equity ownership to increase control and thereby protect proprietary assets (Blodgett, 1991; Gatignon and Anderson, 1988). For instance, in order to align the interests or objectives of IJVs with their parent MNCs, MNCs usually exercise control over IJVs’ operations (Geringer and Hebert, 1989). In addition, some scholars have suggested that dominant control is better for MNCs instead of shared control, since the threat mechanism of dominant control may reduce potential conflicts between partners (Ding, 1997; Mjoen and Tallman, 1997). R&D intensity of an MNC has been used to indicate the level of private expropriation hazard that an MNC may face in its IJV operation (Delios and Henisz, 2000). As Delios and Henisz (2000) claimed, private expropriation hazards lead MNCs to protect their proprietary assets, such as intellectual property, while deploying them in foreign countries. Private expropriation hazards stem from risks of technological leakage and free riding on brand name and reputation during the partners’ interactions.

TCE typically is used to explain firms’ choices of transaction modes (e.g., markets, hierarchies, or hybrid structures), and efficiencies are argued to depend on asset specificity, uncertainty and frequency of transactions (Williamson, 1996). Organizational control is used to protect specific assets and reduce uncertainties in the interactions between organizations (Spekle, 2001). Following the central tenet of TCE, high equity ownership control helps to protect MNCs’ IJV investments against foreign partners’ opportunistic behavior and high uncertainty resulting from goal incongruence and cultural distance (Hamel, 1991; Luo et al., 2001; Martinez and Ricks, 1989). Similarly, Delios and Henisz (2000) argued that the choice of a high ownership level can minimize the cost of exploiting proprietary assets, thereby protecting the rent-generation potential of those assets. As a baseline, we begin with the same, intuitive transaction costs prediction:

**Hypothesis 1 (H1).** The R&D intensity of an MNC will have a positive effect on the MNCs’ percentage of equity ownership in IJVs.

2.2. The moderating role of MNC CEO compensation and tenure

Although the transaction cost approach predicts a positive relationship between R&D intensity of MNCs and their equity ownership in IJVs, so as to prevent technological leakage and the hazard of free riding on brand name and reputation (Delios and
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