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The impact of laws, regulations, and culture on cross-border joint ventures

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ABSTRACT

Both formal (legal) and informal (culture, language, religion) institutions determine the intensity of cross-border joint ventures between one US and one foreign partner. Using a sample of cross-border joint ventures from 105 countries, we investigate the impact of country legal, cultural and business environment factors, industry factors as well as deal specific factors on the intensity of cross-border joint ventures with one US partner. Our results suggest that US firms are more likely to form joint ventures with firms from countries with weaker legal and regulatory environments and with higher cultural, language, and religious disparity from the US. However, compared to mergers between a foreign target and a US bidder, US firms are more likely to form joint ventures with firms from countries with strong laws and regulations, as well as with smaller cultural, language, and religious differences from the US. These findings are consistent with cross-border joint ventures being a "hybrid" organizational form existing in between free-market contracts and firm-like deals such as mergers and acquisitions. Our results further suggest that foreign countries receiving large US foreign direct investments and/or relying less on export and import are associated with higher intensity of cross-border joint ventures. The volume of cross-border joint ventures with US partner is higher for firm from less competitive and/or more politically stable countries. On a firm level, US firms are more likely to form cross-border joint ventures in cases of technology transfers between the joint venture partners, in deals involving partners

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from unrelated industries or with foreign firms not cross-listed in the US. Overall, the results suggest that cross-border joint ventures are optimal, low cost organizational form mitigating information asymmetries, hold-up costs, and poor contract enforceability, especially in environment with larger market imperfections.

1. Introduction

The purpose of this paper is to study the determinants of cross-border joint ventures formed by one US and one non-US (foreign) firm. Over time, joint ventures have become a frequently-used form of organizational structure (SDC Platinum database reports over 4700 cross-border joint ventures involving US subjects between 1989 and 2008). When forming a joint venture, two or more independent entities decide to share certain assets, which are governed jointly, and with substantial influence of the business partners. At the same time, the partners still retain their independence, and they do not establish the traditional "directional" headquarter–subsidiary relationship that bidder and target create as a result of an acquisition. Consequently, the goal of our study is to empirically test the "hybrid" nature of joint ventures, which should be in the middle of the spectrum of contractual forms – between the contracts among independent entities fully governed by market forces – on one hand, and the firm-like contracts where one entity owns another – on the other hand.[3]

We expect the "hybrid" contractual nature of joint ventures, previously empirically tested by e.g. Johnson and Houston (2000) utilizing US data, to be even stronger for deals between subjects from different countries. Because both parties have a "say" in a joint venture, there is a greater need for harmonization in the strategic objectives of each party. Ultimately, joint ventures can be considered contracts that are noisy and associated with difficulties to observe the behavior of the agents (Jandik and Kali, 2009). These problems should be particularly severe in cross-border joint ventures, where the potential information asymmetry between cross-border business partners that arise from different legal and regulatory standards (as well as from cultural and religious differences) in their countries of domicile can impose a greater risk of moral hazard which can potentially result in financial loss. Consequently, joint ventures should be considered market-like alternatives to firm-like mergers and acquisitions (M&A).

On the other hand, joint ventures should be considered firm-like deals when compared to contracts among independent entities fully governed by market forces. Joint ventures can lower business risk, mitigate hold-up costs related to expropriation of business partners in firm-specific investments (Johnson and Houston, 2000), facilitate efficient exchange of information under information asymmetry (Mantecon, 2009; Mantecon and Chatfield, 2007), and limit conflicts due to cultural and religious differences (Lee et al., 2009; Li, 2008), as well as due to corruption (Javorcik and Wei, 2009).

In contrast to previous studies, we analyze the impact of formal (legal), but also informal (culture, language, religion) institutions and Country business climate in terms of overall infrastructure measured by competitiveness index as well as and "openness" to international business on the intensity of cross-border joint ventures. To study these determinants we build a hierarchical model in which we first analyze the impact of country factors, followed by industry factors and at the end joint venture and firm specific factors.

In addition we are the first paper to analyze the determinants of the total number of cross-border joint ventures (with a US partner) in the context of a large cross-section of countries.[4] To further

[3] Johnson and Houston (2000), write on p. 68: "On the theoretical continuum of transaction structures ranging from onetime, discrete, arm's-length market transactions governed by simple contract to complete integration in which the parties become one firm, joint ventures occupy an intermediate position".

[4] In this regard, our study is related to Rossi and Volpin (2004) who analyze the volumes of cross-border M&A.