

# The effect of trust on international joint venture performance in China

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## Abstract

The role of trust between the parent companies of international joint ventures (IJVs) is re-examined, and it is suggested that trust between parents is not only a major predictor of the achievement of financial and non-financial goals by IJVs as reported in the literature, but also moderates the relationship between IJV performance and certain contextual factors.

Based on the responses of senior executives of IJVs and their parent companies in China, it is confirmed that trust influences IJV performance. The moderating effects of trust on the relationships between IJV performance and local reliance and the experience of executives were confirmed for the senior executive sample, but the moderating effect of cultural distance was not consistent between the firm-level and country-level measures. There was no significant result regarding these moderating relationships for the parent sample, except local reliance.

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## 1. Introduction

Kogut (1988) argued that as a method of entry into a new market, a joint venture can reduce transaction costs because it enables the partners to share the ownership, revenue derived, and

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monitoring and control rights. The partner companies are also in a position of mutual hostage, which inhibits their incentive to shirk. Joint ventures are also superior to markets and hierarchies when firms face uncertainty about future development or when information is inadequate (Balakrishnan and Koza, 1993). Nevertheless, the inherent complexity of having two or more owners who may be competitors and collaborators leads to certain difficulties in management. Such problems are magnified when an international joint venture (IJV) is operating in a risky and uncertain setting in which political and opportunistic behavior is rife, as this increases the transaction costs due to increased monitoring, communication, and negotiation requirements (Beamish and Kachra, 2004; Frayne and Geringer, 1990). Thus, joint ventures can only be justified when the benefits of joining outweigh the increased governance costs and possible leakage of know-how (Beamish and Banks, 1987). Maintaining effective and efficient control over operations and sustaining the commitment of the partners are therefore the keys to the success of IJVs.

In the literature, trust between partners is suggested to be an important factor that contributes to the success of IJVs (Currall and Inkpen, 2002; Inkpen and Currall, 2004; Madhok, 2006). Beamish (1993, 2006) supported the view that trust is important for the success of joint ventures in developing countries, and as trust can be easily managed, it can be viewed as a means to facilitate the achievement of the objectives of an IJV (Sheppard and Tuchinsky, 1996). However, large-scale empirical studies on the role of trust in transitional economies have rarely been conducted (Beamish, 1993; Lane et al., 2001).

Since the government adopted an open-door policy to attract foreign investment in 1978, a large number of foreign companies have flocked to the People's Republic of China, and, despite a rising trend in wholly foreign-owned enterprises, the equity joint venture is still a major mode of business operation. IJVs now account for approximately 40% of China's total foreign investment (China Statistical Yearbook, 2005), although this has decreased from about 60% in the 1990s. Most of the studies on the factors that affect the performance of IJVs in China are centered on environmental and market factors (Wong et al., 2003), or the resource commitment of the partners (Yan and Child, 2004). Such studies tend to emphasize the direct effects of these factors on IJV performance, but pay less attention to the evolving relationships and interactions between partners. This study therefore focuses on how trust interacts with market and organizational factors to enhance IJV performance in China.

This study investigates the trust level as it is perceived by both the senior executives of IJVs and the parent companies. This dual emphasis represents an advance in the IJV literature, as most other studies have been conducted either at the joint venture level or at the parent level only (Luo et al., 2001; Osland and Cavusgil, 1998). Furthermore, past studies of IJVs have tended to be conducted from the viewpoint of general managers, with the occasional inclusion of the viewpoint of the foreign parent when it was easy to obtain a response from that party. This study provides richer information by incorporating the expectations of the Chinese parent into the design (Mohr, 2006), and therefore goes beyond looking at the direct effects of trust between parents on IJV performance to examine the interaction of trust with certain market and organizational factors in a transitional economy context from the perspective of both general managers and the local parent.

## **2. Interactions of trust with organizational factors**

Trust has been studied from many perspectives, and remains a complex construct (Lewicki and Bunker, 1996). Rotter (1971, p. 444) defined trust as “an expectancy held by an individual or a group that the word, promise, verbal, or written statement of another individual or group can be relied on.” Mayer et al. (1995, p. 712) asserted that trust “is the willingness of a party to be

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