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# Risk perception and post-formation governance in international joint ventures in Taiwan: The perspective of the foreign partner

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## ABSTRACT

This paper draws on a risk analysis framework in order to develop a systematic understanding of the risks perceived by partners, and to investigate the implications of risk perception for the configuration of control, in the post-formation governance of international joint ventures. The key variables in this framework consist of six situational factors which are considered as potential antecedents of perceived risk: conflict, opportunism, cultural difference, dependence, partner fit, and ownership share; partner's perception of risk; and post-formation governance as a set of outcome variables. The framework is tested using a sample of international joint ventures located in Taiwan. The findings show that conflicts between partners, opportunistic behavior by the local partner, cultural differences, and perceived partner misfit are related to foreign partners' risk perceptions. This study suggests that when foreign partners face likely performance and partnership risks after an IJV is established, they tend to resort to tighter post-formation governance measures in order to increase or maintain their confidence in their joint ventures.

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## 1. Introduction

International joint ventures (IJVs) continue to be an important means for firms to achieve their strategic goals in today's international business environment. However, despite the frequent use of IJVs, they often have a limited life. Some firms may undertake IJVs on a 'real options' basis as a hedge against risk in conditions of uncertainty (Seth and Chi, 2005). Although an IJV may be an alternative to assuming the full risk of investing in a foreign market, it is at the same time an intrinsically risk-taking option. Joint venture partners need to rely upon one another as agents for the fulfillment of their strategic objectives when each needs capabilities that the other can supply. This poses an intrinsic risk if one partner is deficient in its resources, contextual knowledge, or access to markets and local institutions (Doz and Hamel 1998; Child, et al., 2005). The value of an IJV can also be downgraded not only if partners are incompetent or have no intention to meet the other's financial and other business expectations, but also when there is the danger of one partner expropriating key resources from the other (Hamel, 1991; Luo, 2005). Partners in IJVs may incur different types of risk, most of which stem from the inability or unwillingness to pursue agreed goals and from difficulties in the relationships between the partners. Therefore, to make the most of collaborative arrangements, partners need to develop a good understanding of the risks involved in IJV management and learn how to manage them effectively (Das and Teng, 1999).

With a few exceptions (Das and Teng, 2001b; Child and Rodrigues, 2004) most studies have focused on risk assessment at the IJV formation stage. The way in which partners evaluate risks and introduce corrective measures to reduce them once the IJV is

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formed remains relatively unexplored (Inkpen and Currall, 1998; Reuer and Zollo, 2000; Reuer et al., 2002; Brouthers and Bamossy, 2006). The importance of distinguishing the management of IJVs between formation and post-formation stages lies in the fact that, due to the bounded rationality of IJV partners, the viability of an IJV may depend on the flexibility in the relationship between partners and how well partners cope with *ex-post* contingencies and adapt to a changing external environment or interpartner relationship. Moreover, *ex-post* learning may trigger partners' reevaluations and readjustments of the extent of control that one partner can exert over the IJV (Doz, 1996; Child, et al., 2005). Partners may engage in renegotiating *ex-ante* governance mechanisms (e.g. changing the terms of the initial IJV agreement) in order to restore efficiency and equity conditions in IJVs, if required. The present study aims to extend the understanding of risk perception to the IJV's post-formation context by testing a model in which the adoption of post-formation governance mechanisms depends on the perception of risks and conditions that mitigate or exacerbate it, such as the quality of interpartner relationships. Post-formation governance has been studied in different contexts (e.g. Krug and Nigh, 1998; Eden and Molot, 2002; Alpay et al., 2005), but our knowledge of IJVs' post-formation dynamics and control is still limited to a small number of studies. Most of them are either conceptual or case-based (Ring and Van de Ven, 1994; Doz, 1996; Ariño and de la Torre, 1998; Reuer et al., 2002; Lui and Ngo, 2005; Brouthers and Bamossy, 2006).

The fact that many IJVs suffer from management problems and poor performance (Nippa et al., 2007) indicates the need for further research on effective cross-border monitoring and governance practices. Post-formation governance decisions are perceived to be crucial for ensuring that partners' intentions will be met. Studies have found that IJVs often fail because partner firms do not implement 'post-formation processes' by which partners can affect IJV performance through adjusting and adapting governance and control (Inkpen and Currall, 1998; Brouthers and Bamossy, 2006; Ariño et al., 2008). Similarly, Doz (1996) suggests that the outcomes of collaborations are not solely determined by initial formation conditions, but also by partners' adaptive capability to accommodate and manage changing conditions in the evolution of IJVs.

In the study to be presented, governance is defined as 'the process of control over and within the firm (that is, the IJV) that aims to reduce risk to its owners and to ensure that its activities bring a stream of acceptable returns to those owners in the long term' (Child and Rodrigues, 2004, p.90). IJV governance has been studied from different perspectives (e.g., transaction cost, trust, institutional and behavioral approaches), but a risk-based view of it is yet to be fully developed. It is clear from previous studies on strategic alliance that transaction cost theory contributes important insights into the governance forms available for alliance partners to adopt. Nevertheless, it mainly deals with considerations of cost and efficiency and does not suggest methods for maintaining IJVs once they are formed.

This paper proceeds as follows. Section 2 develops a theoretical model and hypotheses on the relations between risk perception in IJVs and its antecedents and, secondly, on risk perception and post-formation governance. The framework allows for two main possibilities: (1) that antecedent situational factors influence post-formation governance measures through the mediation of perceived risk; and (2) that they have direct effects. Section 3 discusses the methodology employed to test the proposed model and constituent hypotheses. The results and findings are presented in Section 4. Sections 5 and 6 are devoted to the discussion and conclusion of this paper.

## 2. Theoretical model and hypotheses

### 2.1. Risk conceptualization and perception in international joint ventures

The notion of risk has been widely discussed and defined in different management disciplines, including strategy, finance, and marketing. Risk, as treated in the so-called 'classical approach', is conceptualized as the possibility or probability of loss as well as variance in the expected outcomes (Baird and Thomas, 1990). However, some studies (March and Shapira, 1987; Miller and Leiblein, 1996; Miller and Reuer, 1996; Ruefli et al., 1999) argue that the 'classical' approach fails to capture the concept of risk as perceived and recognized by managers. From the managerial point of view, risk is often perceived to be associated with hazards, disappointing or negative outcomes (March and Shapira, 1987; Sitkin and Pablo 1992; Miller and Leiblein, 1996) which have a significant impact on the organization's value and its ability to achieve targets. Risk is therefore defined here as the perception of potential instabilities and vulnerabilities faced by companies which impose limitations, restrictions, or even losses in international business (Ahmed et al., 2002). Previous studies (e.g. Miller, 1992; Child and Rodrigues, 2003, 2004) suggest various sources of risk facing multinational companies, such as general environmental uncertainty, institutional risk, industry/market risk, resource deficiency risk, and agency risk. The IJV literature suggests that resource deficiency and other asymmetries between different firms can explain why partners decide to cooperate through forming an IJV. Agency theory nevertheless suggests that these same reasons may encourage partners to cheat and use the partnership opportunistically to advance their interests (Child and Rodrigues 2004). The sources of risk or uncertainties mentioned above have implications for the cooperation among partners and for venture performance outcomes (Ring and Van de Ven, 1994; Das and Teng, 1996).

Risk perception is defined as a "decision maker's assessment of the risk inherent in a situation" (Sitkin and Pablo, 1992, p. 12). The assessment of risk reflects the degree to which an individual perceives a particular situation as negative or as a threat (Sitkin and Weingart, 1995). Risk in IJVs may occur where one partner experiences potentially negative outcomes from the untrustworthy behavior of the other partner (Inkpen and Currall, 1998). In general, according to Das and Teng's (1999; 2001a) research on risk perception, risk in inter-firm collaborations can be one of into two types. First, there is relational risk – the likelihood that partner firms may lack commitment to the alliance. This type of risk is said to be unique to partnering arrangements (Delerue, 2004). Opportunism and cultural clashes have been identified as sources of relational risk (Das and Teng, 2001c). Another source of relational risk can arise from inequity as perceived by partner firms (Das and Teng, 1996). As Das and Teng (1996) remark, 'if

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