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Equity control and the survival of international joint ventures: a contingency approach

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Abstract

This study attends to equivocal results regarding the relationship between equity control and international joint venture (IJV) performance by proposing a transaction-cost-based contingency framework. We examined the moderating effects of asset specificity and uncertainty on the relationship between foreign parent equity control and IJV survival in an empirical setting of Japanese IJVs in 12 Asian countries in the 1985–1996 period. Our findings suggest that in the presence of high asset specificity, high levels of foreign equity control can lead to higher IJV survival rates. Furthermore, we find that social knowledge can serve as a substitute for equity control in IJVs and contribute to higher IJV survival rates.

Keywords: Equity control; International joint venture; Contingency approach

1. Introduction

Ownership position in international joint ventures (IJVs) is a critical issue (Luo et al., 2001). There is a mounting body of research on ownership and equity control that can be divided into two research streams. One stream looks at the initial conditions of IJV parent firms and the optimal level of equity control. The general findings in this stream support a transaction cost argument that higher levels of equity control are preferred when the appropriation risk of firm-specific assets in the IJV is high. Yet, the performance outcomes of these ownership strategy predictions have yet to be explored.

The second stream on ownership and control has focused on the relationship between equity control and the performance of IJVs. However, there is no clear consensus on the relationship between equity control and IJV performance. Researchers have reported a positive relationship (Killing, 1983; Delios and Beamish, 2004), a negative relationship (Beamish, 1984; Lu, 2000) or no clear relationship at all (Kogut, 1988; Steensma and Lyles, 2000) between dominant foreign equity control and IJV performance. A fourth group has suggested a contingency approach for this relationship (Yan and Gray, 1994). Recently, research has taken the perspective of local partners to show that in emerging countries IJVs, equity control was more important for a foreign firm's satisfaction and performance assessment than for a local partner's (Luo et al., 2001).

At best, these findings on the relationship between equity control and IJV performance remain equivocal. In this study, we attend to the equivocal results regarding the relationship between equity control and performance by combining these two IJV research streams. We investigate the linkages between the initial conditions for the IJVs, foreign equity control and the survival of IJVs using a transaction cost-based contingency framework. Particularly, at the formation of an IJV, foreign investors need to account for appropriability risks associated with transferring firm-specific assets as well as with the uncertainty linked to operating in an unfamiliar environment. These conditions may moderate the impact of equity control on performance (Hébert, 1994). Therefore, we contend that it is not the level of equity control itself, but the fit between the initial conditions for the IJV and the level of equity control, which

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influences the performance of IJVs. By adopting a contingency framework, we contribute to both research streams. For the ownership strategy stream, our study provides a direct test of the survival implications of the ownership levels based on the predictions of the transaction cost theory. For the equity control–IJV performance stream, we specify conditions under which different levels of equity control enhance IJV survival. Finally, with its focus on Asia-based IJVs, the study addresses the robustness and relevance of transaction cost economics outside the Western developed world.

2. Theoretical framework and hypotheses

Control in IJVs refers to the ability to exercise authority and influence over the IJV's strategic and operational decisions, systems and methods (Anderson and Gatignon, 1986), with equity stakes being regarded as a central element in parent control (Geringer and Hébert, 1989). Some researchers have raised the point that control was not always a strict consequence of one's equity position. Others have suggested that ownership was only one of many control mechanisms available to firms (Sohn, 1994). Still, evidence has indicated that firms do rely extensively on equity control and related voting control in IJVs, especially for foreign investors in developing country IJVs (Luo et al., 2001). Although the correlation between equity share and control might not be perfect, the two dimensions are difficult to dissociate (Killing, 1983; Hébert, 1994).

Two main streams of research have addressed the ownership and control issue in IJVs (see Fig. 1). We contend that a combination of these two approaches should provide a more complete picture of the relationship between initial conditions of parents, equity control and IJV performance. Specifically, we look at the effects of the fit between a parent firm's initial conditions and its level of equity control on the outcomes of IJVs (Geringer and Hébert, 1989). As transaction cost theory has been an elemental part of the analyses on the optimal level of equity control, we extend those insights into our contingency framework of IJV performance.

3. Equity control and IJV survival

Research on IJV structure and performance, as based in transaction cost theory, has emphasized the appropriability risks presented by IJVs and thus the importance to protect the rent an investor can obtain from its participation in an IJV (Rugman, 1981; Teece, 1986; Madhok, 1997; Oxley, 1997). Specifically, goal incongruence as well as coordination costs between parents can generate substantial transaction costs, associated primarily with opportunism, bounded rationality and asset specificity (Williamson, 1975). Opportunism has been deemed the main appropriability contingency faced by foreign investors, particularly in IJVs (Beamish and Banks, 1987). Opportunistic behaviors by the local partner can take various forms, such as attempts to take advantage of the relationship, "free-riding" and/or limiting its contribution to the venture. In addition, risks of undesired dissemination of a firm's advantages may also result in consequential transaction costs. These transaction costs can limit the potential gains from cooperation, impair its strategic benefits and destabilize an IJV.

Several studies have conveyed the perspective that ownership control embodies the governance features of hierarchical organizations in an IJV. Ownership control provides monitoring, goal alignment and incentives, thereby minimizing self-seeking preemptive behaviors and promoting contract enforcement. Extensive control, however, can generate significant governance and bureaucratic costs; it may entail considerable commitments of managerial resources and executives' attention (Anderson and Gatignon, 1986). These governance and bureaucratic costs can limit the efficiency of the JV, offset its competitive benefits (Hill and Kim, 1988) and create conflicts (Beamish, 1984; Yan and Gray, 1994).

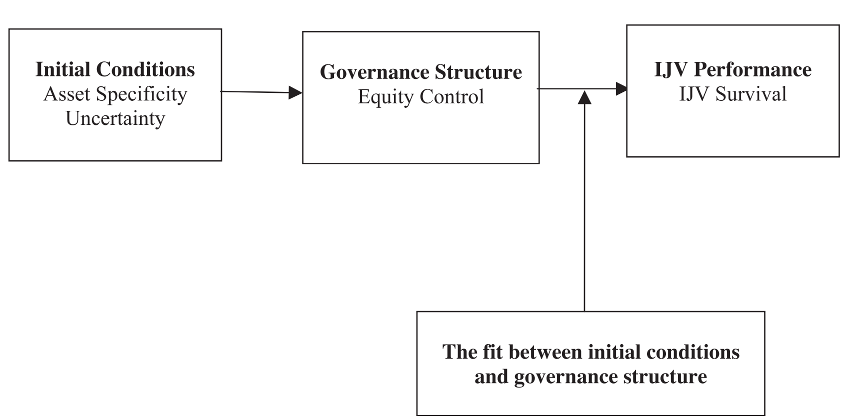

Fig. 1. Equity control and IJV performance: a transaction-cost-based contingency framework.