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Asymmetric wealth gains in joint ventures: Theory and evidence

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Abstract

I examine the causes of asymmetric wealth gains (instances where one partner gains and the other partner loses) and the extent of these gains in joint ventures. I argue that asymmetric gains arise as the common benefits created by the venture are offset by the negative wealth effects of resource appropriation for one parent. Using a sample of 412 joint ventures I find that in 42% of the ventures one parent gained and the other lost. In addition, I find that when the abnormal returns of parents within a venture were compared, firms that gained more from forming the venture experienced $[-1, 0]$ returns of $+3.22\%$ and firms that gained less experienced $[-1, 0]$ returns of -1.37%. Additional analyses showed that asymmetric wealth gains tended to occur in ventures where one parent had relatively high valued resources and the other parent had relatively lower valued resources thus suggesting that resource appropriation may be an important cause of this pattern of gains.
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1. Introduction

Over the last two decades there has been a large body of research in the finance (e.g., McConnell and Nantell, 1985; Chan et al., 1997; Johnson and Houston, 2000) and strategy literatures (e.g., Woolridge and Snow, 1990; Koh and Venkatraman, 1991; Balakrishnan and Koza,

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1993; Madhavan and Prescott, 1995; Merchant and Schendel, 2000; Anand and Khanna, 2000; Kale et al., 2002; Gulati and Wang, 2003) that has examined the valuation effects of joint ventures.[1] Using a wide range of samples and settings this research has found that on average the wealth gains associated with joint ventures are positive, and that joint ventures create value for parent firms.

But although these studies have provided important insights, unlike the mergers and acquisitions literature, they do not examine how the wealth gains of parents *within* each joint venture are distributed. This raises an important set of questions: Do both parents gain from forming a joint venture? To what extent are the gains symmetrically/asymmetrically distributed between parents? What are the causes of asymmetric gains? Addressing these questions is important for two reasons. First, it facilitates a better understanding of factors influencing value creation in joint ventures. Second, it provides insight into why a significant proportion of firms experience negative returns on announcing a joint venture. Previous studies show that somewhere between 33% (McConnell and Nantell, 1985) and 46% (Gulati and Wang, 2003) parents earn negative returns. Hence an exploration into the causes of asymmetric gains would also shed light on the sources of these negative returns.

This paper's purpose is to address the above questions and gaps in the literature. Toward this objective the paper proceeds in the following steps: in the next section I develop initial theoretical arguments for why asymmetric wealth gains are likely to arise in joint ventures. Following this, in the next section I empirically explore the extent of asymmetric wealth gains in a sample of 412 joint ventures. I find two key results. First, I find that in 42% of the ventures one parent experienced positive abnormal returns and the other parent experienced negative abnormal returns. Second, I find that when the abnormal returns of parents within a venture were compared, firms that gained more from forming the venture experienced $[-1, 0]$ returns of $+3.22\%$ and firms that gained less experienced $[-1, 0]$ returns of -1.37%. These results together suggest that asymmetric wealth gains play a significant role in joint ventures. Given these results, in the next section I conduct a more in depth investigation into the causes of asymmetric gains. I find support for the notion that asymmetric wealth gains arise when the common benefits created by the venture are offset by the negative wealth transfer effects of resource appropriation for the parent with more valuable resources. In the final section I conclude with implications and directions for future research.

2. Sources of symmetric/asymmetric gains

Joint ventures create value through various mechanisms. First, they provide a means for combining complementary inputs and deriving synergies (Buckley and Casson, 1988; Hennart, 1988). In this regard they are particularly effective when the combination of inputs through market contracts is subject to imperfections such as asset specificity. Second, joint ventures may help alleviate various constraints on firm growth. These constraints may include financial constraints, or managerial constraints which may prevent other modes of growth such as greenfield investments. Third, joint ventures also provide the flexibility to increase/decrease commitment while sharing investment with another firm. By providing this flexibility they also act as effective real

[1] Joint ventures are defined as independent legal entities in which two or more firms combine resources through equity participation. In this study I consider only two parent joint ventures. In addition I also do not consider non-equity forms of cooperation such as marketing and distribution alliances, and licensing arrangements.

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