



# Termination of related and unrelated joint ventures: A contingency approach<sup>☆</sup>

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## ABSTRACT

Previous research has investigated various factors that influence joint venture (JV) termination. Yet the majority of studies do not distinguish between different types of JVs, particularly whether a JV is related or unrelated to the parent firm. Due to their inherent differences, related and unrelated JVs are likely to evolve distinctly, and their tendency to terminate may also differ under various conditions. This study takes a contingency approach and argues the impact of various factors on JV termination depends upon JV relatedness. An event history analysis finds increases in environmental uncertainty and higher resource complementarity reduce the likelihood that a firm will terminate unrelated JVs as compared to related JVs. Conversely parent firm performance and wider JV scope increase the likelihood that the firm will terminate unrelated JVs as compared to related JVs. The findings suggest the need to consider JV relatedness in understanding JV evolution and termination.

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## 1. Introduction

Joint ventures (JVs) are known to be short-lived, with estimated termination rates in the vicinity of 50% (Harrigan, 1988). Research has investigated various factors that influence JV termination, including uncertainty in the environment (Kogut, 1991; Xia, 2011), parent firm characteristics such as size (Hennart, Kim, & Zeng, 1998) and resources (Cui, Calantone, & Griffith, 2011), and internal factors such as ownership structure (Killing, 1983) and the degree of competition between partners (Dussauge, Garrette, & Mitchell, 2000; Greve, Baum, Mitsuhashi, & Rowley, 2010).

While this research provides valuable insights (Jiang, Li, & Gao, 2008), it does not distinguish between different types of JVs, specifically whether they are related or unrelated to the parent firm. Related JVs are formed to access existing resources and leverage scale and scope economies, while unrelated JVs are to learn about a new market and acquire new capabilities (Lu & Beamish, 2001; Nielsen & Nielsen, 2009). These differences suggest the evolution of related and unrelated JVs is likely to be differentially affected by various factors. While previous research finds related JVs are less likely to terminate than unrelated JVs (Hennart et al., 1998), there is limited understanding about whether their termination is impacted differently by the factors identified in the literature.

This study intends to address this gap and asks the following question: how does the impact of various factors on termination vary between related and unrelated JVs? An event history analysis finds an increase in JV environmental uncertainty and higher resource complementarity reduce the likelihood of termination of unrelated JVs compared to related JVs. Conversely higher parent firm performance and a broader JV scope increase the likelihood of termination of unrelated JVs compared to related JVs. These findings highlight the importance of taking into account JV relatedness and adopting a contingent approach toward studying JV termination (Lu & Hebert, 2005; Nielsen, 2010a).

## 2. Theory and hypotheses

As noted above, important differences exist in terms of motives between related and unrelated JVs. Due to these inherent differences, some factors tend to have a greater destabilizing effect on related JVs compared to unrelated JVs; while others tend to have a reverse effect. The present study proposes and tests hypotheses highlighting how various factors have a *differential* effect on the termination of related and unrelated JVs. Fig. 1 outlines the conceptual framework.

### 2.1. The environment and the impact of uncertainty

The real options perspective provides a useful theoretical lens to examine how environmental conditions influence the evolution of JVs (Kogut, 1991; Reuer & Tong, 2005). JVs allow firms to learn about a new market at relatively low costs because the firm can wait for the right conditions to emerge before further increasing investment. In this sense JVs act as real options in new markets by protecting the firm

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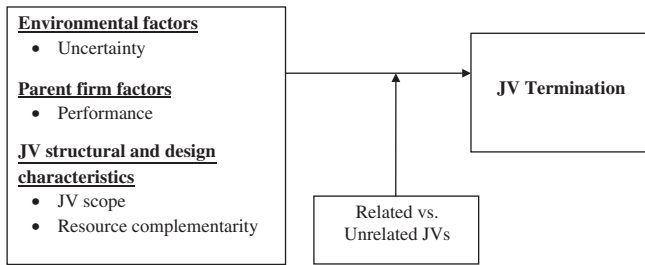


Fig. 1. Theoretical framework.

from down side risk while allowing the firm to capture upside gains when conditions turn favorable (Kumar, 2005).

The real options view predicts a negative relationship between increases in environmental uncertainty and the likelihood of JV termination because when uncertainty increases it pays to 'keep options open'. While this view has received wide empirical support (Cuyper & Martin, 2007; Vassolo, Anand, & Folta, 2004), the literature does not distinguish between related and unrelated JVs. Although Kogut (1991) highlights the real option features of JVs specifically when entering new markets, the literature has assumed all JVs exhibit such features. More recently Tong, Reuer, and Peng (2008) argue that real option theorizing does not necessarily apply to all JVs, and that it is necessary to identify its boundary conditions.

Consistent with Kogut (1991) and Tong et al. (2008) we suggest that the real options prediction may apply to unrelated JVs rather than related JVs. Following Myers (1977), Kogut (1991) and Tong et al. (2008), the value of a JV can be written as the sum of two components:

$$V_{JV} = V_{AIP} + V_{GO}$$

Where  $V_{JV}$  is the value of the JV,  $V_{AIP}$  is the value of the JV's assets in place, and  $V_{GO}$  is the value of the JV's growth options.  $V_{AIP}$  pertains to the rents derived by exploiting existing assets in current environmental conditions.  $V_{GO}$  pertains to the rents derived from future opportunities. Options theory suggests when uncertainty in the JV market increases,  $V_{GO}$  increases since the potential for capturing upside gains increases while the potential for down side losses is limited due to shared investment (McDonald & Siegel, 1986). On the other hand, increases in uncertainty may reduce the value of  $V_{AIP}$  as existing competencies are no longer applicable and need to be reconfigured to deal with a new set of environmental contingencies.

For unrelated JVs,  $V_{AIP}$  is relatively smaller compared to  $V_{GO}$  (that is  $V_{AIP} \ll V_{GO}$ ) because rather than from existing resources, these JVs create value in the future through the gathering of information in new markets (Kogut, 1991; Leiblein, 2003). Thus increases in uncertainty would increase the value of unrelated JVs on the net (Belderbos & Zou, 2009), since  $V_{GO}$  would rise sufficiently to offset any decrease in  $V_{AIP}$ . In contrast, when a JV is related,  $V_{AIP} \gg V_{GO}$ . A significant proportion of the value in related JVs comes from deploying existing competencies in current uses rather than from growth options. When related JVs are exposed to increases in environmental uncertainty, the value of existing competencies may be reduced which reduces  $V_{AIP}$ . This loss in value would offset increase in  $V_{GO}$  thereby lowering the overall value of the JV. Thus when uncertainty in the JV's market increases, there is more value for the parent firm to maintain an unrelated JV than a related JV. In this sense related JVs may be equally prone to risks and uncertainty as wholly owned business units, that is their susceptibility to such risks may be independent of their governance structure. This argument may help explain why some studies (Gomes-Casseres, 1987; Hennart et al., 1998) find risk and uncertainty to

equally impact JVs as other business units, a finding that seems at odds with the real options literature. Hence:

**Hypothesis 1.** Increases in environmental uncertainty in the JV market will decrease the likelihood that the firm will terminate unrelated JVs compared to related JVs.

## 2.2. The impact of parent firm performance

Another dimension that is likely to differentially influence the termination of related and unrelated JVs is parent firm performance. A JV is embedded in the parent firm's overall strategy and coevolves with the parent firm over time (Koza & Lewin, 1998). Hence there is a necessity to take into consideration parent firm factors to further understand JV stability (Cui et al., 2011; Nielsen, 2010a). To examine parent firm factors, the important distinction between exploration and exploitation becomes relevant (March, 1991). Although JVs in related businesses can involve exploration (for example a pharmaceutical company's JV with a biotech company to develop new drug discovery capabilities), on average such JVs are more likely to lie at the exploitation end of the spectrum than unrelated JVs (Hennart, 1988; Teece, 1986).

While March (1991) suggests that firms need to strike a balance between exploration and exploitation, recent work argues that, rather than concurrently pursuing the two objectives, firms are likely to alternate between periods of exploration and exploitation (Gupta, Smith, & Shalley, 2006). The latter view, which Gupta et al. (2006) term as the punctuated equilibrium view, has received strong empirical support (Lavie & Rosenkopf, 2006; Rothaermel & Deeds, 2004). The punctuated equilibrium view raises the question of *when and under what conditions* firms are likely to emphasize one activity over the other. One condition that may influence the choice is the performance of a firm. Firms can be viewed as continually searching for performance peaks on a rugged, competitive landscape (Cyert & March, 1963). When a particular performance peak is attained, there is likely to be an increased emphasis on exploitation as firms temporarily stabilize their position and derive rents before embarking on further search (Hoffmann, 2007).

Accordingly a parent of higher performance is more likely to face the punctuation point and transition from exploration to exploitation while terminating its unrelated JVs (Wu & Cavusgil, 2006). This rebalancing is likely to occur as the firm devotes scarce managerial resources (Kumar, 2009) to maximizing value from related JVs. In contrast, a parent with lower performance is more likely to transition from exploitation to exploration and continue search for growth opportunities through unrelated JVs.

The above arguments are also supported by the *problemistic search* model of decision making (Cyert & March, 1963). When performance is above an aspiration level, the firm's focus is mainly on exploitation; however when performance falls below aspiration exploration is initiated. Thus the problemistic search view also suggests that higher performance will be associated with greater exploitation and emphasis on related JVs. Further, the literature on diversification suggests that firms experiencing lower performance tend to undertake defensive diversification and expand into unrelated markets (Chatterjee & Wernerfelt, 1991; Rumelt, 1982). Thus:

**Hypothesis 2.** Higher performance will increase the likelihood that the firm will terminate unrelated JVs compared to related JVs.

On the other hand, higher performance may also provide firms the resource slack to explore new opportunities (Nohria & Gulati, 1996). This view is termed the *slack search* model of decision making (Cyert & March, 1963). When performance is at higher levels, the potential risks and failures typically associated with exploration can be more easily absorbed, which may incentivize firms to shift toward search

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