joint ventures

Derek F. Channon and Tanya Sammut-Bonnici

Joint ventures are a form of cooperative strategy where firms create an alliance in order to combine their resources and capabilities. The objective is to establish a stronger competitive position. Firms can diminish the negative effects of competitive rivals by building higher barriers to entry through amalgamating financial resources, research and development, production, and distribution channels. Joint ventures increase the profitability of an industry by reducing competition in markets where both firms are present.

The most common entry strategy for global firms to enter international markets is through joint ventures with local firms, followed by acquisitions. The supermarket chain Groupe Auchan created the joint venture Sun Art Retail Group with Taiwan conglomerate Ruentex to establish China's largest hypermarket chain. Global rivals Carrefour and Wal-Mart Stores, United Kingdom's Tesco, and Germany's Metro had to slow down plans in the country in view of the strength of the venture. Auchan recently restructured its stake in the joint venture with Ruentex, leading to the acquisition of a majority stake in Sun Art Retail Group.

Microsoft and General Electric set up Caradim, a joint venture aimed at helping the health industry use online medical records to improve health services. Google and Motorola joined forces to satisfy Google's strategy to acquire patents and Motorola's efforts to compete with Apple's iPhone. Volkswagen Group and GM Motors have set up joint ventures with corporations in China, Mexico, Taiwan, Turkey, and India, among others. The objective was to establish manufacturing presence and distribution chains in the respective countries.

Joint ventures may well prove to be a useful, and indeed necessary, way to enter some new markets, especially for multinational firms. In some markets, which restrict inward investment, joint ventures may be the only way to achieve market access. Within joint ventures, the participants usually take clear equity positions. Such holdings can vary substantially in size, although it is usually important to establish clear lines of management decision-making control in order to achieve success.

A lesser form of participation, which may or may not involve equity participation, involves strategic alliances. Joint ventures do tend to have a relatively high failure rate. Nevertheless, they also enjoy a number of specific advantages.

Advantages of Joint Ventures

First, for the smaller organization with insufficient finance and/or specialist management skills, the joint venture can prove an effective method of obtaining the necessary resources to enter a new market. This can be especially true in attractive developing country markets, where local contacts, access to distribution, and political requirements may make a joint venture the preferred, or even legally required, solution.

Second, joint ventures can be used to reduce political friction and local nationalist prejudice against foreign-owned corporations. Moreover, political rules may discriminate against subsidiaries that are fully foreign-owned, and in favor of local firms, through the placing of government contracts or through discriminating taxes and restrictions against foreign firms importing key materials, machinery, and components. With the development of trading blocs such as the European Union and NAFTA, intergovernmental negotiations have seen the introduction of tariff walls to protect the participants. As a result, despite the development, the use of joint ventures to gain access to trading bloc markets has increased.

Third, joint ventures may provide specialist knowledge of local markets, entry to required channels of distribution, access to supplies of raw materials, government contracts, and local production facilities. Japanese companies have actively exploited joint ventures for these purposes. Triad alliances have, thus, often led to Japanese manufacturers linking with European and/or North American manufacturers to provide badge engineered products, which have enhanced the global volume production of the Japanese suppliers and gained them access to Western developed country markets without

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political friction. Similarly, after the first oil-price shock, the Japanese moved swiftly to use joint ventures in order to gain access to secure supplies of oil.

Fourth, in a growing number of countries, joint ventures with host governments have become increasingly important. These may be formed directly with state-owned enterprises or directed toward national champions. Such ventures are common in the extractive and defense industries, where the foreign partner is expected to provide the necessary technology to aid the developing country partner.

Fifth, there has been growth in the creation of temporary consortium companies and alliances to undertake particular projects that are considered to be too large for individual companies to handle alone. Such cooperations include new major defense initiatives, major civil engineering projects, new global technological ventures, and the like.

Finally, exchange controls may prevent a company from exporting capital and, thus, make the funding of new overseas subsidiaries difficult. The supply of know-how may, therefore, be used to enable a company to obtain an equity stake in a joint venture, where the local partner may have access to the required funds.

Disadvantages of Joint Ventures

Despite the advantages of joint ventures, there remain substantial dangers that need to be carefully considered before embarking on a joint venture strategy.

The first major problem is that joint ventures are very difficult to integrate into a global strategy that involves substantial cross-border trading. In such circumstances, there are almost inevitable problems concerning inward and outward transfer pricing and the sourcing of exports, in particular in favor of wholly owned subsidiaries in other countries.

Second, the trend toward an integrated system of global cash management, via a central treasury, may lead to conflict with local partners when the corporate headquarters endeavor to impose limits or even guidelines on cash and working capital usage, foreign exchange management, and the amount, and means, of paying remittable profits. As a result, many multinationals that generate joint ventures may do so outside a policy of global strategy integration, making use of such operations to service restricted geographic territories or countries in which wholly owned subsidiaries are not permitted.

A third serious problem occurs when the objectives of the partners are, or become, incompatible. For example, a global firm may have a very different attitude to risk than its local partner and may be prepared to accept short-term losses in order to build market share, to take on higher levels of debt, or to spend more on advertising. Similarly, the objectives of the participants may well change over time, especially when wholly owned subsidiary alternatives may occur for the global firm with access to the joint venture market.

Fourth, problems occur with regard to management structures and staffing of joint ventures. This is especially true in countries in which nepotism is common and in which jobs have to be found for members of the partner's families, or when employment is given to family members of local politicians or other locals in positions of influence. From the perspective of the global firm, seconded personnel may also be subject to conflicts of interest, in which the best actions for the joint venture might conflict with the strategy and objectives of the global firm shareholder.

Finally, many joint ventures fail because of a conflict in tax interests between the partners. Many of these could actually be overcome if they were thought through in advance; however, such problems are rarely foreseen. One common problem occurs as a result of start-up losses. Owing to past write-offs, accelerated depreciation, and the like, it is common for capital-intensive businesses to report operating losses in their first few years. It is, therefore, possibly more attractive for the local partner if these losses can be used to offset against other locally derived profits. To obtain such tax advantages, however, certain minimum levels of shareholdings may be necessary, and this may be in conflict with the aspirations of an MNC partner. The precise nature of the shareholding structure of joint ventures, therefore, needs to be considered at the formation stage in order to

maximize fiscal efficiency and avoid this form of conflict.

Joint Venture

Because of the potential difficulties that can occur with joint ventures, they should be formulated carefully and the Articles of Association only drawn up after consideration of the objectives and strategies of the participants, both at the time of formation, and as they might reasonably be expected to evolve in the future. Furthermore, such an agreement should set out, in clear language, the rights and obligations of the participants, taking care that differences in interpretation due to translation are not introduced when more than one language is used. The country of jurisdiction under which any disputes would be settled also needs to be clearly stated. The joint venture agreement should then cover the following points:

- Legal nature of the joint venture and the terms under which it can be dissolved.
- Constitution of the board of directors and the voting power of the partners.
- Managerial rights and responsibilities of the partners.
- Constitution of the management and appointment of the managerial staff.
- Conditions under which the capital can be increased.
- Constraints on the transfer of shares or subscription rights to nonpartners.
- Responsibilities of each of the partners in respect of assets, finance, personnel, R&D, and the like.
- Financial rights of the partners with respect to dividends and royalties.
- Rights of the partners with respect to the use of licenses, know-how, and trademarks in third countries.
- Limitations, if any, on sales of the joint venture's products to certain countries or regions.
- Arbitration clause indicating how disputes between partners are to be resolved.
- Conditions under which the articles of the joint venture agreement may be changed.
- Consideration of how the joint venture can be terminated.

See also *acquisition strategy*; *complex adaptive systems*; *conglomerate strategy*; *cooperative strategies*; *coopetition*; *corporate venturing*; *leveraged buy-outs*; *joint ventures*; *strategic alliances*; *strategic networks*

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