MONASH
UNIVERSITY

Working Paper Series

MAR1/97

International Joint Venture: An Ideal Mode of Entry in a Developing Country

by
M. Yunus Ali

ISBN 0 909170 85 1

School of Business and Electronic Commerce
FACULTY OF BUSINESS AND ECONOMICS

School of Business and Electronic Commerce
Working Paper Series

The purpose of this Working Paper Series is to promote the reporting of research and the discussion of issues relating to the School's seven discipline areas - Accounting, Economics, Law, Management, Marketing, Tourism and Electronic Commerce. The authors are either staff members of the School of Business and Electronic Commerce or other persons invited to contribute to the Working Paper Series. The views expressed herein are not necessarily those of Monash University. Further information concerning the Working Paper Series should be addressed to:

The Convenor - Working Paper Series
School of Business and Electronic Commerce
Monash University
Churchill, Victoria 3842
Australia

or Telephone: (051) 22 6380
(03) 990 26380

or Fax: (051) 22 6524
(03) 990 26524

ISSN 1323-9147

Monash University
Economics and Business Faculty
School of Business and Electronic Commerce

Working Paper Series

MAR1/97

International Joint Venture: An Ideal Mode of Entry in a Developing Country

by

M. Yunus ALI [1]

ISBN 0 909170 85 1

Abstract

Bangladesh has a great potential for foreign firms for both trade and investment but Australian companies have shown little or no interest to that opportunity. Since the liberalisation of its investment policy in the early 1980s, Bangladesh has attracted a considerable number of foreign investment projects, mostly in joint venture with local companies. There is a myth in the foreign investment community that international joint ventures (IJV) are less successful in developing countries. Empirical data on performance of IJVs in Bangladesh are used to examine that myth. The paper also answers the question: why some international joint ventures succeed while other fail? Key determinants of IJV performance have been identified by statistical analyses of empirical data. The paper concludes with recommendations for the prospective Australian investors in Bangladesh.

---

[1] Dr. M. Yunus Ali is Lecturer in Marketing at the School of Business and Electronic Commerce, Faculty of Business and Economics, Monash University Gippsland Campus, Churchill, Victoria 3842, Australia. This research was partly sponsored by the University of Wollongong, NSW, Australia.

International Joint Venture: An Ideal Mode of Entry in a Developing Country

1. Introduction

The number of international joint ventures (IJVs) and strategic alliances (SAs) has been increasing dramatically since the 1980s (Hegert and Morris 1988). In recent years IJV is a widely accepted foreign market entry strategy by most international companies including US Fortune 500 companies to cope with the increasing globalisation of their product markets. Globalisation of most product markets is apparent in recent years, and managers' continuos search for creating a sustainable competitive advantage is necessary for a company's survival in that global competition. Hamel and Prahalad (1987) argued that global competitiveness of a firm derive much from benefits of product and country scope as well as from benefits of scale and experience. Costs competitiveness is also an important survival business strategy in many product markets (Porter 1980).

Some developing countries with abundant supply of human resources have competitive advantage and are attractive low-costs production sites for many globalised industries (Porter 1990). In their development cycle, these countries have also great market potential for many industrial and consumer products. While most managers recognise the strategic importance of developing countries as production sites and potential growth markets, not many managers are confident enough in their decisions on entry strategies. The most pressing question managers face is "**which entry mode can help firm acquire the most benefits of scope and scale in a relatively unknown developing country markets**?"

Although transaction cost theory of foreign investment branded joint ventures as an intermediate form of industrial organisation that balance the benefits of full internalisation through wholly-owned subsidiary and arms-length contracts (Dunning 1981: Rugman 1981), the strategic and learning theories view joint ventures differently (Hennart 1988). The pressure of global competition is encouraging international companies to acquire core competence through joint ventures and strategic alliances with other competitors as well as with small local companies for up-stream or down-stream linkage (Hamel 1990; Harrigan 1986). The basic objective of joint venture is learning other's skills and capabilities which can not be gained either through internal development or through arms-length contracts. Cultural diversity of countries makes joint venture an efficient entry mode in a distant culture because management integration is costly for foreign companies (Kogut and Singh 1988; Parkhe 1991). Local partner's resources and skills such as knowledge of local business and management practices, local market, local culture and work practices are tacit human property and can not be acquired through arms-length contracts (Hennart 1988).

2 Are International Joint Ventures Successful?

Some managers have pessimistic attitude towards international joint ventures, especially in developing countries. Relatively high joint venture failure rate in some developing countries often contributes to that perception[2]. But many managers diligently use this increasingly popular organisational form successfully rather than avoiding it. They try to find answers to the question, "why do some IJVs fail while others succeed?" and use those answers to form and manage IJVs for success. This paper provides answers to the following two questions:

[2] For instance, Killing (1983) and Harrigan (1988) reported 30% joint venture failure rate in developed countries but the comparative figures in developing countries are 45% (Beamish 1988) and 50% (Reynolds 1984).

1. Is IJV failure rate in a developing country really high? and
2. What factors determine success and failure of an IJV?

Answers to these questions are drawn upon a recent study of IJVs in Bangladesh. Bangladesh was selected for its unique features of a Least Developed Countries (LDCs) in South Asia with a sizeable number of IJVs.

The foreign investment environment in Bangladesh is liberal through several steps since the late 1970s. Most industrial sectors (with the exception of few defence related sectors) are open for private foreign investment either in whole foreign ownership or in collaboration with local partners. Since the liberalisation of foreign investment, Bangladesh has attracted a sizeable number of foreign investment projects. Foreign direct investment (FDI) projects are now enjoying a wide range of tax and duty exemptions, repatriation of profits and expatriate managers' earnings, local financing and public issue, and one-stop services from two government bodies: Board of Investment and the Export Processing Zone Authority. Export-oriented projects in the Export Processing Zones even enjoy certain additional concessions on import of machineries and raw-materials, industrial relations, and taxation laws (World Bank 1995). Foreign investors from Western Europe, Japan and other Asian countries are dominant in the country's growing investment market but Australian presence is almost non-existent.

The export-oriented Ready-made Garment (RMG) sector has achieved competitive standards in the European and North American markets in terms of costs and quality; and the sector is moving towards the value-oriented top markets (World Bank 1995). The successful experience of RMG exports has equipped many local business firms to diversify their businesses in export-oriented high technology products markets. Asian and European investors are exploiting these opportunities through joint ventures with local firms. This author's study of International Joint Ventures in Bangladesh examined the performance of a sample of the joint venture projects.

3. Empirical Results and Discussion

Author's study of 59 IJVs in Bangladesh (Ali 1995) examined the failure rate and identified determinants of success in a developing country context. The impact of several firm related, industry related, IJVs' managerial control process and partners' country related factors on IJV success was studied in a multivariate regression model. Data were collected by personal interviews with CEOs or top management personnel of IJVs using a standard questionnaire. The study reported both success and failure stories and analysed the underlying effects of the above variables on success of an international joint venture.

A large majority of the IJVs in this sample (39 out of 59 IJVs) were in export-oriented industries where Bangladesh is being used as a cost competitive production site for off-shore manufacturing to cater Wester European and the North American markets. Firms from Western Europe, Japan, Asian Newly Industrialised Countries (NICs), and South and Southeast Asian developing countries are dominant foreign sponsors of the great majority of this IJV sample in Bangladesh.

The research revealed that at the time of the survey, only five IJVs in this sample were waiting closure due to unsatisfactory performance or partners' inability to work together. Another seven IJVs were taken-over by either partner including one take-over by the foreign partner. Eight IJVs maintained the JV status with some changes in partner's equity holding including three cases where foreign partners increased their equity ownership. These four cases of foreign take-over and increasing equity position indicate foreign partners' increasing commitment to the domestic market or the production site. This total 20 cases of failure, take-over and change in partners equity position constitute 34% of the sample which is relatively low in a developing country context and it is comparable to the 30% instability rate in developed country contexts (Killing 1983; Harrigan 1988). Thus the myth on high

IJV failure rate in a developing country context is not supported. This result may also indicates a positive side of the investment environment in Bangladesh.

IJV success was used as a dependent variable in the model to identify its determinants. Drawn upon past researchers in this discipline, a subjective measure of IJV success was adapted in this research to suit the country context. For the purpose statistical analysis, a composite of weighted score was used in the regression model[3]. Stepwise regression method selected five variables that have significant impact on IJV success (see Table 1).

Results indicates that parents' joint venture experience, the degree of resource complementarity, and degree of cooperation between parents have positive impact on joint venture success. In other words, a joint venture is likely to perform better when parent firms have greater experience in the use of JV, partners' contributed resources have greater degree of complementarity, partners level of cooperation is high. The other two industry related variables are not addressed in this paper.

The regression result for JV experience suggests that the greater the past experience of using joint venture by parents, the higher is the level of JV success. This finding provides empirical support to the proposition that partners' learning from past joint ventures is transferable (Blumenthal 1988). This positive impact of JV experience on success is logical in the sense that the more a firm works with joint ventures, the more it learns the techniques of sharing skills and capabilities, and the more it benefits by transferring the experience to subsequent JVs. The greater use of JV by a firm also indicate the firm's commitment to the mode of market entry, and the committed firm take every step to make the joint venture a success (Beamish 1988). The experienced partner knows how to deal with difficult issues of venturing. Thus a joint venture by a MNE with greater experience of other joint venture is more likely to succeed.

[3] See Endnote box for the measurement of IJV success and other independent variables.

Resource complementarity is another important determinant of JV success in this model. In term of the measurement of resource complementarity, the positive regression coefficient indicates that the higher the degree of balance in partners' contributed resources, the greater is the level of success of a JV. A typical case with balanced contributions from its parents is a JV where the local parent in a domestic market-oriented JV have contributed more in managerial personnel, distribution channel, local market knowledge and other country-related attributes such as market access and national identity to the joint venture company. The foreign parent's matching contribution in such a JV included plant & equipment, technology, technical personnel, established brandname, and materials and components. Each parent's contributions complemented the other's which make them mutually interdependent. Parents are more likely to cooperate with each other to facilitate sharing these skills and attributes in a JV for mutual benefits. The contrasting situation of a typical JV where one parent's contributions are relatively dominant than the other's. Regression result suggests that the former JV is more likely to perform better than the later.

Cooperation between partners is another determinant of joint venture success in this model. Cooperation between partners was measured by the extent of amicable decision making in sixteen areas of production technology, product development, production scheduling, recruitment, training and promotion of executives and technical personnel, procurement, sales, and dividend distribution. Lack cooperation between partners tends create a situation where disagreements will predominate. Interpretation of the positive impact of cooperation on JV success is logical as the more the parents are in harmony in the management decision making and operation of their JV, the more they are committed to adequate supply of skills and capabilities to make it a success. Cooperation is the essence of a joint venture relationship which is built upon the spirit of cooperation to achieve business goals that cannot be achieved working alone. An opportunistic behaviour of one parent can ruin joint venture harmony and these partners tend to disagree more frequently over operating and policy decisions, and contribute to conflict (Awadzi 1987; Habib 1987). A number of JVs in this sample were affected by frequent disagreements between partners over such decisions as import price, import sources, export sales and several other areas of financial and non-financial interest. There are also instances where partners amicably decided most operating and policy matters. In summary, cooperating parents are highly committed to the JV and create an environment conducive to share each other's skills and capabilities for mutual benefits of the JV.

4. Implications for Management Practices

Findings of the empirical study have implications for practicing managers, particularly for Australian managers in their internationalisation decisions. Firstly, managers can consider Bangladesh as a potential market for technology as well as lucrative low-costs production sites. Since the market is unknown to many Australian managers, the joint venture is an ideal mode of entry to learn about the market. Findings of this paper indicate that IJV failure rate in developing countries is not high as many people think.

Managers can benefit from this research in their selection of joint venture partner and management of the JV company. This research identified three key partner selection criteria to emphasise. First, the selection of a company with experience of other joint venture as partner can increase the chance of success. The more a company use joint ventures at home and abroad, the more suitable it can be as a potential partner.

Second, the implication of the positive relation between parents' resource complementarity and joint venture success can be used to guide the partner selection process for successful venturing. Among other criteria of selecting joint venture partner, managers must look for potential partner's ability to provide complementary resources that have synergy potential and balance for both venturing firms. Some firm-specific factors such as updated technology, managerial capabilities, market knowledge and product image are not available off-the-shelves. When these capabilities are essential complementary factors, the managers should select appropriate partner who have the capability to deliver them.

Managers may find a great potential in Bangladesh to establish off-shore production facilities in a low costs site; the firm must posses some basic capabilities to succeed. Technology, technical personnel, management and marketing know-how, capital and finance, access to export market for export oriented projects, and good product image and marketing know-how for import-substituting projects are highly sought for foreign contributions in Bangladesh. A foreign partner with those firm-specific capabilities have greater chance of finding an appropriate local collaborator for successful venturing. Success of a number of joint ventures in this sample was grossly affected due the lack of required resources. Anecdotal evidence collected during the pilot study suggests that several joint ventures projects in Bangladesh did not proceed beyond registration or initial ground work due to foreign partner's inability to deliver the promised resources. A number of projects also did not proceed beyond pilot production when partners realised that technologies acquired from external sources were inappropriate and the technical supports provided by the technology suppliers were inadequate. Those were costly experiences for both partners and could have been avoided by foreign partners' commitment based on their own ability and practical experiences.

Foreign partner should also need careful selection of local partner for successful venturing. A local partner offering only country-specific advantage such as national identity and/or government relations have little value in a liberalised investment environment in Bangladesh. A local firm's firm-specific capabilities such as local management expertise, a pool of technical people, local market knowledge, access to distribution channel are necessary contribution for its commitment to the venture. A foreign firm should find local partner who can contribute firm-specific skills and capabilities to balance its own contributions rather than finding a passive partner to satisfy local nationality requirement and acquire government relation. Country-specific advantages are valuable contributions of a local partner but not necessarily basic ones for successful venturing.

Third, cooperation is another essential ingredient of a successful joint venture relationship, and managers should try every means to build cooperative atmosphere and maintain it for success. Looking for closer interpersonal relationship with potential partner through understanding managers' cultural attitude, business practices, and building a good communication system can help develop that atmosphere quickly. A partner should not act in such a way that may affect other partner adversely. Better communication, consultation with partner and well formulated rules and operating practices can help avoid conflict.

References

Ali, M Yunus (1995), *Performance of International Joint Ventures (IJVs) in Developing Countries: A Study of IJVs in Bangladesh,* Ph D Thesis, University of Wollongong, Wollongong.

Ali, M. Yunus and A B Sim (1995), "An Empirical Investigation of the Determinant of Success of International Joint Ventures in a Developing Country Context" *Proceedings of the Academy of International Business Southeast Asia Regional Conference,* pp. 219 - 224.

Awadzi, Winston K. (1987), *Determinants of Joint Venture Performance: A Study of International Joint Ventures in the United States,* Unpublished Ph.D. Dissertation, Louisiana State University and Agricultural and Mechanical College, USA.

Beamish, Paul W. (1988), *Multinational Joint Ventures in Developing Countries,* London: Routledge.

Blumenthal, Judith F. (1988), *Strategic and Organizational Conditions for Joint Venture Formation and Success,* Unpublished Ph.D. Dissertation, University of Southern California, USA.

Dunning, J. H. (1981), *International Production and Multinational Enterprise*, London, Allen & Unwin.

G. O. B. (1991), *Industrial Policy 1991*, Ministry of Industries, Government of the People's Republic of Bangladesh, Dhaka.

Habib, Ghazi M. (1987), "Measures in Manifest Conflict in International Joint Ventures", *Academy of Management Journal*, Vol. 30, No. 4, pp. 808-816.

Hamel, G. (1990), *Competitive Collaboration: Learning, Power and Dependence in International Strategic Alliance,* Ph D Thesis, University of Michigan.

Hamel, G. and C. K. Prahalad (1987), "Creating Global Strategic Capability", in Hood, N. and J.-E Vahlne (eds) Strategies in Global Competition, London: Wiley & Sons.

Harrigan, K. R. (1988), "Strategic Alliance and Partner Asymmetries", *Management International Review*, Special Issue, pp. 53-72.

Hegert, M., and D. Morris (1988) "Trends in International Collaborative Agreements", in Contractor, F. J. and P. Lorrange (eds), Competitive Collaborations in International Business, Lexington: D. C. Heath

Hennart, J.-F. (1988), "A Transaction Costs Theory of Equity Joint Ventures", *Strategic Management Journal*, Vol. 9, pp. 361-374.

Killing, J. P. (1983), *Strategies for Joint Venture Success*, London: Croom Helm.

Kogut, Bruce and Singh, H.(1988), "The Effect of National Culture on the Choice of Entry Mode", *Journal of International Business Studies*, (Fall), 441-432.

Parkhe, Arvind (1991), "Interfirm Diversity, Organizational Learning, and Longevity in Global Strategic Alliances", *Journal of International Business Studies*, Fourth Quarter, pp. 579 - 601.

Porter, M. E. (1980), *Competitive Strategy: A Technique for Analysing Industries and Competitors,* New York: Free Press.

Porter, M. E. (1990), *Competitive Advantages on Nations,* New York: Free Press.

Reynolds, John I.(1984), "The `Pinched Shoe' Effect of International Joint Ventures", *Colombia Journal of World Business*, (Summer), 23-29.

Rugman, A M (1981), *Inside the Multinationals: The Economics of Internal Markets*, London: Croom Helm.

World Bank (1995), *Bangladesh: From Stability to Growth*, Washington D. C. : World Bank

Table 1: MULTIPLE REGRESSION RESULTS FOR THE SAMPLE
(Standard Model for Variables Selected through Stepwise Regression)

Multiple R	.61131	D,F	5,53
R Square	.37369	F =	6.32466
Adjusted R Square	.31461	Signif F =	.0001
Standard Error	1.36099		

-- Variables in the Equation --

Variable	Correl	B	SE B	Beta	Part Cor	Partial	F	Sig F
MARKET	.327719	1.181309	.443275	.343071	.289698	.343753	7.102	.0102
RESCOMP	.296538	.357589	.132063	.314113	.294347	.348603	7.332	.0091
COOPER	.202162	.752904	.369869	.241459	.221283	.269282	4.144	.0468
JVEXP	.117863	1.001994	.358743	.342157	.303624	.358199	7.801	.0072
TECHLEV	-.277658	-1.064731	.480115	-.284437	-.241074	-.291399	4.918	.0309
(Constant)		.933240	1.932691				.233	.6312

B = regression coefficient of Xi, SE B = standard error of regression coefficient, Beta = standardised regression coefficient of Xi, Part Cor = semi partial correlation of Xi, Partial = partial correlation of Xi.

DATA SOURCE: Personal interview data collected by the author in 1992.

Meaning and Measurement of Variables:

MARKET = Market-orientation of the joint venture. A dummy of 1 = domestic market oriented and 2 = export market oriented (where more 50% of past 3 years' total sales was made to overseas buyers.

RESCOMP = Parents' Resources Complementarity. A 5-point ordinal scale developed on the basis of cluster analysis of parents' proportionate contribution in 13 resource areas weighted by their importance for the success of the joint venture.

COOPER = Cooperation between parents. A composite index of the frequency of disagreements (measured on a 5-point Likert scale) over 16 operating and policy issues. The scale were reversed.

JVEXP = Joint venture experience of the parents. Log value of the sum of number of joint ventures formed and operated by parents.

TECHLEV = Level of technology. A dummy of 1 = Mature 2 = Sophisticated was used.

Joint Venture Performance was measured by a composite of the parents' satisfaction with the extent of fulfilment of nine goals weighted by importance of each goal. Both satisfaction and importance were measured on a 5-point Likert scale.