29

DISCUSSION PAPER

International Joint Ventures in Developing Countries

Happy Marriages?

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Frederick Z. Jaspersen
Yannis Karmokolias

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Foreword

This discussion paper considers an important and increasing phenomenon in developing countries, corporate joint ventures between local companies and firms from industrial countries. Developing countries have been growing faster than the industrialized world, and World Bank forecasts suggest that this trend is likely to continue. Companies have not been oblivious to such trends, with the result that direct investment flows to developing countries have been accelerating rapidly. One way companies have chosen to enter these new markets, while minimizing financial risks, is through establishment of joint ventures with a local companies. In principle, joint ventures offer advantages to firms on both sides of the relationship.

And yet, joint ventures have been fragile affairs, prompting IFC to undertake the research reported here. The study asks essentially: What are the root causes of problems arising in the negotiation, implementation and operation of international joint ventures? What should prospective partners be aware of as they approach creating a new joint venture? Our hope is that the paper will serve to alert business managers to potential difficulties before they arise, thus raising the probability of success in their joint ventures.

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The authors owe a profound debt of gratitude to the executives from the 70-odd joint ventures who agreed to be interviewed for this study. Because we promised anonymity, it is not possible to list them here, but we would nonetheless like each of them to know that their efforts on our behalf are much appreciated. Through this paper, the difficulties that they have been confronting and, usually, overcoming hopefully will become lessons for others who follow. Our interviewees, of course, cannot be blamed for our own errors of interpretation or omission.

Abstract

The study reported here concentrates on a particular form of international corporate entry into developing countries: cross-border joint ventures (JVs). Although offering a variety of positive incentives, ranging in principle from the reduction of financial exposure to the acquisition of complementary knowledge and skills, JVs have had a relatively high failure rate. This study probes why this record seems to be true, and details the types of problems that arise in negotiating JV agreements and, later, in operating the JV itself.

The central conclusion of the study is that managements often fail to remember that JVs are dynamic relationships where the basis for the intercorporate marriage can change considerably over time. Both sides need to sustain comparative advantages in the relationship, the absence of which, on either side, will cause the JV to be less successful or, at the extreme, to fail. While cultural and personal factors can clearly be important to success as well, they are less critical than the maintenance of organizational complementarities between the two or more corporate partners.

I. Introduction

> *An old joke begins with a conversation between a chicken and a pig. The chicken suggests, "Let's get together to form a breakfast business. I'll supply the eggs, and you can supply the bacon." The pig responds, "Well, I have a problem with that, since you can furnish the eggs and go on living, but that's not true with my supplying the bacon!" The pig concludes, "Someone wins and someone loses in any joint venture!"*

This story illustrates a commonly held feeling about joint ventures (JVs): they are often seen to be not in the interests of all partners, with one side or the other ultimately gaining disproportionately. Whether or not this perception is accurate or whether it is accurate in some situations and not others are, of course, empirical questions and ones on which considerable study has been devoted over the past decade. This paper briefly reviews what is known about JVs, particularly those involving developing country firms, and reports on a study undertaken by IFC that focused specifically on a particular type of JV, that between a company in a developing country and a firm from the industrial world.

Joint ventures have been defined as "a common project between legally and commercially independent companies in which the parties jointly bear both the responsibility for management and the financial risk."[1] For purposes here, they are also established as separate corporations in which the ownership interest is split between two or more partners who, in the typical case, are themselves corporate entities. The key, however, is that all partners in the JV are exposed to the same risks, although the way in which this responsibility is divided among the partners through their agreement is quite variable.

IFC's study involved interviews with almost seventy JVs in six developing countries: Argentina, Brazil, India, Mexico, the Philippines and Turkey. These countries represent a fairly wide spectrum of income levels, but they are similar in the sense that all are home to a variety of JVs of the type sought for the study. Sometimes these JVs have been motivated primarily by government regulations that prevented foreign companies from investing alone. Sometimes other motivations were primary. In every case, however, it was IFC's purpose to investigate in some detail how these JVs came together, what difficulties arose in negotiating the agreements and what problems arose during implementation and operation of the joint venture. Although IFC attempted to assess the success or failure, as well as the future, of included JVs, this aspect of the study was not a major goal.

For the most part, interviews were conducted with high level managers of the JVs themselves. Since these managers were usually, but not always, assigned from the developing country company, responses might not have reflected accurately the opinions of both sides of the JV. To offset this obvious source of bias, a few interviews were also conducted in each of several industrial countries: Germany, Japan, Great Britain and the United States.

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1 Rolf Weder, "Internationalization of Switzerland: Competitive Advantages of Joint Ventures and Other Cooperative Arrangements," in *Joint Ventures and Collaborations*, Hans Singer, N. Hatti and R. Tandon (eds.), New World Order Series, Volume 10 [New Delhi: Indus Publishing, 1991], pp. 197-217. Definition is included on p. 201.

Not surprisingly, on some issues opinions were quite different, but in general responses in the two sets of countries were similar. That is, it was unusual for a JV manager to express complete satisfaction with operations and for the industrial country representative to disagree materially.

The results of a study of this type may be biased for another reason. Partners in a JV often are similar to partners in a marriage, and in both cases difficulties that might be occurring in the relationship are not easily divulged to outsiders. This is particularly true where the outsider is not familiar to the interviewee prior to the meeting and, as was the case here, is a foreigner representing a multilateral financial institution. It is fair to say in such circumstances that there is a "halo effect" that will affect the data, especially on sensitive topics. This effect will tend to make the JV relationship appear more positive than might, in fact, be the case.

Still, the study did result in a number of very candid discussions, where the types of difficulties affecting JVs were discussed quite openly. IFC interviewers pledged confidentiality with respect to specific company-based information, unless explicit permission to divulge it was granted by the interviewed executive. That pledge, along with a sincere interest on the part of interviewees in the results of the study, led many of them to be more open than had been anticipated at the beginning. JVs are an increasing phenomenon in developing countries, and managers have great interest in learning as much as they can about what goes into successful partnerships.

Although IFC's study concentrated on various problems that arise in JV negotiations and operations, it should be remembered that most JVs work through their problems and are ultimately successful. The focus on difficulties, therefore, is intended not as a commentary on the prospective future of JVs in developing countries, which should remain bright on the whole, but rather as an effort to identify commonly occurring problems for companies considering formation of a JV. Our hope is that early recognition of prospective problems will reduce the chances that the problems will become irresolvable later.

II. What Motivates Joint Ventures?

The motivations for entering into a joint relationship must be strong for success to be assured, since JVs have a reputation for instability, deserved or not. Although hard data on JV success and failure are scarce, the little information that is available suggests that this reputation is deserved. For example, in an article written fifteen years ago, Killing surveyed 37 international JVs and found that participants rated 36 percent of them as having performed unsatisfactorily, a high proportion indeed.[2] In IFC's study, reported in this paper, the percentage of success was higher, but even here 27 percent estimated that the JV would not continue in its present form. Of those who saw their JVs continuing, one-third conditioned their affirmative answer in one way or another. Clearly, one should not become involved in JVs casually.

The propensity of JVs to be unstable is corroborated in another study of U.S.-based JVs, where terminations through dissolution or acquisition were tracked over a number of years.[3] The results are shown in Table 1, where the ratio of JV terminations to the total number of JVs in the study's sample is given for several years. By the sixth year, about half of JVs in the sample had, for one reason or another, been terminated. It should be remembered that these joint ventures were in the United States, where many of the cultural and other problems associated with international relationships were absent.

Table 1
Hazard Rates* of Manufacturing Joint Ventures in the United States

	Age							
	1	2	3	4	5	6	7	>7
Total Termination	5.4	9.2	15.2	10.4	13.3	11.8	16.6	35
Dissolution	4.3	3.4	3.8	4.5	6.7	5.9	7.1	12
Acquisition	1.1	5.7	11.4	6	6.7	5.9	9.5	22
Number at Risk**	92	87	79	67	60	51	42	31

* Hazard rate is the ratio of terminated Joint ventures to all joint ventures which survive to that age. Rates are computed relative to numbers at risk in the relevant age group and will not sum to one horizontally.
** Number of initial joint ventures minus previous terminations and those still alive but younger than column age.

The prospect of failure, therefore, provides ample reason to look more closely at the motivations for companies to enter into JV relationships. One way to consider these motivations was suggested by one of the interviewed executives: JVs are a second-best solution for both parties. If companies possessed all of the requisite ingredients for success in a

[2] J. Peter Killing, "How to make a global joint venture work," *Harvard Business Review*, May/June 1982, pp. 120-127.
[3] Bruce Kogut, "The Stability of Joint Ventures: Reciprocity and Competitive Rivalry," *The Journal of Industrial Economics*, Volume XXXVIII, No.2, December 1989, pp. 183-198.

particular undertaking, most managers would much prefer to "go-it-alone" instead of entering a JV. The prospect of keeping control of the enterprise clearly is the primary motivation for this attitude, since control implies that the new venture can be melded seamlessly into a company's existing activities or, if not seamlessly, at least be made responsive to the dictates of a single management and a single set of objectives. Thus, few firms would choose a JV if there were a practical alternative.

But, the reality of global competition today is that few companies possess all of the competitive advantages that would enable them to be successful internationally. For firms in industrial countries, prospects for future growth are increasingly seen as being disproportionately in developing parts of the world, not in more familiar markets in the developed nations. But, for a variety of reasons, doing business in developing countries is viewed as being considerably riskier, to be approached with much more caution. Similarly, developing country markets are becoming much more open to international competition, providing both opportunities and dangers for domestic companies. To meet these challenges, managements are attempting to position their firms to become more competitive. Thus, from the perspectives of both industrial and developing country companies, the evolving global market calls for change from past competitive practices.

For this reason, many company managements now attempt to complement their firms' strengths through alliances with other companies. These alliances, many of which are JVs, represent a complicated process of identifying one's own strengths and weaknesses, setting forth clear strategic directions, and then endeavoring to match these directions with those of another company. In the cases of interest here, these matchups involve companies from countries with very different income levels. If JVs tend to be unstable when carried out within a country, as they seem to be, then one might anticipate that international alliances would be even more fragile.

A Successful Case: Titan Timex of India

This joint venture between Timex Group from the United States and Tata, each with 28 percent of the JV's equity, now is the largest watch maker in India. Formed in 1989, Titan represented a not uncommon marriage of partner interests. Tata was looking for better product and process technologies from America's biggest watch manufacturer, while Timex was seeking an expeditious way to enter the Indian market with the help of Tata, which was intimately familiar with India's consumer market. Sales now total over $30 million. Of those sales, about $3.5 million are exports through the American Timex organization. Timex-U.S. also makes watches in the Philippines, and it will be interesting to observe how the distribution of manufacturing will be handled as Titan exports expand.

Industrial Country Companies: Why, then, do companies from developed regions choose to enter into joint venture relationships with local companies in developing countries, instead of "going it alone," as they might prefer to do? Among the most obvious reasons is the fact that in some countries, investment regulations require a link with a local firm. In many cases, in fact, the regulations have called for foreign companies to limit their participation to minority status. India provides a clear example where, until quite recently, foreign firms were required to be minority partners in a joint venture if they were to invest at all. For foreign companies that saw India as a potentially attractive market, investment as a minority JV partner was the only alternative to attempting to import over substantial barriers. Subsequently, this restriction has been relaxed, and many foreign companies have moved to become at least controlling partners in the joint ventures.

In IFC's survey, over half of the companies noted government restrictions as important in their decision to invest through a JV. One can conclude, therefore, that such restrictions remain as a strong motivating factor in persuading companies to utilize a JV structure in their market development strategies. These JVs may represent a maturing of an older relationship where companies have worked together in marketing or technology arrangements. From the multinational company's point of view, in fact, the JV might be seen as an intermediate step in a longer term strategy to exploit a market through its own wholly-owned subsidiary, when restrictions are relaxed. This perception can be a major cause of later difficulty in a JV partnership, a point discussed in more detail below.

There are, however, many other motivating factors which tempt company managements to seek JV partners.

Cost and risk sharing: As noted, even corporate managers with extensive international experience often see developing country markets as inherently more risky than operations elsewhere in the world. These perceived risks, of course, are offset by prospects for higher long-term returns, typically a primary reason for investing in the first place. Still, JVs provide a mechanism through which companies can limit their financial exposure while at the same time gaining experience in a new market. The provision of financing, for example, was one of the most important listed contributions of the local partner in IFC's survey, as shown in Table 2 on the next page.

Lack of country familiarity: For a foreign company seeking to deepen its understanding of local conditions in a country, a JV provides one way to shorten what could be a lengthy and potentially expensive process. Lack of knowledge has several dimensions in all of which a local partner might be expected to make a contribution: local product market and distribution channel familiarity, knowledge of labor conditions, likely problems in managing in the local environment, knowledge of the legal system and government regulations, and familiarity with local customs and conventions, to name only a few.

In IFC's study, in fact, these factors were clearly the most important contributions anticipated from the local partner in the JV. Table 2 provides a summary of the frequency of mentions for important contributions made by the local partner in descending order of frequency and including only frequencies above 50 percent. Aside from the provision of financing, noted above, all have to do with areas that would be seen as reducing uncertainty for a foreign partner, even though answers here were provided generally by managers of the JV itself.

Lack of relevant contacts within the government and elsewhere: Depending on the developing country, the ability to navigate expeditiously through government bureaucracies can be critical to an enterprise's success. In the typical case, companies from industrial countries cannot be expected to have any facility in such an activity, and they look to JV partners to provide guidance and expertise.

Existing facilities: Local companies often have existing production and distribution facilities which can also be of use to the JV. Ford in India provides an example, where the company has teamed up with Mahindra and Mahindra to produce vehicles and will use an existing Mahindra facility for start-up production. Local partners can provide a variety of such advantages. Some companies, for instance, have been successful in building established and well-known brand names which are sold through already developed distribution channels. Without these facilities, a foreign company hoping to produce and sell locally would be faced with substantially higher costs and, possibly, much greater uncertainty.

Table 2
Major Local Partner Contributions

Knowledge of Local Politics	70%*
Knowledge of Government Regulations	68
Knowledge of Local Customs	68
Knowledge of Local Markets	65
Provision of Financing	58
Local Reputation	58
Access to Local Market	54

* Percent of JVs in sample where category was specified. Respondents could specify more than one category.

More effective technology use: Multinational companies are frequently valued because they bring technological expertise to a venture. Conversely, combining with a local JV partner can provide the MNC with an opportunity to earn additional returns from its research and development operations over and above what might have been anticipated from alternative methods of exploiting the technology, such as licensing or export sales.

Developing Country Companies: From the developing country side, it should not be surprising that the motivations for entering into a JV agreement are, on the whole, quite different. After all, in considering the possibility of a JV, company managements look for complementarities with their existing operations, ways in which the hoped-for partner can provide attributes that are missing or weak at home. One motivation that is common, however, is the desire for the MNC to contribute to the financing of the joint enterprise. In about two-thirds of the responses to the IFC survey, financing was mentioned as one of the more important contributions to be expected from the industrial country partner.

There are a number of other contributions of MNCs that motivate developing country firms to form JVs even more.

Access to Technology: In the IFC survey, technology availability was the single most important contribution by industrial country companies to the JV, as noted by JV managers. Table 3 provides the details. In nearly three-quarters of the responses, access to process and product technologies from the foreign partner were seen as important motivations to form the JV.

Table 3
Major Foreign Company Contributions

Process Technology	74%*
Product Technology	72
International Reputation	70
Provision of Finance	65
Management Know-how	59

* Percentage in JV sample where category was specified. Respondents could specify more than one category.

This statistical impression was reinforced in interview after interview, much more so than any other matter. JV managers saw the continuing availability of technology as the single most important contribution of the foreign partners. Because of the importance put on this aspect of the relationship, technology issues were also among the more frequent reasons that problems arose later in the JVs life.

Access to Management Know-how: It is a general, but not universal, feeling in developing countries that management techniques need substantial up-grading. JVs are seen as a vehicle for importing knowledge pertaining to organization, strategy formulation and implementation, marketing, manufacturing and other management functions. The hope is that this knowledge can be learned and transferred to other local operations. Yet, interestingly, typical JVs in developing countries tend to split management functions, with the general manager's position more often than not going to a local. Part of the reason for this tendency is, of course, the cost of maintaining foreign managers abroad, which from a JVs point of view can be seen as exorbitant. Part, too, owes to the fact that, while there may be much to be learned from foreign managers, they also have much of importance to learn about local customs and mores. Thus, the actual appointment of JV managers represents a balancing of financial and cultural interests and, in our survey, often came down on the side of employing local managers, generally with some experience working or going to school in a foreign setting.

Access to export markets: JVs of the type surveyed in this study, where one partner is from an industrial country, are often seen by the other partner as a convenient vehicle to open export markets. Although this motivation did not emerge directly in the study as one of the most important reasons for forming JVs, it nonetheless accounted for around 40 percent of the responses to the relevant query and may have been implied in the importance attached to the foreign company's international reputation in the relationship. The strength of the response is interesting also in view of the fact that many JVs are formed explicitly to do business in the local market, not in exporting. Only about half of the JV companies in the survey exported more than 20 percent of their output. In fact, in many JV agreements exporting has been severely circumscribed, a condition often set by the industrial country partner.

III. What Issues Arise in Joint Venture Negotiations?

Negotiating a JV agreement can be a prolonged and difficult process, one that can cause tensions even between partners who have had long experience in some other form of cooperation (licensing, trading, etc.). There are mixed feelings about the importance of the formal JV agreement itself, with some managers believing it to be a critical element in defining the longer-term relationship and others dismissing its significance. The latter tend to stress the fact that no agreement can work without the good will and dedication of both partners, a point that may be true but also one which does not diminish the importance of the working agreement. In our survey, the vast majority of executives believed the agreement to be an essential building block in structuring the JV.

Nearly 85 percent of JV agreements among the study's companies required at least six months to negotiate, and about 20 percent took over a year and a half. The agreement, therefore, is not something taken lightly. One should not take these figures too literally, however, since in many cases the partners were quite familiar with each others' operations long before negotiations ever commenced and, in such cases, many of the preliminary aspects of the negotiations could be abbreviated. The survey found no relationship between the length of time required to complete a JV agreement and the partners' ultimate satisfaction with the JV's operation.

Two matters dominated in importance in the negotiations, as revealed in IFC's study. First was the JV's equity structure, noted by four-fifths of respondents. Equity structure also turned out to be the most difficult to negotiate, even though in some cases the minority-majority split was dictated by government policy. It is a clear indication that control of a JV is not something given up easily although, as noted below, majority ownership does not necessarily confer control of all aspects of a JV's operations.

The other matter considered very important in negotiations was the set of conditions surrounding technology transfer. Technology exploitation is of great interest to each side and of considerable sensitivity. Almost inevitably, the transfer of technology runs from the industrial country side to the developing country side. Important issues are defining precisely what technologies are to be covered by the agreement, possibly including technologies not yet developed by either side, and the terms under which the technologies are to be made available to the JV. Clearly, the leverage in such a discussion resides with the foreign company, since it has the technology, but the local firm is not entirely helpless. It may have alternative sources for the technologies. Still, both sides are aware that payments for technology represent an important means for transferring benefits from the JV and for indirectly maintaining control. It is, therefore, an issue likely to be the subject of prolonged discussion in the negotiation.

Table 4 summarizes the results of survey questions pertaining to the importance and difficulty of negotiating the JV agreement.

Table 4
Relative Importance and Difficulty of Negotiating Points

	Important*	Difficult*
Equity Structure	80%	33%
Technology Transfer	78	26
Marketing Issues	45	28
Staffing Issues	44	26
Dividend Policy	42	21

* Proportion of respondents noting category.

One consequence of the importance of technology in negotiations is that it, along with provisions for paying the technology supplier, is far and away the most frequent item covered explicitly in JV agreements, and it is typically a matter covered in some detail. Technology providers are interested in protecting their intellectual property, which translates into wanting to set limits on where the technology is used, the terms and conditions of its use, specific limits on how the JV can utilize it, and restrictions on who controls derivative technologies (no matter where developed).[4] The developing country partner, on the other hand, hopes to set bounds on royalties and fees, especially as the technology becomes older, and to broaden as much as possible the JVs control over its use.

Evidence from the survey shows, too, that agreements often specify in some detail which parties are to have veto power over various aspects of managing the JV. These vetoes vary considerably, depending on which partner maintains majority control. In foreign-controlled JVs, for example, the local partner may have veto power over the appointment of the JV's general manager or dividend policy, but rarely over technology use, export markets, quality standards or even supply sources. In a JV with the equity split evenly between the two partners, on the other hand, the foreign partner typically will be able to exercise veto power over these issues. And, if equity control of the JV is held by the local partner, the number of areas requiring approval of the foreign company expands. Foreign veto power in this case usually will include not only those matters covered in the half and half arrangement but also such items as corporate financial issues, dividend policy and the appointment of the JV's general manager. Evidently, foreign partners demand more veto power (control) as their ownership interests diminish.

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[4] A discussion of the relationship between intellectual property protection and foreign direct investment, which supports findings here, can be found in: Edwin Mansfield, *Intellectual Property Protection, Direct Investment, and Technology Transfer: Germany, Japan and the United States*, Discussion Paper Number 27, International Finance Corporation, 1995.

Since the agreement being negotiated covers, in theory, a relationship that is anticipated to go on for many years, companies frequently view the negotiations as an opportunity to discuss potential problems that might come up at any time in the JV's life. As a consequence, virtually any matter that is foreseen by one party or another to be a possible problem area can be the subject of discussion and, sometimes, wrangling. The focus in the remainder of this section is on problems that are fairly common in any negotiation; we leave for later particular problems that arise during the life of the JV.

- Valuation problems: Each partner brings financial and other assets to the JV, and it is often not a simple matter to evaluate just what these assets are worth. One side, for example, may be bringing to the JV a going business, but one where no equity shares exist in a secondary market. Another difficult valuation problem that exists in many developing country JVs concerns new technology to be supplied, usually by the industrial country partner, and which needs to be evaluated to determine an appropriate licensing fee structure. Or, there is technology already incorporated in a product to be manufactured and sold by the JV. What is the value of such technologies to the JV? Problems of this sort are among the most difficult to sort through.

- Transparency: Getting accurate data upon which to base valuations and other decisions can be very difficult in some countries and with some companies. For example, one side or the other may be a family enterprise in which accounting standards might be quite different from internationally acceptable rules. Transparency is a particular problem in JVs being established in former command economies where there have been no real markets for outputs, for supplies or for financial instruments. Available accounting information means very little in such circumstances, yet somehow the JV partners have to come to some mutually agreeable method of assessing the value of assets each side is contributing.

- Conflict resolution: Many JV agreements spell out in some detail just how disputes between the partners are to be resolved, an apparent requirement that some parties on the developing country side often find objectionable because they believe it displays a less-than-hopeful attitude toward the new relationship. Yet, provisions for conflict resolution are clearly important, since the reality is that disputes are virtually inevitable in a relationship as complex and dynamic as a JV. Agreement provisions may involve, at the extreme, quite precise procedures to be used in dissolving the JV, and they are often the subject of intense negotiations.

  One actual example of a procedure for dissolution might be instructive. In the case of an impasse in resolving a dispute, either partner can make an offer for the shares of the other. The second partner can either accept the offer, if deemed adequate, or can reject it, in which event he is allowed to purchase the first partner's shares at the original offer price. The intention is to discourage offers below the JV's perceived value by one partner or the other, but the path to getting to such a provision can be a difficult one indeed.

- Division of management responsibility and degree of management independence: The question of who is to manage the new enterprise is decidedly not a simple matter to resolve, and it is one not necessarily dependent upon which partner maintains majority control. Agreements can be quite specific both on this issue and on the issue of the JV's management independence. As noted, these issues are sufficiently important to companies that many will wish to insert veto restrictions into the JV agreement to assure that actions cannot be taken without explicit approval from one or both partners.

  And yet, there is some evidence that the degree of independence of a JV's management from parent interference is an important determinant of JV success.[5] Attempts by parent companies to micro-manage an enterprise that may be thousands of miles away simply do not work. A better strategy would seem to be setting up clear operational parameters in the JV agreement and then letting the JV management succeed or fail on its own. As one interviewee put it, "JVs, like dogs, cannot serve two masters." The problem, of course, is in arriving at an acceptable management agreement without causing dissension that leads to premature fracturing between the partners.

- Changes in ownership shares: As noted, the original division of ownership shares often is a strongly debated issue in JV negotiations, one that can lead to a breakdown. Possibly of even greater sensitivity is an issue increasingly being set forth by one partner or the other: what are the procedures to be followed in changing this ownership structure as the JV matures? This becomes an important issue because it impinges on a number of other operational matters and is, quite simply, a recognition of the reality that few JVs remain unchangeable over their duration. Although it is probably sensible to handle the matter early on, rather than suddenly confronting the need sometime later without clear guidance, the issue obviously is not one that yields to easy solution. Developing country partners especially can be leery of such provisions, because they see them as their potential death warrant when the industrial country partner, for one reason or another, wants to take full control.

  Closely related to this set of negotiations, yet a matter of somewhat less sensitivity, is exit policy: what should be the procedures followed when one or the other partners wish to leave the JV entirely. In part, this problem is related to that of valuation techniques, noted earlier, but it can include several other dimensions. For example, a question might be to determine under what conditions the dissolved JV could continue to depend on technical transfers from the developed country partner, if it leaves the JV.

- Dividend policy and other financial matters: It may seem that considering dividend policy at the time of negotiations is, at best, a premature exercise. After all, a year or two prior to the JV's start-up profits seem a long way off. Still, dividend policy goes to the heart of the reasons why companies enter JVs, with some companies hoping rapidly to

[5] On this point, see Paul Beamish, "The Characteristics of Joint Ventures in Developed and Developing Countries," *Columbia Journal of International Business*, Fall 1985, pp.13-19.

expand and gain market share while others strive to gain a quick cash flow to support other operations or, in the case of closely held companies, possibly for personal reasons.

A number of other financial issues come up in negotiations, of course, some of which can be the cause of consternation on one or both sides. How, for example, should performance be measured? In the survey, performance measures that were mentioned most frequently had to do mostly with non-financial measures, such as product improvement, mentioned 78 percent of the time, quality improvement (77%) and sales growth (76%). Only one financial measure fell into this group, net return on equity (75%). Somewhat further down the list in importance were other financial measures: net return on sales (59%) and net return on assets (58%). The point is that potential partners can differ significantly on just which such measures are to be considered paramount in determining success.

Overcoming Problems to Achieve Success

One joint venture company in IFC's survey manufactures clothing accessories in the Philippines. Equity is shared evenly in this JV between the two partners, with no other shares distributed. At the time the JV was formed, only 40 percent of equity could be owned by the foreign partner, but this restriction has recently been relaxed to allow higher foreign participation. Several problems have arisen between the partners, all of which have been reconciled in this now-successful company. For example, the local partner sought a distribution of dividends, a suggestion rejected by the MNC which wanted to use internal funds for expansion. There were product line disputes, as the original products chosen for sale were inappropriate for the local markets. The foreign partner came to the rescue by helping the JV export products until suitable items could be produced. Thus far, the partners have worked through such problems, and the JV is a financial success.

IV. Problems that Arise in Joint Venture Relationships

As already noted, JVs tend to have difficulties, first, as detailed above, in coming up with a mutually satisfactory agreement and then joining together in operations. Operational difficulties can come from a wide variety of sources, some probably foreseeable at the time of the JV agreement, some not. In this section, we delineate some of the problem areas that arose in discussions with JV managements interviewed. These problems include in a few cases instances arising from interviews in industrial countries, where the JV might not be in one of the six countries included in the survey.

Problems related to Multinationality: The reality of many JVs in developing countries is that they involve more often than not large multinational companies (MNCs) which have under their purview a mix of other JVs and wholly-owned subsidiaries elsewhere in the world. This contrasts with the developing country firm, which may be quite large by local standards, but not in comparison with its partner. Not infrequently, at least in the companies surveyed by IFC, the local firm is a relatively small, family-owned enterprise. The upshot of such differences is that the business perspectives of the two (or more) companies can vary substantially, and this variability can be at the root of relationship problems later in the JVs life.

One obvious source of difficulty, for example, is in the differing basic objectives of the two types of firms. MNCs hope to operate through the JV in a way that will be optimal over their entire global network, not just within the local market, the usual interest of their JV partner. There are a number of issues discussed below where such differences impinge and over which disagreements can easily arise.

- Export rights: Exporting sometimes represents a fundamental difference between industrial and developing country partners and, again, it is an issue difficult to reconcile satisfactorily. Not infrequently, the industrial country company is a multinational corporation with operations and sales in a variety of countries. Typically, it will not want to allow the JV to be free to export products, possibly of inferior quality, into markets that may already be served from other manufacturing points in its system. The MNC looks upon the JV as one piece of a complex global web, and it is not likely to allow that single piece to dictate its own policies where other pieces or, indeed, the web itself might be compromised. The rule in such situations is for the MNC to put strict limitations on the rights of the JV to export.

  The developing country partner, on the other hand, typically has much different ideas. Here the expectation is that as new technology is brought in and product/process technologies are absorbed by the JV, exports might provide a natural market for expansion. Indeed, increased exports might be a primary reason for the developing country side to have entered into a JV agreement in the first place.
  In most surveyed firms, where exports of manufactured products were contemplated, shipments were restricted in one way or another. In most cases, all exports were directed

through the MNC partner who, therefore, essentially controlled all external sales. In a few cases, however, restrictions were less binding, with the MNC insisting on control only for exports destined for markets already served by the MNC. Thus, shipments to Europe might be prohibited but not sales to Africa.

- Tax issues: Part of the optimization process undertaken by the MNC will cover its worldwide tax burden which, all else equal, it will wish to minimize. Such a tax minimization strategy can affect dramatically relations with the JV, particularly when the JV either imports parts and components from the MNC or, as is usual, exports products through the MNC parent. The MNC in these circumstances will be very aware of transfer prices between JV and parent, and it may attempt to manipulate that price to lower its taxes. For example, if taxes are considerably higher in the JV's country of operations than in the MNC's source country, then there will be a temptation for the MNC to raise transfer prices to lower profits in the JV. Clearly, such a strategy is not necessarily in the interests of the local JV partner, and it is a difficulty that was mentioned in interviews with a number of JVs in IFC's sample .

Overcoming Multinationality Problems

The fundamental problem of differing perspectives owing to the fact that one partner has global interests, while the other does not, appears in nearly an infinite variety of ways, some difficult to overcome, some not. An international soft drink maker, for example, might garner most revenues worldwide from the sale of proprietary syrups, less from sales of the beverages themselves. The MNC's interest, therefore, might be in maximizing profits on syrup, even though such a policy might diminish profits in a beverage joint venture. Here, the obvious solution is to assure that the joint venture is treated no differently than businesses with arm's-length dealings with the MNC.

Or, the MNC might attempt to convert the JV effectively into a subsidiary. In such situations, the local partner can have differing reactions. In our survey, local partner attitudes often depended on the degree of success of the JV, not simply on loss of control. In one case, for example, the MNC ultimately ran the JV as a local subsidiary but, in the process, also greatly expanded both market share and profitability. Although the local partner regretted the loss of influence in JV affairs, he had little financially to complain about. His one quite legitimate concern was that the JV had become a prime candidate for complete takeover by the MNC.

But, the situation can be much more difficult. One case occurred when the JV's product line was specified in the originating agreement; provisions limited not only where the JV could sell but also, precisely, what products could be manufactured. As the market evolved, however, some products which had been imported directly by the MNC in small amounts at the outset became increasingly popular. Quite naturally, the local partner suggested making such products in the JV, an idea not necessarily in the interests of the MNC. The solution clearly is to renegotiate the contract, but the gap between the parties is a basic one to both sides and, therefore, not simple to bridge.

- Dividend and Investment Policies: Where these policies are not spelled out in the agreement, differences can be very difficult to resolve. The problem is that the MNC may have global investment programs that involve the transfer of funds from one region to another. It might in these circumstances much prefer dividends to reinvestment within the JV, a position not necessarily compatible with its JV partner's view. The opposite problem occurs as well, where the MNC might be quite content to delay dividends in favor of faster expansion, and the local partner demurs.

- Differences in Partner Size: Another set of problem areas mentioned quite frequently in IFC's interviews relates to the differing size of the two parties in the JV. In relative terms, the local partner is likely to be considerably smaller than the MNC and, according to some MNC managers, this difference can cause difficulties during a JVs initial, often high growth, years. The local partner may have difficulty coming up with the necessary capital infusions to support the expansion.

  Size differences also seem to have operational implications that can cause problems. First, the JV might be seen as much more important in the overall activities of the smaller, local partner; this company proportionately has more assets tied up in the JV than does the MNC. Several interviewees expressed the feeling that the MNC partner just didn't seem to give enough attention to the JV, and the JV appeared to become lost in the much larger scheme of MNC global activities. Second, and related to the first, is the dissatisfaction that occurs when MNC partners assign managers to the JV for relatively short periods of time. "By the time they learn their way around enough to be useful, they're rotated back home," is a frequent refrain heard in interviews. The other side of that issue, of course, comes from the MNC management, which typically complains about the difficulty of finding executives who are willing to spend long periods of time abroad. For these executives, the JV might not be seen as a logical way to achieve career goals.

<u>Ownership and Control Problems</u>: Although the negotiations often provide tense moments and the disparate size and interests of the partners can cause difficulties, the major problems come over the longer-term of the JV's operation. The reasons for such problems are manifold, and no attempt is made here to catalog them in any exhaustive way. Instead, the focus is on those problems that seem to arise repetitively among JVs in the interviewed companies.

- Ownership Problems: The desirability of having the operational management of the JV independent of either partner has been mentioned above as a problem arising in negotiating JV agreements. When the JV is not established in a way that will allow for that independence, one can expect that relationship problems will emerge fairly quickly. Often this happens when the industrial country partner desires, for one reason or another, to limit the JV's operations in ways which would make it roughly equivalent to a wholly-owned subsidiary. Needless to say, unless such an arrangement had been agreed to early on, it will cause nearly inevitable problems between the partners later in the JV's life.

Control of the enterprise can also be affected by a number of changes, sometimes unpredictable changes, that can occur after the JV has been in operation for some time. One that was mentioned frequently in interviews was the change that can occur because of shifting attitudes of one or more of the JV's owners. For example, the original JV might have been established in a situation where one of the partners, usually the developing country partner, was a closely held, family corporation. In such a case, the motivation and driving force behind the JV might have come from the family patriarch who, in a not infrequent case, may also have been the founder of the company.

But, when the patriarch's company passes to the children, his original commitment to the JV can change materially. Their interests will not necessarily coincide with his, and they may see the long agreed-upon relationship in the JV as being not in the interests of the family and seek changes. Those changes are not likely to be viewed favorably by the JV's other partner.

One should not infer that such adjustments within the ownership structure are confined to the developing country side. There were numerous cases in interviews where changes in either the MNC's management or in its ownership caused the JV relationship to change markedly. In one case a company had been acquired by another MNC, and the acquiring company did not share an interest in continuing operations in the JV's developing country. Similarly, simple management changes in the MNC can have adverse effects on the JV, when the new managers do not share the same objectives as the old. In some cases, the post-change managements simply ignored the JV, for better or worse. In other cases, the MNC sought to dissolve the JV entirely.

- Control Problems: Related to ownership problems, but in some ways quite distinctive, are a series of difficulties that can occur in managing the enterprise. Enumerated here are only a few of those problems mentioned in interviews.

  Product line disputes are among the more common of these problems. These arise generally because the conditions that existed when the JV was formed change and, because of the change, alter the perspectives of one or the other partner. As an example, a major appliance-producing JV might start out manufacturing small refrigerators and, as time goes on, see opportunities in other appliances, such as cooking ranges or clothes washers. However, the industrial country partner might not agree that beginning such production is within the long-range objectives of the MNC. The MNC partner might wish to limit the JV to only a narrow line of products.

  Another common source of disagreement has to do with sourcing raw materials, parts or components. In this case, the JV agreement can specify in detail that certain materials are to be sourced from the industrial country partner. Aside from the transfer pricing issues that such sourcing raises, the original conditions that made the sourcing provision in the agreement seem logical can change. Over time and as economic development takes place, local sources may become available which are, possibly, lower in cost and at least as high in quality. These sources obviously would be attractive to the JV's management. But, the

MNC's view could be different, because it might benefit more from retaining the original agreement and continuing to produce the materials for the JV.

Similar disagreements take place in technology utilization. The JV might be contractually obliged to obtain all process (or product) technologies from the MNC partner, a condition that probably appeared innocuous at the beginning. Yet, as operations continue, other sources of technology become available, some of which may be superior to the MNC's. Clearly, the interests of the MNC in such situations may not be identical to those of the JV or, for that matter, of the developing country partner.

Another technology-related problem sometimes comes up when the JV management believes that the MNC is not providing the JV with the latest or most appropriate technologies. The MNC, of course, may have excellent reasons from its own perspectives for restricting technical information, particularly information involving what are seen to be the "core" technologies of the MNC. Still, from the JV's viewpoint restricting technologies is tantamount to treating the JV as a "poor cousin," and there are always suspicions about the motivations for the action. This is particularly true when the JV management finds out inadvertently that it is not receiving the latest data, as in a visit for other purposes to the MNC parent's headquarters.

Once again, there are numerous potential problems of the type described above, all having to do with who has control of the JV's destiny. Majority control by one partner or the other clearly is not entirely a solution when the JV agreement contains stipulations on various facets of the JV's behavior. As one interviewee put it: "Control may be illusive, even if you have majority control. We have a majority of the equity in our Chinese JV, but there are only 6 of our people on the ground in China and 1,500 Chinese. Moreover, the previous management believed that it had been quite successful before we ever arrived, and it has been nearly impossible to bring them around to our way of thinking."

Cultural Problems: The type of JV that is the focus of this study inevitably results in at least some cultural strain between the participants. Partly, the problems are caused by the obvious fact that the two (or more) partners come from much different cultural backgrounds, and individuals may see the same set of circumstances in quite different ways. But, there are other dimensions to this cultural gap that are important as well. Corporations themselves have "cultures" which condition how people view their environment and how they interpret issues. This factor is one of the primary reasons why JVs established between industrial partners from the same country and even the same industry often run into trouble.

In our study, cultural issues arose in several forms. From the developing country side, MNC partners were often characterized as "arrogant" or "narrow-minded," not able or willing to comprehend the nuances of the culture in which they were intending to do business. The assumption on the part of MNC personnel often seemed to be that their business acumen was superior to that of their developing country partners and, therefore, that the MNC culture (or systems) should essentially dominate in any JV relationship. One consequence was a barely concealed patronizing attitude that seemed to imply: "Our ways are better; were this not the case, this country would be developed, like ours." Needless to say, such an attitude is resented by developing country business people, some of whom have built thriving businesses from scratch under difficult conditions.

But, the cultural street runs in both directions; industrial country JV partners have their complaints as well. One common complaint relates to what MNC managers see as deeply embedded corruption in the developing country business environment, presumably accepted by their partners. In the MNC view, such corruption may be unacceptable for a number of reasons. It leads to inefficiencies which, in turn, can affect competitiveness. It may be, in the MNC view, morally repugnant. And, perhaps more importantly, it is illegal for business persons from some industrial countries to countenance corruption in their activities abroad. Thus, what is seen as corruption by the MNC partners, but which may be viewed by the developing country side as normal business practice, can be a source of considerable contention in many JVs.

There are also a number of business practices which are not corrupt but are viewed by MNC managers as unacceptable behavior. One is the tendency in many developing countries for companies to direct procurement to firms that are related or, at least, considered to be friendly. To the MNC, procurement can be viewed strictly as a competitive matter, sometimes even within the firm. If parts and components of acceptable quality can be obtained on schedule and more cheaply from a potential source, then that source should be utilized. To be sure, it is somewhat more complicated than such a view implies, because the MNC has to worry about optimizing over its complete organization, and it may be to its advantage to source some parts internally, even if they seem more costly to the JV. In the normal case, however, the decision would be based on cost and competitive considerations.

However, this presumed objectivity may be seen quite differently by the developing country partner. Accustomed to a system where directed procurement is normal, the pressure from the MNC side to use particular vendors may be viewed by the partner with suspicion. More than once, the survey ran into cases where the MNC managers were suspected of engaging in their own form of directed procurement, using their favorite vendors instead of the other partner's choices. Clearly, this is a case where the same set of signals are interpreted quite differently by JV partners coming from different cultures.

To a considerable extent, these cultural differences are accentuated in so-called transitional economies. Although these countries were not included specifically in the survey, doing business in them came up in a number of discussions with MNC executives. Some managers had recognized at the outset that inculcating a business orientation in a JV located in a transitional country would require a long time, possibly as long as two years. But, after two years had passed, the feeling often was that relatively little had been achieved and that a far longer period of time would be required, partly because of the strength with which older ways were maintained and partly because the economic and political system still was transmitting ambiguous signals on what type of behavior was expected of individuals.

Finally, there are innumerable instances of differing viewpoints causing tensions. One will suffice as an example. The Western practice of using discounted cash flow analysis as a major guide to investment decisions is faulted by some Asian partners in JVs. They assert that with high real interest rates, any project that promises to yield only late returns will be rejected, even where the future market might be attractive. As one interviewee stated, "American businessmen don't take the 'long view,' like Asians do." It is one case where Japanese partners are sometimes preferred to those from Europe or the United States.

Problems Related to Dynamic Changes in the Relationship: JVs are exposed to an ever-changing panoply of forces that shape and direct outcomes. The changing environment within which the JV operates also alters partner relationships in ways which can sometimes cause stresses that are difficult, and at times impossible, to resolve. Summarized below are a few cases that arose repetitively in interviews.

- Probably the most common cause of change-related problems is the fact that experience in a JV results in learning, and learning can modify how one views the contributions of one's partner. For example, MNCs often enter JVs expressly to provide a vehicle to learn about country-specific aspects of doing business. This seems particularly true for managements with little foreign experience, who might feel uncomfortable about their level of understanding with respect to government relations, labor recruitment and management, or marketing and distribution techniques. Thus, these aspects are a primary source of comparative advantage to the local partner when the JV is formed.

  However, as learning takes place over the years, this advantage begins to erode, and the MNC side may begin to feel more confident about its abilities to handle these issues. Put slightly differently, the MNC may come to believe that the contributions being offered by the local partner are no longer commensurate with his rewards. At such a time, pressure will begin to mount for a change in the JV's ownership structure to provide more equity to the MNC.

  Learning, of course, occurs on both sides of the JV. If, for example, the MNC provides only a once-and-for-all transfer of technology at the beginning of the relationship, then it is likely that the local partner will become increasingly reluctant to pay continuing royalties based on the JV's rising sales. Such an outcome is especially probable in situations where the technology has been substantially absorbed and even successfully modified within the JV. On the local partner side, there can be a strong element of: "What have you done for me lately?" Some JVs, in fact, become sufficiently accomplished with the MNC's technology that locally-derived modifications are employed elsewhere in the MNC itself. JV agreements often state that such modifications are not to generate reverse royalties, a provision that in an *ex post* sense is not likely to be well received by the local partner side of the JV.

- Changing technology causes other disagreements as well. Consider the case of a JV established some years ago to build and market mainframe computers in an Asian country. Over the course of the JVs operations, technologies related to miniaturization caused an upheaval in the market, not only in industrial countries but also in the developing world. The personal computer, along with networks, began to substitute for larger systems in both regions. Smaller, lower valued products require much different production and marketing skills than do mainframes, essentially reducing the advantages of producers of the latter.

  As the market changed, more agile competitors began to take over PC markets everywhere. As might be anticipated, a JV set up to serve the older, now less relevant, market was ill-equipped to deal with the new technical and distribution conditions. To the MNC partner, the problem was seen as an inability of the JV to respond in an agile manner to new competition in the marketplace. This argued for establishing a new JV which focused exclusively on PC markets. The developing country side, however, viewed the problem quite differently. It saw the JV as being hampered by late and sometime non-existent access to the latest in technology developments from the MNC.

  Technology change can also alter the previously existing production relationships in the JV. For example, new technology might require the JV to adopt much more capital intensive production methods in order to maintain competitive costs and quality. Such a change can mandate new and large capital infusions into the business, infusions that might be acceptable to one side of the JV but not to the other.

- Another common source of problems is that changing circumstances not anticipated when the JV was formed cause parts of the JV agreement to become essentially obsolete. While both sides to the agreement might agree that the relevant provisions no longer work properly, making the necessary modifications to the agreement in a going operation can be quite taxing. One side or the other may have made commitments in other parts of their operations that are difficult to alter.

  Offtake agreements provide a ready example. As part of the JV agreement, for instance, one partner might agree to purchase a given amount of the JV's output, usually products of a particular kind and quality. The MNC partner might agree to accept, say, one-third of the JV's production for sale in its own home market. As time goes on, however, market requirements in that country can change drastically, while needs in the developing country remain largely unchanged. The JV's production becomes quite suitable for the local market but not for the offtake. Yet, the one-third of output destined for abroad might allow economies of scale to be realized, and its loss could raise production costs materially. The JV's management under such circumstances will not easily agree to a change in the terms of the original agreement.

Obsolescing provisions in a JV agreement are a product mostly of attempting to insert excessive detail into the agreement and often are difficult to resolve once conditions that motivated the provisions change. This would argue generally that detailed provisions which directly affect the on-going operational characteristics of the JV are probably to be avoided. The drive for legalistic purity in spelling out the precise relationship between the partners and that between the JV and its partners more often than not wind up adding rigidity to the agreement that requires change later. Sometimes that change is not a simple matter to carry out.

V. Conclusions

JV relationships are, on average, fragile affairs, difficult to negotiate and, once negotiated, to hold together. Although the reasons for breakdown may differ substantially between countries and between different types of partners, the pattern of frequent JV dissolution seems to a global occurrence. This paper has cited a number of reasons why this pattern holds and, implicit in their enumeration, also may suggest methods that might be used in reducing the probability of relationship difficulties among new partners. This is important, because JVs are becoming more and more common in developing countries as economic growth continues to take place more rapidly in these countries than in the industrial world. The contribution of these JVs to the development process is contingent upon their success as viable and ongoing business enterprises.

The study did not explicitly consider the search process to be undertaken in locating potential JV partners, but it is clearly a vital dimension in any future relationship. Although personal compatibility is important at the beginning, it can be a transient phenomenon as managers move to new assignments. JV relationships should be determined much more by complementarities that will continue to exist between the respective organizations. These complementarities, together with a careful matching of corporate cultures, are the most promising focus of the search process.

- Even for partners who have had experience with one another, the agreement specifies terms of a relationship that is normally anticipated to go on for many years. While it is certainly true that no agreement can substitute for partners who are deeply committed to making the JV work, even committed partners can be expected to have conflicts of interest. An agreement doesn't have to be an overly legalistic document in order to provide the basis for overcoming these future conflicts in an orderly manner. Negotiating a suitable agreement, therefore, is a vital component of a successful relationship.

- The JV agreement is best considered as a "living" document in the sense that among its provisions are procedures to amend or change the agreement itself. Rigid documents can themselves become the source of friction, and partners need to have confidence that if disagreements arise, there are clear procedures in place to allow further negotiations and reconciliation.

- Partners need to realize at the outset that their respective comparative advantages in establishing the JV may change over time. JVs are, after all, power relationships. Therefore, wise partners make sure that their companies are vital to the JV's success over the long-run. It is not sufficient for firms to depend on their intimate knowledge of government affairs or familiarity with local financial markets for continuing relevance in the JV, since these contributions are bound to erode. More substantive advantages are required: control of distribution channels, access to continuing sources of technology, control of export channels, etc.

- There is a belief that JVs not controlled by one party or the other are more susceptible to failure; equally shared ownership is to be avoided. The study did not support this belief. Nor is there evidence in the study that earlier experience with JVs by either partner had much to do with the enterprise's ultimate success or failure. The lesson would seem to be that satisfaction with a JV's performance is likely to have more to do with the ability of the partners to adapt to changing circumstances and to maintain mutual respect than to any formal aspect of the JV itself.

- Technology transfer is one of the more sensitive and difficult issues confronting JV managements. It is a topic, therefore, that deserves detailed attention by both parties during negotiations, and clear and complete provisions are best included in the agreement. The problem for developing country firms is that technology also is an area where they have least control over the actions of their industrial country partners and, therefore, implicitly have to rely on trust. Although agreement provisions are important in setting out an operational framework for technology use in the JV, it is one area where formal provisions cannot substitute entirely for good will and understanding between partners.

- Agreements need to contain fairly detailed provisions covering dispute resolution and, in the event of failure to reconcile differences, the exit mechanism to be employed in terminating the JV. Such matters should not be avoided in the belief that good relations will be maintained over the life of the JV or that thinking about disputes at the outset somehow is tantamount to assuring that disagreements will ensue. In our interviews, several cases arose where problems were apparent but where no such provisions existed in the agreement. Trying to resolve disputes in an *ad hoc* fashion as they occur can be a messy exercise.

Finally, the fact that this paper accented difficulties that arise in JV relationships is not intended to imply that JVs are to be avoided. Correctly structured between two or more partners with sustainable complementarities, JVs can be advantageous to all sides. There were many examples in the survey of JVs that had successfully endured a variety of difficulties and had gone on to become thriving businesses in which the partners both continued to make contributions. Mutual trust and respect among the partners is important to such relationships, but so too is attention to maintaining compatible corporate goals and to assuring that the JV business continues to depend importantly on contributions from all partners.

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