Evolution of Japanese Partnership Behavior in Japanese-European Joint Ventures in the EU: A Test of the Trojan Horse hypothesis

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Abstract

The Trojan Horse hypothesis (Reich and Mankin, 1986) argues that Japanese firms form joint ventures (JVs) with Western partners in order to internalize the knowledge held by them and that they dissolve the JV once they have successfully internalized it. The cooperative specialization view (Hennart, 1988; Zeng and Hennart, 2002), on the other hand, argues that firms use JVs to access, but not to internalize, each other's know-how. These two views have contrasting implications for the evolution of parent stakes in JVs. This paper tests these competing theories by examining the behavior of Japanese firms in their Japanese-European JVs in the European Union. We find that the partnership behavior of Japanese firms is more consistent with a cooperative specialization view than with a THH view.

Keywords: Japanese-European joint venture, Trojan horse hypothesis, Cooperate specialization

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1. Introduction

This paper investigates whether the behavior of Japanese partners in their joint ventures (JVs) with European partners in Europe can be explained by the Trojan Horse Hypothesis (THH) or whether it is more consistent with a cooperative specialization view (Hennart, 1988; Zeng and Hennart, 2002). THH proponents, such as Hamel (1991) and Reich and Mankin (1986), argue that JV partners are competing to learn from each other during their collaboration. They have suggested that firms use the knowledge that their partners contribute to JVs as one important way to build their organizational capabilities. Hence JVs can be seen as Trojan Horses by which some firms steal the knowledge of their partners to enter their market. Both Hamel and Reich and Mankin have suggested that Japanese firms are particularly prone to this type of behavior.

There are two aspects of the THH view, learning behavior and partnership behavior. Reich and Mankin (1986) have argued that Japanese firms are adept at capturing market knowledge from their American JV partners in the US. As soon as they have learned, they dissolve the JV. Hamel (1991) has argued that three factors facilitate learning in JVs: learning is greater when the firm intends to learn and is receptive to new information, and when the learning content is transparent. He argued that Japanese JV partners have greater intent to learn and are more receptive to learning while the knowledge held by Western partners is more transparent than that of their Japanese partners. Pucik (1988) has argued that Japanese firms are able to learn from their JVs with foreign partners in Japan by arranging frequent exchanges of information and by rotating employees between the JV and their domestic operations. These discussions have influenced research in the area of inter-organizational learning, such as absorptive capacity. The observations of THH proponent about Japanese learning behavior may also account for how Japanese companies caught up with their Western competitors after the Second World War.

Turning now to partnership behavior, the main topic of this paper, THH proponents suggest that Japanese partners find it more important to learn from their partners than to nurture the relationship with them. Hamel (1991) explained that JV partners which follow a THH strategy terminate their JVs by buying out their partner’s stakes, selling off their own JV stakes, or liquidating the JV because learning from the JV partner is their first priority; after they have learned from their JV partners, the JV is no longer necessary. He also explained that even if the other JV partner refuses to terminate the JV, the JV will be terminated anyway. The reason is that partners who have won the learning race have increased their bargaining power and will request a larger piece of the JV pie, which will damage the inter-partner relationship. Hamel constructed such a model of JV partnership behavior based on his observation of Japanese JV partnerships with Western partners. Reich and Mankin (1986) also warned American firms of the danger of JVs with Japanese partners because the latter are good learners and bad JV partners who might easily terminate the JV after completing their learning mission. We will discuss these JV partnership scenarios based on the THH view later. In short, THH argues that Japanese firms tend to quickly terminate their JVs because they only emphasize their own learning from their JV partners.

These implications from the THH view contrast with the “cooperative specialization” (CS) view (Hennart 1988; Zeng and Hennart 2002). That view emphasizes the value which is created in JVs by combining resources and allowing partners to specialize in their unique competences. Once partners invest in the JV to create joint value, they will emphasize JV longevity to improve the efficiency of their collaboration. CS proponents believe that JV partners will engage in long-term cooperation. Hennart et al. (1999) showed that Japanese partnership behavior in Japanese-US JVs in the US is consistent with a CS view, and inconsistent with a THH perspective.

The question remains “Do Japanese partners use their JVs as Trojan horses?” as claimed by THH proponents. We will explore this question by testing the generality of Japanese THH strategies in their JVs in Europe. First, we will categorize international JV strategies according to the expected strategic context of the JV. Then we will explain the THH partnership scenarios upon which we construct our operational hypotheses. Finally we will test our operational hypotheses on Japanese JVs in Europe and present our findings.

2. THH strategy

In this section, we explain how the THH strategy of Japanese firms is positioned in the international JV strategy category of inter-partner knowledge combination. We postulate that in JVs between a foreign partner and a local partner, the foreign partner typically contributes technology-related knowledge, and the local partner contributes local market-related knowledge. The foreign partner intends to internalize market-related knowledge to enter the local market of the JV, while the local partner intends to internalize technology-related knowledge from its foreign partner to catch up with the technological capability of its partner.

Figure 1, modified from Ishii and Hennart (2007a; 2007b; 2008) and Hennart and Ishii (2007), presents a typology of JV partnership strategies between Japanese and European partners in Japan and Europe. This figure differs from that presented in our past studies in which we treated the foreign market entry strategies of foreign partners as THH strategies and the technology catch-up strategies of local partners as hedgehog strategies. Those strategies can be treated as THH strategies, as we did in previous studies by focusing on learning at the JVs in a broad sense. However, in this paper, we focus on strategies intended to internalize local market knowledge. Therefore, in this paper we only use the term THH strategy for foreign partners who enter foreign markets using JVs with local partners.

In addition, we exclude from this typology JVs between partners from the same country and

JVs between both partners in third countries or regions. This is because the THH and the cooperative specialization views mainly discuss JVs between foreign and local partners.

Figure 1 categorizes the JV partnership strategies of Japanese and European partners in Japan and Europe.

Figure 1 Japanese–European JV strategy categorization is inserted here

The vertical dimension in Figure 1 indicates whether the nationality of the focal partner is Japanese or European. Its horizontal dimension indicates whether the location of the market of the JV is in a home or a foreign market for the focal partner.

In cells (B) and (C), the JVs are established in a market that is foreign for the focal partner. Japanese firms form JVs in foreign markets (Europe) with local partners (European) in cell B, and we will construct operational hypotheses for firms in this cell. On the other hand, European partners establish JVs in foreign markets (Japan) with local partners (Japanese) in cell C. In both cases, the focal partner expects to obtain local market-related knowledge, such as awareness of customer demands, of human resource management, and of purchasing and distribution. This strategy allows foreign partners, the focal partners here, to exploit the local partner’s local knowledge without having to accumulate the knowledge by themselves in a newly set up wholly owned subsidiary. Hence, we can call the JV strategy of these cells a foreign market entry strategy, which can be a THH strategy.

In cells A and D, the JV is established in the home market of the focal partner. In these cases, focal partners intend to obtain technology-related knowledge from their foreign partners who are invading their home market, a strategy we call the “hedgehog” strategy.

3. Japanese THH partnership scenarios in Europe

In this section, we develop scenarios for the evolution of Japanese JVs in Europe. These scenarios, presented in Figure 2, are mainly based on the THH literature and efforts to empirically test it.

Figure 2 inserted here

The first scenario (S-1) is described by straight-lined arrows. This scenario starts when the Japanese partner uses the JV to capture local knowledge by the European partners. Since Japanese partners are assumed to learn from their European partners more quickly than the European partners learn from them, Japanese partners increase their bargaining power vis-à-vis their European partners. Hence, the Japanese partners can persuade their European partners to sell-off their JV stakes to them and they can then exploit the knowledge in their wholly owned subsidiaries.

In the second scenario (S-2), Japanese partners follow the path indicated by the dashed arrows. This leads to three possible patterns of JV termination: Japanese buy-out of the JV stake, Japanese sell-off of the JV stake, and JV liquidation. The first arrow follows the same path as

S-1 in which Japanese partners increase their bargaining power vis-à-vis their European partners by winning the learning race. If the Japanese partners succeed in persuading their European partners to buy out the JV stake, they follow the S-1 path. However, there is a possibility that the European partners refuse the offer of their Japanese partners to sell off their JV stake to them. In that case, the JV continues for a while. However, the inter-partner relationship may worsen because the Japanese partner can be expected to request a larger share of the JV profits because their bargaining power has increased. Hence, inter-partner conflict frequently erupts between partners and they often consider exiting the JV. Then, buy-out and sell-off of the JV stake by the Japanese partner and JV liquidation are possible paths.

The third scenario, S-3, is represented by the dashed-dotted arrows. In this scenario, Japanese partners recognize that the JV will no longer be useful after they complete their learning from their European partners. At this point, they may wish to sell-off their JV stakes, and if their European partners or other companies find the JV assets still useful, they may buy the JV stakes of the Japanese partners. Otherwise, if no company deems the JV assets useful, the JV will be liquidated.

4. Operational hypotheses

Based on the THH scenarios above, Japanese firms are assumed to expropriate the market knowledge of their European partners in Japanese-European JVs in EU markets and to transfer it to their organizations. When Japanese partners finish learning from their European partners, they do not need the partnership anymore, so they terminate it. If the JV assets remain useful for the Japanese partners, they will try to persuade their European partners to sell their JV stake to them. If the European partners agree, then the Japanese partners will transform the JV into their wholly owned subsidiaries. However, there is a possibility that the Japanese partners fail to persuade their European partners to sell their JV stakes because the European partners find that the JV assets are still useful to them. In such cases, the Japanese partners will request to increase their profit share from the JV because they have gained more bargaining power vis-à-vis their European partners. This can be expected to lead to inter-partner conflicts. As a result, one or both JV partners may terminate the JV by selling off their JV stakes to their partners or other firms or by liquidating the JV. If the Japanese partners find that the JV assets are no longer useful but the European partners or other firms find that they remain useful, then Japanese partners will sell their stakes to them. If the JV assets are not useful for any other firms, the JV will be liquidated.

Our first hypothesis compares the number of JVs that have evolved in ways that are consistent with THH scenarios to those that have evolved in ways inconsistent with them[1]. If the

[1] Note that increases and decreases in JV ownership short of full buy-out and sell-off are considered to be inconsistent with a THH scenario. Our database contains cases were JV parties have changed the 50-50% ownership of a JV to 49-51% in order not to have to disclose information. Such a change cannot be seen as the result of THH strategies. Also, JV stakes have often to be adjusted to reflect changing conditions, so changes in ownership percentage that stay

former is greater than the latter, then THH is supported:

> H1: THH is supported if the number of cases of Japanese-European JVs in the EU where Japanese partners buy full ownership from their European partners, where the JV is liquidated, or where Japanese partners fully divest their stakes to their European partners or to other firms, is higher than the number of JVs where the Japanese remain JV partners.

Not all THH scenarios are equally likely. The most desirable strategy for Japanese firms who follow THH strategies when entering foreign markets is to buy out the JV stake of their local partner (Hennart et al., 1999). This is because they can then immediately utilize the knowledge they have acquire from their European partners by transforming the JV into their wholly owned subsidiary. In addition, Japanese partners might prefer to continue the relationship with their subsidiaries rather than completely sever it if they value long-term relationships. Moreover, Japanese firms should find buying out their partner's JV stake to be preferable to selling it to their European partners because if their European partners can transform the JVs into wholly-owned subsidiaries, they may be able to use some of the technology they have obtained from their Japanese partners to start competing with them. Hence, if Japanese firms use JVs as Trojan Horses, most Japanese-European JVs in Europe are likely to be fully acquired by their Japanese partners. This leads to the next hypothesis:

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within a range of less than 95% (more than that is counted as a buy-out) or more than 5% (less than that is counted as a sell-off) cannot be seen as resulting from THH strategies.

> H2: THH is supported if the number of cases of Japanese-European JVs in the EU where Japanese partners buy full ownership from their European partners is higher than the number of JVs where the Japanese remain JV partners.

There is another possibility. Liquidation or bankruptcy of the JV may also be an attractive option to Japanese partners in addition to JV buy-outs. If Japanese partners internalize the market knowledge obtained from their EU partners, they can set up their own manufacturing subsidiaries in the EU. However, Japanese partners can also use the knowledge acquired from their European partners to increase their exports from Japan. In addition, liquidating the JV that obtained technology from the Japanese partner reduces the possibility that the European partner will become a direct competitor of the Japanese partner in the future, as would be the case if the Japanese sold their JV stakes to their European partners. Based on the above, we constructed a weak version of THH behavior:

> H3: THH is supported if the number of cases of Japanese-European JVs in the EU where Japanese partners buy full JV ownership from their European partners or where the JV is liquidated, is higher than the number of cases of JVs where Japanese partners remain JV partners

On the other hand, if Japanese partners do not follow THH strategies but instead choose cooperative specialization strategies, they will stay in the JV. A strong test of the cooperative specialization hypothesis would be to compare cases where the Japanese continue their stake and cases where the Japanese terminate the JV:

> H4: CS is supported if the number of cases of Japanese-European JVs in the EU where Japanese partner continue their JV ownership is higher than the number of JVs where Japanese partners buy full JV ownership from their European partners, where

the JV is liquidated or where Japanese partners sell of their JV stakes to their European partners or to other firms

5. Results

We collected data on the changes in the ownership levels of Japanese partners in Japanese-European JVs in Europe between 1987 and 1996. A list of Japanese-European JVs was obtained from *Japanese Multinationals, Facts and Figures* published by Toyo Keizai. To be included in our population, JVs had to meet the following criteria: the JV and the JV partners had to be in manufacturing, the JV had to be owned by one Japanese partner and one European partner with the JV stake of each partner being more than 20% but less than 80%, the JV had to produce in Europe in its own plant or by outsourcing to a local firm, and it had to have more than 10 employees. We look at ownership changes over a nine-year period. This should be sufficient to measure JV ownership changes because Kogut (1988) has shown that the instability rates of JVs peak in their sixth year.

Table 1 presents the changes in ownership levels of Japanese partners in Japanese-European JVs in Europe between 1987 and 1996.

Table 1 inserted here

Japanese partners changed their JV ownership levels in 22 cases (58% of the total). In 13 cases (34% of the total), the Japanese partners acquired a JV stake of over 95%, transforming the JVs into their wholly owned subsidiaries. In six cases (16% of the total), Japanese ownership dropped to 0-4.9%. In 16 cases (42% of the total), the Japanese ownership level remained unchanged.

Table 2 summarizes Japanese ownership changes in Japanese-European JVs in Europe between 1987 and 1996. Total B is the total number of JVs in our population. Total A excludes one case of JV evolution that is due to reasons that cannot be explained in terms of either a THH or CS strategy[2].

Table 2 inserted here

Table 2 shows that there are 13 cases where Japanese partners bought out the JV stakes of their partner: Japanese partners bought out the JV stake from their original European partners in 12 cases and in one case acquired the original European partner itself. In three cases the Japanese partners sold their JV stake, in one case to its original European partner and to a firm other than the original partner and in two cases to firms other than their original European partners. Three JVs were liquidated or dissolved. The total number of Japanese ownership changes that can be considered reflecting THH strategies was 18 out of 38 cases (47.3% of Total A). This is a slightly higher ratio than in the case of European THH strategies in Japan, where

[2] This is a case where the Japanese partner acquired its original European JV partner. The Japanese partner intended to expand its sales and production network in Europe and Australia by acquiring its European JV partner. The Japanese parent already owned 28% of the European JV partner and the president of the Japanese parent was the chairman of the European JV partner at the start of the observation period. The Japanese acquisition of the remaining stock of the European JV partner seems to have been motivated by a desire to acquire customers and facilities and not by a desire to obtain the European parent's knowledge, which the Japanese partner could have obtained from the joint venture or from its European partner without acquiring the European partner itself. Hence, we think that this case is not an example of THH behavior or CS behavior.

we have 32 THH cases out of 69 cases (46.3%) (Ishii and Hennart, 2007a). In seven cases, Japanese partners increased their JV share but not above 95%. In one case, the Japanese partner decreased its ownership share but not below 5%. The number of cases of unchanged Japanese JV stakes was 11 out of 38 or 28.9%; this rate is lower than that for European JV stakes in Japan, which is 37.8% (Ishii and Hennart, 2007a).

Table 3 inserted here

The results of our operational hypotheses are shown in Table 3. Recall that H1 stated that THH would be supported if the number of cases where Japanese partners bought the full JV stake of their European partners plus the number of cases where JVs were liquidated and plus the number of cases where Japanese partners sold off their stake to their European partners or other firms was larger than the number of cases where their JV stakes remained unchanged. Table 3 shows that the number of Japanese buy-outs, sell-offs and liquidations was 18, while there were 19 cases where Japanese parents stayed in the JV, that is where they stakes remained unchanged, increased but stayed short of 95%, and decreased but remained above 5%, Hence, H1 is not supported. H2 also tests the THH model, but argue that in contrast to H1, cases where the JVs were liquidated and where the Japanese sold off their JV stakes to their European partners or to other firms should not be interpreted as providing support for THH. Since the number of cases where the Japanese partners bought out their European JV partner’s share was

12, while that where the Japanese remained JV partners as evidence of cooperative specialization strategies, then the total is 19, and H2 is also not supported. H3 provides a weaker test of THH compared to H2 because in contrast to H2 we count cases of JV liquidation as supporting THH. Since the number of cases where Japanese partners acquired full ownership of JV by buying the JV stakes of their European partners plus that of JV liquidations add up to 15, while the number of cases where the Japanese remained JV partners add up to 19, H3 is not supported.

H4 tests the hypothesis that Japanese firms follow cooperative specialization strategies in their JVs with European partners. H4 sees the 19 cases where the Japanese stayed in their JV as supporting CS strategies, while the 12 cases where they bought their partner's stake, the 3 cases where they sold their stake, and the 3 cases where the JV was liquidated do not. H4 is thus weakly supported.

Our results may underestimate the importance of the CS view and overestimates that of THH. This is because we start measuring the duration of JVs in 1987, but most JVs were already by then in existence. In fact, the average foundation year of foreign affiliates in the Toyo Keizai database, excluding two cases where the foundation year is not known, is 1980. That year roughly corresponds to the foundation year of the JV between the Japanese and European partners. However, the foundation year of the foreign affiliate is not necessarily that of the JV because the foreign affiliate may have been established as a wholly-owned subsidiary of the Japanese JV parent, the European JV parent, or another firm, or as an independent firm before becoming a JV of the present Japanese and European parents. Therefore, it is probable that most of our JVs were founded at least a few years before our measurements started. The longer the observation period, the more likely JVs will terminate. If we had measured just nine years of inter-partner JV collaboration, the result might have been less supportive for the THH view and more supportive for the CS view.

6. Discussion and Conclusion

Our results suggest that, in general, Japanese partners chose to stay in their JV relationships with European partners, thus choosing a cooperative specialization strategy that emphasizes joint value creation within the JV. Conversely, the THH strategy to terminate their JV partnerships in the short term, here in less than nine years, was less common among Japanese partners, and hence it does not seem that the use of this strategy characterizes Japanese firms. While these findings do not support the THH view, they are consistent with other evidence. For instance, evidence suggests that Japanese automobile assemblers prefer to have long-term relationships in their supply chain management in Japan (Asanuma, 1989; Clark and Fujimoto, 1991) and in the US (Dyer and Nobeoka, 2000). These studies point out that Japanese auto assemblers develop an effective and efficient method of collaboration with their component suppliers. The important learning in such relationships is how to utilize mutual knowledge to effectively maximize joint value creation, and to avoid stealing partner's knowledge for one's own profit. Such relationships strongly rely on the mutual trust created through long-term relationships between partners. We infer that Japanese partners have tried to construct similar inter-partner relationships with their European JV partners.

Furthermore, Japanese partners also seem to have emphasized their partnerships with the JV itself. We have found that the buying out of the partner's JV stake is the most common termination pattern taken by Japanese partners. Although we treated such Japanese buy-outs as evidence of THH behavior, buying out a partner's JV stake can also be seen as a way to maintain a continuous relationship with the JV. When the initial JV partner intends to exit the JV, the focal partner may buy out the partner's JV stake to maintain stability in JV management. Recall that the most common Japanese JV partnership pattern was continuation of the JV (including increase and decrease of JV shares), and the second pattern was buy-outs of JV stakes. These results imply that Japanese partners emphasize value creation within their JVs, though they also imply that Japanese partners may not be good at radical restructuring decisions, even if the JV business is not profitable at all. We know of cases where the Western JV partners told their Japanese partners that, because of financial reasons, they would sell-off their JV stake, and where the response of the Japanese partners was to buy the Western partner's JV stake so as to avoid the uncertainty inherent in taking in a new JV partner. Whether Japanese buy-outs are explained by a desire to appropriate the knowledge of the partner, as argued by THH proponents, or by a desire to maintain the stability of the JV and hence to foster cooperative specialization, probably hinges on whether the acquisition was triggered by the Japanese partners or by the actions of their Western partners. This requires detailed investigations of all cases of JV evolution, a task we leave for future research.

Our results suggest other areas for future research. First, it would be interesting to do a fully parallel study of Japanese partnership behavior in the same strategic context of foreign market entry but in a different market, for example the United States.[3] Second, the stability of Japanese-European partnership may also vary with the nationality of the European partner. Ishii and Hennart's (2007b) study of JVs between European and Japanese firms in Japan shows that, Japanese partners had relatively long JV partnerships with German firms and short ones with British firms. In this context, it is interesting to note that Hamel's (1991) THH model was mainly based on case studies of Japanese-British collaborations. The short duration of these may have influenced the development of his theory. Third, we only measured whether Japanese firms followed THH strategies. We did not compare the extent to which Japanese and Western partners follow THH strategies in the same strategic context. To do so, one would need to

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[3] Hennart *et al.* (1999) is not fully comparable because of differences in the time frame and in the sample.

compare Japanese JV partnership in Europe and European JV partnership in Japan.

Figure 1. Japanese–European JV strategies

		Market	
		Japan	Europe
Partner's nationality	Japanese	(A) Japanese Hedgehog strategy (JV partnership in home market)	(B) Japanese THH strategy (JV partnership in foreign market)
	European	(C) European THH strategy (JV partnership in foreign market)	(D) European Hedgehog strategy (European JV partnership in home market)

Figure 2 Japanese THH partnership scenarios

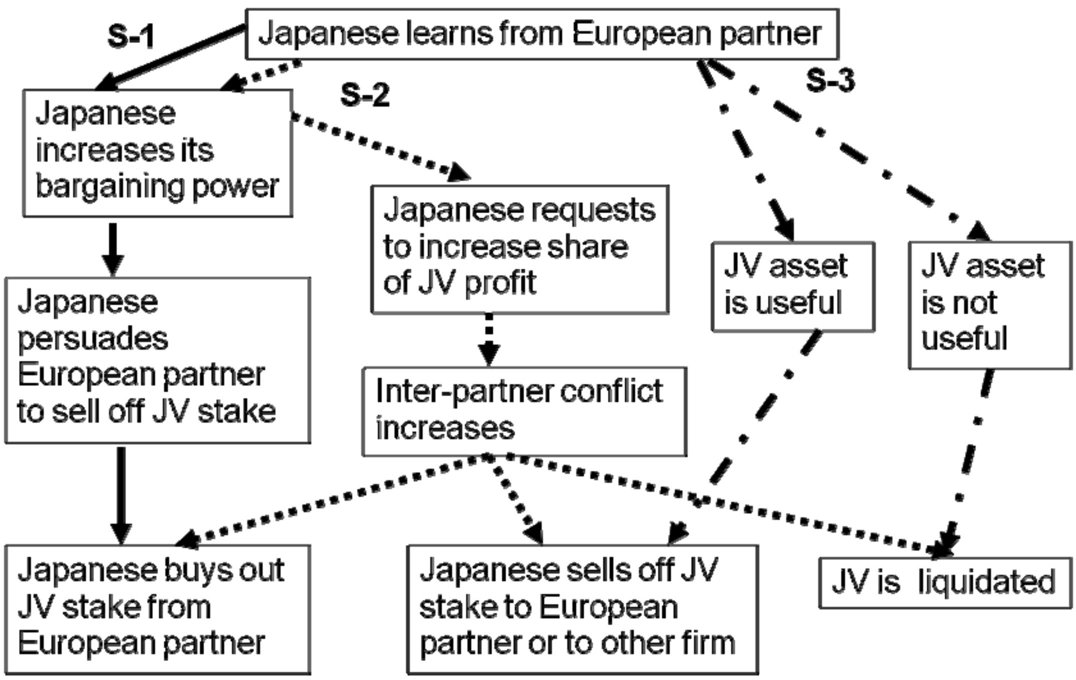

Table 1 Changes in ownership levels of Japanese partners in Japanese–European JVs in Europe (1987–1996)

		Final level (1996)					
		0-5%	5.1-49.9%	50%	50.1-94.9%	95–100%	Total (1987)
Initial level (1987)	Minority	4	4	0	2	4	14 (37%)
	50%	2	0	7	1	3	13 (34%)
	Majority	0	0	0	5	6	11 (29%)
	Total (1996)	6 (16%)	4(11%)	7 (18%)	8 (18%)	13 (34%)	38

Table 2 Summary of changes in ownership levels of Japanese partners in Japanese-European JVs in Europe (1987–1996)

	N
Japanese partner’s stake increased to 95-100%	13
Stake bought from original European partner	12
Japanese partner acquired original European partner	1
Stake bought from firms other than original European partner	0
Japanese partner’s stake increased but not to 95-100%	7
Japanese partner’s stake decreased but not to 0-4.9%	1
Japanese partner’s stake became zero	6 (Note)
Stake sold to original European partner	1
Stake sold to firms other than original European partner	3
Japanese partner was acquired by original European partner	0
Japanese partner was acquired by firms other than original European partner	0
Joint venture was liquidated or bankrupted	3
Japanese partner’s stake unchanged	11
THH	18
Total A (excludes cases where Japanese partners acquired original European partners, Japanese partners were acquired by original European partners or by firms other than original European partners)	37
Total B (all observations)	38

Note: One case in “Japanese partner’s stake became zero” is that the Japanese partner sold off its JV stake to its original European partner and a firm other than the original partner at once. This is counted as one case in each of the following three categories: (1) Japanese partner’s stake became zero; (2) Stake sold to original European partner, and (3) Stake sold to firms other than original European partner.

Table 3: Results of data analysis for operational hypotheses

	Elements	Numbers of JVs	Results
H1 (THH)	BO + SO + L > OC (ownership continued= OU + JV share increase /decrease)	12+ 3+ 3 < 19	Not supported
H2 (THH)	BO > OC	12 < 19	Not supported
H3 (THH)	BO + L > OC	12 + 3 < 19	Not supported
H4 (CS)	OC > BO + SO + L	19> 12+ 3+ 3	Supported

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