Creating Value through Joint Ventures in China:

Critical Success Factors

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Abstract:

A very high percentage of international joint ventures (IJVs) were failed or unable to achieve the expected objectives due to uncertain local business environments and the lack of operating experiences. The existing research focuses on individual issues such as motivations, ownership and partnership. An overview of the key strategic issues is missing; and their linkage is unclear.

This research was designed to understand how foreign companies successfully design and implement their joint venture strategies in China. A preliminary understanding about the key issues was acquired through exploratory studies. In-depth case studies were conducted to refine and enrich the preliminary understanding. An integrating framework was developed and validated through multiple case studies.

This paper suggests that, to successfully create value through setting up joint ventures in emerging economies, parent companies should have a robust value creation mechanism; invest adequate resources; excise effective partnership control; and adopt sustainable value appropriation policies. This could provide a guide for companies to effectively design and implement their IJV strategies in emerging economies.

Key Words:

International Joint Ventures, Strategic Alliances, International Business, Emerging Economies, China

1. Background and Introduction

Joint ventures (JVs) are legally and economically separate organisational entities created by two or more parent organisations that collectively invest capital and other resources to pursue certain strategic objectives (Pfeffer & Nowak 1976). As a form of strategic alliances, JVs sit in the middle of the spectrum from cooperative ventures to mergers and acquisitions (M&As) according to the degree of interdependence between alliance partners (Contractor & Lorange 1988) or integration with parent organisations (Lorange & Roos 1992). An international joint venture (IJV) is formed by parent organisations from different countries and regarded as a local legal entity in host countries (Gutterman 1997).

The number of IJVs (or cross-border JVs) increased dramatically in the past decades (UN 2007). It is a major approach for multinational companies (MNCs) to access the markets, resources, technologies, talents or expertise on a global scale (Dunning 1993; 1997). However, a very high percentage of IJVs were failed or not able to achieve the expected objectives (EIU 1997; Cullen 2002; Larimo & Rumpunen 2006). Inadequate joint venture strategies were ranked high among those factors blamed for unfavourable outcomes (Bleeke & Ernst 1993; Neves 2006; Nippa et al. 2007). Implementation issues were considered as critical to establish and maintain the cooperative advantage of IJVs (Golub 1994; Doz and Hamel 1998).

However, the existing studies of IJV strategy were focused on individual issues such as motivations (Killing 1983, Dunning 1997; Lyles & Salk 2007), ownership choice (Kogut 1988; Gomes-Casseres 1989; Steensma, et al. 2008), partner selection (Geringer 1991; Glaister & Buckley 1997; Larimo & Rumpunen 2006), partnership control (Beamish 1994; Hebert 1996; Buckley, et al. 2002), and resource commitment and performance (Peng 2000; Child & Yan 2003; Ainuddin, et al. 2007). An overall framework to represent the essential elements of IJV strategies is missing, and the research on implementation is rare. It's difficult for researchers and practitioners to effectively design and implement IJV strategies, particularly in emerging economies due to the lack of operating experience and the uncertain local business environment.

China has recently experienced one of the fastest growing economies in the world (UN 2007). The rapid growth, together with changing investment policies and market conditions, has given rise to a highly dynamic host environment for market entry. Over 610,000 foreign-funded enterprises had registered in China by 2007 and the investment exceeded US$720 billion (MOFTEC 2008). The abundance and diversity of foreign-funded enterprises provide researchers with an unprecedented opportunity to observe the nature of competitive strategies in a form of joint venture (Child 1994). Given the relatively short operating experience of foreign companies in China and the dynamic local business environment, the partnership between foreign and local companies raised many questions about joint venture formation, management and evolution (Beamish 1993; Baran, et al. 1996; Fan 1996; Child and Yan 2003; Nippa et al 2007; Zhan & Luo 2008). There is a need to uncover the best practice for the formation and implementation of IJV strategy in China.

This paper reveals the essential characteristics of successful IJVs in emerging economies from the perspective of strategy formation and implementation. The critical success factors for IJVs in China are identified and integrated though a grounded theory-building approach. The research methodology is introduced after this session. Particular attention will be given to the rationale of case selection, methods of data collection and data analysis, and the tactics to ensure the reliability and validity of the research findings. A preliminary understanding of the strategic issues of IJVs is acquired through reviewing relevant literature, e.g. IJV motivations, ownership choices, partner selection, and partnership control. The exploratory study suggests four essential elements of an effective IJV strategy: value creation mechanisms, resource commitment, partnership control approaches, and value appropriation policies. This preliminary understanding is enriched and refined through in-depth case studies of three successful and three less successful IJVs. An integrating framework is proposed and then validated through two IJVs of a same foreign parent company but with different outcomes. Finally, this paper discusses the practical implications, theoretical contributions and limitations of this research, and suggests three main areas for future research.

2. Methodology

This research was designed to understand how foreign companies successfully design and implement their joint venture strategies in China. The case study approach was adopted because it can enable researchers to generate a rich understanding of the research question from a small number of situations while using a range of data collection methods (Eisenhardt 1989). This research thus enables the triangulation of data and increase the validity and reliability of research findings (Yin 1994).

(Insert Figure 1 about here)

This research was organised into three phases (see Figure 1). The exploratory phase acquired a preliminary understanding of the key issues relevant to this research through literature review and interviewing industry people and experts. The development phase refined and enriched the preliminary understanding with in-depth case studies and developed an integrating framework to represent the critical success factors. The validation phase tested the framework by two IJVs of a same foreign parent company but with different outcomes.

The reported cases demonstrate a spectrum of IJVs from the perspectives of industry sectors, geographic locations, ownership, and performance (see Table 1).

Case data were collected through interviews, documentary studies and participant observation. Open and semi-structured interviews were the primary data collection method. Open interviews were used to understand broad issues related to IJV strategies. Based upon augmented understandings, semi-structured interviews were then carried out. Interviewees were senior managers who involved in the decision making processes and operation managers who involved in the implementation processes. There were at least two rounds of interviews for each case. The first round of interviews aimed to understand the context in which these joint ventures were established and how the partners' strategies evolved. This was then followed with the second round of interviews to identify the key issues in implementation and strategy changes. Additional interviews were conducted to clarify equivocal data or complement missing data when necessary.

The study of internal and external documents enabled the researchers to triangulate the data collected from interviews. Internal documents include JV contracts, JV feasibility study reports, JV management reports, and meeting minutes. External documents include market research reports, books written by company insiders, industry reports from government agencies, and news archives (e.g., Reuter Business Briefing and FT Profile).

Participant observation was deployed to supplement the above two data collection methods. Most of the JVs were visited twice, with plant tours, meetings and informal discussions. In some cases, the researchers were able to participate in management meetings and listen to the discussion of business issues.

Collected data were analyzed mainly through methods of coding (Strauss & Corbin 1998) and patterns matching (Yin 1994). Wherever possible, data display was used to bring in visual formats that present information systematically. Conclusion drawing and verification were facilitated by within-case and cross-case analysis. Within case analysis helped the researchers to cope with the voluminous amounts of data collected from the field work and secondary sources. For each case an attempt was made to generate categories, themes and patterns. This process allows the unique patterns of each case to emerge before attempting to generalise themes across cases. Cross-case analysis was conducted to identify common regularities, explanations and patterns. Similarities and differences between cases were also noted and documented.

3. Literature Review and the Key Issues

3.1 Value Creation Mechanisms

Carefully identifying all the important motivations on which alliance decisions are based is perceived as the most crucial step in gaining an understanding of the value creation mechanism of an IJV (Killing 1983; Beamish 1994). The primary impetus of IJVs in the 1950s was to facilitate market entry and access to natural resources by building up equity partnerships. The motives expanded in scope subsequently, e.g. strategic asset seeking, technology/skills seeking, and economies of scale/scope (Dunning 1997). Nowadays, a company can achieve a variety of strategic objectives in setting up joint ventures, including reducing the time to enter a market

(Harrigan 1988), obtaining access to technology and markets (Killing 1983), achieving economies of scale and scope (Harrigan 1985), gaining a better position vis-à-vis competitors (Porter and Fuller 1986), and facilitating inter-firm knowledge transfer (Hamel 1991; Lyles & Salk 2007).

Ownership choice is another critical step to form the value creation strategy of an IJV. Factors that favour the selection of JV over arm's-length acquisition or organic development as a strategic alternative may from different perspectives. Kogut (1988) suggested that the cultural distance between countries and attitudes towards uncertainty avoidance discourages firms from deploying acquisitions to achieve market entry. Gomes-Casseres (1989a) observed that MNCs are twice as likely to enter joint ventures in restrictive countries as in non-restrictive countries. Stopford and Wells (1972) found that R&D-intensive industries seem to deploy far less joint ventures than others as a market entry alternative. The preference of MNCs for ownership rests on their perceived need to protect their intellectual proprietary rights and to control decision making. Joint ventures are most likely to be selected when the parent companies have little knowledge of local business and where speed of entry is essential. Gomes-Casseres (1989) argued that a joint venture would be less appropriate when a company aims to exploit an existing competitive advantage. A joint venture arrangement seems to be more suitable when the company seeks to expand its capability into new sectors or markets, e.g. to acquire capabilities and assets that cannot be purchased through arm's-length transaction. More recently, Steensma, et al. (2008) investigated IJV ownership changes in transitioning economies. The study suggested that an IJV is more likely to convert to a wholly owned subsidiary when there is a power imbalance and high levels of conflict between the parent companies.

3.2 Partner Selection and Partnership Control

Whether a firm can achieve its strategic objectives through IJVs is dependent not only upon its vision and possessed capabilities, but also upon the commitment and capabilities of its partners. Tomlinson (1971) identified six categories of partner selection criteria, including favourable past association, facilities, resources of partners, partner status, and forced choice. Geringer (1991) distinguished the criteria into task-related criteria and partner-related criteria. Harrigan (1988) once assumed that task-related criteria might rank relatively higher than partner-related criteria. Glaister and Buckley (1997) found that the relative importance of partner selection criteria is not that clear cut. Larimo and Rumpunen (2006) further investigated the relative importance of partner selection criteria and the impact of contextual variables on partner selection criteria, e.g. foreign partner-specific, location-specific, and investment-specific variables.

The purpose of exercising control in a joint venture can be traced down to the desire of each partner to ensure that the benefits it seeks are actually realised and possibly maximised in the long run. Killing (1983) suggested that JVs in which one parent exercises dominant control tend to have a higher level of performance than those whose control is shared among partners. However, such a relationship would depend upon the nature of resources contributed by each parent. If the resource contribution is complex and embedded in nature, a shared control should be encouraged as the transfer of these resources requires ongoing managerial involvement of both parents. Only in the case that the resource transfer does not pose problems can this casual relationship be established firmly. Beamish (1994) found no evidence to support the positive casual relationship between dominant control and performance. On the contrary, a higher occurrence of unsatisfactory performance is attributed to the dominant control of a parent firm. Hebert (1996) suggested the relationship between control and performance is subject to various mediating and moderating effects and therefore direct causal relationship might be difficult to ascertain.

Partnership control approaches have been identified and categorised in the existent research. Shaan (1983) identified the bases for a parent company to exercise partnership control, e.g. (i) the parent provides the JV with resources; (ii) the parent executes formal contractual agreements; (iii) the parent has its representatives on the board of the IJV; and (iv) the parent appoints senior managers of the IJV. Geringer and Hebert (1989) distinguished three types of control mechanisms: context-oriented mechanisms embedded in the IJV organisational setting, content-oriented control mechanisms relying on the direct intervention by the parent to meet certain aims of controlling the IJV, and process-oriented mechanisms rendering parents a certain level of control through reporting relationships or influence on IJV planning and decision-making processes. Buckley, et al. (2002) identified four sets of partnering skills for cross-culture IJVs, including inter-partner skills, managing the IJV managers, managing the partner partners, and managing the IJV itself.

3.3 Resource Commitment and IJV Performance

With a resource-based view, a firm can be considered as a bundle of linked idiosyncratic resources and resource conversion activities (Barney 1991). Resources may be tangible or intangible, such as equipments, financial assets, technologies, intellectual prosperity rights (IPR), reputation, business links, managerial skills and political connections (Grant 1991). Firms are different from each other to the extent that the resources they could deploy vary in one way or another. These resources are synthesized to maintain a variety of organizational services whilst supporting all kinds of strategic initiatives. To gain competitive advantages from resources, a firm needs the ability to achieve integration, cooperation and coordination between individuals and teams (Teece, et al. 1997). Dynamic capabilities that use resources to match and even create market changes would be required in changing business environments (Eisenhardt & Martin 2000).

A joint venture consists of a bundle of resources contributed by the parent companies.The attributes, quantity and quality of the resources provided by the parent companies influence the performance of an IJV significantly. This is particularly important for IJVs in emerging economies. For example, the quality of resources from foreign partners is critical for the performance of an IJV in China because China has been short of the capital, technology and expertise to sustain its rapid economic development (Peng 2000). Ainuddin et al. (2007) investigated the relationship between resource attributes and performance of IJVs. Four categories of resources were identified, including product reputation, technical expertise, local business network and marketing skills. The value, rarity and non-substitutability were found to be significant performance drivers. Child and Yan (2003) revealed that the quality of resources provided by foreign partner is critical in a developing country where FDI is a necessary vehicle for the transfer of technology and management expertise. At the same time, resource commitment processes would influence partner control mechanisms. Foreign partners would excise a higher level of control if the quality of provided resources is poor. When the quality of resources is good, foreign partners would share control with local partner who can assist in dealing with complex environments.

3.4 Key Issues for IJV Strategy Formation and Implementation

The above literature addresses a number of key issues for IJV strategy formation and implementation (see Figure 2). Understanding and matching the motives and objectives of the parent companies lay a foundation for an IJV's value creation mechanism. An IJV needs sufficient resources to operate as an independent business entity. Comparing various ownership choices could be a start point to develop a robust value creation mechanism and a feasible resource commitment plan. Parent companies are unlikely to satisfy with the performance of an IJV without working with right partners and excising appropriate partnership control. The ultimate goal for the parent companies to form an IJV is the value it creates. Sustainable value appropriation guarantees the long-term prosperity of an IJV. Value appropriation issues such as dividend allocation and transfer prices were considered as critical in the exploratory interviews with practitioners and experts. Value appropriation will be a main portion of the case studies although they are not directly addressed in existing literature.

(Insert Figure 2 about here)

4. Case Studies and the Integrating Framework

In-depth studies of three successful and three less successful IJVs were carried out to understand the essential elements of IJV strategy and the critical issues in implementation. Table 2 presents the characteristics of the six cases from the perspectives of value creation, resource commitment, partnership control, and value appropriation.

(Insert Table 2 about here)

Some joint ventures are relatively successful (e.g. Case A, B and C) but some are less successful (Case D, E and F). The case studies reveal that the extent to which the parent companies can capture value from an IJV is dependent upon how well they can form and implement their IJV strategies. The characteristics of an IJV which determine the extent to which its foreign partner is able to capture the expected value are identified through cross-case analysis. Collectively, the cases demonstrate four critical success factors of IJVs in China: robust value creation mechanisms, adequate resources, effective partnership control, and sustainable value appropriation.

4.1 Robust Value Creation Mechanisms

An IJV is a legally independent business entity. Having a robust value creation mechanism is critical for an IJV to cope with the uncertainties that may occur during the implementation stage. If the market sector chosen for entry turns out to be very competitive once the project starts, the parent companies may find it difficult to justify further investment and continued expansion leading to diminishing returns on their investments. If competitive advantages established by a joint venture cannot be sustainable, this would bring about similar dilemmas for the parent companies.

In *Case A*, stable demand from the automotive industries, the rapid growth of refrigeration markets and a low level of tubing product competition created a highly profitable niche market for the IJV. *In Case B* the IJV maintained about 45% market share in the Chinese marine and protective paints markets at the time of the visit. The success of the IJV had a lot to do with the brand name of the foreign partners and its product technology, which were unavailable to its Chinese competitors and relevant to the key success factors in the marine paint market: reliability and quality. In *Case E*, one of the critical reasons for the poor performance was that the contributed vane compressor technology did not fit well into Chinese markets whilst the Chinese partner provided little help towards product sales and distribution. The IJV's financial performance was aggravated by the high unit costs of the finished air compressors and the need to fight off market competition. In *Case F*, changes in the competitive environment forced the foreign partner to cancel the production of key components. The lack of production localisation also weakened the cost position of the IJV as an optimal transmission vendor. In the end the joint venture had to change its line of business to a more service-oriented agency, an outcome which fell far short of the foreign partner's expectations.

4.2 Adequate Resources

The survival and growth of a joint venture depends heavily on the inputs from the parent companies. Value creation would not happen if there were inadequate quantity and quality of resources pooled into the proposed IJV in a timely manner. Lack of adequate resources will put the whole value creation process in jeopardy, which in turn leads to the dissatisfaction of partners and resultant internal conflicts.

In *Case C*, the investment scale of the IJV was below the expected capital expenditure normally required for an IJV of that production capacity due to constraints in the ownership and financial position of the Chinese partner. The IJV was therefore left with a very tight budget from the beginning. The cost constraint had inevitably led to compromises in engineering design and project start-up in order to save money. This let to the delay in the start-up the precision casting line which compelled the IJV to reschedule production planning and import extra raw materials. In *case D*, the IJV should have dominated the domestic mechanical seals market with little local competition in the late 1980s. However it failed to achieve this objective due to low resources commitment. As a state-owned enterprise, the Chinese partner had been on the brink of financial bankruptcy. It was reluctant and also not able to inject capital for business restructuring in this collaboration with the foreign partner. The foreign partner, for many reasons, also overlooked the importance of investing adequate resources in this strategically important venture. The limited involvement of the foreign partner equipped the IJV with little competitive edge in terms of product and process technology.

4.3 Effective Partnership Control

In order to ensure that IJV strategy can be smoothly implemented, the parent companies have to exercise effective partnership control. It will enable the parent companies to monitor the project process, safeguard financial integrity and maintain high-level management efficiency. When the control is ineffective, the parent companies are unlikely to extract value from the partnership to its full extent. This is likely to result in a low interest in resource commitment and an inability to deal with uncertainties facing the project and partnership.

In *Case A*, the foreign partner deliberately invited the Australian ambassador in China and the Minister of the Chinese Metallurgic Industry to attend the opening ceremony. This not only raised the profile of the IJV as the first foreign-funded enterprise in the Qinhuangdao region, but also reinforced the perception of the foreign partner's strong commitment to this IJV. The high-profile support laid down a solid foundation for the foreign partner to establish a close relationship with its Chinese counterpart. In *Case C*, the successful partnership management has helped alleviate the serious problems in the project start-up. The internal financial control and report system functioned well to help sort out operational difficulties. Communications on different levels between the partners was effective and timely. This reduced the level of internal conflict over operational and strategic controls. In *Case F*, owing to poor performance, the collaborative passion at the early stage of the alliance gradually disappeared as well as mutual trust. Later on the joint venture experienced internal conflicts on the suspension of key component production. Endless disputes over transfer pricing also made the IJV management troublesome. These problems would have been contained if the foreign partner had paid enough attention to the importance of communication and relationship development in the joint venture and at the same time strengthened its overall control over operations.

4.4 Sustainable Value Appropriation

Value creation, resource commitment and partnership control have laid down a basis upon which a joint venture could generate value for its parent companies. However, the performance of a joint venture is difficult to predict during the formation stage due to environmental uncertainties. For this reason, the value which a partner can extract from the joint venture is also difficult to determine and the value distribution between partners may drift away from the original plan. Sustainable value appropriation policies are required to ensure the long-term prosperity of a joint venture. The dissatisfaction of one partner could lead to a sense of unfairness and damage mutual forbearance between the partners, which in turn may lead to power struggles over IJV control and a non-co-operative attitude towards project implementation and resource support.

In *Case A*, the foreign partner kept the transfer price at a reasonable level and gradually reduced the volume of the materials supply transaction due to a successful implementation of production localisation. A structured approach was also established to facilitate an annual re-negotiation of transfer pricing. The transaction issue seldom brought about problems for the parent companies in this IJV. In addition, the foreign partner raised the stake to reflect the change of continuous contributions from the parent companies. This adjustment of value appropriation policies enabled the parent companies to balance their interests better as the nature of resource contribution evolves along the development of their IJVs. In *case E*, the foreign partner intended to capture value through a technology royalty agreement and component supply contracts. A fixed rate of royalty fee was agreed in the IJV negotiation and there was not much dispute over that after production began. But the transfer prices had been a highly contentious issue between the partners. Concerned about high unit costs, the Chinese partner attempted to reduce component transfer prices charged by the foreign partner. This request had been rejected because the foreign parent company tended to regard the IJV as their customers rather than affiliated partners. Ultimately, the foreign partner seemed to fall in a vicious circle as the low level of IJV sales reduced the amount of components ordered by the IJV and made cost reduction even harder than before.

4.5 An Integrating Framework

Critical success factors of IJVs in China are captured from cross-case analysis. Figure 3 presents an overall framework to integrate the issues of value creation, resource commitment, partnership control and value appropriation.

(Insert Figure 3 about here)

- **Robust value creation mechanisms:**

  The value creation mechanism of an IJV describes how its operation generates value in a stand-alone manner. Key issues are selecting attractive entry markets and building competitive advantage in targeted business. The robustness of an IJV's value creation mechanism indicates whether value creation can be immunized from uncertainties and remains on a track of smooth evolution.

- **Adequate resources**

  Resource commitment of an IJV describes how the parent companies contribute and transfer tangible and intangible resources to the IJV. Key issues are ascertaining the quantity and quality of resource commitment and assessing the fitness for transfer of the pooled resources. The adequacy of resources indicates whether resource commitment 'fits' with the requirement of IJV project execution.

- **Effective partnership control**

  Partnership control of an IJV describes how a parent company to influence its partner (or partners) and joint venture management. Key issues are controlling IJV management and influencing partners through effective communication and partnership building. The effectiveness of partnership control indicates whether the control is adequate to prevent downside risks associated with shared management from occurring and encourage partners to play a more positive role in the development of the IJV.

- **Sustainable value appropriation**

  Value appropriation describes how a parent company extracts value from the operation of the IJV. Key issues are avoiding the potential risk of transaction hazard and achieving consensus on dividend allocation. The sustainability of value appropriation indicates whether value appropriation can ensure the avoidance of detrimental value extraction by either of the partners.

5. Case Studies to Validate the Framework

The above theoretical framework is validated by two joint ventures of a same foreign company but with different outcomes. Case G is an industrial gas provider in Shanghai. Its foreign parent company is a global leader in the manufacturing and supply of industrial gases and gas handling technology. Its Chinese parent company is a state-owned enterprise in Shanghai. Case G purifies, liquefies or compresses and markets the gases provided by it Chinese parent company. Case H was an industrial gas provider in Tianjin. Its Chinese parent company was a state-owned enterprise under the administration of Tianjin Chemicals Bureau. The production facilities of Case H were mainly made up of the assets pooled by its Chinese parent company. In 1995 Case H established a new site in Tianjin Economic Development Zone. Such a two-site operation situation went on until the joint venture was dissolved in April 1998.

(Insert Table 3 about here)

Table 3 presents the characteristics of Case G and H with the theoretical framework (see Figure 2). Case G is successful because of its robust value creation mechanism, adequate resources, effective partnership control, and sustainable value appropriation. Case H was failed due to its vulnerable value creation mechanism, poor quality resources, ineffective partnership control, and unsustainable value appropriation. This validation process suggests that the theoretical framework is mature because no significant changes of the structure or contents emerge from additional case studies. At the same time, the theoretical framework could be generalised because the terms and definitions can be comfortably applied in other settings. In addition, the theoretical framework has a fairly good level of reliability and validity because critical success factors are significant to interpret the outcomes of IJVs.

6. Discussions

6.1 Theoretical Implications

The extant IJV research tends to devote attention to a few key strategy formation decisions, such as motivations, ownership choices, partner selection and IJV control. The discussions on these individual issues, albeit important, are unlikely to provide a holistic view on IJV strategy. There is a need to integrate strategic considerations into a framework to facilitate the systematic formulation and implementation of IJV strategy. This research, for the first time, systematically presents the essential elements of IJV strategy, identifies the critical issues in implementation, and articulates the relationship between the issues of value creation, resource commitment, partnership control and value appropriation. This provides a fresh approach to the conventional analysis of IJV strategy, and a holistic view which would allow us to design and implement IJV strategy systematically.

At the same time, the existent IJV research pays little attention to the dynamic nature of value appropriation issues. It is important to define value appropriation policies before the setup of a joint venture. An issue of equal importance but not well addressed by existing studies is to review and adjust value appropriation policies to reflect environmental changes. This research demonstrates two basic channels through which a parent company can benefit from the IJV. One is to capture profits through transactions with the IJV. The other is to gain dividends through shareholding. It is evident from the less successful cases that inappropriate exploitation of transactions with IJVs could jeopardise the business viability and threaten the partnership. Exploitative and rigid transfer prices have been the root of many conflicts between partners. At the same time, it is important for parent companies to agree on a sound dividend allocation policy which helps to balance the need for IJV growth and the demand for profit taking. In the relatively successful cases nearly all the profits generated at the early stage were reinvested in the IJVs.

In addition, many multinational companies (MNCs) consider their joint ventures as a learning stage of their long term plan in China. By doing so, they will be able to strategically increase their shareholding or directly establish their own subsidiaries when sufficient knowledge about the local circumstance is accumulated. However, few existing IJV studies address the specifics of setting up joint ventures in China (Child & Yan 2003; Nippa, et al. 2007). This research has made some progress by addressing the dynamics of local business environments, the influence of local government and the importance of network relations in the discussion of critical success factors.

6.2 Practical Implications

This conceptual framework is able to provide a guide to the critical issues of IJVs, from the first contemplation of co-operation to the dissolution of the partnership after it has ceased to serve all parties well.

In the pre-alliance stage, the framework may help companies understand the nature of an IJV investment and avoid ungrounded assumptions for co-operation. An IJV becomes troubled often when its partners fail to understand each other's strategy, e.g. their motives, goals and concerns in the first place (Harrigan 1985). The integrating framework shows essential elements of IJV strategy and articulates their contribution to IJV performance. This offers a means through which a parent company can integrate its IJV activities directly with business strategy planning.

In the negotiation stage, the framework may help companies foresee critical issues and be a reminder of the significance of their outcomes and interconnectivity. Strategic decisions of IJVs require long-term planning rather than operational tactics alone. Without an effective formation stage, the subsequent management of joint ventures can become problematic and put the business success in jeopardy (Inkpen and Li 1999). The conceptual framework shows how co-operative advantage is shaped through IJV formation decisions and offers a communication tool to stimulate discussions of how a parent company can enhance the value-adding potential of its joint venture.

In the IJV management stage, the framework may help to remind companies the existence of potential implementation problems and prepare managers for active problem-solving. Although it is still too early to generalise a set of broadly applicable best practice for others to follow, it is definitely not premature to summarise lessons from the established IJVs and point out the barriers which may hinder the process of capturing co-operative advantage. In this sense, the framework offers a way to enhance the viability of a joint venture.

The issue of evolution becomes salient when an IJV matures (Gomes-Casseres 1989a; Kogut 1989; Steensma, et al. 2008). There is a need to refine the IJV strategy either to maintain the initiative for collaboration, if necessary or to facilitate strategic change where the underlying rationale for the alliance has been eroded by environmental changes. The conceptual framework offers a holistic view of the strategic issues involved and facilitates the necessary strategic alignment.

6.3 Limitations and Future Research

Possible avenues for further work link closely with the approach taken so far. The topic of this research, IJV strategy formation and implementation, is a relatively unexplored area of research in strategic management and this research is mainly concerned with Sino-foreign joint ventures. Therefore the same topic analysed within a different research setting, such as in another emerging /developed country or from the view point of local partners, represents potential areas of research. At the same time, it is of value to test the generality of the framework to further the theory-building process. In addition, the framework deserves further refinement so as to develop it into a practical tool with a higher level of usefulness and usability.

- **Comparative Research:** the research setting used here has been characterised by the combined result of unprecedented social-economic reforms, rapid changes in industrial structures and escalating domestic competition in China. It is particularly different from other developed countries in the sense that it evolved from a centrally-planned economy and differs from other developing countries for its sheer size and diversity. The framework generated from those Sino-foreign joint ventures may or may not automatically apply to other research settings. The topic of IJV strategy can be explored in another country or from the view point of local partners with the same research approach. A comparison would be very valuable in terms of the development of IJV research in the field of strategic management.
- **Theory Generalisation**: theory building requires only sufficient evidence to establish a suggestion, rather than an excessive accumulation of evidence from a statistically selected sample to establish a proof. The findings in this research are mainly applicable to Sino-foreign joint ventures. However, owing to their sound

theoretical bases the research so far has found no reason why the framework cannot be applied to joint ventures in other economic setting. Taking this into account, this research points to a need for more work to help confirm (or falsify) the generality of the theoretical framework.

- **Tool Development:** although the research presents an overview of the critical issues for IJV strategy formation and implementation, it is largely based upon historical case studies. A decision-making tool based on the theoretical framework would be particularly valuable for practitioners. The framework needs further research, possibly action research, to improve its usefulness and usability.

7. Conclusion

This paper captures the critical success factors of international joint ventures in China. Through in-depth case studies, the tentative theory has been gradually enriched and its underlying logic verified. The refined theory has then been validated by two joint ventures of a same foreign parent company but with different outcomes. Finally, an integrating framework has been proposed to present a systematic view of the critical issues for IJV strategy formation and implementation. By bringing together the theoretically rich constructs and empirical observations, the framework would help managers, in a context of global economy, to better assess inter-firm collaboration opportunities, design strategic alliance agreements and avoid problems likely to be encountered in implementation.

This research suggests that there are some characteristics of an international joint venture arrangement which determines the extent to which a parent company is able to captures value from its international joint venture. The characteristics could be described from the following four perspectives.

- Robustness of value creation mechanisms, which indicates whether value creation mechanisms immune from uncertainties and remains on a track of smooth evolution. If the IJV operation was vulnerable to uncertainties which occurred during the implementation stage, the joint venture project will be forced to change or even be abandoned. The parent companies might find it difficult to justify further investment and continued expansion due to the diminished return on their investment. Ultimately the two partners could end up accusing each other for the failure.

- Adequacy of resources, which indicates whether the resource commitment meets the requirements for IJV project execution. If the committed resources failed to support the IJV management in implementing the business start-up and achieving operation to the level planned in the joint venture's agreement, the backlash will put the whole value creation process in jeopardy, which in turn could lead to the dissatisfaction of partners and internal conflicts.
- Effectiveness of partnership control, which indicates whether the partnership is sufficiently well based to mitigate the risks associated with shared management and encourage partners to play a positive role in the development of the IJV. If a parent company does not have appropriate influence over its partner and the joint venture, the lack of control will result in power struggle, mistrust, indifference or opportunistic behaviour. Consequently, the parent company is unlikely to extract value from the partnership to a full extent, which could then result in a low interest in resource commitment and an inability to deal with uncertainties facing the project and partnership.
- Sustainability of value appropriation, which indicates whether value appropriation can guarantee fair value extraction by partners. If the appropriation of value between partners contradicted the initial consensus, a sense of unfairness and damaged mutual trust will be created, which in turn could lead to a power struggle over IJV control and the erosion of co-operative spirit in project implementation and resource support.

Limitations of this research link closely to its exploratory nature and focus on Sino-foreign joint ventures. This would suggest three main areas for future research. The first is to analyse the same topic within a different economic setting, such as in another emerging or developed country. The second is to test the generality of the framework to further the theory-building process. The third is to develop the framework into practical tools with a higher level of usefulness and usability.

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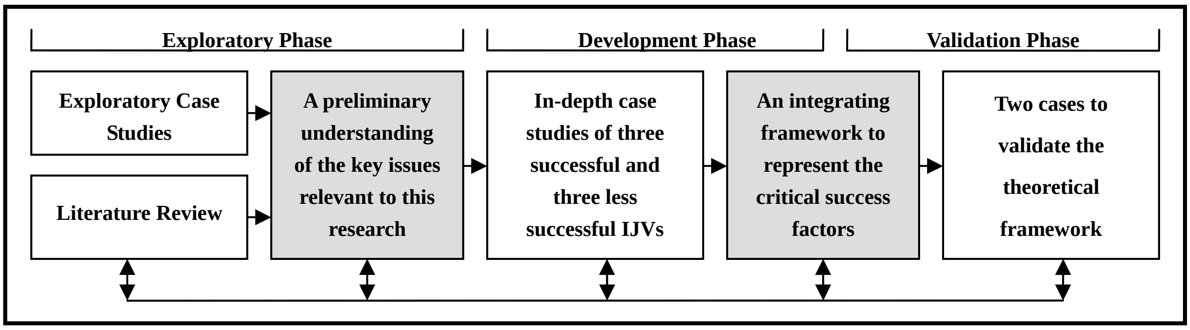

Figure 1. An overview of the research design

Key Strategic Issues	Literature Relevant to IJV Strategies
Resource Commitment	• Resource commitment processes and partner control processes
	• Resource attributes and IJV performance
Partnership Control	• IJV motivations
	• Ownership choice and culture difference
	• Ownership choice and IJV performance
Value Creation	• Partner selection criteria
	• Partnership control and IJV performance
Value Appropriation	• Partnership control approaches

Figure 2. Key issues for IJV strategies

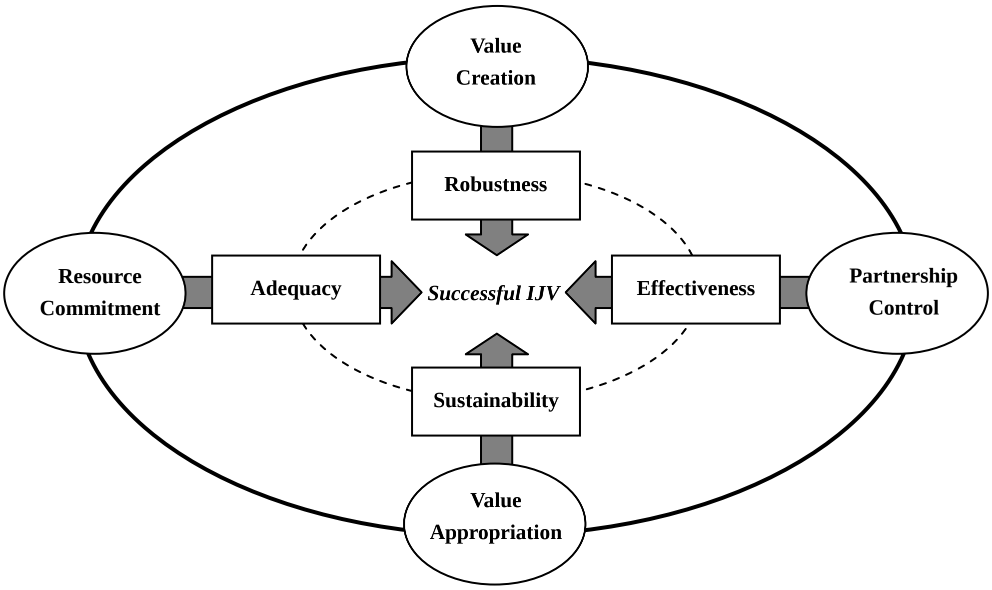

Figure 3. Critical factors for IJV strategy formation and implementation

Table 1. An overview of the cases

Cases	Location	Main Products	Ownership*	Investment	Start Year	Performance
A	Qinhuangdao	Copper tubing	50% (90% from 1996)	US$3.5m	1985	satisfied performance
B	Shanghai	Marine paints	51%	US$4.2m	1990	satisfied performance
C	Xian	Aero-engine parts	49.5%	US$30.4m	1996	satisfied partnership; promising financial performance
D	Tianjin	Mechanical seals	33% (67% from 1995)	US$2.0m	1987	unsatisfied performance
E	Shanghai	Screw compressors	51%	US$8.0m	1994	unsatisfied performance
F	Shenyang	Telecom transmission	55%	US$12.0m	1995	regarded as a project failure
G	Shanghai	Industrial gas	50%	US$5.0m	1988	satisfied performance
H	Tianjin	Industrial gas	50%	US$10.0m	1992	partnership terminated in 1998

* Ownership of the foreign parent companies

Table 2. Characteristics of the cases

Cases	Value Creation	Resource Commitment	Partnership Control	Value Appropriation
A **Foreign parent company:** a global tubing product manufacturer **Chinese parent company**: a subsidiary of Qinhuangdao government	• low competition • high-quality business plan and accurate demand forecast • JV's capability for product and process development for local needs	• successful technology transfer • local sourcing of raw materials • securing foreign currency supply through government relationship	• appoint experienced expatriate managers for critical positions • operations following the standard of foreign partners • efforts to build healthy relationship	• agreed dividend policies • early profit re-invest to the JV • defined routines to adjust transfer prices
B **Foreign parent company:** the biggest marine paints manufacturer and supplier in 1990s **Chinese parent companies:** state owned enterprises in paint production, freight, and shipbuilding.	• increasing market demand • first mover advantage • well-planned business strategy • vigorous quality control • efficient production system • well-established sale network	• Both partners contribute resources as agreed • foreign partners continuously support technology transfer and marketing, and help to seek export opportunities • local partner provide experience workforce and well trained technology staff	• foreign partner hold strong control of the JV through staffing, reporting and relationship building • foreign partner demonstrate high commitment to its business in the local market	• preventive measures to ensure that the partners' focus was aligned with the profitability of JV • formal and informal channels to negotiate transfer prices • long-term plan to lower the proportion of imported raw materials and improve local sourcing
C **Foreign parent company:** a British manufacturer and supplier of engineered products and services **Chinese parent company:** a state-owned engine manufacturer.	• foreign partner expects to establish competitive advantage by exploiting low-cost yet high-skill worker and engineers • foreign partner for market share in developing countries • AE-100 program to design and produce local aircraft in 2002 • foreign partner to establish its manufacturing presence in the local market	• local partner was cash-strained but required majority ownership, thus the JV was set at a minimum investment scale • foreign partner lends US$5.03 to the JV with a cost of 21.5 profit of the JV in 10 years • foreign partner provide product and process technologies for free	• foreign partner obtains dominant operational control; GM and all technical directors are from the foreign partner • all the organisational procedures and reporting systems are from foreign partner • informal mechanisms to build up personal relationship • all JV managers were brought to UK for two-week teamwork training	• partners will reap the economic benefits through dividends • smooth supply of components to the JV helps the foreign partner reduce the burden of engine offset obligations • expand the JV to a full-scale engine plant helps increase sales in the local market
D **Foreign parent company:** a worldwide supplier of engineering sealing systems **Chinese parent company:** the market leader for mechanical seals in China before the IJV was established.	• focusing on high-end market but the cost is too high • improve operational efficiency by introducing advanced production planning and control systems but with little support from foreign partner	• limited investment and involvement of foreign partner • limited technology transfer/support • local partner unable to invest capital to the JV • under-investment	• foreign partner has no substantial operational or strategic control • no financial control measures • many disputes over staffing, sales and marketing • few communication channels	• local partner offer little help to explore other business opportunities • local partner accuses the foreign partner of exploiting the JV by charging high transfer prices
E **Foreign parent company:** a UK-based global compressor manufacturer. **Chinese parent company:** a local industrial equipment supplier.	• advanced technology but with high cost • crowded market • heavy competition based on cost advantage instead of technology advantage • low market growth	• local partner is extremely short of capital and reluctant to commit resources; and foreign partner is fear of being trapped • foreign partner cannot provide technical support due to conflicts of service fees • local partner unable to provide qualified workforce and local suppliers	• foreign partner appoints a general manager hired from outside with little knowledge about the technology or business • foreign partner has little influence to the JV due to a lack of communication no effective mechanisms to motive local partner to commit more effort to help the JV	• foreign partner intends to capture value through royalty agreement and component supply contract • transfer prices are a highly contentious issue between the partners • low level of IJV sales (because of high component costs) makes cost reduction even harder
F **Foreign parent company:** one of the world's largest suppliers of digital network solutions in the telecom industry. **Chinese parent companies:** subsidiaries of Liaoning provincial government.	• foreign partner has no absolute advantage over its competitors in technology • the JV failed to establish a competitive cost base through incremental localisation plans • local partner has political power to influence regional market • low product credibility and high unit costs • slow in sales growth	• foreign partner contribute technology • local partner makes an equity contribution only in the form of capital • local partner provides the IJV with assistance in project bidding in this region and local political influence • unqualified core products and poor marketing support	• the JV is based on shared control • foreign partner insisted on the adoption of its organisational procedures and reporting systems, but the transfer was unsuccessful • passive attitude to support the JV • no formal mechanisms to reinforce the relationship • communication channels were ill-structured, infrequently board meeting	• foreign partner charge the JV with relatively high transfer prices to safeguard its commercial interest • foreign partner use the partnership to break into provincial markets

Table 3. Characteristics of Case G and H

Key Success Factors	Case G (Successful)	Case H (Failed)
Robustness of Value Creation Mechanisms	• increasing demand for industrial gases in emerging economies • no competition in this niche liquid gases market • launch cost reduction programmes once early success established	• over-capacity due to international competitors establishing major production sites in the region • major project plan change-the second operation site • low production efficiency due to unqualified key equipment from local partner • slow sales growth and over crowded market • low profit margin due to high costs
	high	low
Adequacy of Committed Resources	• full capital injected into the JV by foreign partner • reliable and high-quality raw material supply • cautious investment plan • begin with selected technologies which are easy to be transferred	• little due diligence was conducted to verify the actual investment needs • local partner using its existing assets as equity contribution, but without proper procedure to value them or assess their working conditions • shortage of cash due to capacity expansion • foreign partner has little resource to support the IJV constantly • little training and lack proactive management
	high	low
Effectiveness of Partnership Control	• project team assembled by the foreign partner • experienced expatriates lead the JV • clear financial disciplines and reporting lines • regular board meeting • cultivate trust and mutual understanding	• shared control agreed, but the local partner dominated the control because of foreign partner's minority position in the first 18 months • no systematic plan to introduce the organisational procedures, reporting systems and financial control of the foreign partner • poor communication • uncontrolled workforce and power struggle
	high	low
Sustainability of Value Appropriation	• well-defined approaches to benefit from profit • agreed ownership change • early profit re-invest into the JV • robust partnership help solve conflicts on transfer prices of materials and utility services • preventive clauses in contract for transactions with local partners (supply of raw materials and utility services)	• royalty fee paid to the foreign partner at 1% of sales in the first four years and 2% in the subsequent years (very low in the industry) • foreign partner expected to reap the economic benefits mainly from the sales of equipment and dividends • no locatable profit • unfair transfer pricing with local partner (raw materials and utility services)
	high	low