Determinants of International Joint Venture Performance:

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Abstract

International joint ventures have increasingly their role in business world and also in research field of international business. There have been a lot of studies related to determinant factors of international joint ventures (IJVs) performance. However, there are very few studies focusing on the measurement of IJV performance. Especially, researchers have ignored how foreign parent firms really choose their measures in the evaluation of their IJV performance. This research investigates determinant factors of performance measures of IJVs. Determinant factors of IJV performance measures include motives for establishment, establishment mode, location of IJVs, distributions of ownership in IJVs, cultural background of parent firms, trust between partners, and IJV life stages. Performance measures consist of non-financial measures and financial measures. The paper shows how different determinant factors expect to lead foreign parent firms to prefer non-financial and financial measures.

Keywords: international joint ventures, performance measurement, non-financial measures, financial measures.

1. Introduction

Organizational performance measurement is one of the key areas in management research (Richard, Devinney, Yip, & Johnson, 2009) and is increasing important topic in the field of international business (Hult et al., 2008) and also in the case of hybrid organization like international joint ventures (Arino, 2003; Geringer & Hebert, 1991). Performance measurement is a crucial issue among academicians and practitioners (Jusoh, Ibrahim & Zainuddin, 2008). In addition, measurement of international joint venture (IJV) performance has become an important tool for parents to evaluate the ongoing relationships and trust between partners (Chong, 2008).

However, there are contradicted views on how to measure IJV performance (Osland & Cavusgil, 1996; Parkhe, 1993). Geringer (1998) argues that it is necessary for future research focusing on alliance performance measures. Chong (2008) maintains that "there is a lack of consistency in the research findings on how IJV performance is measured and the links between the internal and external factors that lead to a different set of measurements". In the same vein, Abdel-Maksound, Asada, and Nakagawa (2008: 1) propose that academics and researchers should be interested in considering factors that affect managers´ decisions to use non-financial performance measures. In addition, Hult et al. (2008) suggest that issues related to international business performance measurement will be one of important topics in future international business research.

Some researchers suggest that performance may vary depending on the measures (e.g. Ali & Sim, 2001). Abdel-Maksound et al. (2008) argue that traditional accounting measures do not provide feedback of the effectiveness and competitiveness of an organization. Similarly, Ratnatunga and Montali (2008) insist that financial performance measures are inadequate when firms start to focus on shareholder value as the primary long term objective of the organization. While other researchers point out that there is positive correlation between objective measures and subjective measure (e.g. Glaister & Buckley, 1998). Mohr (2006: 248) points out that there is no study that has properly analyzed the differences that exist in the way partner firms measure the performance of an IJV. In addition, there are a great deal of research focusing on international business performance (Hult et al. 2009) and are over hundred studies that focus on IJV performance (Larimo, 2006) however, there are quite a few studies that are really analyze how firms select of their performance measures or what factors may influence their preference on the choice of financial measures or non-financial measures in the evaluation of their IJV performance.

Under above research gap and research puzzle, this study attempts to address the issue of measures of IJV performance by analyzing the factors that are expected to affect IJV performance measurements in two different groups including financial measures and non-financial measures. The factors that may affect IJV performance measures are motives for establishment, establishment mode, location of IJVs, distribution of ownership in IJVs between foreign firms and local firms, level of trust between partners, and IJV life stage.

In this paper we aim to contribute to IJV research by offering an analysis of the key factors in the selection between financial and non-financial measures when companies valuate their IJV performance. This paper is an attempt to deepen our knowledge on how parent firms are assumed to select the measures to their evaluation IJV performance and whether these two main groups of performance measures are related to each other. In this paper, an IJV is regarded as a separate firm formed by two or more partners with an expected proportional share of dividend as compensation (Contractor & Lorange, 1988) through whether greenfield or partial acquisition (Hennart, 2009).

Evaluation of IJV performance can be drawn from different perspectives (Yan and Gray, 1995): from the viewpoints of foreign parents, local parents, IJV management team, or other stakeholders of IJVs such as shareholders, and/or local political actors. In order to be able to go deeply in the analysis of influence factors of performance measures, the evaluation of performance will be centered on a single viewpoint.

Furthermore, we also exclude the comparison about the measures of IJV performance from different stakeholders´ viewpoints in the scope of this study. Therefore, in this paper, we focus only on the determinant factors that have impact on foreign parent firms (who establish an IJV with local firms in the target markets).

We first review previous studies on IJV performance measurement. After that we discuss different factors that may influence the preference of IJV performance measurement - financial and non-financial measures. We conclude this paper with offering an IJV performance measurement model, discussing of implication of this study for managers, and also pointing out opportunities for future research.

2. Prior Research on IJV Performance Measurement

Performance measurement system is important for firms because it is a key influenced factor on how firms are going to develop strategic plans, evaluate the achievement of their objectives, and compensate their managers (Jusoh et al, 2008).

The concept and measurement of organizational performance have been a controversial topic (Yan & Gray, 1995). Due to the lack of consensus on this concept, the extant empirical research has not produced theory of performance measurement that can be applied across organizations (Tatoglu & Glaister, 1998a). Moreover, measurement of performance in international business context is particular difficult because of cross border variations in accounting standards, nature of firm boundaries, and the geographic scope of operations (Hult et al., 2009).

According to Andersson (1990), parents have their objectives in creating IJVs, and thus a venture´s performance against these objectives is relevant. In addition, IJVs are not always formed to achieve conventional business goals such as profit and market share, but are set up for qualitative objectives such as organizational learning, co-opting or blocking competition (Contractor & Lorange, 1988; Hennart, 1988; Kogut, 1988). Some researchers have defined performance as the ultimate test of a firm’s strategy (Schendel & Hofer, 1979), and also as multidimensional construct (Vryza, 1997). Thus, performance measure often reflects the level of achievement of firm´s strategy and includes complex ways of measures.

Measurement of the performance of IJVs has become an important research topic in international business (Geringer & Hebert, 1991; Yan & Zeng, 1999). There are two main categories used to measure IJV performance. The first category uses *financial measures* of performance including a variety of traditional indicators such as profitability, growth and cost position, (e.g. Killing 1983). Financial measures base on the reliance on cost information and financial data which are short-term in nature (Jusoh et al., 2008). According to Spencer, Joiner, and Salmon (2009) financial measures can provide guidance to effective performance for firms to obtain their targets and are directly reflection of current profitability and operating efficiency, and future earning potential.

Financial measures have several limitations: measurements such as they are not always appropriate to the effective assessment of IJV performance (Killing, 1983). They are only good to explain the past performance of IJVs but fail to reflect the long term objectives of IJVs (i.e. reputation) (Anderson, 1990). According to Jusoh et al., (2008), financial measures fail to recognize value creation activities which are intangible in nature that generate future growth to the organizations. Therefore, choosing performance measures depends on the parent firm’s objectives (Lyles et al., 2000) and is to identify whether performance meets planned targets (Nenadál, 2008).

The second category is non-financial *measures.* These measures are often related strategic goals; targets set by parent firms (see Table 1). In non-financial measures, foreign parent firms point out their satisfaction on the achievement of their IJV activities (Yan & Gray, 1994).

Non financial measures are used to capture different aspects of the performance of the units such as 1) management related; 2) strategic related; 3) product related; and 4) competitiveness (see Table 1 for detail).

According to Abdel-Maksoud (2008), managers use non-financial measures in performance assessment because financial measures do not provide feedback on the competitiveness of organizations.

Table 1. IJV performance measures (Adapted from Schaan, 1987; Geringer & Herber, 1991; Yan & Gray, 1995; Buchel & Thuy, 2001)

Performance measures
Financial Measures
➢ **Cash flow, growth in sales**
➢ **Profitability: ROI, ROA, ROE**
➢ **Productivity (Capital utilization, Cost Levels)**
➢ **Dividend**
➢ **Royalty**
Non-financial Measures
➢ **Management related: degree of conflicts with partners, effectiveness of marketing and distribution systems, labor productivity, turnover and satisfactory of employees**
➢ **Strategic related: market share, market position, innovation & learning, technology development, level of exporting**
➢ **Product related: quantity of products, quality of products, product design, level of defect and returned products**
➢ **Competitiveness: pricing level, reputation, customer satisfaction**

They, in addition, specify that financial measures do not address the aspects of a firm´s business such as quality of product, employee participation, on time deliveries and customer satisfaction.

In addition, non-financial measures are more actionable and future oriented, and their use can improve an organization´s capabilities in future planning and strategy implementation (Spencer et al., 2009: 96).

Therefore as a result of above discussion, in some cases, managers may use non-financial measures in the evaluation of their IJV performance in order to haves better view of how their IJVs really perform. In the following section we shall elaborate when and how foreign parent firms prefer non-financial measures to financial measures and vice versa.

3. Determinants of IJV Performance Measurement

Previous research (e.g. Parkhe, 1996; Larimo, 2006; Nguyen, 2009) suggest several important factors that have influence on parent firms behavior in management control and monitoring their IJVs such as motives of entering IJVs, form of establishment (entry mode strategies), location, ownership strategies, cultural background of parent firms, IJV life stages, and trust between partners.

In business world, it is common that firms evaluate their IJV performance basing on both financial and non-financial measures. Therefore, in this paper we shall focus on the preference ("prefer" means more weight is given to) of foreign parent firms to non-financial vs. financial measures in their evaluation of IJV performance.

3.1. Motives of entering IJVs

Foreign parent firms enter to IJVs with different motives such as risk reduction, economies of scale, technology exchange, co-opting or blocking competition, overcoming government investment barriers, expansion to international markets, resources exchange (Contractor and Lorange, 1988). Foreign parent firms enter IJVs in developing countries often to gain presence in new markets and enabling faster market entry (Tatoglu & Glaister, 1998b). Lin, Yu and Seeto (1997) and Calantone and Zhao (2001) classify IJV motives into three types such as 1) efficiency: an IJV is formed to reduce costs, risks, and increase economies of scale; 2) competition: an IJV is formed to reduce competition or enhance market powers; 3) learning: an IJV is formed to enable a parent to gain partner´s know-how or resources.

According to Spencer et al. (2009), organizational and management systems are designed to support the business strategy of the firms. Tatoglu and Glaister (1998a) argue that objectives of partner firms to enter to IJVs have an impact on the criteria of the evaluation of performance. Similarly, Ratnatuga and Montali (2008) maintain that it is important to recognize that the evaluation of a firm´s performance is related to its strategies.

Ali and Sim (2001) suggest that the way partners evaluate their IJVs depends on their long term objectives of entering IJVs. They, in addition, maintain that for long term non-financial objective such as learning in IJVs, profit criteria are not appropriate for the performance assessment. In their research, Hult, Ketchen and Slater (2004) find the positive relationship between multinational enterprise focusing on acquiring knowledge and subjectively measures of performance. Thus, foreign parent firms who enter IJVs with learning purpose may prefer to non-financial measures to evaluate their IJVs performance. On the other hand, when foreign parent firms enter IJVs to gain efficiency or with competitive purpose, they need to measure the effectiveness of IJVs if it matches with their initial targets. To measure the efficiency and the competitive position of IJVs, foreign parent firms need objective measures such as financial indicators including sales figures, cost of sales, return on investment, loss profit account. As a result, we propose that:

Proposition1a: In learning oriented IJVs, foreign parent firms prefer non-financial measures to financial measures in the evaluation of their IJV performance.

Proposition1b: In efficiency oriented IJVs foreign parent firms prefer financial measures to non-financial measures in the evaluation of their IJV performance.

Proposition1c: In competition oriented IJVs foreign parent firms prefer financial measures to non-financial measures in the evaluation of their IJV performance.

3.2. Establishment Mode

When foreign firms prefer acquisition to greenfield to enter to local market, they often choose the established firm in local markets to acquire in order to capture strategic objective like market share and realize growth goals (Porter, 1980). The established firms selected as the partner often have good financial records and existing network (Demirbag, Tatoglu, & Glaister, 2008). Thus, when foreign firms enter to IJVs by partial acquisition, they expect the IJVs to continue to make profits and to show good financial results such as profits, market share. On the other hand, when foreign firms enter to local market through greenfield established IJVs, they do not often expect the IJVs make profit right away. This is because it takes time for the new IJVs to develop and run smoothly and meet technical and quality requirements from both parents and also from local governments. In addition, the new IJVs may also need time to develop their own network and building relationships with their partners and customers. Therefore, foreign parent firms may not be able to rely on financial measures to evaluate their IJV performance. As a result, we expect that:

Proposition2a: In IJVs established through partial acquisitions, foreign parent firms prefer financial measures to non-financial in the evaluation of their IJV performance.

Proposition2b: In IJVs established through Greenfield, foreign parent firms prefer non-financial measures to financial measures in the evaluation of the performance of their greenfield established IJVs.

3.3. Location of IJVs

Entering to IJVs in different international markets, firms may have different motives (Tatoglue & Glaister, 1998a), especially between developing countries and or developed countries. Tatoglu and Glaister (1998a) argue that the differences in IJV location are reflected in performance evaluation method. In addition, environmental factors and specific conditions of target countries such as political, legal, and economical systems have an important influence for performance measurement (Lee, 1987; Zhao & Culpepper, 1996). Beamish (1985) suggests that firms have different approaches in developed and developing countries. In some particular big markets such as Russian or Chinese market, gaining footholds in these markets can be major strategic targets for foreign firms. Child and Yan (2003) report that developing countries lack significantly resources and have unfamiliar environments. Thus, foreign parent firms are more concerned how to present and market their products in the market more than obtaining financial objective (Fey, 1995). Pangarkar and Klein (2004) argue that "in many developing markets, MNC affiliates may be used to source low-cost components or finished products, and purely objective measures such as profitability may be inadequate". This leads to following propositions:

Proposition 3a: In developed countries located IJVs, foreign parent firms prefer financial measures to non-financial measures in the evaluation of their IJV performance.

Proposition 3b: In developing countries located IJVs, foreign parent firms prefer non-financial measures to financial measures in the evaluation of their IJV performance.

3.4. Distribution of Ownership

Distribution of ownership control in IJVs can be divided into minority, equal, and majority ownership (Killing, 1983; Ramaswamy, Gomes, Veliyath, 1998). Anderson (1990) proposes that the choice of appropriate performance criteria depends on parent firm´s ability to assess and measure. If foreign parent firms have dominant ownership in IJVs, they are often the main contributors in their IJVs and must consider their IJVs as strategic important for them. Selekler-Göksen and Uysal-Tezölmez (2007) specify that equity ownership is strongly related to strategic control in IJVs, which in turn determines the preference for financial performance measures. As a result, parent firms are likely to have detailed evaluation and criteria for the performance of the IJVs, mostly based on financial measures. On the other hand, holding minority ownership position in IJVs may prevent parent firms to have full access to financial measures of IJV performance. In addition, as a minor contributor for IJVs, parent firms may regard the IJVs as not so important units for them. Therefore, we expect that:

Proposition4a: In IJVs where foreign parent firms have majority ownership position, they prefer financial measures to non-financial measures in the evaluation of their IJV performance.

Proposition 4b: In IJVs where foreign parent firms have minority ownership position, they prefer non-financial measures to financial measure in evaluation of their IJV performance.

*Proposition 4*c: There is no relationship between equal distribution ownership (50/50) and the preference for non-financial measures versus financial measures by foreign parent firms.

3.5. National cultural background

National culture of the firm has an impact on a wide range of its organizational behavior (Sirmon & Lane, 2004; Chong, 2008), the strategies used in its subsidiaries (Hennart & Larimo, 1998) and is an important aspect that influences its perception of performance measurement (Glaister & Buckley, 1998; Tatoglu & Glaister, 1998a). Partners coming from very distant cultures to each other may have different purposes in entering IJVs as well as different ways to measure their IJV performance (Geringer & Hebert, 1991). Hofstede (1980) identifies four dimensions of culture such as power distance, uncertainty avoidance, individualism/collectivism, and masculinity/femininity. Later on, he adds fifth culture dimension: long term orientation (Hofstede, 2001). As national cultural background has strongly influenced on organizational behaviors (Hostede 2001, Sirmon & Lane, 2004), we expect that these four cultural dimensions also affect foreign parent firms to prefer one type of measure over the other.

In individualistic cultures, people pay more attention to details in their business evaluations and contracts (Hofstede, 2001). Barkema and Vermeulen (1997) insist that individualism has strong influence on organization´s choice of control, evaluation form reward systems. According to both Hofstede (2001) and Gong, Shenkar, Luo and Nyaw (2005), in collective cultures, directive appraisal of performance such as specific, formal objective measures like financial indicators is considered as a threat to harmony and may be disapproved by members, leading to the preference of non-financial measures in the performance assessment. On the other hand, in individualistic cultures direct appraisal of performance through detailed indicators is regarded as motives for improving productivity, therefore financial measures are considered as preferred ones to evaluate the performance.

Arrindell (1998) maintains that in masculine culture, organizational values emphasize material success and assertiveness. As such firms in this type of culture, managers often prefer financial measures to non-financial measures to the evaluation of their IJVs. In contrast, in the femininity culture, people accentuate other types of quality of life rather than a performance society (Arrindell, 1998). As a result, firms in this type of culture may prefer to use non-financial measures such as employment situation (Abdel-Maksoud, 2008), job satisfactory of their employees etc. to evaluate the performance of their IJVs. Therefore, in femininity culture, firms prefer non-financial measures to financial measures to evaluate their IJV performance.

In high uncertainty avoidance culture, people are intolerance of ambiguity, rigidity, intolerance of different opinion (Hostede, 2001). Thus, in their performance evaluation, they may avoid the measures that are not clear cut and could cause different opinions and arguments in organizations like with non-financial measures such as firm´s competitiveness or market positions or the satisfactory of customers and employees with the firms´ activities. Financial performance measures shows clearly how firms or organizations have performed. On the other hand, in low uncertainty avoidance culture, people may be more tolerant for ambiguity, have lower sense of urgency (Hostede, 2001) and as such they may be more willing to use non-financial measures in the evaluation of IJV performance.

In the discussion of long term orientation dimension (LTO), Hofstede (2001) mentions that in low LTO cultures, firms expect to have quick results with strong financial records. On the other hand, in long term oriented cultures, business organizations are accustomed to working toward building up strong positions in the markets and they do not expect immediate financial results (Hofstede, 2001: 361) but rather emphasize on strategic non-financial gain. In long term oriented culture, partners seek to continuous relationship, investments in education and training, persistence, and delayed gratification (Chong, 2008). As a result, in evaluation of their IJV performance, firms from low LTO may prefer financial measures to non-financial measures. In contrast, in high LTO culture, firms may be expected to prefer non-financial measures to financial measures to evaluate their IJV performance.

As a result of above discussion, we suggest that:

Proposition 5a: Foreign parent firms from individualistic cultures prefer financial measures to non-financial measures in evaluation of their IJV performance.

Proposition 5b: Foreign parent firms from collective cultures prefer non-financial measures to financial measures in the evaluation of their IJV performance.

Proposition 5c: Foreign parent from masculine culture prefer financial measures to non-financial measures in the evaluation of their IJV performance.

Proposition 5d: Foreign parent firms from femininity culture prefer non-financial measures to financial measures in the evaluation of their IJV performance.

Proposition 5e: Foreign parent firms from high uncertainty avoidance culture prefer financial measures to non-financial measures in the evaluation of their IJV performance.

Proposition 5f: Foreign parent firms from low uncertainty avoidance culture may prefer non-financial measures to financial measures in the evaluation of their IJV performance.

Proposition 5g: Foreign parent firms from low long term oriented culture prefer financial measures to non-financial measures in the evaluation of their IJV performance.

Proposition 5h: Foreign parent firms from high long term oriented culture prefer non-financial measures to financial measures in the evaluation of their IJV performance.

3.6. Trust between partners

Cousins, Lawson, and Squire (2008) find that socialization has strong effect on the choice of performance measurement. Inkpen and Birkenshaw (1994) also suggest that nature of interfirm interactions influence parent firm´s assessment of IJV performance. Through interaction partners establish trust towards each others. According to Inkpen and Birkenshaw (1994), trust is the belief that word or promise is reliable and that a partner will fulfill its obligations in the relationship. The level of trust among IJV´s partners can have direct influence on the way they measure their IJV performance. In established trust relationship, partners may prefer non-financial measures to financial measures. Park and Ungson (1997) maintain that relationship that based on trust helps to overcome problems with formal procedures, monitoring goals, and performance. Chen (1997) mentions that financial measures used in long term trust for assess performance within short period of time may lead to undesired results. Therefore, we propose that:

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Proposition 6a: In IJVs, where there is high level of trust between foreign parent firms and local parent firms, foreign parent firms prefer non-financial measures to financial measures in the evaluation of their IJV performance.

Proposition 6b: In IJVs, where there is low level of trust between foreign parent firms and local parent firms, foreign parent firms prefer financial measures to non-financial measures in the evaluation of their IJV performance.

3.7 Life stage of the IJV

Time gone from the establishment of the IJV is an essential factor to measure its performance (Chong, 2008; Olk, 2006). This is because during the life cycle of an IJV, the purpose of unit and the context of operating environment may change (Olk, 2006), and thus managers may use different measures for IJV performance at its different life stages. Yan and Luo (2001) suggest that traditional financial indicator can serve as appropriate measures of performance for mature IJVs, but not for young IJVs. They argue that it is necessary to rely on subjective assessment to evaluate performance of young ventures. In the same vein, Geringer and Hebert (1991) emphasize that financial indicators for many IJVs in their early stage of the lifecycle often show that IJVs have low performance. They specify that it is often the cases in which IJVs are formed to develop new technologies or to develop new markets, thus they cannot immediately produce profits.

Fey and Beamish (2001) insist that maximizing profit measured by financial indicators in the short term is often not a goal of foreign parent firms. Yan and Gray (1995) also argue that “it is often not realistic to expect joint ventures to be profitable or to bring substantial financial gains earlier in their operation.” Similarly, Pangarkar and Klein (2004) point out that objective measures such as profit and sales growth by themselves may be quite meaningless as measure of performance in the early stage of IJV life cycle. In the same vein, Andersson (1990) proposes that it may takes seven to eight years before parent firms can evaluate their IJVs basing on economic measures such as ROI and cash flow. However, in the later stage, stability of IJVs – financial indicator of IJV performance is necessary to maintain trust relationship between partners (Al-Ali & Ali, 1991). Supporting for this, Anderson (1990) proposes that: “for relative mature ventures, output measures such as profitability and cash flow may be appropriate. Thus we expect that:

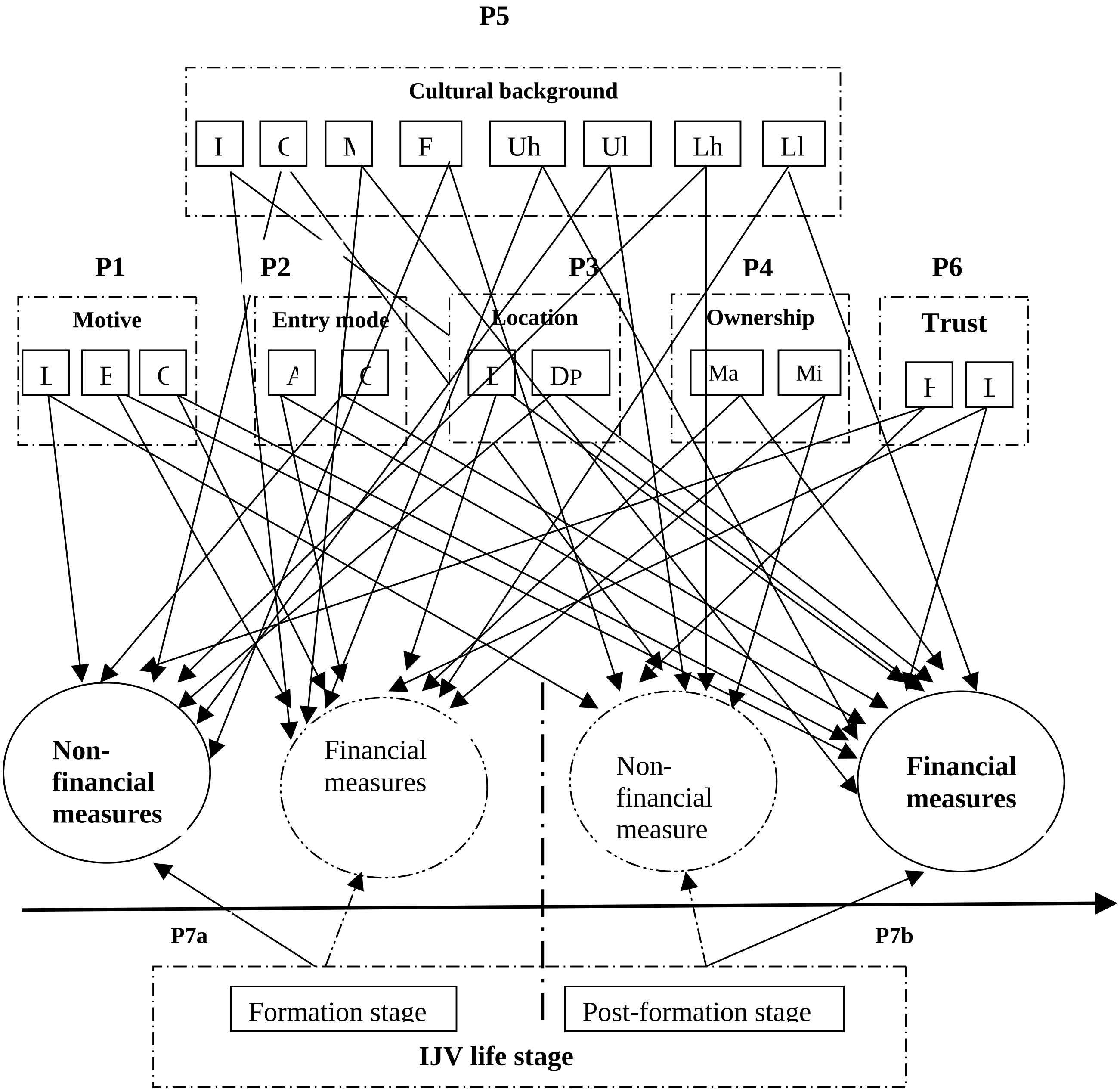
Proposition 7a: In IJVs being at their early stage of their life cycle, foreign parent firms prefer non-financial measures to financial measures in the evaluation of their IJV performance.

Proposition 7b: In IJVs being at later stage of their life cycle, foreign parent firms prefer financial measures to non-financial measures in the evaluation of their IJV performance.

4. Summary and conclusions

This paper aims to analyze the relationship between different determinant factors and foreign parent firms´ preference for non-financial measures versus financial measures in their IJV performance assessment. The paper contributes to IJV research tradition by extending our knowledge on how foreign parent firms are likely to choose their measures for their IJV performance since the measures make a difference in the evaluation of performance (Bourne, 2008). While previous studies of IJV performance measurement focus on an effort to providing a “perfect set” of performance measures and the relationships between different measures (e.g. Geringer & Hebert, 1991; Glaister & Buckley, 1998; Buchel & Thuy, 2001; Morh, 2006).

This paper differs from previous studies by pointing out the key factors that are expected to affect foreign parent firms´ choices between non-financial and financial measures. In addition, previous studies suggest that sense making and action in organizations are more a function perception than objective reality (Geringer, 1998). However, this paper proposes that organizations´ actions can be both a function perception and objective reality in their choice of performance measurement depending on influenced factors such as motives of entry IJVs, entry mode of IJVs, IJV location, ownership distribution in IJVs, national cultural background of foreign parent firms, trust between partners, and which stage their IJVs are in (See Figure 1).



Motive
L: Learning
E: Efficiency

Entry mode
A: Partial acquisition
G: Greenfield

Trust
H: High trust
L: Low trust

Cultural background
I: Individualism
C: Collectivism
M: Masculinity
F: Femininity

C: Competition

Uh: High uncertainty Avoidance
Lh: High long term orientation
Ul: Low uncertainty Avoidance
Ll: Low long term orientation

Location:
D: developed countries
DP: developing countries

Ownership
Ma: Majority
Mi: Minority

P: Proposition

Figure 1 Model of determinants of IJV performance assessment

As many other academic research papers, this paper has also its own limitation. This paper is based solely on theoretical analysis and thus future study is needed to be validated the propositions of this paper by empirical data. In addition, in this paper, we focus on only the viewpoint of foreign parent firms; future study may expand this paper by discussing determinants of performance measurements from local parent firms´ view point. Furthermore, this paper excludes other factors that may influence foreign parent firms choice of performance measurement such as the level of economic development, competition, and political stability of local markets. Thus, additional research is needed to investigate these factors and their relation to performance measurement choice by parent firms.

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