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INTERNATIONAL JOINT VENTURES CREATE SYNERGY BY FLEXIBILITY IN PROCESSES AND OPERATIONS

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ABSTRACT

The present paper aims at exploring various dimensions of international joint ventures as a strategic move to take advantages of flexible systems. An international joint venture (IJV) is one which is created in a country outside the home country of at least one of the partners. Firms entering new territories have various options and IJV is one of them. Firstly an attempt is made to explain the concept of IJV and then the case of automobile industry in India is taken for understanding the operational issues. The paper is conceptual in nature and a generic model is proposed to show how synergy is created in operations and processes by flexibility occurring through IJV.

Keywords: Strategic alliance, Joint Ventures, International Joint Ventures, Synergy

Introduction

Researchers have emphasized that performance does not improve automatically as experience accumulates, but rather, improves as the outcome of organizational learning, which is posited to differ systematically across organization (Pisano, Bohmer & Edmondson, 2001). Organizational learning occurs in an iterative fashion when firms engage repeatedly in an activity, draw inferences from their experiences and store and retrieve the inferred learning for future engagements in the activity (Levitt & March, 1988). Alliances have become an important strategic tool (Hagedoorn, 1993).

A firm's knowledge of managing alliances may be embodied in manuals, databases, diagnostic tools, and simulations that codify the key insights gained through reflection on past alliance experiences. Such tools may aid the firm in assessing current alliance performance and guide it in selecting appropriate future alliance partners. Experience may also result in new intra-organizational and inter-organizational routines that facilitate internal coordination. New organizational structures that are charged with developing a firm's alliances capabilities can aid knowledge codification and facilitate cooperation over functional areas within the firm (Eli Lilly, 1999, Gueth, Sims & Harrison 2001). In general, firms with prior alliance experience are more likely to establish a dedicated alliance function, which contributes to improved alliance performance as assessed by both managerial perception and stock market response (Kale et al. 2002). There is a positive linear relationship between alliance experience and more aggregated performance measures like firm-level patenting (Shan, Walker & Kogut, 1994) or stock market responses (Anand & Khanna, 2000).

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Generally, firms face limited financial and, more importantly, limited managerial resources. Simultaneously managing multiple alliances will eventually accentuate the cognitive limitations of managers (Simon 1947), even those specifically trained to oversee a firm's network of relationship. The ability of firms to learn from one another in an alliance depends on the similarity between the two firms' knowledge bases, organizational structures and dominant logics (Hahoang & Insead, 2005).

Joint Venture

"Joint Venture refers to a particular form of doing business by one party in a jurisdiction either foreign or domestic by means of a stable, permanent legal entity with another party, for a term, usually indefinite with economic independence and a lawful commercial purpose" (Wolf, 2002, pg 6). A joint venture (JV) is a business enterprise involving two or more legally distinct parent companies, each of which plays more than merely an investment role in the enterprise. (www.ftmastering.com DOA 05.01.06)

Contractual Joint Venture are temporary commercial alliances for a specific period between two or more parties where the rights and obligations of the parties are expressed usually in a written document and where the individual partners are responsible personally for the acts of the others. There is neither permanent legal form nor a statutory capital but instead an elaborate system of contractual obligations, normally including cash contributions. (Wolf , 2002, PP 48). Since at the time of Joint Venture the terms and conditions of partners are predefined in the basic contract therefore there is less chance to raise the problems regarding properly rights, Management rights, ownership rights, financial rights etc. Also, since in a JV the elements (Partners) of collaboration for a specific period minimizes the tendency for conflict between partners.

Joint Venture is a Temporary alliance of entities and effective utilization of shared resources of partners to create value and achieve a common purpose.

The real option view suggests, that joint ventures offer a number of advantages in terms of entering in to new market, expansion of existing market, vertical integration, horizontal integration, diversification etc. The general implication of this view is that once the necessary capabilities have been absorbed and learning is complete, a firm may acquire a venture as a step forward further growth and expansion in a target market.

International Joint Venture (IJV)

An International Joint Venture (IJV) arises when the Joint Venture is created in a jurisdiction that is not the country of origin of at least one of the parties. IJV has been an area of specialization primarily developed in the collaboration that exists between entrepreneurs and lawyers; it has grown up from commercial origins, practical necessities, resolutions to problems devised by managers and lawyers (Wolf, 2002).

A Joint Venture is considered international if at least one partner is headquartered outside the country of operation or if the venture operates significantly in more than one country. Hence, an IJV can be defined as inter company collaboration over a given (international) economic space and time for the attainment of mutually defined goals. A number of integrative relationships between companies are not considered IJVs according to this definition for example: mergers and acquisition (where ownership changes), subcontracting agreements, licensing and franchising. On the other hand strategic networks, strategic alliances and other strategic agreements that fulfil the conditions of the definition all quality (www.flmastering com. DOA 05.01.06) are considered. Moreover, these IJVs offer the relatively inexperienced private

sector role models and insight into management imperatives (Bruton, 1998).

Yan (1998) distinguishes between two dimensions of IJV control structure: ownership control and management control. Ownership control refers to the residual rights to making decisions regarding an assets use that is not contractually affect to another party (Gross man and hart 1986, Roberts, 1992). Management control on the other hand, is the observable, pattern of decision - making power. Although ownership control may lead to management control over the IJV through board membership, other more informal control mechanisms including contractual arrangements, management terms and the implementation of management systems from one Partner may provide decision making power apart from that which is derived from ownership (Beamish and Banks, 1987; Makhija and Ganesh, 1997, Mjoen and Tallman, 1997: Yan and Gray, 1994). These informal mechanisms may be the outcome of a bargaining process influenced by the resource (eg. Technology know how, market access) that each partner can provide to the IJV (Yan and Gray 1994).

Social exchange theory provides insight on the relationship between the parent firms, their relative control over the IJV, Parental conflict and its effect on IJV survival (Geringer and Hebert, 1989; Killing, 1983; Makhija and Ganesh, 1997). A knowledge based perspectives is used to examine the relationship between parent firms and Joint Ventures, subsequent learning from the parents and its effect on IJV survival. Steensma and Lyles (2000) maintain that these two sets of relationships (Parent to Parent, Parent to IJV) are inter-dependent and the relationship between an IJV parent and the IJV is likely to have an effect on the relationship between the parents.

Despite extensive efforts to examine the link between IJV control structure and various IJV outcomes such as survival, the nature of these relationships remains inconclusive. One line of theory suggests that because of their dual control structure and inherent potential for instability, IJVs that have a dominant controlling Parent will be the most stable and successful (Killing, 1993). The equal division of control between the Partners leads to coordination problems and transaction costs that ultimately reduce the value of venture (Geringer and Hebert, 1989). Although there has been some empirical support for their relationship between control structure and performance or survival (eg. Awadzi, 1987; Kogat). Indeed, some studies have found that shared or balanced control leads to positive outcomes because of higher levels of trust and mutual forbearance (Beamish and Banks 1987; Blodgett, 1992; Geriner and Woodcock, 1989). Lyles and Salk (1996) found that IJVs with equally shared ownership control had significantly higher levels of knowledge acquisition than majority controlled IJVs.

Although an IJV with a shared-control structure may be more difficult to manage in terms of coordination than an IJV with a dominant control structure (Geringer and Hebert 1989) it may also ensure the mutual forbearance necessary for stable relationship with limited conflict. In sum, we expect an imbalance in IJV control structure (ownership and management) to lead to conflict between the parents of the IJV.

The nature and relative strength of these relationships may depend on the economic content of the IJV. Local management may not perceive the relative levels of partner ownership as indicative of relative power and influence over IJV Operations. This is reflected in the bargaining between potential IJV partners, Yan and Gray (1994) discovered equity share to be a relatively minor issue in negotiations for Chinese IJVs. Stark (1996) found Hungarian Managers often unwilling to assume high levels of ownership because of their avoidance of risk and overall lack of appreciation for the benefits of ownership control and management control appears to be loosely linked in a transitional context. Control and decision making influence over the IJV may be determined by resource provision and other sources of bargaining power outside the

ownership make up of the IJV. Because of their contribution of more sophisticated know-how, foreign multinationals, are often able to exercise greater management control than their proportion of equity holdings would suggest (Beamish, 1993).

Research Design

The objective of present research is to find out the logic behind companies opting for an international joint venture. It is also aimed to look at possibilities of synergy in operations and processes of the new entity. On basis of previous researches done in different contexts following three basic reasons are preempted.

1. **Accelerated Growth**; which may be attained through expanding existing markets and/or by entering into new markets (Eli Lilly, 1999; Gueth, Sims & Harrison 2001; Yan and Gray 1994).
2. **Exchange of expertise**; a very common reason for IJV may be sharing tangible and intangible assets (Yan and Gray 1994).
3. **Diversification of risk**; creating a balanced portfolio of risk is another strategic tool in the hands of growing organisation by way of diversification (Beamish, 1993; Pisano, Bohmer & Edmondson, 2001).

Further, it is perceived that there can be various possibilities of creating an international joint venture, which have been summarized in Table 1 taking the contextual environment of India.

Table 1: Possibilities of International Joint Venture (IJV) in Indian Context

SI No.	Home Place of company A	Home Place of company B	Place of IJV	Types of IJV
1	India	India	India	Domestic JV
2	Foreign	Foreign	India	IJV
3	India	Foreign	Foreign	IJV
4	India	Foreign	India	IJV

The case of Automobile sector in India is undertaken and the cases are identified where IJVs has taken place. The logic for choosing automobile sector is that among all the IJVs established in India automobile sector has maximum number of technical collaborations where as most of the other large sectors prominent for IJVs such as software, consultancy and pharmaceutical nature of IJV is primarily in the area of finance as is clear from Table 2.

Table 2 shows that Computer Software has been the most favourite area for IJVs in terms of number of IJVs taken place whereas in terms of total foreign equity flowing in Commercial Complexes dominates the scene. At the same time very significantly marked information is available that is international collaborations in the area of technology are highest in Automobile sector. In fact the number is so large that it is more than 45% of total IJVs done in technology. Since our research is primarily aimed at finding the improvements in operations and processes we have focused more on technological aspects of IJVs. Therefore Automobile sector emerges a natural choice.

Table 2. Top Fifteen sectors in IJVs (in terms of foreign equity)

S.No.	Name of Industry	Area of IJV created		Total No. of IJV	Total Foreign Equity in Rs. (Crore)
		Finance	Technology		
1	Automobile ancillaries	128	121	249	1707.48
2	Banking services	22	1	23	2527.95
3	Brokers	18	1	19	4728.54
4	Business consultancy	470	20	490	2074
5	Cement	4	1	5	2946.91
6	Commercial complexes	84	4	88	6350.34
7	Computer software	1560	5	1565	2059.76
8	Drugs & pharmaceuticals	168	41	209	4455.92
9	Electricity distribution	82	3	85	1812.96
10	ITES	156	0	156	2632.34
11	Misc. financial services	85	0	85	5475.71
12	Other telecommunication services	255	3	258	4751.02
13	Refinery	11	27	38	5901.94
14	Storage & distribution	53	2	55	1784.21
15	Trading	352	1	353	1198.17

As a representative of automobile sector, a preliminary study of TATA Motors is undertaken using secondary sources.

Table 3. Tata Motors Ltd. (Commercial vehicles & multi utility vehicles)

S No.	Month & Year	Type of Collaboration	Name of Foreign Company
1	Sep, 2002	Technical	STILE BERTONE S P A
2	Sep, 1995	Technical	Institute of development in Auto
3	Dec, 1997	Financial	Daimler Benz A. G.
4	Dec, 2003	Technical	AVL LIST GMBH
5	March 2004	Technical	Idea Institute
6	July, 2006	Technical	I A V GMBH

(Source: CMIE, 2007)

Tata Motors and Fiat plan Joint Venture, (Firm to undertake production of passenger cars, engines) since the inputs and outputs for both the companies are same like in input, they added complementary strengths, convergent objectives and shared values have a good option to prefer IJV. Process may be different due to combining Technology, products & human skills of both organizations. Tata group would have access to modern engineering to support its growth plan. Whereas in output, Fiat to boost its position in the rapidly growing Indian car market, expansion of existing market and entering in to new market segment. (Source: Business Standard News paper, Wednesday, 26th July 2006). Therefore adding the strengths of domestic company (Tata Motors) and foreign company (Fiat) can create synergy.

According to industry experts the new Joint Venture makes eminent sense as it will give Fiat a local partner that knows the Indian market inside out and it will give Tata Motors access to Fiat's world – class Technology. At a time when Tata Motors is looking at expanding its global portfolio the alliance will open up new markets for the Indian company through the Italian company's manufacturing and distribution networks. (Source: Tata, Fiat ink MoU for

50:50 passenger vehicle venture, “Ranjangaon Plant To Also Make Engines & Transmissions” The Economic Times, Wednesday, 26th July, 2006). After making a Joint Venture of the companies Tata Motors and Fiat consists of production & process activities then it is linking value chain to the supply chain management.

As an outcome of our study a conceptual model is proposed which elaborates the possibility of synergy emerging due to flexibility of operations through IJV. The model is illustrated in Figure 1, Figure 2 and Figure 3.

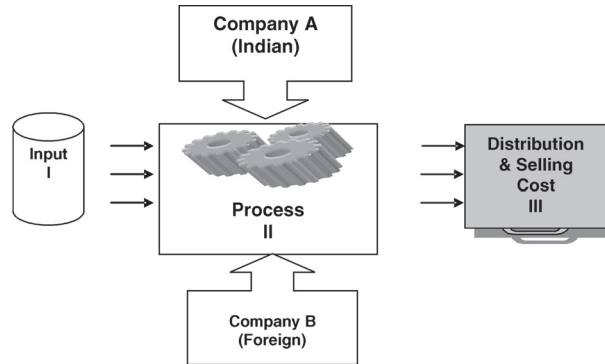


Figure 1: Production & process activities of A & B joining IJV

I	II A	III
I	II B	III

Figure 2: Joint Venture Linking Value Chain to the Supply Chain Management

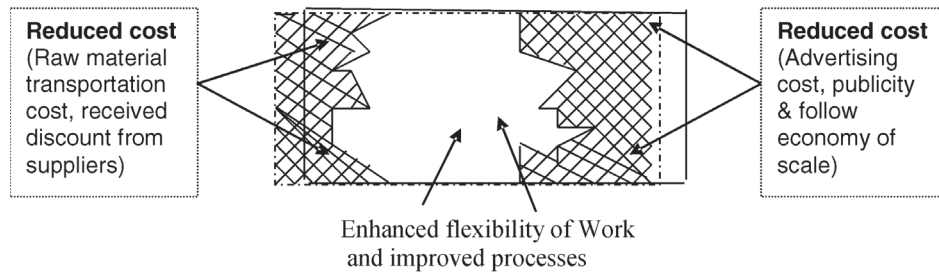


Figure 3: Synergy from IJV

The model takes a hypothetical case of two companies A is Indian and the other B is foreign and the two have decided to collaborate as IJV. Figure 1 illustrates the nature of collaboration which is primarily technical in nature hence affects operations and processes. Since the two companies A and B are producing same product they use same inputs (Stage I) say P,Q,R and join the process as stage II shows and also use same distribution channel thus share the selling and distribution cost (stage III). Figure 2 further illustrates this process that the IJV is linking Value chain to the supply chain management.

This IJV Company can demand good quality of raw materials in bulk in stead of frequently demanding small quantity from the suppliers and thus receive some discount from suppliers as well as reduce some transportation cost of raw material. Therefore they can save some

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amount of cost at stage I (Input level) (figure 2 & 3). In stage II (Process), they use latest technology and undertake research & development for manufacturing the product, at this stage the cost incurred is more or less same with respect to previous one (before formation of IJV) but it is justifiable, the duplication of work can be minimized and there is also a possibility for vertical growth owing to the good quality of product produced. At last stage III (Distribution and Selling cost), firstly the cost of placing and promoting the cost will be less, Secondly, due to economies of scale the product price will be less as compared to pre IJV. The outcome shall be increased market share hence a synergy is created (figure 3).

Analysis and Discussion

Although an IJV relationship and the contingent foreign Parent support provide the opportunity for the IJV to attain the capabilities necessary for survival, it is the learning process that converts parent support in to IJV capabilities that can be exploited for a competitive advantage (Lyles and Salk 1996). Learning is the mechanism by which IJV Technological and managerial capabilities are internationalized through the support of foreign parent. Such capabilities enable the IJV to effective by compete against other IJVs or subsidiaries that are vying for market share and a position in the emerging economy. Thus foreign parent support enhances the likelihood of IJV survival through IJV learning and capability development.

The model depicts this learning process in form of synergy which is created from following aspects:

- I. Common inputs:** as we take the case of Indian automobile industry the IJV between Tata and Fiat or Maruti and Suzuki clearly indicates that the two companies would use same inputs if they were to operate independently. The IJV provides them not only the economies of scale but also of economies of scope.
- II. Common production process:** the basic technology, programming, scheduling and other processes would be again similar but if Indian company wants to use state of art technology it has three options, to develop the technology (which is very costly in terms of money, resources and time); buy the technology (costly proposition because for updates every time cost will increase); the third collaborate on technical front, this helps share the benefits as well a the risks. Hence the third option is most suitable and hence picking up fast.
- III. Common distribution & sales process:** The final stage of supply chain is distribution. Foreign company finds the advantage of market knowledge of local player. The creditworthiness of local player also enhances the benefits. At the same time local player take care of cultural issues.

The above three dimensions of operations create a synergistic relationship mainly because of the ensuing flexibility. Adding the strengths of domestic company and foreign company create synergy on various accounts as is illustrated in Figure 4.

The Figure 4 clearly shows that IJV generates economy of scale, due to downsizing of organization & reduction in duplicity of work. This synergy creates competitive advantage to IJV. Cost effectiveness and diversification of risks deter other competitors from entering the market as the IJV becomes a larger player. Larger customer base, that is, increased market power results in enhanced profitability hence accelerated growth.

Conclusions

IJV/JV and strategic alliances have continued to grow in prevalence. A successful strategic alliance or joint venture starts with a detailed plan, well drafted and comprehensive legal

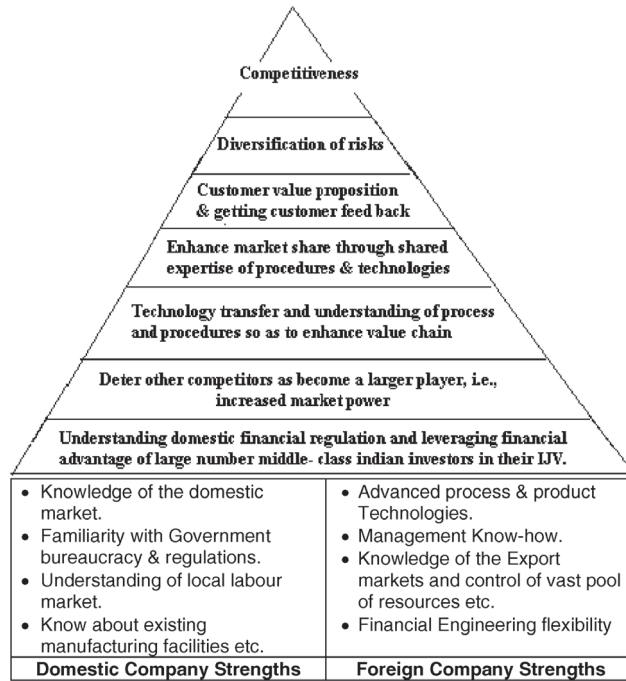


Figure 4: Synergy from Complementary strengths

agreements. The unique combination of legal and Technical expertise offers an advantage to companies considering entering in to marketing or manufacturing ventures or alliances. Technology transfer is one of the more sensitive and difficult issues confronting joint venture managements. For either side, the possibility of joining with another company in the new venture lowers capital requirements relative to going it alone. IJV creates advantages for both the players and results in a special kind of synergy which may not be created otherwise. The proposed model highlights this synergy in the form of possibility of utilizing flexible systems due to enhanced pool of resources, technical know how and better understanding of local market. However, it is to mention here that the model is tentative and theoretical and is yet to be tested in real life for its applicability. At the same time on basis of preliminary results of the study conducted, we are hopeful of its applicability in large number of sectors entering into IJV.

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