6 Equity Investment Alliances and Joint Ventures

Introduction

The next step along the strategic alliance progression is when a globalizer invests in a venture overseas or, in other words, takes an equity position. Equity can take the form of acquiring a minority shareholding in an ongoing operation or the establishment of a new enterprise with two or more partners in the form of a joint venture. This chapter will examine both types of strategic alliances—minority stakeholdings and joint ventures, and relate the participants' experiences back to the existing research.

Collaborative strategic alliances: Equity investments

Once the decision is made to form an alliance via an equity position in a new geography, the globalizer has the option of taking a minority stake in an existing business or combining their resources with the new partner or partners and creating a new entity in the form of a joint venture. Of all the topics covered in the survey, none was more contentious as joint ventures. The vast majority of participants (almost 80 percent) disliked them for a variety of reasons and would avoid them if they could. One participant when summing up his view of joint ventures as being an unrealistic business situation commented, "I don't like them; they are like being half pregnant—they just don't make sense."

Participants also realized that in the complex and enormous world in which they operated, joint ventures were an inevitable part of doing business and were resigned to their existence. A few embraced the innovation and synergies that arose from mutually beneficial relationships. The issues, key success factors, and pitfalls will be examined and illustrated through examples of both. But first, the other form of equity investment strategic alliance will be examined, in which a minority stakeholding is taken in an existing organization.

Cross-shareholdings and business groups

Minority equity cross-holdings are a long-standing characteristic of most of the developing world with many emerging market countries having key families and institutions controlling a significant amount of the countries' commerce. The history of minority holdings and cross-holdings is a long one that is more prevalent in Asia than the Anglo-European world though it is gaining increasing popularity in South American business.

The "business group" discussed further in Chapter 10 is also a long-standing Asian tradition with roots in the Japanese *keiretsu* and the Korean *chaebol*, and is increasingly popular in Chinese and Indian conglomerates. Many business groups sprang up historically as families diversified their business interests into complicated networks of reciprocity. In doing so, they took minority shareholdings in each other's enterprises to ensure emotional connection (Miwa and Ramseyer, 2005). In Japan at present there are six major *keiretsus*: Mitsubishi, Mitsui, Sanwa, Sumitomo, Dai-Ichi Kangyo, and Fuji and all of which have at their center a bank. The definition of a *keiretsu* is generally that the organization's largest source of funding for three years in a row was the *keiretsu*'s bank and that at least 20 percent of its shares were held by other members of the same *keiretsu* (ibid.).

South Korean *chaebols* are very similar in design to *keiretsus* with the exception that they are not allowed to have a stake in a bank—so while the *keiretsu* had a bank as the epicenter of their existence, South Korean *chaebols* relied on the South Korean government for their major funding (Chang, 2003). Their meteoric rise in the international scene is unprecedented: within 15 years the largest three—Samsung, Hyundai, and SK Holdings—have entered the top 100 largest globalizers in the world with Samsung now ranked 16th largest while LG hovers just outside the top 100.

The use of a cross-holding in business groups is the true essence of a strategic alliance—the partners are intertwined without full ownership yet operate in a fully collaborative manner through which they are able to achieve goals that they on their own are unable to attain. Words that describe the workings of business groups include collaboration, compromise, and trust. The ability to gain this kind of relationship without the tradition of a business group is extremely difficult but not impossible. Some organizations have utilized the minority equity stake element of business groups to replicate the relationship with success.

Minority equity stakes

Equity stakes offer an organization the opportunity to enter a market without the financial cost of a full acquisition. In many cases, the company holding the equity stake can achieve their strategic objectives with this lower level of investment.

The use of an equity stake to gain a foothold in another market has been used quite successfully by organizations that wish to influence and parlay those relationships well beyond their financial investment. In other words they can create "equity synergy," in that while they spend a defined amount in purchasing that stake, they get an inordinately large amount of benefit over and above the investment purchase price. In addition, they don't have the implementation costs associated with a full acquisition. Taking an equity stake is a practice also used sometimes quite effectively as a defensive move when specific resources are scarce in order to secure exclusive access to those resources and ensure preference over competitors.

An excellent example of a minority entry equity stake is the 20 percent equity stake the Industrial and Commercial Bank of China (ICBC) took in South Africa's Standard Bank for $5.5 billion (see Case 6.1). Not only was the 2011 transaction the largest FDI into South Africa, it was the largest overseas transaction by a Chinese bank (http://www.southafrica.info/business/investing/tanbank-261007.htm). It enables ICBC to operate effectively in Africa without having direct operations there at a time when by their own admission, they don't have the international management time or skills to devote to the continent. In addition, when Standard Bank decided to sell Standard Bank Argentina to concentrate on its African expansion, it sold 80 percent to ICBC giving it the largest Chinese bank presence in South America; Standard Bank will retain a minority holding of 20 percent in the Argentinean operation. Thus for the outlay of $6 billion, ICBC gets two continents of market-leading coverage without utilizing excessive amounts of scarce management resources.

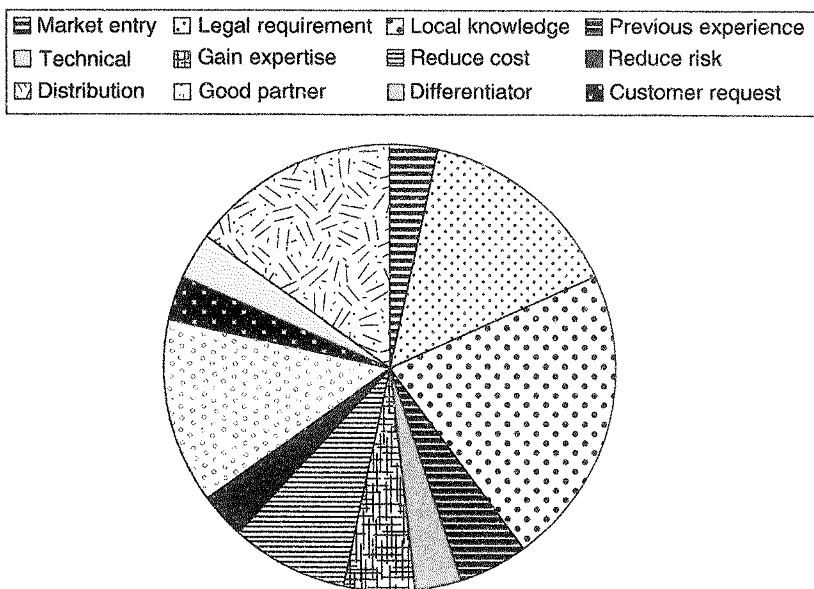
Joint ventures

Joint ventures are those collaborations where two or more parties invest in a new entity with each party contributing both tangible and intangible resources. Joint ventures are also a subset of strategic alliances, and in fact the most collaborative type, in that assets from all parties are merged together in order to form the new entity. As such joint ventures occur for the same reasons and suffer the same underwhelming success rates. Despite the dismal track record, international joint ventures are the most dominant form of strategic alliance especially in entering emerging markets (Beamish, 1985) and in fact account for up to 80 percent of FDI into lesser-developed countries (Purkayastha, 1993). The high rates of occurrence in the past have been due to government restrictions in many emerging markets—lesser developed economies have insisted upon joint ventures in order to ensure that incoming parties commit resources toward the local economy usually in the form of capital investment, new technology, and even simply management skills (Valoir and Dai, 2008). Joint ventures have been used as a learning mechanism for emerging economies to absorb as much from more seasoned globalizers in exchange for access to cheaper cost manufacturing and local markets. In that respect, on a macro level, joint ventures have served their purpose well.

This is evident when analyzing what Chinese firms look for in selecting strategic partners. Research has found that when entering a joint venture in China, developed market firms look for market knowledge, unique competencies/special skills from the partner, industry attractiveness, and previous alliance experience in their Chinese partners. Chinese firms, on the other hand, are interested in the incoming firms' technological capabilities and their willingness to share this expertise, intangible assets, financial assets, and their capability for quality (Hitt et al., 2000). These differences can be considered complementary or divisive, depending on the perspective and how they are managed.

The survey participants were asked why they chose joint ventures as a vehicle. Interestingly a large proportion (15 percent) of participants refused to use joint ventures at all; another 12 percent used them only if required by law, instead preferring other options such as commercial contracts and non-collaborative strategic alliances. One participant said, "I don't do JVs because [they] don't work usually. It's a good way to lose a lot of money. We will only go in if [there is] a clear route to control. We would rather have a commercial contract than a joint venture." As seen in Graph 6.1, the survey participants' four overwhelming reasons for doing the last joint venture were as follows:

1. It was legally required to operate in that jurisdiction.
2. The globalizer was interested in securing a partner who understood local culture, politics, and distribution to market.



Graph 6.1 **Reasons for last joint venture given by survey participants**

3. They wanted to gain expertise in that region.
4. A good candidate was available to partner.

The last point was two sided: firstly the partner was available, and secondly it took on a defensive edge—why compete with a marketing leader when you can join them. This "defensive" joint venture objective featured more prominently than expected, indicating that the ability to take out a competitor by partnering rather than competing was a major consideration for the venture. One participant commented, "The local players were very strong and we decided it was too resource heavy to try and compete with them head-to-head in a market that was, frankly, not significant for us. Joint venture was the more opportunistic answer."

Key success factors in joint ventures

There has been a host of research on factors that dictate joint venture and alliance success and failure. They are illustrated in the following three-part process: the strategic objectives of the investment, partner selection including fit and process, and the ongoing operation of the venture (see Table 6.1).

Table 6.1 Research reasons leading to successful joint ventures

Strategic Objectives	Partner Selection: Fit	Partner Selection: Process	On-going operations
• **Business objectives** • Overall • Regional • Philosophical • **Control** • **Ownership** • **Resources** • Have • Need • Willingness to share	• **Commitment** • Of resources • Time • Willingness to collaborate • Transparency • **Control** • **Capabilities** • Management style • Culture • Reputation • Experience • **Complementary** • Objectives • Resource fit	• **Project scope** • **Objectives** • Boundary settings • Contract • **Collaboration mechanisms** • **Information sharing** • Resource sharing • IP sharing • Communication	• **Structural** • Performance milestones • Reporting structures • Conflict resolution • Exit contingencies • **Adjustment mechanisms** • **HR management** • **Symbiotic** • Cross-acculturation • Knowledge management

Survey respondents also commented on what three factors they felt led to joint venture success. Their responses in order of frequency are:

- ▷ Strong strategic fit/clear objectives and long-term goals (18 responses)
- ▷ Trust and respect between partners/treating partner well (14)
- ▷ Strong cultural/organizational fit (12)
- ▷ Picking your partner well (8)
- ▷ Good team on the ground, including local nationals (8)
- ▷ Good use of assets/delineation of asset use (5)
- ▷ Strong due diligence pre-venture (4)
- ▷ Good relationship at the top of the organizations (3)
- ▷ Making money (2)
- ▷ Perseverance (2)
- ▷ Communication (2)

Strategic objectives

Joint venture success is predicated on it supporting the organization's overall business strategy and in the specific region, a view supported by the survey participants. While this sounds quite obvious, research has found that foreign investment is often almost accidental as opportunities arise in terms of partnering options. Almost one-quarter of participants indicated that clearly agreed and articulated strategic objectives were critical to joint venture success. The longer-term strategic objectives were seen as often misunderstood as partners focused on the immediate opportunities at hand. In addition, participants indicated corporate objectives changing over time further exacerbated the immediacy and short-term perspective often seen in joint ventures. One participant whose company is involved in dozens of alliances said, in hindsight, of their last joint venture that he would have

> [g]iven more time to the exploration of the longer-term strategic intention from both sides at that time [of venture formation], but it moves on with the passage of time. So even if both sides believe they have the same vision on day one, we move down the road a decade that's unlikely to still be the same picture I had in view ten years earlier.

There is a chicken and egg scenario in joint ventures and alliances: once the target country is agreed, does one choose the degree of control and mode of entry first and then find the partner or find the partner first and decide how far to collaborate? There is no easy solution to this question. The process seems to evolve with some degree of give and take—what mode of entry is preferred and from this seek out an appropriate partner if indeed partnering is the answer. Once that partner is found, negotiations begin and

a final level of scope and control are decided upon. One survey participant does it the opposite way—he described their process:

> In my mind what we don't do is we don't say JV and acquisition are different things, we actually think more, "Well, we want to be involved in that business, what's the best structure we want to base that [on]? Do we buy 100 percent, do we buy 80, do we buy 51?" There isn't the conversation, "Should that be a joint venture?" as opposed to, "Should that be an acquisition?" It's more about what percentage do we want to own.

Level of venture control and ownership

Level of control and the venture's ownership structure are separate but related issues. As seen in the last chapter, control is the amount of influence the various partners have in the operational, managerial, and strategic direction of the joint venture and should not be confused with the venture's percentage of share ownership. There are differing degrees of joint venture involvement depending on the amount of operational control exercised by the various partners.

Dominant parent structures are those in which the joint venture operates as if it were a wholly owned subsidiary of one of the venture partners (Killing, 1982) with the other partner(s) having little input on managerial issues and instead receiving a financial dividend based on their shareholding. It provides maximum operational control to the dominant parent company. Dominant parent structure was by far the preferred control level by those in the survey with 30 percent of venturing globalizers saying they would not enter into a joint venture if they did not have dominant parent structures. This preference appears to be culturally related, however, as all of the respondents were either American or European while the rest of the world's globalizers were more accepting of alternative forms of joint ventures. Indeed research supports this as over 60 percent of Indian joint ventures with American firms give the latter control compared to only 10 percent of Asian joint ventures (Adarkar et al., 1997). European firms fall somewhere in the middle (ibid.). One participant commented:

> For us the biggie is when we buy [into] a company we need to have control, so we are not going to do a JV with you if you don't give us control. Less than 51 percent we don't talk. We can continue to talk, we can sell you some machines, and we will sell you some technology for your business, but if we don't have control, we are not going to do anything with you.

Another participant indicated his company's position differed depending on the development of the country. In the developing world where corporate governance is a major issue they insist on control; in the developed world they are more flexible. He explained why:

> We would still see ourselves in the driving seat. And therefore control ... is something that is very important to us; we won't do something where we don't feel we're not driving it. Definitely we would always like to have the deciding vote at the board. I think if you're investing money into a developing market and you're putting your corporate reputation on the line, which you are every time you do business in [an emerging market], then we want to be steering our own destiny. So if we screw up, then it's our fault, but we know what's happening, and we don't have to be always worrying about "Well, what's that guy doing, what's that guy doing?" We know and, therefore, we do have 100 percent control; sometimes even where we have less than the 50 percent shareholding, we still have control of the business because we insist on that.

In those cases where one is using a joint venture purely because it is a legal requirement, a dominant parent structure can work very successfully as small collaboration is usually necessary and this structure encourages small collaboration for fear of unilateral opportunism. As one participant who uses a dominant parent structure in his 80/20 joint venture said, "We view it [the 20 percent in dividends] as the cost of doing business in that market" while they maintain full operational control. An example of a successful joint venture structured in this way is a Middle Eastern joint venture where the local ruling family owns 20 percent of the operation while the European partner owns 80 percent and uses a dominant parent structure. The CEO explains:

> We bought at the low price and kept them to be a partner with us so you get much more cooperation than when you buy the company. They accepted that because they realized that the business is very complicated and they didn't make a lot of money out of it. They see it is better to attract a leader in the world who can grow the business and yes they only have 20 percent of the dividends from that but that is much more than 100 percent of something that does not make money. We manage everything; they are not involved at all. They are only vital when we want to, say, build [onto the facility]—I call [the ruling family] in the morning and I can begin building by 2:00 pm. It is worth 20 percent.

Shared control is one in which the venture is co-managed by the partners. Interestingly, some Western companies fixate on shared ownership as being the same as control. As seen in the earlier chapters and especially in the developing world, most notably Asia, the two are not synonymous. While a percentage point or two of ownership makes a difference legally, it does not give the majority partner the right to dictate terms. Instead anything within the 40–60 percent range is seen as where mutual agreement and

communication are required for decision-making. One participant whose company is heavily involved in joint ventures puts it this way:

> We have every kind of JV under the moon ... if you're 51/49, you're still 50/50 with respect. You got a partner, the material, and you have got to get along. And so what we found is that it's just too simplistic to say that governance is exactly based on equity ownership. In fact, if you are anywhere between, in our experience, roughly 25 and 75 you have to respect and get along and work with your partner.

One successful way of sharing control is using what is termed "split control." The venture partners split up the functional responsibilities based on their areas of expertise and manage those with an overriding coordination at the top. While this approach has led to a silo effect in merger situations, it has been found to be preferable in less-developed-country joint ventures (Beamish and Choi, 2004). In order to be successful, however, it is wholly reliant on a foundation of trust, mutual commitment to the objectives, and strong communication, again all activities seen as cornerstones of long-term joint venture success. In these cases there is a feeling of being "mutually held hostage situation," which lessens opportunistic behavior of the parties (Gulati, Lavie, and Singh, 2009).

There were a few notable exceptions among those interviewed who actually preferred shared control joint ventures. One respondent said, "I've done lots and lots of different joint venture structures, but equal partnership is actually my preferred way of doing business often, because it allows you to bring together that local expertise and international expertise." Another commented:

> 50/50 issues? You know, but there's always a power struggle. It's just like when I get home with the kids. There's always somebody shooting for something. Just because it is manufacturing and marketing and sales or product development and somebody else, everybody has an idea of how it should be done best and they are pushing their views. It's that kind of thing. And as long as both sides are willing to respect each other's views and go through the data generally it seems to work itself out okay.

Another participant said:

> There's something beautiful, in my view, being in a 50/50 [joint venture] where the partners are forced to work together. And, unless they get to such a catastrophe and that's almost never business related, that is, unless there's nothing going down with no hope to resolve it because the economics of the business don't make sense. If it's going to crash, it's because the partners didn't, couldn't, work together.

One participant's company had an equal partnership with an outstanding 18 percent publicly traded shareholding. He commented, "The joint venture in Turkey is an equal joint venture with an 18 percent public ownership. And the public oversight actually is even healthier because it forces additional disciplines on partners." That joint venture's highly successful results are attributed to the long-standing relationship and a clear commitment to the ongoing processes in place. Indeed, the most successful joint ventures in history have been shared control joint ventures, including Royal Dutch Shell, Unilever, British American Tobacco, and the highly publicized TNK-BP Russian joint venture (see Case 6.2).

While most of the survey participants had joint venture experience as majority shareholders several others talked of their experiences as minority shareholders. In the cases where the experiences were positive, the minority shareholder was treated with respect by the majority equity holder—in fact, they were treated as equal partners regardless of the shareholding. Information was transparent and shared equally, and it was clearly appreciated that they were bringing a key skill or resource to the venture. One emerging world globalizer who was highly successful at growing through joint venture made this distinction adding, "The actual shareholding is not really important with us—it is being treated as having equal rights as a partner that is much more important for us." This is seen in the Centrica joint venture with Électricité de France (EDF) where Centrica is the minority (20 percent) shareholder (see Case 6.3). Both parties brought valued assets to the venture and the ongoing process is considered fair and transparent. While EDF could take a more aggressive stance due to their majority shareholding, they do not with a philosophy enforced throughout the organization. In addition, guidelines of what was expected were clearly articulated to ensure collaboration and performance is maximized.

Partner selection

Partner selection has been seen to be the most critical step in ensuring joint venture success (Saxton, 1997). This process can be broken into both partner "fit"—that is, how well do the partners complement each other—and "process" or ensuring key elements of the negotiation and setup phases are adhered to. Shah and Swaminathan (2008) reviewed more than 40 studies pertaining to alliances and found that three elements of partner "fit" were seen as critical: partner complementarity, partner commitment, and partner compatibility. In those cases where partners share similar characteristics and strategic philosophies, they are considered to be symmetric (as opposed to asymmetric), which lead to greater stability, coordinated reactions to market changes, and greater reciprocity (Jiang, Gao, and Li, 2008).

Partner complementarity

Partner complementarity can include elements such as the firm's strategic fit and resource distribution, a combination that Harrigan (1988) refers to

as "strategic symmetry." Absolute agreement on the venture's overall objectives was seen by the survey participants as the most important element in determining joint venture success with 30 percent stating this was a primary driver of success. Interestingly, this research found agreement on objectives to be of higher importance than previous research.

Resource distribution can be considered either scale or link related (Kim and Parkhe, 2009). *Scale resources* are those that are similar in the venture partners—that is, the partners are gaining size or market share by participating. While there are examples of success in scale ventures (South Africa's 2008 three-way joint venture between competitors Diageo, Heineken International, and Namibia Breweries) there is also seen to be a tendency for rivalry and competition where the partners seek to learn more from their partners to enhance their stand-alone capacities. This can lead to negative behavior in terms of competition and stealing of trade secrets, employees, and customers. "Link-related" resources are differing steps along vertical integration where resources are unique to each partner and fills the void of each partner's value chain when working together (ibid.). They are often delineated along functional lines and then become split-control joint ventures with one party managing part of the supply chain while the other manages the other portion.

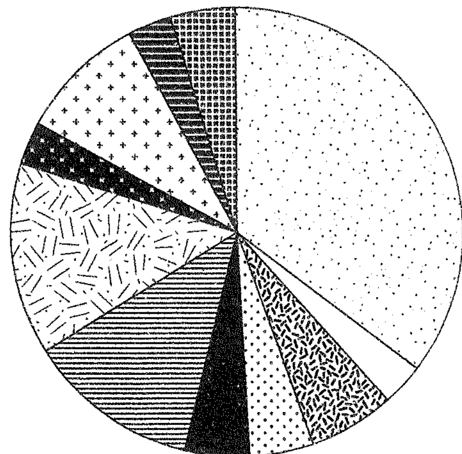
Research has found link-related joint ventures to be more successful as each party brings an individually lacking but mutually beneficial resource to the venture (ibid.). One participant was in a split-control joint venture where his organization was responsible for some of the functions in the joint venture while their partner performed others. He commented:

> We partnered together based on their expertise in development and production and we are bringing to the table the "go-to-market" marketing and sales—each company is bringing in their assets in that respect. It is not just about the investment or capital expenditure, it is also about the know-how.

Over 35 percent of participants undertook joint ventures due to market-entry/top-line growth initiatives. In over half of these cases, they were providing complementary skills in that the globalizer was providing technology, product, and branding while the host-country organization was providing local market knowledge and distribution. Interestingly the desire to strategically differentiate oneself via joint venture was used primarily by Japanese respondents with 80 percent saying this was a key reason for entering into their joint venture (see Graph 6.2).

Partner commitment and trust

Partner commitment can be defined as "the willingness of a partner to make resource contributions required by the alliance but also to make short-term sacrifices to realize the desired longer-term benefits" (Kale and Singh, 2009, p. 47). It can include capital, assets, technology, expertise, and also intangible resources such as energy, management time, and a positive



Graph 6.2 **Reasons for joint venture given by survey participants**

willingness to collaborate and be transparent in dealings, all of which are linked to the venture's chances of success. Strong partner commitment has been linked repeatedly to joint venture success in numerous studies (Mohr and Spekman, 1994; Morgan and Hunt, 1994; Das and Rahman, 2010). Anecdotally this was seen several times in this survey, for example, with India's GMR Group partnering four times with Malaysian Airports Holdings Berhad to great success—their current project, the construction and operation of Maldives' international airport, is featured in Chapter 9. This has also certainly been the experience with IMAX and their partnership with Wanda. The relationship, built upon partnering in numerous locations, means that the mutual trust is considerable. As Greg Foster of IMAX explains:

> They [Wanda] are communicative, honest, encouraging, enthusiastic, supportive. They are not only supportive of our individual network with them but they are supportive of the film business in general, and we have a very symbiotic relationship with them. It works really, really well. And we have found Wanda to be very long-term focused. What you need on the ground is a partner who supports and protects your brand. Wanda is the third largest retail shopping center developer in the world, third only to Westfield and Simon and their corporate headquarters is right in the heart of Beijing on a huge street. And their sign on their building says Wanda and it says IMAX and you'd think that company was

called Wanda IMAX. It is fantastic support from a local partner; it's incredible how supportive they are.

The willingness to collaborate and share information in an honest and transparent manner is seen as integral to joint venture success (Valoir and Dai, 2008). If partners are able to build upon their collaboration, over time a degree of trust will permeate the relationship. Mutual trust is formed over periods of time in which parties' expectations are met in a realistic and timely manner through credible communication (Hubbard, 1999). If aligned objectives are the bricks of joint venture building, trust is the mortar. The role of trust leads back to control—one wants control if trust isn't present. As one participant commented:

> 50/50 joint ventures of course are the most difficult of all because nobody has control, so it forces both parties to align to get anything done. Everyone worries about being a 49 instead of a 51 and that's because of course nobody trusts the other guy.

Trust is seen as having two elements: benevolence and competency (Abrams et al., 2003); competency is the level of expertise the partner holds while benevolence is a willingness to put the joint venture's objectives above their own. Thus, when alliance processes or outcomes become difficult to manage or interpret, trust between partners will be the primary basis for the partnership proceeding positively. Trust leads to a greater willingness to share and collaborate without parties feeling that they will be put at a disadvantage by their partner. This research supported the importance of trust in joint ventures, with mutual trust and respect being second only to aligned strategic objectives in being cited as the most critical facet of joint venture success. One participant agreed, saying:

> It is important to build the trust especially with family companies. With so many companies you cannot buy the company without the trust; it is impossible. They can really destroy the company before you arrive, so you need to build the relationship telling them you are not going to destroy what they are doing. We just commit to bringing our technology to add to what they are doing and it works.

As trust takes time to develop, some research has found that repeat alliance partners have a great level of mutual trust and therefore are more successful although the research is by no means conclusive. Anecdotally, this has certainly been the experience with IMAX and their repeat partnering with CJ Entertainment as well (see Case 10.2 in Chapter 10). The relationship has been built over a decade of repeated partnerships meaning that mutual trust is considerable. In fact, several of the survey participants indicated that they chose partnering and geographic options based on positive previous experiences with those partners. There were two examples in addition to IMAX of organizations that entered new markets with an existing joint venture partner from differing geographies rather than find an untried partner indigenous to the new territory.

Partner compatibility

The final element of partner fit is compatibility that includes such areas of cultural fit, management style, reputation, and experience. The fit between organizations is seen to be more important than having two companies of the same national origin. In other words, organizational fit is seen as more important than country fit; management-style fit is seen as critical especially in terms of managing a split-control or collaborative joint venture. This was the third most widely cited key success factor by survey participants. One survey participant that uses joint venture to great success has a sophisticated process of partner selection built primarily around values fit stating that while the rest is important values alignment was the cornerstone of partnering.

In addition, how senior management on both sides gets along is also seen as key. As one participant commented, "Certainly the relationship is key. I think the respect on both sides has gone up and down depending on who the management teams are on both sides. But I think that's probably the most important thing—the relationship: the relationship has to be good, very high up in the company on both sides to make the business work."

Reputation in terms of corporate governance is also seen as critical in terms of ongoing management and is often a key factor in the choice of a joint venture partner especially in the developing world (Eisenhardt and Schoonhoven, 1996). Roughly 20 percent of participants indicated that corruption played an issue in the majority of markets in which they operated; choosing a joint venture partner that shared their view on adhering to anti-corruption principles was paramount to their selection. In fact, one participant said they were willing to partner with a less desirable candidate in terms of tangible resources if that partner indicated a stronger willingness to adhere to stricter anticorruption principles. Thus corporate governance and following ethical business practices can be seen as a source of competitive advantage in terms of joint venture partner selection in emerging markets. It is also highlighted in BP's joint venture with TNK (Case 6.3).

Process issues in partner selection

In addition to fit issues relating to partner selection, the process of partner selection is also seen as critical for future joint venture success. It begins with ascertaining clear venture guidelines and objectives and setting partner expectations on both sides. The scope and boundaries for the venture need

to be framed and agreed. Boundaries are defined as "a clear statement of the scope of the alliance" in which the firms are allied (Slowinski, Hummel, and Kumpf, 2006, p. 34). In those areas out of bounds, the firms are not allied and may be competitors. Boundaries include a true understanding of what the venture is supposed to achieve and how it is measured. One participant agreed, saying:

> The decision-making hierarchy has to be absolutely clear. Defining roles and responsibilities is very important. This includes boundaries for both companies and individuals and defining who gets what in the JV in terms of expertise and culture. One needs to get into as much detail as possible. The more detailed the planning the better.

The next phase is due diligence: survey participants indicated that extensive due diligence especially in terms of what resources are being committed was essential to venture success. One participant indicated that, in hindsight, they should have done more, "We did all the usual Western due diligence that one would expect but [the potential partner] made great claims about his relationships and political connections that we should have checked out but didn't. They weren't as robust as he claimed."

Another commented that in emerging world joint ventures, they undertake financial, tax, marketing, commercial and market, operational, and legal due diligence. In certain geographies such as India, there is a need for more rigorous due diligence. He added:

> Financial due diligence is the most challenging. The issue is more about what they want to conceal and what they want to reveal and the question of how much is real. There are revenue recognition issues and cash transactions which needs to be checked. In terms of environmental and regulatory—there can be a lot of "in-principle" approvals, which may not have been formalized. A simple confirmatory check with the concerned departments may not be a solution to it. One needs to use industry examples to know the ways in which these approvals are obtained. Also, if there are instances of things which appear too good to be true, one should take it with a pinch of salt and challenge this. One needs to check the presence of many cases of "managed approvals" which could command value in the deal. This may be attractive but does hit later—so double check. Only 5–7 percent of deals are successful with them! There are tax issues but they are solvable.

Typical questions in due diligence include:

- ▷ What is the ultimate goal for the venture? Is it permanent or a short-term measure? Is it location specific? Industry specific? A single venture or wider scope of cooperation?
- ▷ What is the time frame for its setup and milestones?
- ▷ What is success being measured upon (financial, transfer of knowledge, full employment)? Do partners agree on the terms of measurement as to what is "success?" How is that measured?
- ▷ Which resources are both committing? Do both parties have the resources they say they do and will they commit these to the venture?
- ▷ Is the venture's success important to all the participants?
- ▷ What are the time frames of resource commitment?
- ▷ How is information going to be shared? What information is off limits? Is that agreed upon?
- ▷ What is the juxtaposition of the joint venture within the wider firms—will there be competition with other parts of either firm?
- ▷ How are interests to be protected? What controls are in place to ensure compliance?

One participant outlined their process:

> We start by discussing a business plan, long-term vision, and how to grow in that country. That's point number one. Point number two, there is a question of principals of action, and I have very often rejected partners because they have accepted corruption, things that are directly contrary to our culture and ways of operating. So we find we have to have the same philosophy and the same business philosophy. Now, however, even if you have checked those two and ticked those two boxes, you need to conduct a very careful study of their business and operations; there are still risks that can sour the objectives. They may not have the resources they say they do in order to grow the business.

The understanding behind the initial contract is seen to be a crucial foundation for any joint venture. The contract, however, is not enough to ensure success. In fact, in many parts of the world contract enforcement is difficult at best and impossible at worst. One survey participant recounted the issues with contracts in Asia, "On the other hand you always have to take some risk. It's cultural—it's very well known in China that contracts mean very little. You can write pages of American law in China and it won't achieve a lot, except that you make the other side nervous." Because of this, a multifaceted approach is seen as the most effective in ensuring joint venture success—one in which extensive expectation exchange, informal relationship building, and contract framing are interwoven. Over time assuming a positively proactively managed relationship, trust can serve as a glue binding the sought-after behaviors and formal agreement. Indeed, research has found that the use of formal and informal safeguards together is more effective than either in isolation (Poppo and Zenger, 2002). As such trust is seen as a substitute for a formal contract and "operate[s] as a self-enforcing safeguard that is a more effective and less costly alternative to both contracts and vertical integration" (Poppo and Zenger, 2001, p. 3).

In addition to agreeing contracts, systems for collaboration need to be agreed upon. The tone set by a frank exchange of expectations can help

reduce ambiguity and given guidance of expected behaviors that can be especially important in cross-border collaborations. In fact, "clearly articulated contractual terms, remedies, and processes of dispute resolution as well as relationship norms of flexibility, solidarity, bilateralism, and continuance may inspire confidence to cooperate in interorganizational exchanges" (Lu, 2007, p. 70). Because of the heightened opportunities for misunderstanding due to cultural differences, cross-cultural training programs are also seen to be excellent foundations for mitigating cultural misunderstandings between partners and thereby encouraging mutual learning (Kim and Parkhe, 2009).

A recent high-profile example of a successful joint venture being anchored on extensive cross-cultural training programs is the Renault–Nissan alliance. Literally thousands of managers underwent rigorous training to facilitate collaboration between cultures (Pooley, 2005). What must occur alongside the training is enforcement of desired behaviors and leadership at the organization's top. One without the others is simply not effective. In order to achieve this, senior management must be involved in the joint venture in more than just a nominal fashion—this is discussed later in this chapter.

Systems for collaboration are especially relevant in terms of intellectual property (IP) and technology in related industry collaborations. For those industries with sensitive IP issues, it is suggested that a framework be agreed upon in which partners concur that information falls into three categories:

1. Information that must be shared
2. Information that might be shared
3. Information that can never be shared (Slowinski, Hummel, and Kumpf, 2006).

Employees can then be trained as to the levels of information available to the partners to ensure compliance. As seen in the car industry case of Chapter 10, some joint venture partners will systematically move employees around between venture partners to ensure maximum learning potential. If this behavior is not desired, it needs to be specified and agreed upon prior to the venture's commencement.

Ongoing processes

If understanding the joint venture objectives is seen as fundamental to its overall success, so must the ongoing processes support those objectives. Clear guidelines in terms of performance milestones and time frames are seen to be key to building trust, especially trust in the process. A mutually agreed and respected process for managing any disputes is essential and so are agreed targets and objectives for ongoing business success. Transparency in decision-making is also critical according to the survey participants. One participant in a highly successful 50/50 joint venture with their Turkish partner attributes the success to trust in the ongoing process:

> In the structure we have basically a matched pair concept, an internal junior and senior person from each company representing the interest of each company. Those who couldn't work together are going to have a problem ... It's mostly trust in the process. If you believe both understand that their interests have to be protected, and I would say even more in Turkey where both sides are working to get their maximum value out of the partnership. But since the information inside the JV is available to both partners and as long as the information is presented in a fair way about what the outcomes are, and the negotiations are negotiated in a fair way about what the outcomes are, while they can be extremely difficult, I don't want to say they are easy, but they are almost always around the division of spoils and not around the success of what the JV is trying to accomplish. And I would say there's plenty of angst working with joint venture partners from inside the company because the joint venture partner doesn't have to do exactly what the company would want in some of the cases. So where they would sometimes be able to dictate result it's much harder to do that in a joint venture.

An understanding of respecting minority partners was also seen by this European study participant as he discussed his Asian joint venture. He recounted:

> I think we are a bit arrogant in the way we treat our partners in board meetings. Yesterday, for instance, I corrected something immediately when I found out about it. We initially refused our partner's request to set up an audit committee when they have 42 percent of the company. The argument was that it's not a listed company, so therefore we don't need an audit committee. The instinctive reaction of the joint venture manager was to say, "No, we don't need this." But if a partner who has 42 percent of the company asks for an audit committee, then they should have it. The venture partner was not pleased, but he [the manager] passed a message to me and yesterday it was corrected. At least we are able to correct our mistakes.

Exit strategies are seen by some as almost the equivalent of a prenuptial agreement for joint venture marriages. In fact, 10 percent of respondents said they would not enter into a joint venture without some kind of exit strategy clearly outlined in the agreement. It could be a strategy to full control either through an earnout, buyout, or floatation. One participant indicated a robust exit strategy was critical to his joint venture planning and added, "There should be in-built exit options and again the details and clarity is very important."

In two cases, the venture was partially floated that added the ability to exit the venture if necessary; in two others, the terms for exit via buyout were

clearly outlined. Research has found that in some cases, the cost to exit is much more damaging to one partner than the other. In these cases, an exit strategy can be used in which the penalties associated with prematurely exiting the agreement can be more harsh for one party than the other (Adarkar et al., 1997).

There is an increasing trend of globalizers to use joint ventures as a reduced-cost means of accessing markets. In some cases, globalizers establish joint ventures knowing that in several years they will be interested in buying out the partner. They let the local organization establish the presence and build the business only to buy the business when it reaches critical mass. In most cases, it is mutually agreed by the joint venture partner—in some cases the multiples of pricing are agreed up front. In other cases, the joint venture partner instigates a conflict with the local partner using this as an excuse to restructure the agreement (ibid.). A robust exit strategy and asymmetric punishments associated with this kind of behavior can mitigate this type of occurrence.

Finally, performance tracking is seen as key for ongoing alliance success. In successful joint ventures performance objectives are clearly spelled out and measured. Access to timely and transparent information is seen as fundamental not only for building ongoing trust but also for ensuring agreement on setting and meeting objectives. Several participants commented that they had a centralized joint venture and acquisition unit that systematically tracked performance of the various alliances. One added, "We have a very detailed process to track and monitor synergies and sales growth for each transaction. These are monitored and reported on regularly as part of the financial reporting processes."

Future trends in strategic alliances

There are four trends in strategic alliances that appear to be gaining momentum: project-based ventures, nontraditional partnerships, virtual joint ventures, and alliance units. The first trend, project-based ventures, is one in which joint ventures are formed for a time-specific, short-term projects in which the time frame for collaboration is clearly spelled out in the agreement. The partners work together for a specific project and when the project finishes, so does the collaboration. One respondent was partaking in such a project with some success. He commented, "We won a contract and it was not in our strong sector so we partnered with a company that was smaller and couldn't run the entire contract themselves but were established in that sector. It worked well—we learned about the sector from them and they got a piece of work they could have never serviced themselves." It appears to be a trend for the future.

The second trend is the partnering of nontraditional partners whether they are NGOs, nonprofits, or direct competitors. Globalizers are collaborating with a host of nontraditional organizations, including not-for-profits and tiny individually based companies who possess a skill or resource that is useful to the globalizer (Yiu, Lau, and Bruton, 2007). It is a trend seen especially from emerging market countries although it is used increasingly throughout the world. This kind of arrangement was seen earlier in this chapter, in Diageo's joint venture with Namibian Breweries and Heineken in which they collaborated in South Africa only to compete elsewhere throughout the continent. While this has inherent risks especially in terms of knowledge management, if properly managed it allows smaller organizations to broaden their reach and international footprint much more quickly than their size would normally allow while giving larger globalizers access to fast-paced innovation and in filling market niches.

There are some inherent problems with these kinds of relationships. There is almost always a size imbalance between the partners, which can lead to difficulties. Often smaller partners can't find the appropriate person with whom to liaise in the larger partner; this is sometimes exacerbated by larger organizations having internal transfers which can lead to key relationships between partners being disrupted or terminated (Singh and Mitchell, 2005). In addition, in some cases the collaboration is not always given the overall organizational prioritization it requires. Finally objectives between asymmetric parties may also differ at various stages of the relationship making goal congruence difficult to maintain (ibid.).

The third trend in strategic alliances is the virtual venture in which smaller companies, predominately from the emerging world, are assembling teams of skills without actually forming a joint venture (Adarkar et al., 1997). Individuals with required skills are being brought in and combined with other skills and technologies to meet the objectives at hand. This form of alliance is gaining momentum by those organizations where brand awareness is not necessary and speed to market and tailorization is more important such as in information technology and innovation-based enterprises. It is also sometimes combined with the project approach described earlier.

The final trend is related to the first three trends: as can be seen from this chapter, organizations' strategic relationships are getting progressively more complicated. Because of this, organizations are increasingly using internal units to manage their alliance portfolios. In some cases our participants had separate internal teams either focused entirely on alliances while others had teams working as part of their acquisition team—in one organization this team was called the Inorganic Growth Unit. If one is global and involved in numerous alliance initiatives, this level of centralized coordination makes sense—there needs to be an overreaching strategy of partner management. Despite this, several of the survey participants complained that even after having a centralized team they failed at times to capture and coordinate all the relationships especially as their global reach was so broad and conditions changed so rapidly. It will only get more complicated in the future.

Conclusion

No topic covered in the research brought a greater disparity of opinion than strategic alliances. It is easy to see why. There are countless examples of failed joint ventures especially in emerging world economies. One, Danone and Wahaha is highlighted in Chapter 10 of this book. They are difficult and time consuming to manage, and even when managed well they rely on the goodwill and effort of another organization for success. They require a leap of faith in trusting your partner hence partner selection becomes so crucial to the venture's long-term success.

If managed properly, however, they do provide a larger pool of resources from which organizations can draw. For, in this rapidly changing global marketplace, there are few if any organizations that have in-house all the resources they need to successfully tackle every market their strategy dictates.

Case 6.1 Standard Bank and ICBC

When the Industrial and Commercial Bank of China (ICBC) took a 20 percent stake in Africa's leading bank, Standard Bank, in 2007, their $5.5 billion investment made it the largest single investment in African history. The investment brought more than a close relationship between China and Africa; it gave Chinese companies a highly trusted platform for doing business on the continent. China, after all, remains the biggest foreign investor in Africa (UNCTAD, 2010).

Rather than just make the investment a financial one, Standard Bank and ICBC work closely together on several fronts to ensure they are able to maximize the mutual benefits of their relationship, including the flow of funds between Chinese and African corporations. "They [ICBC] use us as their eyes and ears for Africa," said one senior Standard Bank executive. The relationship is built on a cross-fertilization of personnel in both China and Africa. ICBC supply support staff in all the major Standard Bank branches throughout Africa to facilitate African investment by Chinese companies. In return, Standard Bank second some of their most senior executives to China to work at ICBC in Beijing. The executive continued,

> With ICBC, most of the time, we put a Chinese-speaking person into all our entities in the country; we bank [with] our Chinese-speaking clients, and can talk to them. We are the only bank in the world who can give them directly soft local currency and South African currencies and other currencies. We have done some high-profile investment banking deals ... so we are using Chinese capital for Africa. So they didn't just invest in us. It gives me a legitimate card for any meeting. I can go to any meeting; it doesn't matter how big the financing request is, I can go in there knowing that with ICBC behind us, we can fund it. That gives us a world platform. We can fund any project in the world; so up to now it has worked out very well for us.

The banking relationship has proven beneficial in other parts of the world. In 2011 Standard Bank sold an 80 percent stake in their Argentinean bank, Standard Bank Argentina, and their two affiliates for excess of $380 million. This gives ICBC a commanding position in Argentina as the only Chinese bank with a significant presence, and freed Standard Bank to pursue their regionally focused African strategy. The deal was hotly contested with over a dozen interested parties, but the long-standing shareholding and positive working relationships meant that Standard Bank can keep an active minority involvement in the Argentinean operations to facilitate South American and African banking operations while concentrating resources on their pan-African strategy. All in all, the relationship has proven to be greatly beneficial to both parties.

Mutually beneficial banking relationships underpinned by financial minority stakeholdings are not unique to Standard Bank and ICBC. Santander and Royal Bank of Scotland also had a similar relationship with Santander taking a 5 percent minority holding in Royal Bank. This stake ensured a high degree of cooperation as seen in the secondment of staff between banks. For instance, English-speaking Royal Bank of Scotland staff members were stationed in Santander branches on the southern coast of Spain where a large percentage of British holidaymakers had vacation homes and utilized the dual banking relations to mutual benefit.

Case 6.2 BP and TNK-BP

TNK-BP, British Petroleum's 50/50 joint venture with Alfa-Access-Renova (AAR), have never been short of publicity—they resembles a very public celebrity marriage. As one of the most financially successful joint ventures in history, they have attracted their share of media attention. After all, they accounted for 17 percent of BP's operating cashflows in 2011 generating $3.7 billion. But the joint venture is probably unjustifiably more famous for the very public differences of opinion between the two major shareholders, BP and the four Russian oligarchs who own AAR. While they have had subsequent public disagreements, the joint venture's formation in 2003 appeared highly complementary. Dr. Byron Grote, Executive Vice-President of BP, explained,

> We brought to the joint venture our experience in the oil sector, technical understanding of reservoir management, and operational capability. Our partners brought an understanding of operating in Russia. TNK-BP is one of the best-run companies in Russia. We've met all of the promises that we made at the time we formed the venture: to improve oil recovery, to do this in an environmentally responsible way, to be good citizens of the communities in which we operate, and to ensure that TNK-BP's fiscal obligations were fully met. We've brought our way of doing business elsewhere into our operations in Russia. Operationally it has more than met expectations. However, the JV requires a lot of management time and attention and it generates negative publicity because of the periodic disagreements with our partners. Nonetheless, TNK-BP has been a great investment. We have received dividends equal to about twice our original investment and still own 50 percent of one of the largest oil companies in the world.

The joint venture's success has been in a large part down to the TNK-BP team; Grote added, "We have recruited some excellent people with deep technical and operational capability into the joint venture." However, where the joint venture has faltered has been in the long-term alignment of philosophies of the two parties. Grote continued,

> I think that the biggest difficulty with joint ventures is that they normally occur because there is short-term alignment of objectives. The challenge is then maintaining that alignment over an extended period of time. Most joint ventures fail because the strategic alignment begins to fall apart. There are differences of objectives and it grows harder and harder to work together, whatever the size of the prize.
>
> The formation of TNK-BP presented a unique opportunity for both partners. It was, at that time, the only opportunity for BP to gain a significant presence in Russia and it remains a distinctive position today. However, our strategic ambitions have diverged and this is the issue in front of us today.

Since this interview, it has been announced that Rosneft are going to acquire the entire joint venture. In return for their shares, BP will receive shares in Rosneft and a reputed $27 billion in cash, some of which will be reinvested placing BP's stake in Rosneft at close to 20 percent.

Case 6.3 Centrica and EDF

When Centrica wanted to enter the UK nuclear energy market, they possessed the home market expertise and contacts, but neither the nuclear power expertise nor funding required. They turned to Électricité de France, one of the world's acknowledged leaders in nuclear energy, and formed a joint venture with Centrica holding 20 percent and EDF having 80 percent. The project includes a partnership in EDF's eight existing nuclear facilities as well as building several more in the next decade. Sir Roger Carr, commented, "They were good people and we were comfortable with the safety record or we wouldn't have got involved. They were our partner of choice and indeed we were their partner of choice for the obvious reasons. So far the marriage has worked." He continued,

> We have been working together now for two years. The culture fit is good; [there is] considerable transparency, a healthy debate on issues, with commitment to getting resolution. Although the actual share in the joint venture is 80 percent/20 percent, we have for the most part worked as equal partners. The people on the ground are some of the best in the world and the mutual respect is high. It has been well thought out and well executed so far, but there is still some way to go in finalizing the design and cost. In the end, it will be all about economics. We all know the risk of joint ventures is that "however they start, they always end in tears." At this stage, this one has some way to go before it feels tearful. The relationship is good.

This case highlights the importance of partner relations regardless of control. In those successful joint ventures, there is a strong strategic logic where both parties can see that they have brought key assets and resources to the joint venture—and these are acknowledged by the partner. This is then supported by a fair and open process and strong lines of communication. When one partner begins to act unilaterally or in only their best interests, the ventures fail.

Case 6.4 Fast Retailing and Lotte

Japan's Fast Retailing is best known by its iconic brands: UNIQLO, g.u., Theory, Comptoir des Cotonniers, Princesse tam tam, and Helmut Lang. They operate over 2,200 retail outlets throughout the world with roughly half in their native Japan and half internationally, which is even more notable considering they first expanded internationally only ten years ago. They have chosen to expand internationally through a variety of means including acquisition and joint venture. The most notable acquisitions include Comptoir des Cotonniers and Princesse tam tam in France and Theory in the United States. Interestingly, Fast Retailing took a minority stake in Theory in 2004 before assuming full control in 2009. This staged equity approach gave Fast Retailing considerable knowledge of Theory before acquiring the business outright and is not an uncommon approach for Japanese globalizers.

Fast Retailing chose joint venture as their route into the fast-growing and lucrative South Korean market. Partnering seemed the option most likely to generate success as Fast Retailing could then enter the market as a "local retailer." Fast Retailing chose South Korean giant, Lotte, as their joint venture partner. Lotte, one of the world's leading retail developers with an annual turnover of over $45 billion, was a natural choice. Lotte operates a series of joint ventures and is comfortable using this format. In fact, they have a very successful joint venture arrangement with another survey participant, IMAX. In addition, their premier retail spaces made them a natural candidate.

Prior to the joint venture's inception, considerable effort was expended at a senior management level in order to build a positive platform. Talks between senior management teams were extensive, and to this day they continue to meet face-to-face on a quarterly basis at the highest levels of the respective organizations. It is the senior management's deep commitment that, Fast Retailing management feels, continues to support the venture's ongoing success. In addition, Lotte sent three management candidates to Japan to undergo intensive training at Fast Retailing as well as working for three months in their retail operations. From this, Lotte management understood Fast Retailing's unique culture and ways of working. It also solidified a deep foundation of mutual trust and commitment in both parties.

The joint venture was established with a 51/49 percent ownership structure with Fast Retailing having nominal control. What developed was an organizational structure and culture of mutual trust and benefit. The senior position is shared by joint chief executives, one from each partner company. The joint venture also enjoys the full support and commitment from the senior leadership of both companies, a characteristic that Fast Retailing's senior management feels

contributes significantly to the venture's continuing overall success. From this has developed a win–win relationship—Lotte gets excellent tenants and Fast Retailing gets the local brand recognition and top locations. The glue that binds the relationship together is trust, as a senior executive at Fast Retailing added, "We are open to discuss everything [with Lotte] and judge everything based on mutual trust ... we have been in a good relationship with each other for a long time. We had mutual understanding before launching the JV." It is a trust built over years of mutual respect and support.

This case highlights the importance of mutual trust in successful joint ventures. In the joint ventures analyzed, the ventures' successes relied on a win–win situation that can only be built upon a platform of mutual trust. Exploitative relationships may work for a period of time but ultimately break down when the relationships become too lopsided in terms of benefit. The key to mutual trust is deep partner knowledge and cultural understanding built on extensive and ongoing communication and expectation management. Face-to-face interactions only solidify trust and commitment and ensure communication accuracy.

7 Mergers and Acquisitions

Introduction

When in doubt, acquire. That seems to be the mantra for most internationalizers. Acquisitions are the cornerstone of any expansionist strategy. They do not, however, provide all the answers in every circumstance. There are situations where acquisitions are the appropriate vehicle for growth, but they come with their own inherent risks: picking the wrong target, management's time in sourcing and in post-acquisition implementation, to say nothing of purchase price and associated premium. Most research puts the chances of successful acquiring at roughly 50 percent with cross-border transactions being even lower. Yet, as will be seen, acquisition remains the entry mode of choice. Acquisition strategy, reasons for acquiring, and key success factors and issues will be discussed in this chapter as will the related research.

The reasons for pursuing acquisitions are similar to those of strategic alliances—fast entry into a market and a need for intimate market knowledge; the difference is the level of control being exercised by the parent company. In the case of acquisition, it is total. In those cases where less than full ownership is taken, or where the local jurisdiction requires an indigenous company to retain a minority shareholding of the operation, the position is that of a shareholding, discussed in Chapter 6.

Methods of expansion and reasons for acquiring

Survey participants were asked whether they considered other methods if they acquired in a region. Over 60 percent said they did not. When asked why they chose acquisition, they gave a variety of answers. Surprisingly, control didn't feature prominently especially in light of their comments regarding joint ventures; instead speed (23 percent) was the dominant factor. Several participants (18 percent) indicated that the opportunity of an excellent target presented itself and the transaction was opportunistic while 15 percent considered all options before deciding that acquisition was appropriate for that market. Twelve percent indicated that they wanted to acquire a significantly sized presence in that country and the only way to do that was through acquisition, while just under 10 percent wanted to acquire a specific resource and acquisition was the most direct route. Finally, 15 percent said they made