Hubbard, N. (2013). Chapter 5: *Nonequity Modes of Investment* (pp.59-71)

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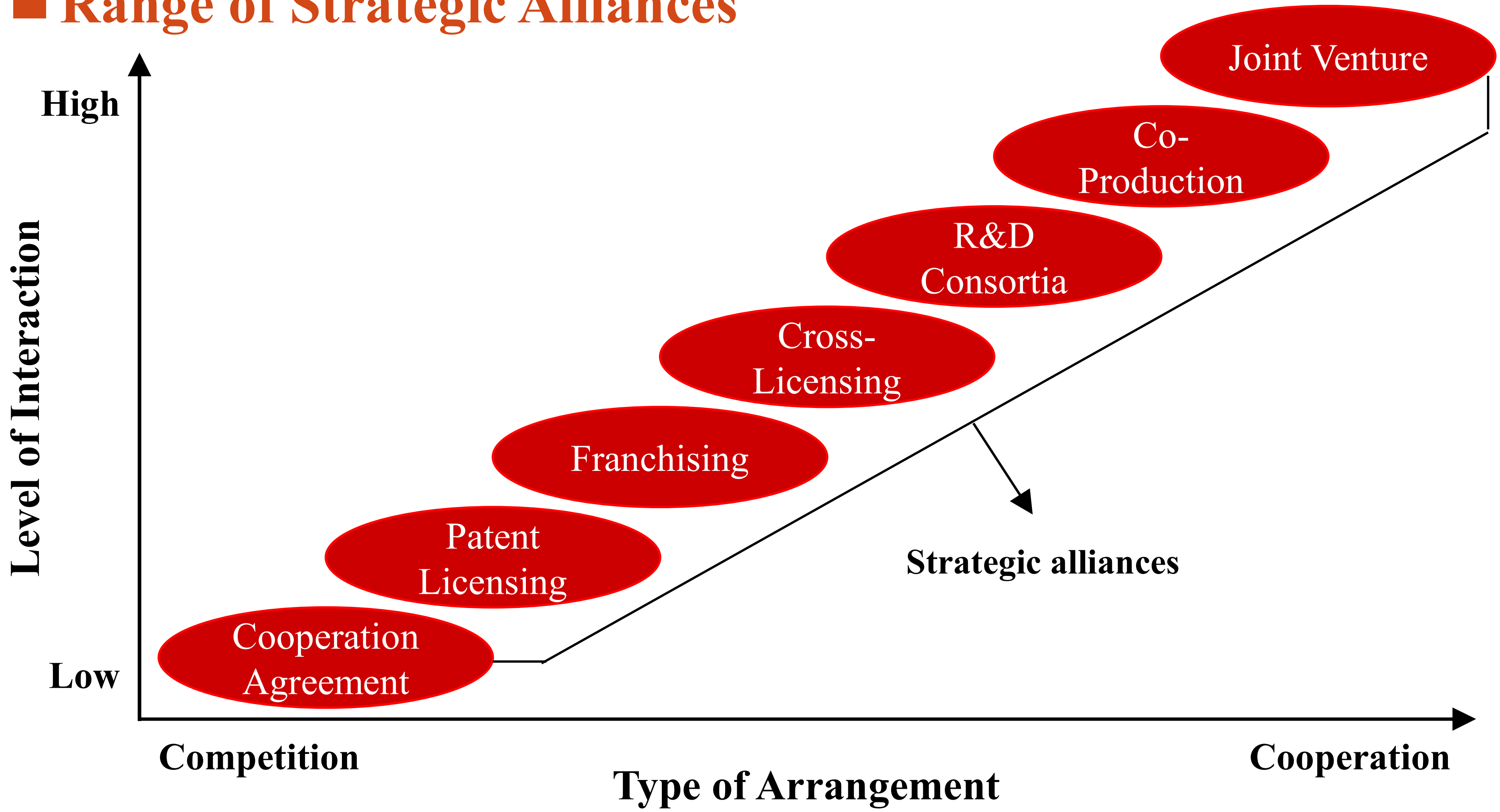
■ Opening Question

What are strategic alliances?

General Strategic Alliance Research

Range of Strategic Alliances



Source: Johanson & Vahlne (1977).

Why Companies Enter Collaborative Strategic Alliances?

Country's Economic Status		Low	High
	Developed	☐ Access to established brands. ☐ Access to technology. ☐ **Access & learn about the local market**.	☐ Share costs (*e.g.*, R&D). ☐ **Enter restricted market**. ☐ Gain access to market with reduced risk exposure.
	Emerging	☐ Lower-cost manufacturing center. ☐ **Market access.** ☐ "Replace" internally lacking resources.	☐ Government requirement. ☐ **Access to domestic market**. ☐ Access to cheap manufacturing. ☐ Reduce uncertainty.

Stage of Globalizer's Development

Source: Hubbard (2013: 60).

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Types of Nonequity Investments

❖ Top-Line Growth Alliances

- To increase sales by **entering a previously untapped market & with the assistance of another organization**.
- A commonly used vehicle is the **co-marketing alliance**.

❖ Cost-Savings Alliances

- An organization seeks a strategic partner from whom they **can source lower-cost manufacturing product** to focus on their supplier chain.
- **Nike:** The lack of its control over working conditions at some locations.

❖ Outsourcing of Non-Essential Business Activities

- Outsourcing occurs when one organization has another firm perform its **non-critical business activities**, including **payroll**, **call centers,** & **logistics**.
- **Outsourcing** vs. **offshoring** (*i.e.*, Business activities are performed overseas.)

Case Analysis

■ Nike

❖ **HOW** did Nike deal with the dark side of nonequity investments?

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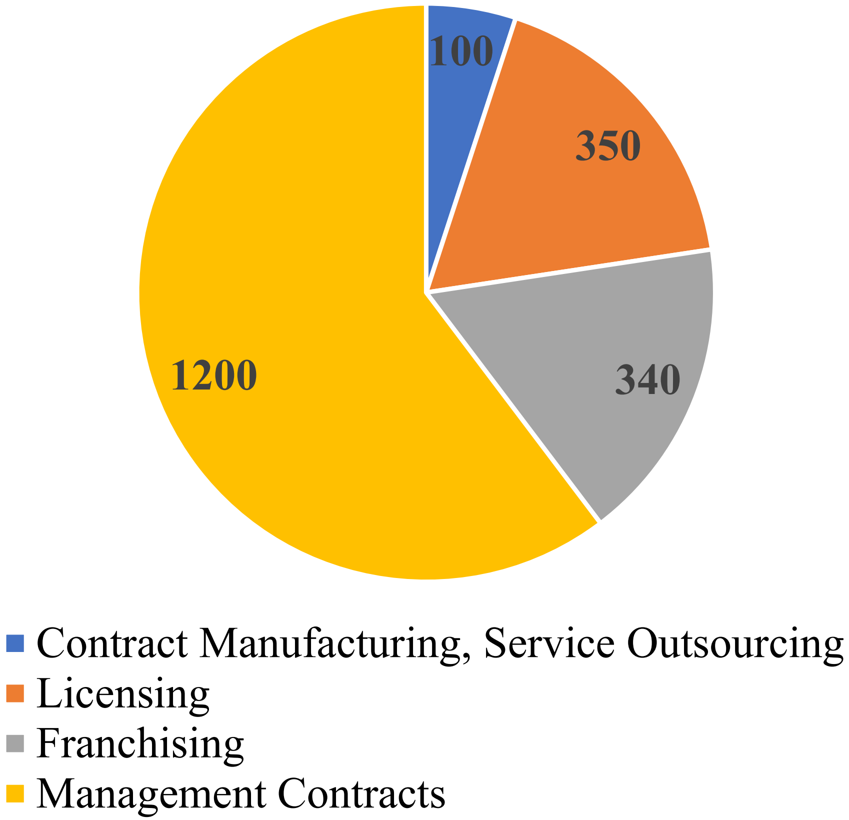
■ Estimated Non-Equity Modes of Investment in 2009 (Sales in US$ Billion)



Source: Hubbard (2013: 60); **original source:** UNCTAD (2011).

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■ Management Contracts

- ❖Foreign management contracts are used primarily when **the foreign company** can **manage better** than the owners.
- ❖Contracts usually cover **3-5 years**, & **fixed fees**.
- ❖The British Airport Authority (BAA) has contracts to manage **airports** in Indianapolis (US), Naples (ITA), & Melbourne (AUS).

■ Turnkey Operations

- ❖… are most commonly performed by **industrial-equipment, construction**, & **consulting companies**.
- ❖… are often performed **for a governmental agency**.

【Example 1】 Bechtel (U.S.) built a semiconductor plant for Motorola in China & a pipeline for BP in Algeria.

【Example 2】 China State Engineering & Shanghai Construction Group have worked on a subway in Iran, railway line in Nigeria etc.

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■ Cost-Reducing Nonequity Alliances

❖ Benefits of Using Emerging MNCs

- **A significantly lower degree of risk** in terms of legal liability, market & political risk when selecting emerging world partners (Doh & Stumpf, 2005).
- **Lower up-front & working capital costs** as they are usually generated by the emerging world partner (Peng, 2000).
- The great benefit of an emerging world partner relationship is the **flexibility** the relationship provides the globalizer in terms of the **ability to terminate** the relationship or **change locations** with much reduced costs other than opportunity costs.
- If the cost base of the globalizing partner rises, the globalizer has the **ability to search out another partner** either in the same or a complementary geography.

Cost-Reducing Nonequity Alliances

Risks of Using Emerging MNCs

- The quality of the emerging MNCs' service or product has a direct impact on the globalizer with whom it partners – **poor services or workmanship** can **negatively affect** the perception of **the globalizer's image**.
- **The risk of coordination (↑)** = Globalizers make **many alliances**.
- The globalizer is put in the **increasingly difficult position of being responsible for their alliance partners' behaviors** in ensuring those businesses operate in just & socially acceptable means while not actually having operational control over them.
- The biggest risk of relinquishing control over any part of an organization to an overseas entity is to **fail to protect its core competency**.

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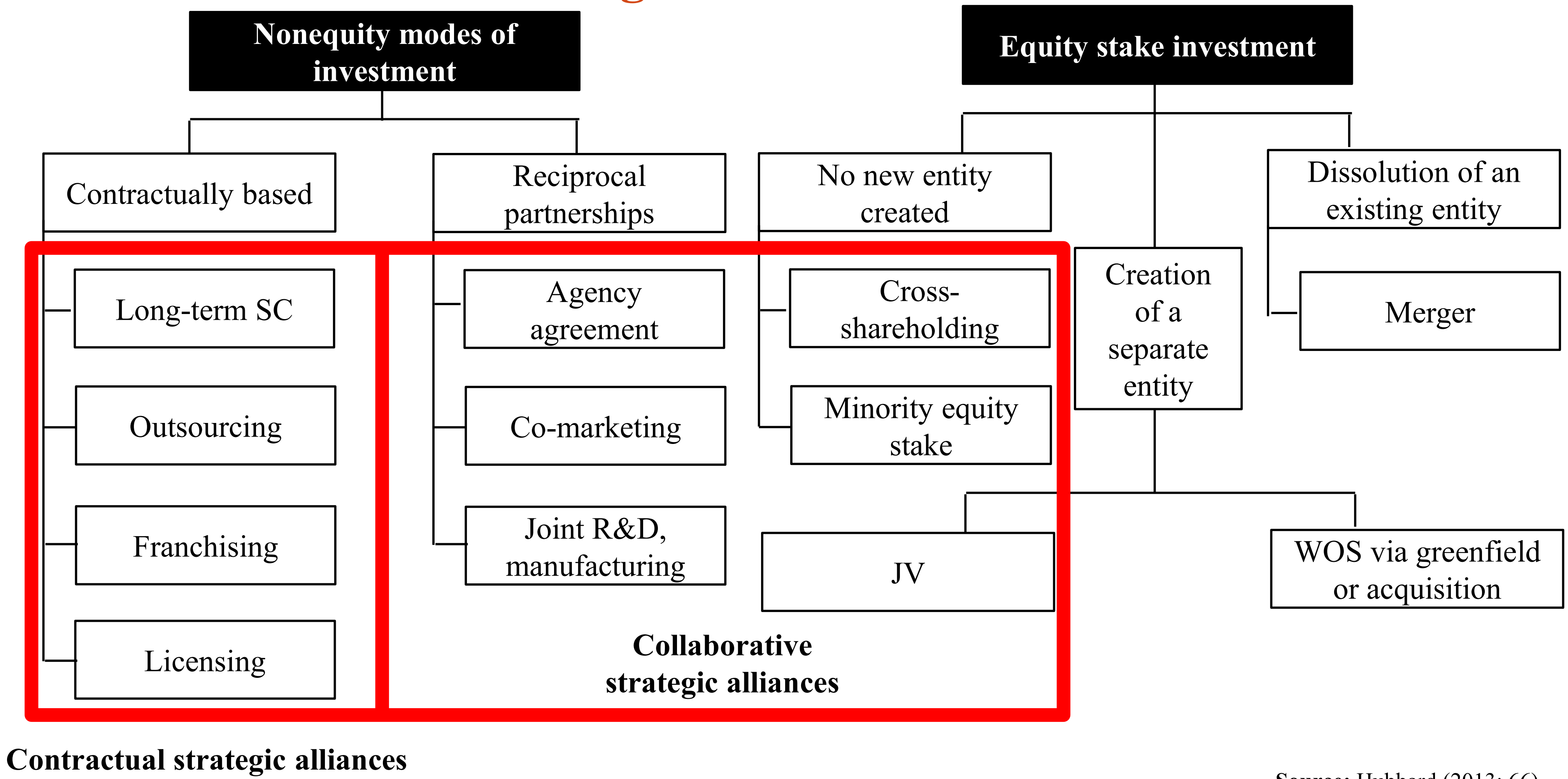
Differences in Strategic Alliances



Source: Hubbard (2013: 66).

Conclusive Remarks

Summary

- **What are Strategic Alliances?**
  - It is **not easy to reach an agreed definition** that nonetheless understand viable options for success.
  - Some companies enter into alliances simply to **acquire the resources** they do not have internally to support their expansion plans.
- **Contractual vs. Collaborative Alliances**
  - **Contractual alliances:** Licensing, outsourcing, franchising etc.
  - **Collaborative alliances:** Co-marketing, joint R&D, JVs etc.
- **What Make Strategic Alliances Successful?**
  - **Long-standing relationships** built on years of **mutual objectives & common ways of working**.
  - **Share risks & resources**.

Hubbard, N. (2013). Chapter 6: *Equity Investment Alliances & Joint Ventures* (pp.72-96)

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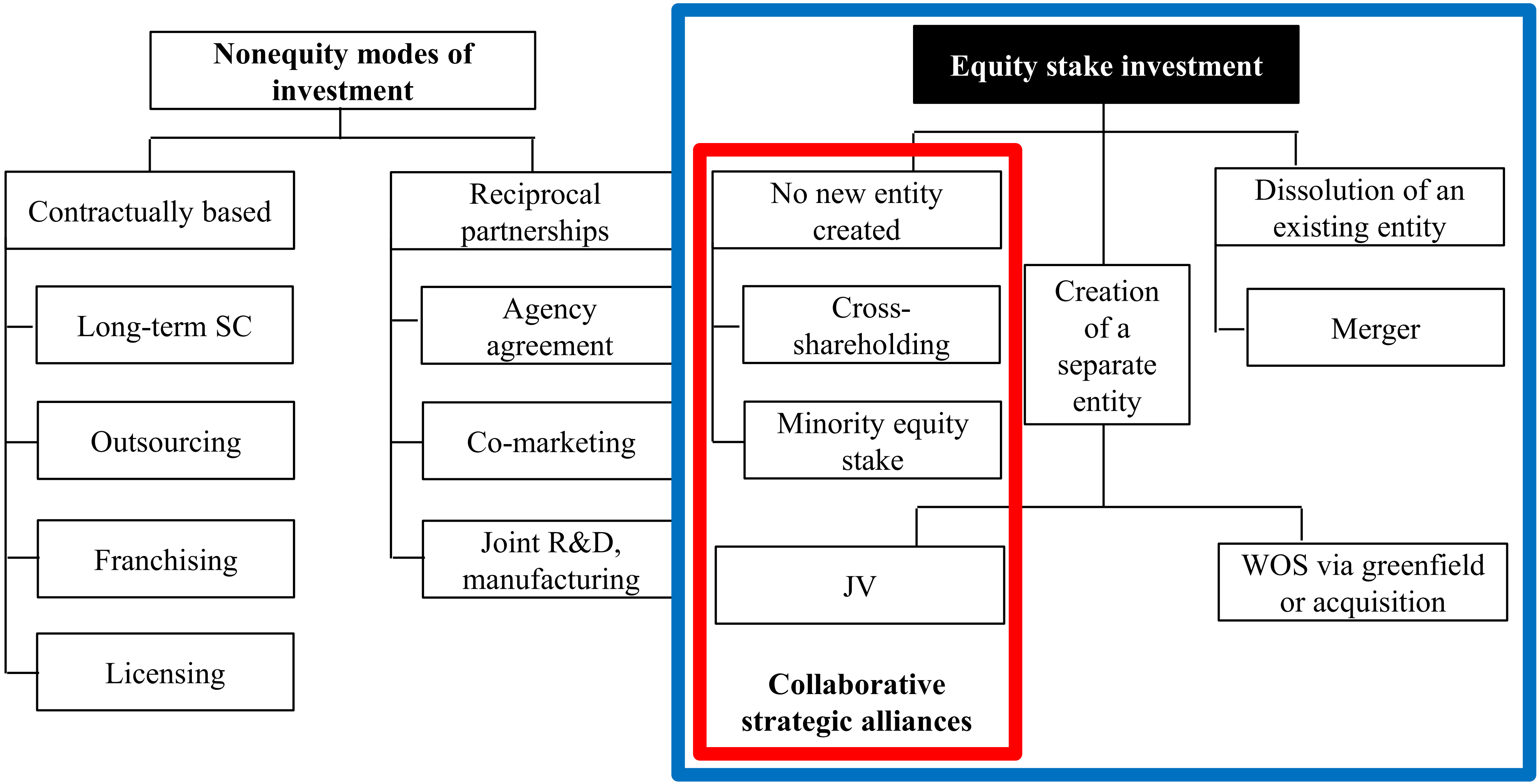
Introduction



Source: Hubbard (2013: 66).

Introduction

■ Collaborative Strategic Alliances: Equity Investments

❖ Cross-Shareholdings & 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 & institutions** controlling **a significant amount of the countries' commerce**.

❖ Minority Equity Stakes

– Equity stakes offer an organization the opportunity to **enter a market without the financial cost of a full acquisition**.

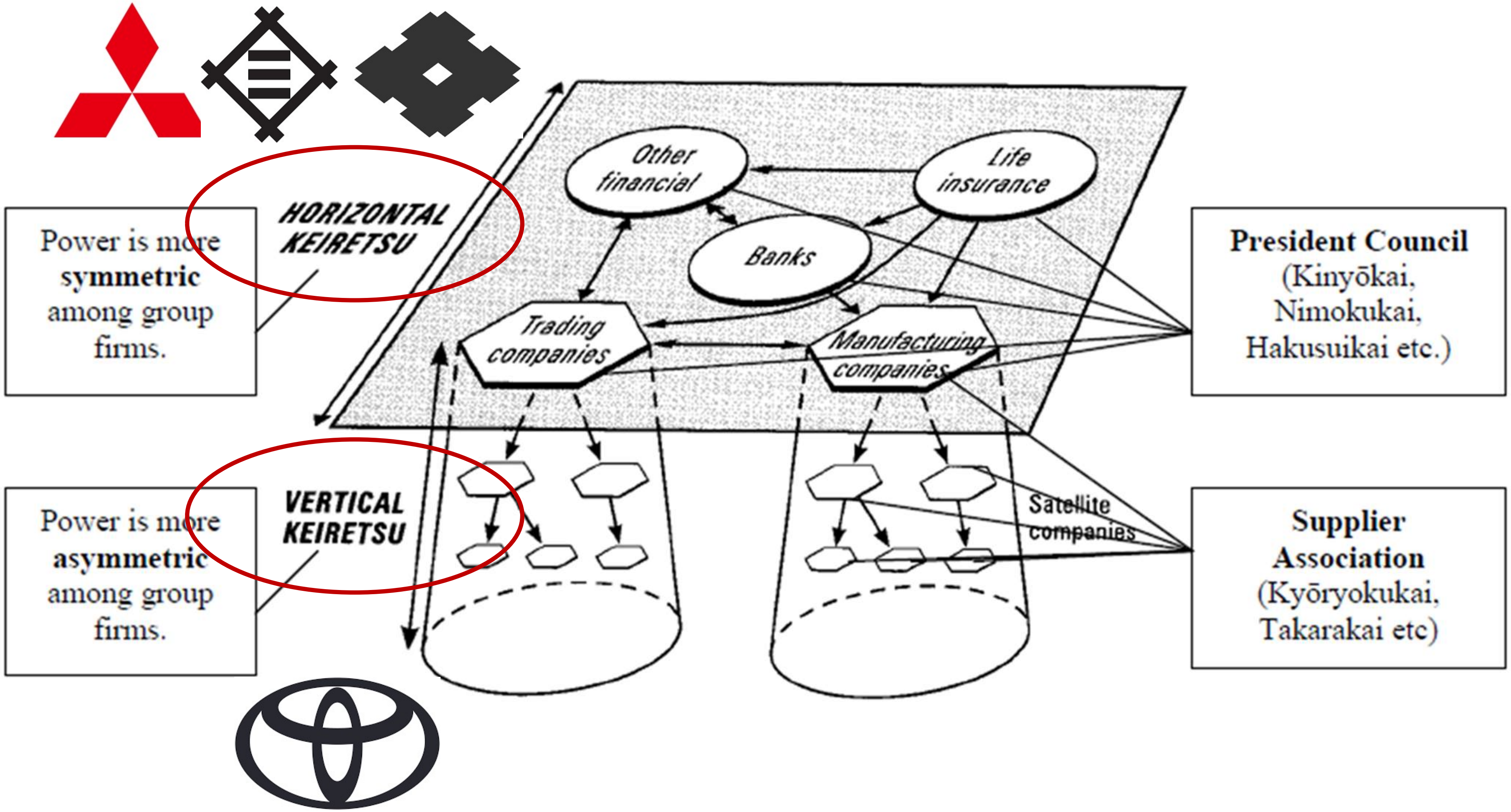
❖ Joint Ventures

– JVs are those collaborations where **two or more parties** invest in **a new entity** with each party contributing both tangible & intangible resources.

– JVs are also **a subset of strategic alliances**, & in fact the most collaborative type, in that assets from all parties are **merged together** in order to form the new entity.

Cross-Shareholdings & Business Groups

■ Japan - *Keiretsu* (系列) Network



Source: Own modification based on Dicken (1998, Figure 7.10: 224).

Cross-Shareholdings & Business Groups

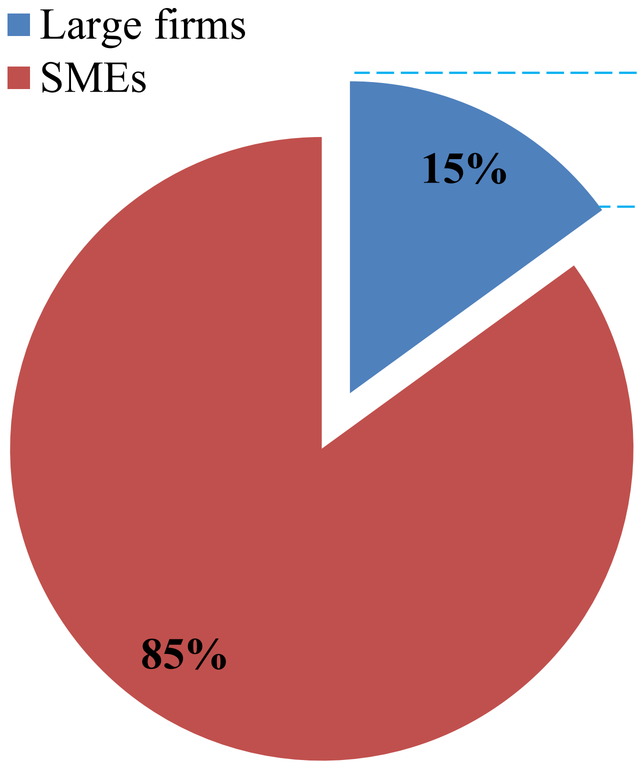
Benefits/Costs of Vertical *Keiretsu* Networks?

	Car Assembler	Car Parts Suppliers
Benefits	1. well-established supplier relations 2. dissemination of corporate identity 3. less opportunistic risks 4. streamlined organization by externalization of various operations 5. production flexibility and adjustment	1. upgrading of technical capabilities and managerial know-how 2. a high degree of sales and demand stability 3. effective communication and coordination in product development 4. long-term contract
Costs	1. pressure from foreign competitors 2. slow technological innovation 3. financial burden to assist own suppliers 4. cost rigidity	1. less independence 2. dependence on specific car assemblers 3. less adaptable to market environments 4. managerial and operational control by car assemblers 5. less opportunities to learn

Source: Own illustration based on Tabeta (1998), Gerlach (1992), & Lincoln & Gerlach (2004).

Cross-Shareholdings & Business Groups

■ Overview of the Korean Economy



Business groups (*Chaebols*)

> *Chaebols* dominate the export oriented industries & possess international competitiveness.
> SMEs (are focused on domestic business activities.

Cross-Shareholdings & Business Groups

Chaebol

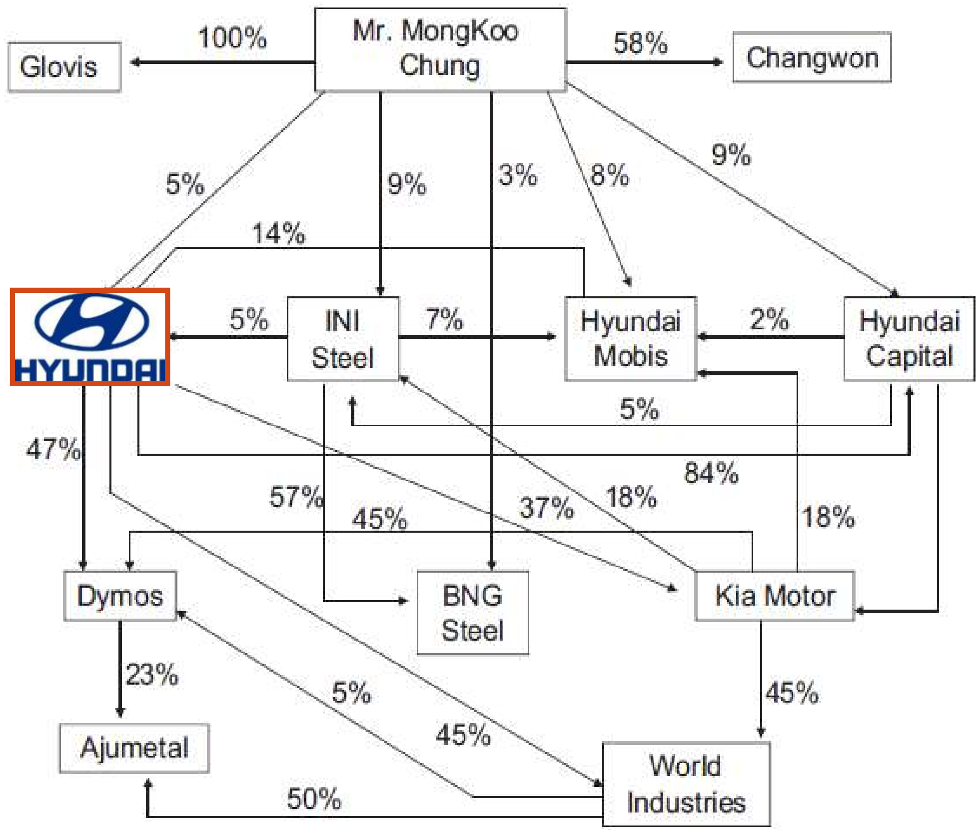
Chaebol		*[A] Founders (Years)*	*[B] Current Chair (Years)*	*Relationship of B to A*
Samsung		Lee Byung-Chull (1938-1987)	Lee Kun-Hee (1987 - present)	Son
Hyundai		Chung Ju-Yung (1947-1987)	Chung Mong Koo (2000 - present)	Son
LG		Koo In-Hoe (1931-1969)	Koo Bon-Moo (1995 - present)	Grandson
Daewoo		Kim Woo-Choong (1967-1999)		
SK		Choi Jong-Keun (1953-1973)	Chey Tae-Won (1998 - present)	Son

Cross-Shareholdings & Business Groups

■ The Business System

- ❖The great strength of the *chaebol* has come from the **ambitions & the vision of the owners** who ran them.
- ❖The **government** invests to back the *chaebol*.
- ❖Such concentration of power does bring great capacity to **inspire creativity** & to **respond to change**.

Ownership Structure of **Hyundai Motors** in 2004



Source: Almeida et al. (2011: 453) in *Journal of Financial Economics*.

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Minority Equity Stakes

The Industrial & Commercial Bank of China (ICBC)

❖ICBC Took 20% the Stake in South Africa's Standard Bank.

- It cost ICBC **US$5.5 billion**.
- Not only was the **2011 transaction the largest FDI into South Africa**, it was the largest overseas transaction by a Chinese bank.
- 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% to ICBC** giving it the largest Chinese bank presence in **South America**.
- In sum, ICBC **gets 2 continents** of **market-leading coverage without utilizing excessive amounts of scarce management resources**.

Joint Ventures

■ Collaborative Strategic Alliances: Equity Investments

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Joint Ventures

■ The Logic of Entering in a JV in China:

❖ What Do Developed Market Firms Look for?

- Market knowledge;
- Unique competencies/special skills from the partner;
- Industrial attractiveness;
- Previous alliance experiences; &
- Political connections.

❖ What Do Chinese Firms Look for?

- Technological capabilities;
- Intangible assets (*e.g.*, patents, copy rights, knowhow, knowledge etc.);
- Financial assets; &
- Capability for quality.

Source: Hitt et al. (2000); Hubbard (2013)

Joint Ventures

Hubbard's (2013) Survey

The '4' Major Reasons for Engaging with JV Projects

I. Strict **government restrictions** (particularly, in many emerging economies);

II. To **secure a partner** who understood **local culture, politics, & distribution** to market;

III. To gain **expertise in that region**; &

IV. The **availability of a good candidate** to partner.

A "Defensive" JV Objective

– Foreign MNCs **get rid of a competitor by partnering rather competing**.

– "*The local players were very strong & was decided it was too resource heavy to try & compete with them head-to-head in a market that was, frankly, not significant for us. Joint venture was the more opportunistic answer*".

Source: Hubbard (2013).

Joint Ventures

■ Due Diligence

❖ WHAT Questions Should be Asked?

- **WHAT** is the ultimate goal for the venture? Is it permanent or short measure? Is it location specific? Industry specific?
- **WHAT** is the time frame for its setup & milestones?
- **WHAT** is success being measured upon (*e.g.*, financial, knowledge transfer, full employment)?
- **WHICH** resources should be both used?
- **WHAT** are the time frames of resource commitment?
- **HOW** is information going to be shared?
- **HOW** are interests to be protected? **WHAT** controls are in place to ensure compliance?

Source: Hubbard (2013).

Joint Ventures

■ Key Success Factors in JVs

Source: Hubbard (2013: 77).

Joint Ventures

Key Success Factors in JVs

Strategic Objectives

- **Clearly agreed & articulated strategic objectives** are important to successful JV performance.
- The **misunderstanding** likely exists between MNCs & their partners that the former focus on the **long-term strategic objectives** whilst the latter focus on the **immediate opportunities** at hand.
- **Corporate objectives change** over time !

  "*[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 1, we move down the road a decade that's <u>unlikely to still be the same picture I had in view 10 years earlier</u>.*"

Key Success Factors in JVs

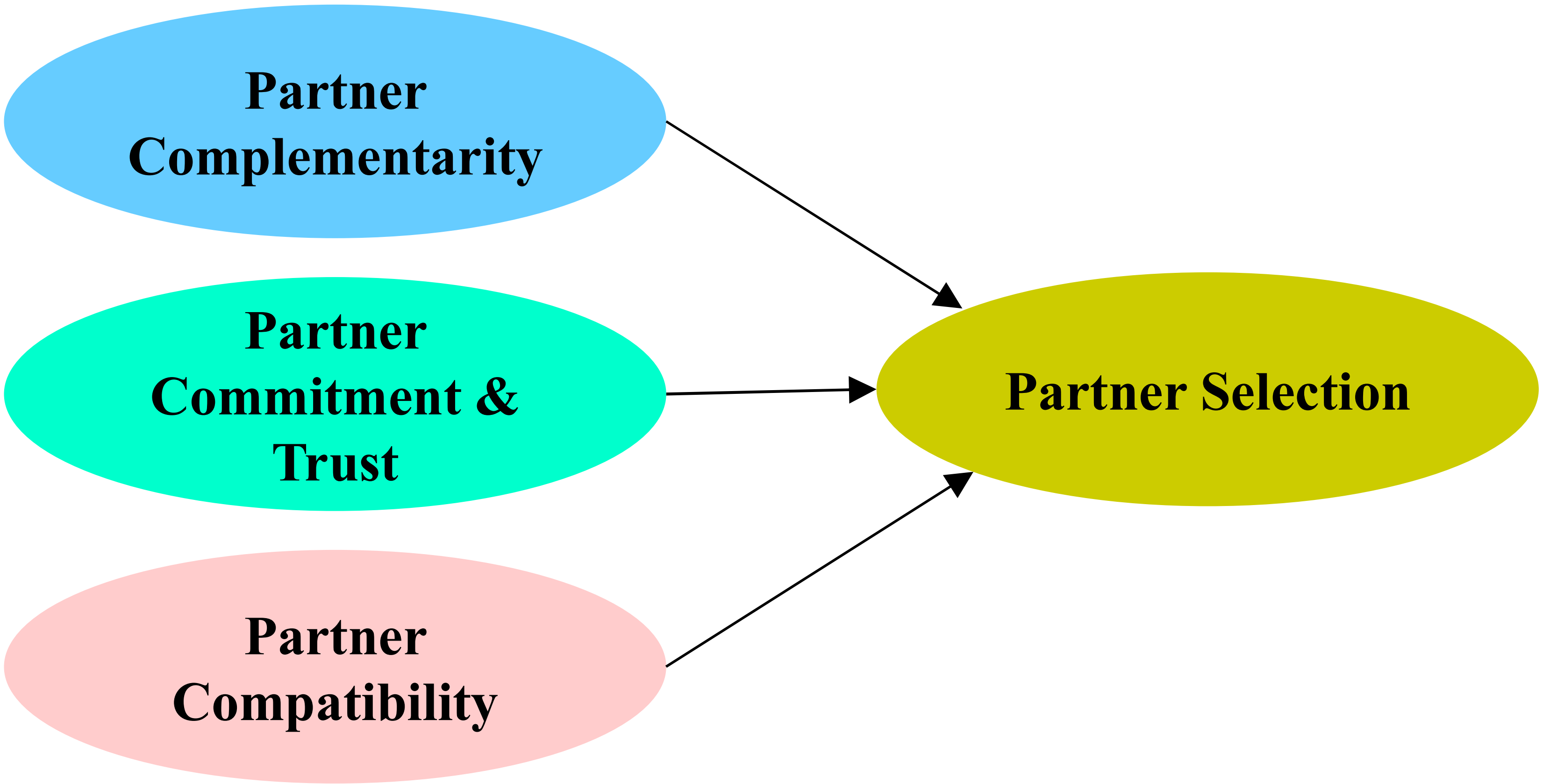
Level of Venture Control & Ownership

- The **distinction** between **control** & **ownership** !
- **Control** is the amount of influence the various partners have in the operational, managerial, & strategic direction of the JV.
- **Dominant parent structures** are those in which the JV 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.
- According to Hubbard (2013), **dominant parent structure** is by far the preferred control level.
- The **level of control** highly depends on **the development of the country** (Control matters when investing in the developing market due to the issue of corporate governance).

Joint Ventures

■ Key Success Factors in JVs

❖ Partner Selection

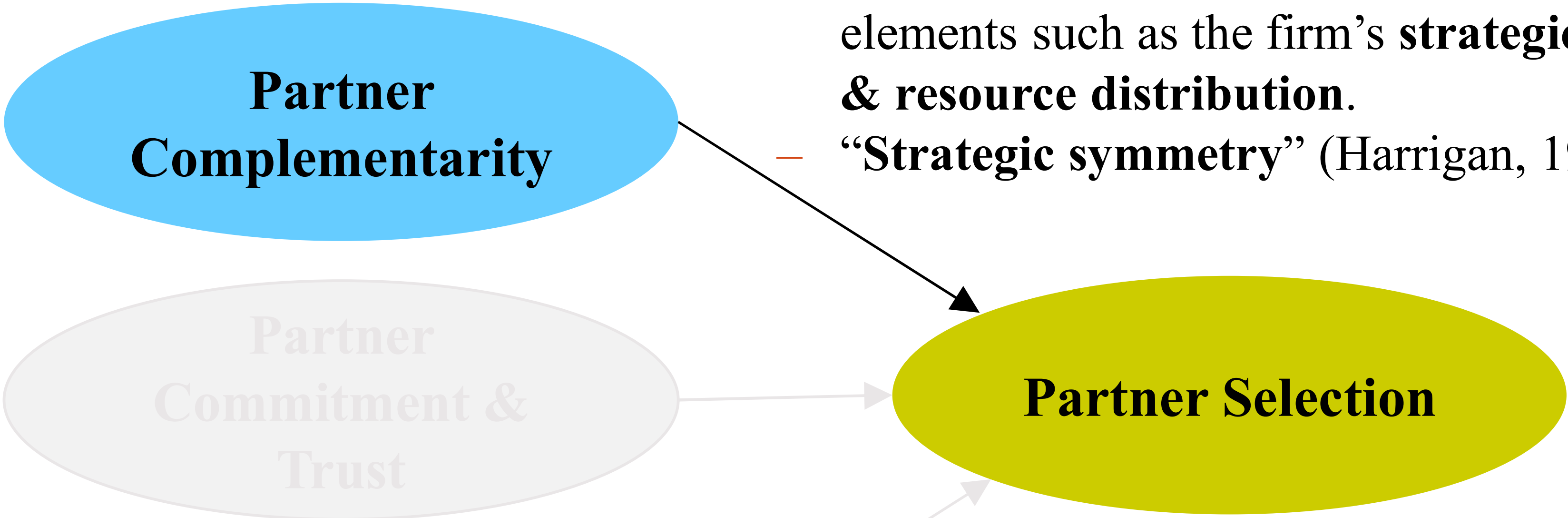


Source: : Instructor's illustration based on Hubbard (2013).

Joint Ventures

Key Success Factors in JVs

❖ Partner Selection



KEY POINTS

– **Partner complementarity** can include elements such as the firm's **strategic fit & resource distribution**.
– "**Strategic symmetry**" (Harrigan, 1988)

KEY POINTS

– In JV projects, MNCs provide **complementary skills** (*e.g.*, technology, product, reputation, & branding) while the host-country organizations provide **local knowledge & distribution channels**.

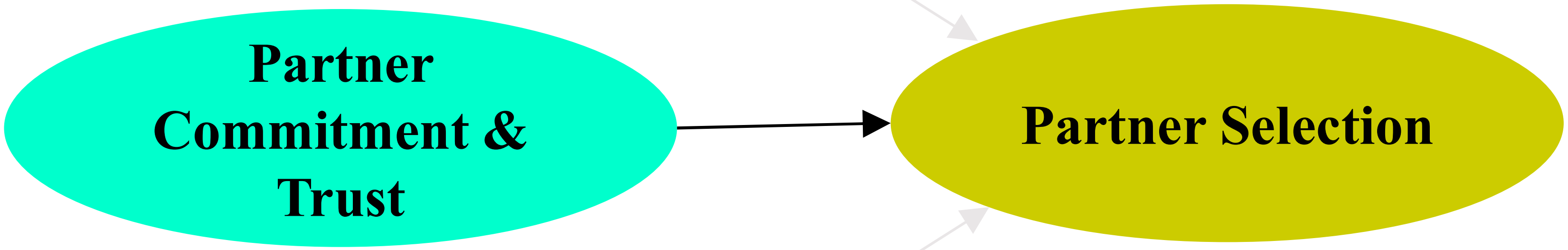
Source: : Instructor's illustration based on Hubbard (2013).

■ Key Success Factors in JVs

❖ Partner Selection

KEY POINTS

– **Partner commitment** can be defined "*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 & Singh, 2009: 47)



KEY POINTS

– **Mutual trust** is formed over periods of time in which parties' expectations are met in **a realistic & timely manner** through **credible communication** (Hubbard, 1999).

Source: : Instructor's illustration based on Hubbard (2013).

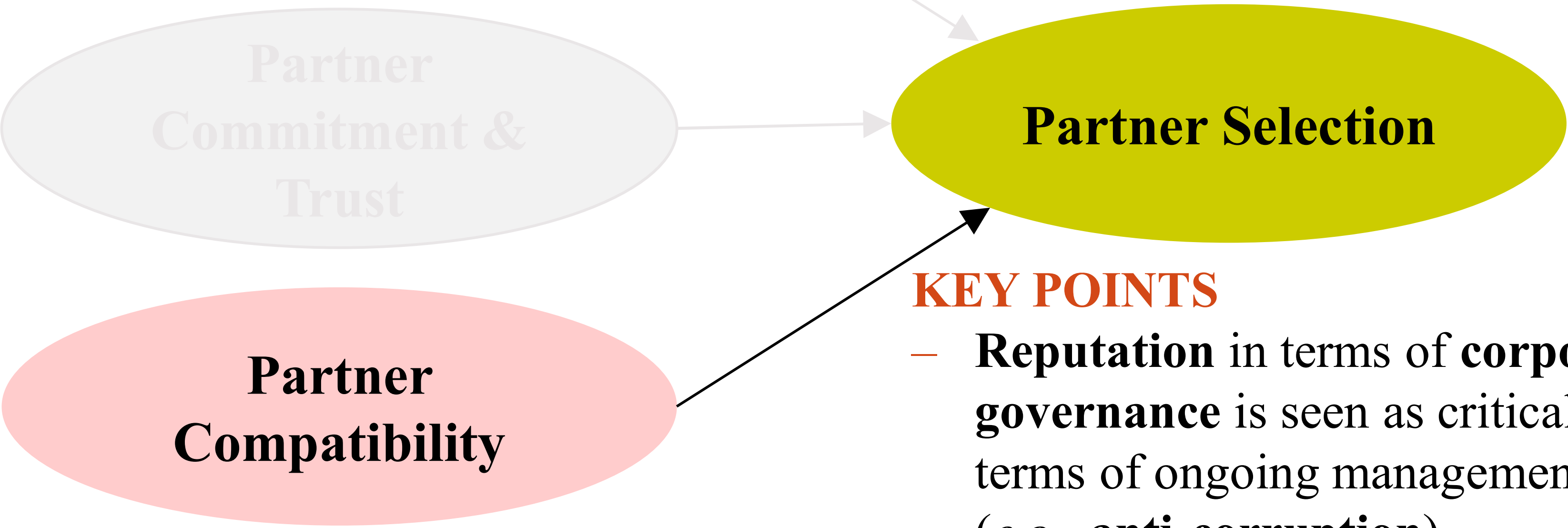
Joint Ventures

■ Key Success Factors in JVs

❖ Partner Selection

KEY POINTS

- **Compatibility** includes (1) cultural fit, (2) management style, (3) reputation, & (4) experience.
- **Organizational fit** is seen more important than country fit.



KEY POINTS

- **Reputation** in terms of **corporate governance** is seen as critical in terms of ongoing management (*e.g.*, **anti-corruption**)

Source: : Instructor's illustration based on Hubbard (2013).

Future Trends in Strategic Alliances

■ '4' Major Trends

❖ Project-Based Ventures

– **JVs** are formed for **a time-specific, short-term projects**.

❖ The Partnering of Non-Traditional Partners

– **MNCs** often cooperate with **NGOs**.

❖ Virtual Ventures

– The **virtual venture** is sort of strategic alliances where **small firms set up teams of skills without forming a JV**.

❖ More Complexity in Strategic Alliances

– Even after having a centralized team involved in managing numerous alliance initiatives, they fail at times to capture & coordinate all the relationships as **their global conditions change so rapidly**.

Source: Hubbard (2013).

Reading Assignments

■ Reading Assignments (For 01.03.2024 Friday)

❖ Antecedents of Firm Internationalization

- **Boustanifar, H., Zajac, E. J., & Zilja, F.** (2021). "Taking Chances? The Effect of CEO Risk Propensity on Firms' Risky Internationalization Decisions.", *Journal of International Business Studies*, 1-24.
- **Rubén Fernández-Ortiz & Guadalupe Fuentes Lombardo** (2009). "Influence of the Capacities of Top Management on the Internationalization of SMEs.", *Entrepreneurship & Regional Development*, 21(2), 131-154.
- **Matta, E., & Beamish, P. W.** (2008). "The Accentuated CEO Career Horizon Problem: Evidence from International Acquisitions.", *Strategic Management Journal*, 29(7), 683-700.