Joint Ventures in the Face of Global Competition

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THIS ARTICLE PRESENTS A FRAMEWORK that helps managers decide when to use a joint venture to do business abroad. It recommends a joint venture when a firm needs to expand its capabilities to compete successfully, but not when it will merely exploit an existing advantage. A joint venture is also not recommended when there are potential conflicts of interest between the partners. If a firm prefers whole ownership but host government policies restrict foreign ownership, some multinational corporations prefer not to invest, but managers can often bargain for exceptions to restrictive policies. A firm is usually in a strong bargaining position if it brings advanced technology or is willing to make major investments. Governments tend to have the upper hand if they control access to an attractive domestic market. *Ed.*

AMERICAN FIRMS seem to have discovered a new strategy for competing abroad: joint ventures. Until a decade ago, many U.S. multinational companies (MNCs) shunned joint ventures, arguing that shared ownership led to loss of control and profits. As one General Motors executive put it, "If it was worth doing, it was worth getting all the benefits." In search of ways to bolster their global competitive advantages, these same firms are now finding new merits in joint ventures. (Let us define a joint venture as any affiliate of an MNC where the equity is partly owned by another firm, usually one from the host country. This definition excludes non-equity cooperative ventures, such as licensing.)

General Motors is a case in point. Until the early 1970s, it owned 100 percent of the equity in each of its subsidiaries abroad. By 1975, six of GM's forty foreign subsidiaries were owned jointly with another firm, usually one from the host country. Since then, twelve out of twenty of GM's new foreign subsidiaries have been joint ventures! In the United States itself, the company launched its joint venture with Toyota in 1983, a cornerstone of its strategy to expand its small-car offerings. GM's joint ventures in Korea (with Daewoo) and Japan (with Isuzu and Suzuki) are also important elements in this strategy.

General Motors is not alone in its new-found love for joint ventures. Evidence from industries as diverse as cosmetics and computers suggests that, after insisting on whole ownership abroad in the 1960s, U.S. multinationals began to use joint ventures more extensively in the early 1970s.[1] This trend seems to have accelerated in the early 1980s, to the point where one prominent international consultant claimed that "no company can stay competitive in the world today singlehandedly."[2] Among the U.S. firms forming major joint ventures abroad are Honeywell (with France's Bull and Japan's NEC), AT&T (with Italy's Olivetti and Holland's Philips), and Whirlpool (also with Philips). In addition, scores of firms have recently entered the Chinese or South Korean markets with joint ventures; these include Johnson & Johnson, Gillette, Heinz, Procter & Gamble, Corning Glass, W.R. Grace, Xerox, General Electric, Rohm & Haas, McCormick, and Allied-Signal.

Business leaders and researchers cite five main reasons for the rising popularity of joint ventures. First, the governments of many countries with attractive domestic markets—including China and South Korea—try to restrict foreign ownership. Second, many U.S. firms have found that host country partners could help them enter new markets quickly by providing management expertise and

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local connections.[3] Such help is particularly important because of the intensifying competition from European and Japanese carmakers, which is a third reason for U.S. firms' increasing use of joint ventures. These competitors are often willing to settle for joint ventures in host countries where U.S. firms have insisted on whole ownership.[4] Fourth, foreign firms, especially from Europe and Japan, have become more attractive joint venture partners for U.S. multinational corporations as their technological capabilities and market presence have grown. Finally, in many industries global scale is becoming a distinct advantage in R&D and production, leading all but the largest firms to consider joint ventures as a way to achieve such scale and share risks.[5]

Joint vs. Whole Ownership

This evidence suggests that joint ventures can be more useful in global competition than managers of U.S. multinational corporations thought just a decade ago. But does this mean that the old reasoning was wrong? By no means. Joint ventures still entail huge costs when used at the wrong time. The loss of control is real, as are the risks of creating new competitors, damaging the firm's reputation, and eroding its technological edge.

As a result of such costs, joint ventures are often unstable. GM and its South Korean partner Daewoo are blaming each other for the disappointing exports from their formerly promising joint venture. Disagreements between AT&T and its computer partner Olivetti have also made the pages of the business press. And a highly profitable joint venture between the chemical firms Hercules and Montedison was quietly dissolved when the latter bought the former's shares. These are not isolated cases. Empirical studies suggest that anywhere between one-third and two-thirds of joint ventures eventually break up.[6]

But why do so many firms enter into joint ventures that eventually cost them headaches and money? There are two explanations for instability in any joint venture. First, the partners simply made a mistake: they formed a joint venture when it may not have been the best thing to do, or they joined up with the wrong partner. Second, their initial decision was right, but conditions changed so that the joint venture was no longer useful.[7] In both cases, the joint venture form itself is not to blame. It is more likely that the process for deciding when to use joint or whole ownership was inadequate.

There is a time and a place for joint ventures in a firm's global strategy. Recognizing that time and place allows a firm's managers to avoid partnerships that end in costly divorces. It also allows them to evaluate from time to time, before serious disagreements arise, whether their joint ventures are still useful. This article presents a framework to help managers decide when a joint venture is appropriate, and when it is not.

Host Government Restrictions

But even when an MNC prefers to own all the equity in a subsidiary, it may not be able to do so. Governments of countries such as India, Mexico, China, and even France try to encourage joint ventures with local firms in a variety of ways. In China, for example, major sectors are reserved for local firms or joint ventures. The French government might use subtler ways to favor local firms and joint ventures, such as national standards and preferential procurement.

Does this mean that the MNC's choice between joint and whole ownership is irrelevant in these cases? No. All governments with restrictive ownership policies have, at one time or another, made exceptions for firms insisting on whole ownership. IBM, for instance, recently negotiated a wholly owned subsidiary in Mexico. Foreign investors in India, too, have found creative ways to respond to the government's demands; sometimes they retained management control of critical activities, while at other times they gained exceptions to the demand for shared equity.[8] In their efforts to attract foreign investors, the governments of South Korea, Venezuela, and even China are also softening their ownership restrictions.

Firms preferring whole ownership in such restrictive countries might thus be able to bargain for an exception. But not every MNC has the bargaining chips necessary to pull this off. My framework also helps managers identify the strengths and weaknesses of their firms in such negotiations.

Evidence from a variety of sources supports the guidelines presented below. I used statistical data collected at Harvard in the 1970s to identify when and why U.S. multinational corporations chose to use joint ventures in the past, and when they did not (see the Appendix).[9] The results of this analysis are consistent with studies based on recent, but more limited, data from researchers at Wharton.[10]

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I also interviewed more than forty international executives from five major global companies to understand the dilemmas they faced. I learned that many factors influenced the ownership decision, but that only the few discussed here were critical.

Deciding When to Use a Joint Venture

Assuming that managers are free to choose the ownership structure for a foreign venture, the decision should depend on their strategies for managing the firm's capabilities and geographic scope. The role of the venture in these strategies influences the *costs and benefits of joint as compared with whole ownership.*[11]

Expanding or Exploiting Capabilities

Whether a joint venture is appropriate depends on the capabilities and goals of the firm. In the GM-Toyota joint venture, each partner contributed in an area in which the other was weak. GM brought its U.S. distribution network to the deal, and Toyota brought its small-car designs and efficient manufacturing methods. Outside the U.S. market, too, GM's need for a low-cost manufacturing base for small cars led to its joint venture with Daewoo in Korea. This venture was to sell 200,000 compact cars in the United States through GM's Pontiac Division. For Daewoo, it was a way to compete against Hyundai in the U.S. market.

The joint venture between AT&T and Olivetti, too, was motivated by complementary capabilities of the two firms. AT&T had little experience doing business abroad, and wanted to sell its minicomputers in Europe. Olivetti, on the other hand, was relatively strong in Europe, but wanted to sell its personal computers in the United States. A similar combination of goals and capabilities brought together Honeywell, Bull, and NEC. The three companies had longstanding supply and licensing relationships, but decided in 1987 to integrate their computer operations further through a freestanding, jointly owned venture. NEC was to supply technology for high-end computers; Honeywell offered an extensive distribution network and customer base in the United States; and Bull was strong in midsize computers and in the French market.

• **Some Risks of Joint Ventures.** These strategies contrast strikingly with those of other firms I studied. Managers from both Gillette and Johnson & Johnson insist that joint ventures are anything but ideal, at least in their core businesses. Gillette's technological edge in making razor blades makes it unnecessary for them to cooperate with other firms. Furthermore, such cooperation might risk sacrificing the high quality standards for which Gillette blades are known worldwide. Gillette headquarters staff make sure subsidiaries maintain these standards by monitoring their raw material supplies, furnishing process equipment, and regularly spot checking final products. Joint venture partners would have little to add to this process and might dilute the control exercised from headquarters.

A commitment to quality and central control is also what drives Johnson & Johnson to shun joint ventures. J&J's business depends greatly on intangible assets such as trademarks, patents, and reputation. Sharing control of such assets with another firm might risk eroding these competitive advantages. For example, a local partner might cut corners to sell in markets where quality was not valued highly, and so hurt J&J's reputation in other areas. Royalty agreements could provide some protection in these areas, reported one executive, but 100 percent ownership provides the best assurance. This is another case where the MNC has little to gain, and much to lose, from a joint venture.

Even J&J, however, uses joint ventures in some situations. It entered the Japanese pharmaceuticals market with a joint venture, partly because of the presence of strong local competitors who had more experience in pharmaceuticals than did J&J. The company also turned to a joint venture to enter the French consumer products market, after failing with a wholly owned venture. French companies had well-established reputations and distribution networks in this market; J&J found that the only effective way to compete with them was to join them.

• **Ownership Tradeoffs: Capability.** These cases suggest that *a joint venture is more appropriate when the firm seeks to expand its capability into new fields, and less appropriate when it aims to exploit an existing competitive advantage.* In GM's joint ventures in Japan and Korea, AT&T's in European computers, and J&J's in French consumer products, a joint venture was used to expand the firm's capabilities through cooperation with a partner that had the needed know-how and market position. On the other hand, in their core businesses Gillette and J&J (and GM in the 1960s) merely exploited the competitive advantages that they already had.

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Usually a partnership was unnecessary—and in fact it could dilute the firm's advantages.

The competitive advantages of multinational corporations are typically based on their organizational know-how and skills, or on intangible assets such as patents, trademarks, and reputation. By their very nature, such advantages cannot be readily bought from outsiders, as is the case, for example, with machinery, labor, or raw materials.[12] But MNCs can acquire such advantages through a joint venture with another firm, which typically involves some transfer of personnel, provision of training and advice, and cooperative marketing and research. Joint ventures are thus more than just convenient financial vehicles for geographical expansion—indeed, they may be costly mistakes where that is their only rationale. Rather, successful joint ventures are arrangements to acquire capabilities and assets that cannot be purchased through arm's-length transactions.

The examples cited above also illustrate the importance of choosing the right joint venture partner. In each case, the U.S. firm chose a partner that could complement its capabilities—one that was strong in precisely those areas in which the U.S. firm was weak. In this sense, the first criterion for choosing a partner is that the firms be different. The potential for joint gains is greater the more *dissimilar* the partners. But it is also important that their goals be compatible, as discussed in the next section.

My statistical analyses supported these conclusions. I found that U.S. MNCs were less likely to form joint ventures in their core business than in fields in which they had less experience. Similarly, those with extensive experience abroad were less likely to form joint ventures than others, and all seemed to prefer whole ownership in countries with which they were relatively familiar. Firms in businesses that depended on intangible assets such as proprietary technical know-how and product image were particularly unlikely to form joint ventures, as these advantages could be eroded by a misbehaving partner. The case data suggests, however, that local firms can sometimes add to an MNC's local market image when they have established brands and distribution networks.

And even in industries where proprietary technical know-how was important, those firms that needed to *acquire* technology to compete effectively often used joint ventures to do so. Thus high-technology firms exhibited two extreme behaviors: either they were dead set against joint ventures or else they found these arrangements critical to success. Until recently IBM took the former position; firms like Honeywell and AT&T now argue the latter. Which side of the debate these high-technology firms are on depends, once again, on whether they are exploiting or expanding their technological capabilities.

Global or Local Scope

The cases discussed above begin to illustrate another factor important to the choice of ownership structure. In insisting on wholly owned subsidiaries, both Johnson & Johnson and Gillette were concerned with the effect of the joint venture on their *global strategies*. Both maintained global quality standards that upheld their image and reputation worldwide. The risk of a joint venture stemmed from the fact that the partner, often a local firm, was concerned only with *local strategies*, where lower standards might suffice.

This is one specific illustration—probably the most important one—of the old adage that partners in a joint venture need to have compatible goals. That is a second criterion in selecting a partner. In contrast with the condition about complementary capabilities, here the greater the *similarity* between the partners, the lower the likelihood of conflicts. Of course, the geographic scopes of no two firms are alike, especially not those of multinational corporations and local partners. But the goals that each has for the joint venture should be alike, which can often be the case for MNCs following multidomestic, rather than global, strategies.[13]

• **Ownership Tradeoffs: Scope.** The potential for conflict between an MNC's global strategy and a host country partner's more localized concerns appears in many forms. Firms pursuing a global strategy often incur costs in one location to benefit their operations elsewhere.[14] Local profits in such cases are secondary to global profits. But a local partner would, of course, be concerned only with local profitability, and so would try to block policies that represented net costs to the joint venture but net benefits to the MNC. This suggests that *joint ownership with a local firm may not be appropriate for ventures that are to be integrated into the MNC's global strategy.*

IBM followed this rule religiously in the 1960s and 1970s. Originally, IBM had managed its six plants in Europe independently of each other, as

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each served a local market. In the early 1960s the firm decided to merge them and manage them as parts of an integrated regional system. Products and components were traded among the plants, and all followed similar marketing and product strategies. Since then, explained former CEO Jacques Maisonrouge, "The control issue [has become] critical, because optimization of the whole system was not equal to optimization of the subparts."[15] Partly because joint venture partners would be interested only in optimization of the "subpart" in which they had a share, IBM has traditionally insisted on whole ownership.

The recent disagreements between General Motors and its South Korean partner also point to a conflict of interest based on differences in geographic scope. The joint venture's sales in the United States were running 33 percent below target in mid-1988, and Daewoo lost $40 million on the deal in the first half of that year alone. Daewoo and Korean auto analysts blamed GM for failing to promote the car in the United States and for not placing a high priority on it. On the face of it, GM would seem to have stronger incentives for promoting car sales from its wholly owned divisions than from the joint venture. Similarly, Daewoo wants to expand in its local market, but GM is cold to the idea. As a result, Daewoo has been forced to turn to Japanese suppliers for technology to make a new inexpensive "people's car," a pet project of the president of Korea.[16]

- **Global Strategies and Expanding Capabilities.** The relationship between the U.S. firm Hercules and Montedison, Italy's chemicals giant, illustrates both aspects of the joint venture decision: management of capabilities and of geographic scope. In 1982, Montedison launched a strategy to "internationalize" the company by using joint ventures. According to one of the company's top planners, joint ventures would be used "where Montedison had good technology and decent business positions, and where it needed to grow, but couldn't do so alone." Two such fields were polypropylene plastics and pharmaceuticals.

Montedison developed a new polypropylene process that slashed electricity costs by 30 percent and steam use by 90 percent. The process also used a lower-grade raw material than other technologies then on the market, and the finished product had a number of advantages. But Montedison's global market position in polypropylene was weak. It held about 17 percent of European capacity, but had failed to enter the U.S. market with a wholly owned subsidiary some years earlier. The costs of learning to operate in an unfamiliar environment and building market share from scratch proved too high for Montedison.

Hercules was the dominant polypropylene producer in the United States. It also had the largest market share worldwide, just slightly ahead of Shell. In addition, Hercules was strong in areas where Montedison was weak: product applications and marketing. On the other hand, Hercules was weak in process technology, having traditionally depended on licenses from Montedison.

This combination was ideal for a joint venture. Montedison could expand its capabilities in downstream activities and in the U.S. market, while Hercules could do the same in upstream activities. Himont, a new fifty-fifty joint venture between the companies, thus became the world market leader when both parents transferred their polypropylene businesses to it in 1983. Montedison's new technology was installed in all Himont plants, and the joint venture adopted Hercules's successful marketing strategies. In this case, Montedison's global strategy did not seem to conflict with the goals of Hercules, because the latter, too, operated on a global scale.

But such conflicts did appear in another joint venture between these two companies. Before launching Himont, Montedison and Hercules each owned 50 percent of Adria Labs, a pharmaceutical company in the United States that sold a highly successful anticancer drug. To Montedison, Adria was primarily a sales arm of its pharmaceutical division, which developed and produced the drug. But Hercules wanted Adria to be the core of a new, self-sufficient company capable of manufacturing its own products. The costs of such an effort seemed to conflict with Montedison's plans to integrate Adria into its global strategy, which called for introducing to the U.S. market a number of new drugs developed in Italy. As in the case of IBM's regional integration in Europe, control of this venture seemed critical to Montedison. So, at the same time that Hercules and Montedison formed Himont, they also shifted majority ownership of Adria Labs to Montedison.

My statistical analysis yielded additional evidence of the link between global strategies and ownership. It suggested that vertical integration between a joint venture and its partners could affect the likelihood of conflicts between them. Subsidiaries that

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sold a substantial share of their output to the MNC or to other subsidiaries in the MNC's system were less likely than others to have joint ownership. Such sales might be part of a global strategy in which each subsidiary produces what it is best at. The transfer prices used in these transactions are likely to be a perennial source of conflict with local joint venture partners. The MNC will want prices that maximize its global profits, which implies shifting profits to wholly owned subsidiaries. The local partner will, of course, want just the opposite.

The effect of vertical integration inside the host country was different. When an MNC's venture depended on raw material inputs from local suppliers, particularly when there were few suppliers, it was likely to have joint ownership. In such situations, MNCs apparently find it advantageous to give the supplier a stake in the venture to assure a constant supply. Transfer prices for the inputs might be a problem here too, but the local supplier has an even greater incentive to insist on high transfer prices if it does not own a share of the venture.

Negotiating with Host Governments

If, based on the analysis above, MNC managers decide that a joint venture is the best structure for a foreign subsidiary, then the host government is likely to agree. Almost without exception, host government policies have aimed to encourage, not discourage, joint ventures. So it is the multinational corporation preferring *whole* ownership that may have to negotiate with restrictive host country governments.[17]

In such ownership negotiations, MNC managers make tradeoffs among a number of issues, including ownership. An analysis as described above should precede these negotiations, because it suggests why the firm needs whole ownership and how important this is. For example, if control really is "critical," as IBM claimed, then the point should probably not be conceded in negotiations. But if the firm only mildly prefers whole ownership, it may well decide to trade this issue off against others.

The ability of the host government to make the MNC change its position on ownership depends on what it can offer the firm in return. The same is true for the firm's ability to gain an exception to the government's rules. This ability of one party to get its way reflects its *bargaining power* in negotiations. Case and statistical studies suggest that the bargaining power of firms and host governments vary according to the circumstances of the investment.[18]

MNC Strength: Contributions to Country Goals

IBM's ownership negotiations with India in 1978 and with Mexico in 1985 suggest when MNCs can expect to "win" at the bargaining table. The governments of both countries had rules restricting foreign ownership of manufacturing subsidiaries. In the first case, the government enforced this rule strictly, and IBM ended up divesting from India rather than ceding 60 percent of its existing operations to local investors. In the second case, IBM gained a rare exception to the Mexican rules, and set up a wholly owned venture to manufacture personal computers. What made the difference?

One difference between the two cases was that Mexico in 1985 was more desperate for foreign investment than India was in 1978. India was pursuing a fairly successful strategy of self-sufficiency and nonalignment that led it to want local control of an indigenous computer industry. Foreign investment was valued only because it brought in skills that contributed to this goal. Clearly, IBM could supply these skills, but so could a number of second-tier U.S. and European companies that were willing to share ownership with Indian firms.[19] IBM, for its part, felt that yielding to India's demand for a joint venture would set precedents that it could not afford, given its previously untarnished record of complete ownership worldwide.

The situation in Mexico was different. The country had just endured its second foreign exchange crisis in a decade and was well on its way to a third. This situation led the Mexican government to soften its restrictions on foreign investment, much as other developing countries had been doing. Mexico, too, wanted computer technology, but in addition it wanted foreign investors for the capital they would bring in, the exports they could generate, and the confidence they might instill in the country's recovery.

IBM's promise to transfer technology to Mexican firms and export a major part of the output from its Mexican operations proved to be just the sweetener the government needed to approve the

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wholly foreign-owned investment. During the negotiations, IBM agreed to triple its planned investment to $90 million, export 90 percent of the output, and help the Mexicans set up, run, and fund a semiconductor development center. IBM also agreed to a number of provisions that favored local producers: it promised to buy inputs from local suppliers, develop a local dealer network, and sell its final output in the domestic market at prices that were 15 percent above international levels. (This last provision implicitly protected higher-cost domestic producers.)

The key bargaining chips that IBM wielded in this negotiation were its *technology* and *degree of commitment to the host market.* In high-technology fields with high barriers to entry, producers from developing countries usually cannot break into world markets without the help of a global firm. And many governments, following Japan's example, are promoting precisely these types of industries. The ownership regulations in a number of countries explicitly make exceptions to projects in high-technology sectors. But even when such exceptions are not mandated by law, MNCs contributing to the host government's goals are in a strong bargaining position in ownership negotiations.

MNCs making major commitments to restrictive host countries are also more likely than others to gain an exception to the ownership rules. My statistical studies suggested that the bargaining power of the MNCs increased with the size of their investment. Aside from the inflow of capital, host country governments also seem to value the substantial managerial skills and domestic linkages that accompany major projects. These factors seem to have been important in the case of IBM in Mexico.

Government Strength: Attractive Markets

Historically, the host governments that have had most success enforcing ownership restrictions were those with *attractive domestic markets.* Numerous U.S. firms were forced to form joint ventures in Japan in the 1960s and 1970s, or to license their technologies, because that was the only way to get access to the booming Japanese market. Today, China is using its large and rapidly growing market to gain concessions from MNCs. Until April of 1986, the Chinese government refused to approve wholly foreign-owned ventures; since then W.R. Grace and others have set up such facilities. But the Chinese have continued to encourage joint ventures through a variety of incentives, and foreign firms are often more than willing to comply. Gillette, for example, did not hesitate to set up a joint venture in China, even though it insisted on whole ownership elsewhere. Johnson & Johnson has already formed two joint ventures there; it owns 50 percent of one venture making pharmaceuticals and tampons, and 60 percent of one making Band-Aid bandages.

India, Mexico, and Brazil also have used the attraction of their domestic markets to force MNCs to form joint ventures with local firms. One reason IBM went out of its way to reach an agreement with Mexico was to gain access to the Mexican market and use it as a base to develop a Latin American business. Smaller countries imposing ownership restrictions, such as those in the Andean Common Market, have had much less success. In these instances, foreign investors sometimes preferred to stay away altogether rather than give in to the government's demands.

- **Alternative Strategies for Firms.** Even when the country offers an attractive market, however, managers may feel that the risks of joint ownership in some ventures are too high. What are they to do? First, they should consider whether the venture could be modified to reduce these risks. Maybe the subsidiary could be set up to sell exclusively in the domestic market, rather than in world markets, thus reducing the need for control that stems from following a global strategy. Gillette and Johnson & Johnson seem to have done that in China. Where this is not possible, the solution may well be to decline to invest altogether. My statistical analysis indeed showed that ventures in restrictive countries tended to be less tightly integrated than others into the MNCs' networks.

A second option for firms that are forced to concede on the ownership issue is to seek concessions on aspects of control that are less publicly visible. Sometimes restrictive governments hold their ground on the ownership issue, but allow MNCs to have management control of the operations. Gillette, for example, owns only 49 percent of a ballpoint pen business in Mexico, but controls general administration, manufacturing, finance, and product quality through a management contract. General Motors' managers, too, have found that host country governments are usually more will-

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ing to make concessions on management control issues than on the basic demand for some local participation.

The Future of Joint Ventures

Partly for reasons cited above, more and more MNCs have been forming joint ventures abroad in recent years. Are we thus seeing the passing of the traditional form of investing abroad, the wholly owned subsidiary? The answer to this question affects the way global firms will be managed in the 1990s. It depends on trends in the factors that determine the costs and benefits of joint ventures.

The current popularity of joint ventures is not unique. Between 1955 and 1961, the share of joint ventures in the new investments of large American MNCs went from 28 percent to 55 percent. But just as rapidly that share fell to 31 percent in 1969.[20] The 1970s saw another increase in the use of joint ventures abroad, to a new level that seems to have been sustained into the 1980s.

The reasons behind the ebb and flow of joint ventures in the past seem to lie in the changing global strategies of the multinational corporations. The 1950s are sometimes referred to now as a "flag-planting" period; U.S. firms rushed abroad to establish footholds in many countries at the same time. Forming joint ventures with local firms was an ideal way to enter new markets quickly. But the trend in the 1960s was toward consolidation and integration of the firms' global networks, as suggested by the IBM Europe example cited above. Conflicts with joint venture partners, who had purely local concerns, became more common in this period. The U.S. firms thus shunned joint ventures in this period, and even bought out many of the partners who had been useful earlier. This pattern may well repeat itself in the future.

Joint Ventures and Globalization

One trend sometimes credited with the popularity of joint ventures in the 1980s is the widening of the competitive arena from national to global markets. Marketers call this the "globalization" of markets; industry analysts point to the increasing need to pursue worldwide economies of scale and scope; and trade statistics reflect the rising competition from a myriad of foreign sources. These trends are probably affecting all industries, even though some, such as telecommunications, are changing more dramatically than others.

Globalization forces led Montedison to launch the polypropylene joint venture with Hercules. Montedison was traditionally an Italian producer, with minor operations in other European countries. But in the early 1980s all the major chemical firms elsewhere became global competitors. Firms like Hoechst, BASF, ICI, and Dow not only exported from their home bases, but also manufactured abroad, raised capital on international markets, and formed supply and other relationships with each other. These companies used their strengths in one country to help them compete in others, and they drew on technological and managerial resources from several countries.

Montedison's joint venture with Hercules was an effort to move in one leap into the league of global chemical producers. As such, it illustrates how *globalization encourages joint ventures when it drives firms to expand their capabilities and access to markets.* Similarly, firms might form joint ventures to do R&D in industries where costs could not be recouped in national markets alone, such as in telecommunications. Or they might join forces to draw on scientific resources in various countries, as is happening in biotechnology.

But there is another side to the globalization of industries. Firms with operations in various countries often find it profitable to manage these in an integrated way, using one plant to supply the other, or following common marketing and manufacturing strategies. Globalization here implies greater central control of worldwide operations; joint ventures are more of a hindrance than a help in this process. Thus, *globalization discourages joint ventures when it drives firms to integrate their worldwide operations.* Given this tendency, it is not surprising that, once Himont established its position as a leader in global polypropylene production, Montedison bought out Hercules's share.

Opposing forces are thus likely to drive the choice of ownership structure for foreign subsidiaries in global industries. The tension between the need to expand globally and the need to control the network is likely to be felt in industry after industry. International managers will thus continue to struggle with this dilemma in the future. That prospect is clearly better than simply following the current joint venture fad, or blindly pursuing the old preference for whole ownership.

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A Final Checklist

A substantial body of evidence now exists to guide managers struggling with this dilemma. The framework I have presented suggests that six questions are critical. For every proposed business investment abroad, managers should ask these questions.

• **What ownership structure do we prefer, if we are free to choose?** In answering this question managers should consider the next two questions. Even when there are restrictions on foreign ownership, it is important to start with this question, because it prepares the firm for negotiations.

• **Can we exploit an existing competitive advantage, or will we need to expand our capabilities to compete successfully?** The stronger the latter possibility, the more attractive a joint venture will be. Of course, a firm may have an advantage in one area, such as technology, but still need to expand its capabilities in another, such as marketing. A joint venture partner should then be chosen to complement the firm's existing capabilities.

• **Will we be following a globally integrated strategy?** If so, a joint venture with a local partner can lead to costly conflicts of interest. The key is to make sure that the partners agree on the level – global or local – at which profits are to be maximized. Potential problems may arise when the MNC supplies or buys from the joint venture, when quality standards exceed requirements of the local market, and when exports from the venture compete with those of the MNC's other subsidiaries.

• **If the host government restricts foreign ownership, do we have the bargaining power to win an exception?** Answering this depends on answering the next question. If the firm's bargaining power is limited, it should consider modifying its strategy for the new business so that whole ownership is no longer critical. It is often possible to learn to live with a forced joint venture by limiting the scope of the venture and negotiating management contracts.

• **What will we contribute to the country's goals, and how much will we depend on the host government?** The key here is whether the firm's contributions to the country are valued highly by the government. Firms bringing advanced technology and willing to make major investments are generally in a strong bargaining position. Conversely, the host government's bargaining position will be stronger the more attractive the domestic market is to the MNC.

• **Will answers to these questions change with industry evolution?** The firm's ownership strategies are likely to vary over time, just as they vary across industries and countries. Thus, each proposal should be evaluated on its own merits. Moreover, a decision made today may need to be revised later. Managers sensitive to the global evolution of their businesses will be able to avoid unnecessary surprises and costs in joint ventures. ■

Appendix

The framework presented in this article is based partly on extensive statistical analysis of data from almost 200 large American MNCs collected in the 1970s by Harvard's Multinational Enterprise Project. This database is still the most detailed and comprehensive one available on the activities of U.S. MNCs abroad. The sample used here contained information on ownership structure and other characteristics of 1,877 subsidiaries in a broad cross section of countries and industries. I added country variables from the World Bank and industry variables from the Profit Impact of Marketing Strategies (PIMS) database to the Harvard data. I then used binomial regression methods to develop and test a model describing the conditions under which the MNCs chose joint or whole ownership for the subsidiaries in existence in 1975. I tested the applicability of this cross-sectional model over time with earlier data from the same database. Finally, the results of this analysis were complemented with case data on five large MNCs gathered through field interviews in 1985. The statistical results were consistent with these cases, as well as with statistical data collected by other researchers in the 1980s. Further details on the statistical results are in my "Ownership Structures of Foreign Subsidiaries: Theory and Evidence," forthcoming, and "MNC Ownership Preferences and Host Government Restrictions: An Integrated Approach" (1988).

References

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1

In 1969, 31 percent of the new foreign manufacturing ven-

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tures of large U.S. multinationals were jointly owned with local partners, compared with 41 percent six years later. See B. Gomes-Casseres, "Joint Venture Cycles: The Evolution of Ownership Strategies of U.S. MNEs, 1945–1975" in *Cooperative Strategies in International Business*, ed. F.J. Contractor and P. Lorange (Lexington, MA: Lexington Books, 1988).

2
Kenichi Ohmae quoted in "Are Foreign Partners Good for U.S. Companies?" *Business Week*, 28 May 1984.

3
Extensive anecdotal evidence on the role of joint ventures in providing local connections in China and Japan can be found in S. Goldenberg, *Hands across the Ocean* (Boston: Harvard Business School Press, 1988).

4
Evidence for the automobile, automotive parts, food, computer, and pharmaceutical industries is in L.G. Franko, "New Forms of Investment in Developing Countries by U.S. Companies: A Five Industry Comparison," *Columbia Journal of World Business*, Summer 1987, pp. 39–56.

5
See T. Hout et al., "How Global Companies Win Out," *Harvard Business Review*, September-October 1982, pp. 98–108.

6
In one McKinsey and Coopers & Lybrand study, 70 percent of the joint ventures broke up. See "Corporate Odd Couples," *Business Week*, 21 July 1986, pp. 100–105.
In L.G. Franko's pioneering work on the topic, one third of the joint ventures were eventually dissolved. See his *Joint Venture Survival in Multinational Corporations* (New York: Praeger, 1971).

7
Two articles in the Summer 1987 *Columbia Journal of World Business* present unconventional views on joint venture instability. My own "Joint Venture Instability: Is It a Problem?" analyzes the two types of explanations noted in the text. It also suggests that joint ventures can often be transitional forms that are expected to give way to whole ownership after they achieve their purpose. If so, joint venture instability is a sign of success, not failure.
Roehl and Truitt argue that partner disagreements are not only inevitable, they are also useful. See T.W. Roehl and J.F. Truitt, "Stormy, Open Marriages Are Better: Evidence from U.S., Japanese, and French Cooperative Ventures in Commercial Aircraft," *Columbia Journal of World Business*, Summer 1987.

8
See D.J. Encarnation and S. Vachani, "Foreign Ownership: When Hosts Change the Rules," *Harvard Business Review*, September-October 1985, pp. 152–160.

9
The data was collected by the Harvard Multinational Enterprise Project, as described in J.P. Curhan et al., *Tracing the Multinationals: A Sourcebook on U.S.-based Enterprises* (Cambridge, MA: Ballinger, 1977).

10
See S.J. Kobrin, "Trends in Ownership of U.S. Manufacturing Subsidiaries in Developing Countries: An Interindustry Analysis" in Contractor and Lorange (1988).

11
For recent theoretical perspectives on the costs and benefits of joint ventures, see my "Ownership Structures of Foreign Subsidiaries: Theory and Evidence," *Journal of Economic Behavior and Organizations*, in press;
E. Anderson and H. Gatignon, "Modes of Foreign Entry: A Transaction Cost Analysis and Propositions," *Journal of International Business Studies*, Fall 1986, pp. 1–26; and
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Pioneering work on this topic appears in J.M. Stopford and L.T. Wells, Jr., *Managing the Multinational Enterprise: Organization of the Firm and Ownership of the Subsidiaries* (New York: Basic Books, 1972).

12
See D.J. Teece, "The Multinational Enterprise: Market Failure and Market Power Considerations," *Sloan Management Review*, Spring 1981, pp. 3–17.

13
The distinction between global and multidomestic strategies rests on whether the MNC integrates its worldwide operations or pursues separate strategies in each host country. See Hout et al. (1982).

14
See G. Hamel and C.K. Prahalad, "Do You Really Have a Global Strategy?" *Harvard Business Review*, July-August 1985, pp. 139–148.

15
Talk at Harvard Business School, 17 April 1985.

16
See "Is the GM-Daewoo Deal Running on Empty?" *Business Week*, 12 September 1988, p. 55.

17
Of course, in many countries there are other terms to negotiate with host country governments, such as capacity licenses, foreign exchange allocations, tax rates, and so on. This discussion focuses on negotiations about ownership structures.

18
Theoretical discussions and empirical evidence on the role of bargaining power in ownership negotiations are in my "MNC Ownership Preferences and Host Government Restrictions: An Integrated Approach" (Boston: Harvard Business School, working paper, 1988);
N. Fagre and L.T. Wells, Jr., "Bargaining Power of Multinationals and Host Governments," *Journal of International Business Studies*, Fall 1982, pp. 9–23; and
S.J. Kobrin, "Testing the Bargaining Power Hypothesis in the Manufacturing Sector in Developing Countries," *International Organization* 41 (1987): 609–638.

19
See J.M. Grieco, "Between Dependence and Autonomy: India's Experience with the International Computer Industry," *International Organization* 36 (Summer 1982): 609–632.

20
For a detailed analysis of historical trends in joint venture formation, see my "Joint Venture Cycles" in Contractor and Lorange (1988).

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