Joint Venture Instability: Is It A Problem?

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The paper examines the evidence for joint venture instability in a sample of over 5,000 subsidiaries of 180 large US multinationals. It compares the instability of jointly-owned with that of wholly-owned ventures and explores the possibility that instability in ownership structures reflects sequential strategies in foreign investment. In some cases, ownership changes after entry were corrections of mistakes made when the subsidiaries were first established. In other cases they represented adaptations to changes in environmental conditions, which sometimes resulted from actions of the joint ventures themselves. The paper suggests that in the latter cases joint venture instability may be seen as a sign of success, not failure.

IN THE RECENT furor about joint ventures, academics have tended to focus on the benefits of cooperation between firms. Joint ventures are said to allow firms to share information, resources, markets, and risks, to build trust among firms, to yield economies of scale, and so on.[1] But managers often stress the costs of joint ventures, such as the potential for disagreements between partners, for diffusion of proprietary information, and for creation of future competitors.[2]

Such problems are often blamed for what many see as a high "divorce rate" among joint ventures. Seventy percent of the partnerships in studies by McKinsey and Coopers & Lybrand eventually broke up, as well as half of those in Harrigan's sample, and a third of those in Franko's.[3] The implication on the part of many observers is that this high degree of "instability" of joint ventures is a sign that the organizational form is prone to failure.[4]

This article puts the question of joint venture instability in a different perspective by addressing three points. First, it presents evidence for different types of instability in a sample of over 5,000 subsidiaries of 180 large US multinational enterprises (MNEs). Second, it compares the stability of jointly-owned ventures with that of wholly-owned ones. (A joint venture is defined as a subsidiary in which the MNE owns 5% to 95% of equity. Only joint ventures with local host country partners are considered.) Third, it examines some reasons why firms might change the ownership structures of their subsidiaries after entry.

In some cases, the dissolution of a joint venture did indeed imply that the initial organizational choice was wrong for the task at hand. But in other cases of instability, a joint venture may well have been the right choice when it was formed. After that, however, changed conditions,

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possibly as a result of the joint venture itself, may have led to changes in ownership structure.

JUST HOW UNSTABLE ARE JOINT VENTURES?

Following Franko's pioneering work on the topic, we can distinguish three possible types of instability in a joint venture. First, the venture may be liquidated completely, i.e. its operation halted and its assets sold or scrapped. Second, the venture may be sold to the local partner or to outsiders, in which case it remains in operation, but under different ownership. Third, the MNE may buy out its joint venture partner and create a wholly-owned subsidiary.[5]

Each of these three types of instability may also occur in wholly-owned ventures, an obvious but rarely noted point. Wholly-owned subsidiaries too can be liquidated or sold outright to local businessmen. In addition, MNEs may sell off only part of the equity of a wholly-owned venture, thus creating a joint venture. Although it is tempting to think of the instability of wholly-owned structures as in some sense the mirror-image of joint venture instability, none of the studies examining the latter also looked at the former. It is in fact more informative to compare and contrast the instability of these two types of ventures than to limit the discussion to the instability of joint ventures alone.

The importance of joint venture instability can be easily misstated if one ignores the instability of alternative structures. As Table 1 shows, in the sample used here,[6] wholly-owned ventures were in fact more likely to end in liquidation than jointly-owned ones. But liquidation was not an important source of instability in either case, representing only 10% of the total instances of instability. Outright sales represented 37% of the instability in the sample, and changes in ownership structure represented 52%. Joint ventures were more likely to be sold outright than wholly-owned subsidiaries. The likelihood that a joint venture was changed to a wholly-owned subsidiary was also greater than the reverse. But in each case, the instability of wholly-owned ventures was not negligible.

In total, 30.6% of joint ventures were unstable, compared to 15.7% of wholly-owned subsidiaries. The rate of instability of joint ventures was thus about twice that of wholly-owned ventures. The fact that substantial levels of instability were not unique to joint ventures suggests a general tendency for ownership structures to change over the lifetime of a venture. For reasons examined below, joint ventures simply experienced a higher rate of change than wholly-owned ventures. In no way does this imply, however, that joint ventures are inherently prone to failure.

A SEQUENTIAL VIEW OF OWNERSHIP STRUCTURES

The characterization of all joint venture instability as "failure" is subject to question when the data are carefully examined. Liquidation of a business is a likely sign of failure; but joint ventures do not stand out from wholly-owned subsidiaries on this score. On the other hand, selling a business, or acquiring a partner's shares, does not necessarily imply failure. These steps could well have been anticipated in advance, i.e. the joint venture may have been intended as a transitional structure.

The data suggest that many of the ownership changes in the sample were not accompanied by changes in control. MNEs were more likely to buy out their partners when they already controlled a majority of the shares of a joint venture than otherwise; 26.9% of majority-owned joint ventures later became wholly-owned compared to 10.1% of minority-owned ones (Table 1). Similarly, MNEs were more likely to sell a subsidiary outright if they held a minority of its equity than otherwise (Table 1). Many of these instances of ownership instability, therefore, involved less radical changes in the venture's management than might appear at first sight.

Eliminating a partner, even from an operation that one controls through

TABLE 1

Three Types of Instability in Subsidiaries of US MNEs By Ownership Structure at Entry, 1900-1975

	JOINT VENTURES				WHOLLY OWNED
	MNE's Share of Subsidiary's Equity at Entry				
	<50%	50%	50-95%	<95%	>95%
Liquidated	1.8%	1.6%	2.1%	1.9%	2.4%
Sold	13.0%	12.1%	8.3%	11.1%	6.1%
Structure Changed:					
to Whole Ownership	10.1%	16.2%	26.9%	17.6%	—
to Joint Ownership	—	—	—	—	7.2%
Total Instability as % of all subsidiaries in category	24.9%	29.9%	37.3%	30.6%	15.7%
N =	884	672	822	2378	3555

Note: The data is for subsidiaries set up between 1900 and 1975. The table shows the share of subsidiaries in each ownership category that had been sold or liquidated by 1975, and any changes in ownership structure between date of entry and the date of liquidation or sale, or between date of entry and 1975. Thus, of the 884 joint ventures in which the MNE held less than 50% of the subsidiary's equity at entry, 1.8% were liquidated, 13.0% were sold, and 10.1% became wholly-owned subsidiaries (first column). N denotes the number of subsidiaries that were in each ownership category at entry.

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majority ownership, can mean two things. First, it might imply that the relationship did not work out, with neither partner receiving the benefits expected from the venture. In this case, the joint venture can be said to have failed. Second, it may mean that the venture was successful as an intermediary step, but that cooperation was no longer necessary. Here the partners received the expected benefits, but conditions evolved to the point where the future costs of cooperation exceeded the benefits.

Following Kogut's view of foreign direct investment as a sequential process[7] we may consider any ownership structure as a temporary organization providing options on the future. The role of joint ventures is clear in this regard. A limited interest in a venture provides a firm with cheap but excellent means of tracking performance and puts it in a good position for acquiring further interests if conditions warrant it. Joint ventures thus may be instruments providing firms with flexibility in responding to trends that are difficult to predict. They also allow firms to learn new skills incrementally, so that they can buy into the venture as their capabilities grow.

Wholly-owned subsidiaries can also play such a transitional role, though this probably occurs less frequently. A firm may set up a small wholly-owned subsidiary in a new market with the intention of possibly expanding with the help of local partners should conditions warrant this in the future. The wholly-owned subsidiary is then a way of gaining preliminary information on new markets and testing whether or not a partner will be needed for a full-scale operation.

There are two critical differences between this sequential view of ownership changes and that equating instability with failure. First, the sequential view claims that the initial choice was right, the failure interpretation claims it was wrong. Second, the sequential view argues that conditions have changed since entry, while the failure interpretation ignores such changes. In the first case, the ownership change is essentially an *adaptive* move, in the second it is a *corrective* one. The evidence suggests that both of these processes contributed to joint venture instability in the data used here.

CORRECTIVE OWNERSHIP CHANGES

Research has shown that the ownership choices MNEs make when setting up a new subsidiary ("at entry") follow distinct patterns that reflect the relative costs and benefits of joint and whole ownership.[8] MNEs that initially misjudge these costs and benefits and that choose the wrong ownership structure at entry, can be expected to have to make corrections later. For example, when an MNE is not familiar with a country, a joint venture is likely to be more attractive than otherwise. So, if under these conditions the MNE still chooses whole ownership at entry, it may well be forced to take on a partner later on. Similarly, when MNEs follow globally integrated strategies, the costs of joint ventures are high. Under such conditions, MNEs that choose joint ventures at entry are likely to need to switch to whole ownership later on.

When ownership structure instability represents corrections for mistakes made at entry, therefore, one would expect certain consistent patterns. Changes from joint to whole ownership would be more likely in situations where whole ownership was the right choice at entry. Conversely, changes from whole to joint ownership would be more likely where joint ventures should have been chosen at entry.

Table 2 shows precisely this pattern. In those MNEs, industries, and host countries where the use of joint ventures at entry was highest, changes from joint to whole ownership were the least likely. For example, 17% of the joint ventures of parent firms with above-average shares of joint ventures at entry eventually became wholly-owned, compared to 25% in firms that tended to use joint ventures less frequently at entry. Conversely, in these same MNEs, the frequency of changes from whole to joint ownership was highest. For example, 11% of the wholly-owned ventures of parent firms that used joint ventures relatively frequently at entry eventually became jointly-owned, compared to only 6% in other firms. Similar patterns occurred across industries and host countries.

Statistical studies with specific firm, industry, and country variables corroborated the view that ownership instability often represented corrections of mistakes made at entry. For example, changes from joint to whole ownership were more common in countries with which the MNE was familiar than elsewhere, while changes in the other direction were less common. Similarly, changes from joint to whole ownership were more common in R&D-intensive industries, where joint ventures were scarce to begin with, than elsewhere. Also, highly diversified MNEs that were typically attracted to joint ventures brought in new partners after entry more often than they bought out existing ones.[9]

This evidence suggests that in a number of cases MNEs made ownership changes because their initial choices were wrong. In one sense, therefore, the structures they chose had failed. But the source of this failure lay with the initial decision making process, rather than with the ownership structure itself. It would be misleading to claim that because the joint ventures and wholly-owned subsidiaries were dissolved, the ownership form per se was in any way prone to failure. This type of joint venture instability thus indicates specific failures in entry decisions rather than a general problem inherent in joint ventures.

ADAPTIVE OWNERSHIP CHANGES

If optimal ownership structures are determined by firm, industry, and country conditions, then they may vary over the lifetime of a venture as these conditions change. As countries develop, firms grow, and industries mature, the conditions that favored a joint venture when a subsidiary was first established may give way to circumstances favoring whole

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TABLE 2

Ownership Instability Rates and Initial Entry Choices: Firm, Industry and Country Patterns, 1900-1975

TYPE OF OWNERSHIP CHANGE	PARENT FIRMS		SUB INDUSTRY		HOST COUNTRY	
	SHARE OF JOINT VENTURES IN TOTAL ENTRIES					
	BELOW AVE.	ABOVE AVE.	BELOW AVE.	ABOVE AVE.	BELOW AVE.	ABOVE AVE.
JV to WO	25%	17%	24%	13%	19%	4%
WO to JV	6%	11%	6%	5%	5%	11%
N =	93	84	55	71	53	45

Note: The table shows the frequency of each type of ownership change in firms, industries, and countries with, respectively, below and above average shares of joint venture at entry. In other words, in parent firms that had below average shares of joint ventures at entry, 25% of joint ventures eventually became wholly-owned and 6% of wholly-owned ventures became jointly-owned. In those with above average shares of joint ventures at entry, changes from joint to whole ownership were less frequent (17%) and changes in the opposite direction more frequent (11%). (N denotes the number of firms, industries, and countries in the sample).

Source: Harvard Multinational Enterprise Project.

ownership. As a result, MNEs may need to adapt the ownership structures of their subsidiaries to changes in the ventures' environments.

One type of change that may lead to the dissolution of joint ventures is the partners' acquisition of new capabilities. Often an MNE will enter a joint venture to benefit from the experience of another firm. After the MNE has acquired the needed capabilities, perhaps from the joint venture itself, it will no longer need the local firm and may convert the subsidiary to whole ownership. A special form of this process occurred when MNEs acquired shares in existing local companies. The MNEs often kept local partners involved in the businesses while they still needed to learn to operate in the foreign environment, but bought out the partners after they had acquired sufficient experience.[10] In the data used here, 27% of acquisition joint ventures eventually became wholly-owned, compared to 10% of greenfield joint ventures.

Growth in the parent firm's international network can also lead to changes in optimal ownership structures for individual subsidiaries. To exploit the increasing potential for economies of scope that accompany such growth, the MNE has to rationalize globally and coordinate tightly its operations in various countries. The requirements of this global strategy often conflict with the interests of local partners.[11] Thus, while in the early stages of foreign expansion the MNEs may use joint ventures to penetrate foreign markets quickly, in later stages they may well shun joint ventures in an effort to exploit global economies of scope.[12]

The data used here confirmed this prediction. A measure of the growth in MNEs' global systems between a subsidiary's entry date and 1975 was constructed for this purpose. In any year, the extent of an MNE's global system in an industry was measured by the number of subsidiaries that the firm had in the industry. The growth of this system between 1975 and the year of entry for each subsidiary was then calculated. Finally, these growth rates were averaged by parent firm and compared with joint venture instability rates.

In about half the firms in the sample, the MNEs' global system grew more than two-and-a-half times between their subsidiaries' year of entry and 1975. On average, these MNEs eventually converted 24% of their joint ventures to wholly-owned subsidiaries. The MNEs in the other half of the sample converted only 17% of their joint ventures to whole ownership. In other words, the greater the rate of the MNEs' foreign expansion, the more likely they were to change earlier joint ventures into wholly-owned subsidiaries.

Another factor that sometimes led to ownership changes after entry was host government policy. In the 1960s and early 1970s, many governments instituted policies restricting foreign ownership. These policies encouraged joint ventures at entry[13], as well as changes from whole to joint ownership after entry. In the data used here, 6.3% of wholly-owned subsidiaries in host countries without ownership restrictions were eventually changed to joint ventures, compared to 15.7% in countries with strict foreign ownership restrictions (Japan, India, Mexico, Pakistan, and Spain). Conversely, the frequency of changes from joint to whole ownership was lower in the latter countries than in the former.

Changes in the experience of local firms could also lead to changes in ownership structures. When local firms are highly sophisticated, MNEs find joint ventures with them more attractive than otherwise.[14] Thus, when the experience of local firms grows rapidly, shifts away from joint ventures should be less likely than otherwise. The data yielded some evidence for this proposition.

To the extent that the local firm learns from the MNE, its capabilities may expand to the point where it no longer needs the MNE, leading to a sale of the joint venture to the local partner. Alternatively, increases in the local partner's experience may simply even out the increases in the MNE's capabilities discussed above. In that case, the incentives for a joint venture could continue to exist, as both firms will have more to offer the other. The apparent stability of the joint venture in this case masks significant dynamic changes in the relationship.

Local firms can also gain experience as a result of economic growth in the host country. Often a local partner in a joint venture is also involved in other businesses or is connected with business groups that grow as the overall economy expands. The size of the host country's GDP

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was thus used as a proxy for the experience of local firms; an economically large country is likely to have more large, experienced local firms than a small country. Changes in the experience of local firms were then measured by the rate of growth of GDP.

The GDP of about half the host countries in the sample grew at over 3.5% per year in 1960-75. On average, only 12% of joint ventures in these countries were eventually reorganized into wholly-owned subsidiaries. In the other countries, where GDP grew slower, 23% of joint ventures were converted to wholly-owned subsidiaries. In other words, MNEs were more likely to buy out local partners in their joint ventures in low-growth countries than in high-growth ones.

There are alternative explanations for this pattern. MNEs may prefer joint ventures in rapidly growing countries for two other reasons. First, joint ventures provide the parent firms the flexibility to take advantage of future developments, as noted above. Such options are likely to be most important where business conditions change rapidly. Second, joint ventures are usually more autonomous from MNE headquarters than wholly-owned subsidiaries. As a result, they can take advantage of local developments more quickly than would more centrally managed subsidiaries.

CONCLUSION: JOINT VENTURING AS A SELF-LIQUIDATING STRATEGY

The empirical evidence and conceptual approach presented here suggests that instability in joint ventures has a lot in common with the little studied instability in wholly-owned ventures. Some instability in joint ventures stems from the same sources that lead to instability in wholly-owned subsidiaries. Both types of ventures may require corrective behavior when initial choices were wrong. Also, both types of ventures may need to change to adapt to changes in the factors that determine the costs and benefits of ownership structures.

But some of the instability of joint ventures stems from elements that are unique to that organizational form. Joint ventures allow firms to tap into the resources of other firms, and, in the process, to increase their own capabilities. As a firm's capabilities grow, it may no longer need the cooperation of its joint venture partner.

Also, joint ventures allow firms to expand abroad rapidly. During this process new opportunities for economies of scope are created. But joint ventures are not the ideal instrument to take advantage of these opportunities, therefore, the joint venture structure itself may contribute to changes in the factors that made it an attractive choice to begin with.

In both of these instances, a joint venture may lead to changes in firm capabilities and scope that reduce the benefits or increase the costs of the partnership. To adapt to these changes, therefore, an MNE may well have to dissolve its joint venture. This process, which occurs in jointly-owned ventures but not in wholly-owned ones, is no doubt part of the reason why the former are more "unstable" than the latter. But rather than seeing this as evidence that joint ventures are prone to failure, one might well consider this self-liquidating feature of joint ventures a somewhat paradoxical sign of success.

NOTES

1. See the papers presented at a recent conference on the topic, published in Farok Contractor and Peter Lorange, eds., *Cooperative Strategies in International Business* (Lexington: Lexington Books, 1988).
2. See, for example, "Are Foreign Partners Good for US Companies?" *Business Week,* May 28, 1984, pp. 58-60; and Jonathan B. Levine and John A. Byrne, "Corporate Odd Couples," *Business Week,* July 21, 1986, pp. 100-5.
3. The McKinsey and Coopers & Lybrand findings are cited in Levine and Byrne, "Corporate Odd Couples;" Kathryn R. Harrigan's findings are reported in "Strategic Alliances and Partner Asymetrics," in Contractor and Lorange, eds., *Cooperaitve Business Strategies* and in her *Managing for Joint Venture Success* (Lexington: Lexington Books, 1986); Lawrence G. Franko's pioneering work on the topic is *Joint Venture Survival in Multinational Corporations* (New York: Praeger, 1971).
4. Harrigan, however, notes that joint venture survival should not be equated with success. She recognizes that ownership changes can be adaptations to changing conditions, as argued in this paper. See her *Joint Venture Success.*

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5. Franko, *Joint Venture Survival.*

6. The sample contains all manufacturing subsidiaries of the 180 US MNEs in the Harvard Multinational Enterprise Project. The database is described in Joan P. Curhan, William H. Davidson, and Rajan Suri, *Tracing the Multinationals: A Sourcebook on US-based Enterprises* (Cambridge, MA: Ballinger Publishing, 1977).

7. Bruce Kogut, "F.D.I. as a Sequential Process," in *The Multinational Corporation in the 1980s,* eds. C. P. Kindleberger and D. Audretsch (Cambridge, MA: M.I.T. Press, 1983).

8. The pathbreaking work on this topic is John M. Stopford and Louis T. Wells, Jr., *Managing the Multinational Enterprise,* Part II. A more extensive model and set of findings is in my 1985 Harvard D.B.A. thesis, *Multinational Ownership Strategies,* and in my "Ownership Structures of Foreign Subsidiaries: Theory and Evidence," Harvard Business School Working Paper, 1987.

9. Gomes-Casseres, *Multinational Ownership Strategies,* p. 461.

10. Gomes-Casseres, *Mulnational Ownership Strategies,* pp. 107-16.

11. Stopford and Wells, *Managing the Multinational;* Franko, *Joint Venture Survival;* and Gomes-Casseres, *Multinational Ownership Strategies.*

12. For historical evidence of this, see my "Joint Venture Cycles: The Evolution of Ownership Strategies of US MNEs, 1945-1975" in Contractor and Lorange, eds., *Cooperative Strategies;* see also Franko's findings on the correlation between joint venture instability and MNEs' organizational evolution in his *Joint Venture Survival.*

13. Gomes-Casseres, *Multinational Ownership Strategies,* Chapter 7.

14. Gomes-Casseres, "Ownership Structure of Foreign Subsidiaries."

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