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Explaining equity shares in international joint ventures: Combining the influence of asset characteristics, culture and institutional differences

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ABSTRACT

This paper investigates the determinants of the observed contracted equity share ownership structure in international joint ventures (IJVs). We propose that the inherent intangibility of the assets that partner's contribute to the IJV, and both formal (legal) and informal (cultural) institutional differences between partners contribute to explaining the negotiated division of the IJV's equity share. Empirical results from 442 UK-based home-foreign IJVs, indicate that an IJV partner's equity share ownership is positively correlated with the intangibility of the assets they contribute to the IJV relative to those of the second partner. Both cultural and formal institutional differences exert a moderating influence on the observed asset intangibility-equity share relationship for the foreign IJV partner. We attribute this finding to both risk perceptions and the liability of foreignness.

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1. Introduction

International business scholarship pays significant attention to the factors determining both the formation and subsequent performance of international joint ventures (IJVs). A large literature investigates the considerations influencing the formation of IJVs in preference to other cross border modalities for market entry and development (Kogut and Singh, 1988; Barkema et al., 1996; Hennart and Larimo, 1998; Brouthers, 2002, 2013; Brouthers et al., 2008; Jandik and Kali, 2009; Meyer et al., 2009; Slangen and Van Tulder, 2009; Demirbag et al., 2010; Georgieva et al., 2012; Maekelburger et al., 2012). Related literature studies those factors at play in partner selection, adopting a relationship management focus towards resolving incomplete contracting problems and mitigating the risks entailed in IJV undertakings (Beamish and Banks, 1987; Madhok, 2006; Bierly and Gallagher, 2007; Yung-Chul, 2008; Gulati et al., 2009).³ Other studies specifically consider those variables which are influential in determining the performance of IJVs and other forms of alliance (Lavie and Miller, 2008; Merchant, 2005; Lu and Hebert, 2005; Malhotra et al., 2011).

One aspect of IJVs receiving only limited research attention to date relates to the factors that influence the terms of the initial IJV contract itself, in particular the contracted distribution of equity share ownership negotiated by the partners at IJV formation. This issue is of critical importance issue, as the allocation of equity ownership in the IJV has significant consequences both for the venture's governance and subsequent implementation of the overall strategic objectives of the partnership. To summarise our position, we conjecture that the distribution of share ownership is likely to be influenced by two types of factor. The first set is *internal* to the IJV, namely the characteristics of the assets that a partner contributes to the IJV, in particular the degree of asset intangibility. This line of reasoning is informed by the measurement branch of property right theory, and argues that the partner whose asset contribution is responsible for engendering the greatest amount of variability in the IJV's overall productive performance, will own a larger share of the equity capital. The fact equity is a residual claim, endows it with many of the properties of collateral, as the value of the claim is forfeited in the event the IJV is unsuccessful. The partner who contracts to own a larger share of equity capital, whose value is foregone if the IJV is unsuccessful, is therefore providing a form of performance guarantee to their collaborating partner. The subsequent argument in this paper proposes intangible assets inherently contribute more to the partnership's performance variability than more generic assets, so the optimal contractual structure allocates a greater share of the equity to the partner providing more of the former class of assets. If the value contributed by a collaborating partner's assets to the IJVs performance is more easily measured and monitored, this reduces the need for that partner to provide a performance guarantee (Foss and Foss, 2005; Barzel, 1982; Kim and Mahoney, 2005; Chi, 1996; Hart and Moore, 1990). We also maintain that the equity shares negotiated by the IJV partners are influenced by a second set of factors that are *external* to the IJV, and encapsulate a specifically international dimension of the relationship. These factors reflect how both formal (rule-based) and informal (cultural) institutional differences between the partners' respective home jurisdictions affect perceptions of risk and vulnerability to opportunism when collaborating through equity sharing ownership arrangements.

The internal dimensions inherent in this conceptual framework underpinning the determinants of equity share ownership are grounded in the notion of the guarantee function of equity capital, and apply equally to both domestic and international JVs. The external determinants of share ownership in an IJV collaboration are those influenced by the perceived risks related to differences in partner nationalities and cultural characteristics (Yamin and Golesorkhi, 2010) and as such, apply only to IJVs. When the IJV is located in the home market of one of the partners, as represented by the 442 UK-based 'home-foreign' IJVs analysed in this paper, it is logical to infer that the institutional differences between countries may have an asymmetric effect, acting to the disadvantage of the foreign partner by enhancing both their perceived risks and relative monitoring costs. This perspective accords

³ In this paper, we do not address the partner selection issue, per se, but develop a conceptual framework that specifically addresses the determinants of the ownership structure of an IJV, as manifest in the contracted division of equity share ownership between collaborating partners. Our perspective, therefore, complements prior literature that focuses on the importance of partner selection and relationship building in managing IJVs.

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