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An analysis of the disposition of assets in a joint venture

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Abstract

The final disposition of assets at the conclusion of joint venture arrangements is important to an understanding of the motivation to pursue a joint venture and the wealth created by these collaborations. A comparison between conventional asset sales and asset sales occurring within a joint venture structure shows that the total wealth created is larger if the assets have been under shared control in a joint venture. Our results support the contention that the establishment of a joint venture creates an opportunity for a relationship-based exchange of information that can serve as a mechanism to transfer assets in the presence of a high degree of asymmetric information.
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1. Introduction

In a joint venture (JV) two or more independent corporations share the control, costs and benefits of a newly created entity. The choice of joint ventures (JVs) instead of

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alternative productive arrangements can be explained on the basis of lower transaction costs, as suggested by Williamson (1979, 1989) and Klein et al. (1978). However, the lack of information regarding the contracts that regulate JVs, and the scarce detail provided about JVs in accounting reports, limits our understanding of these organizations. These empirical difficulties have been circumvented by financial economists by working with the assumption that excess returns to partners around the announcement of JVs reflect the net effect of the unobservable costs and benefits involved. Using this methodology, prior studies have found JVs to be value creating events.

We argue that the excess returns to partners at the announcement of the initiation of a JV provide an incomplete description of the motives and value generated. Joint ventures generally have a shorter life than ongoing independent corporations and a diverse set of potential outcomes. We contend that the analysis of the different outcomes (identified by the alternative disposition of the operating assets) is necessary to an understanding of the motivations and valuation effects of JVs. As an example, some partners enter into a JV and soon afterwards merge, suggesting that JVs may be used as a means of "dating" through a transitional vehicle (the JV) to enhance the value of the subsequent "marriage" or merger. Other JVs are announced but never enter into fruition. We do find that different methods of disposing of JV assets are associated with different valuations effects. For JVs that are terminated by the transfer of assets to both partners, by the acquisition of the assets by one partner, or by a merger of partners, we find the JV creates value. The largest combined wealth to both partners occurs in JV buyouts by one partner. However, parents do not experience significant gains in JVs that are later cancelled, when the JV is sold to a third party, and in the set of JVs for which there is no news about termination.

When compared to internal production and different types of arms-length arrangements, JVs are unique in that this productive collaboration fosters an exchange of information on commonly owned resources. The common ownership of the JV is a potential source of synergistic gains (i.e. McConnell and Nantell, 1985) and may be more efficient than arms-length contracting because common ownership ameliorates opportunistic behaviors often occurring in non-JV contractual relationships (Alchian and Woodward, 1987).[1] The high frequency and large valuation effects of JVs that are acquired by one partner suggests an alternative explanation for JVs that we explore in this study. Our results suggest that the information exchanged in a JV ameliorates asymmetric information and increases the value of the assets in a JV. There are several theoretical and empirical analyses that support this view. Arms-length acquisitions are costly because prices have to be discovered (Coase, 1937) and buyers and sellers may not agree on the transaction value in the presence of asymmetric information (Akerlof, 1970). The exchange of information in a JV can ameliorate these costs and facilitate the transfer of assets. Consistent with this view, BalaKrishnan and Koza (1993) and Reuer and Koza (2000) argue that the greater the asymmetries of information, the more likely firms will prefer JVs over acquisitions. Robinson (2001) and Robinson and Stuart (2007) also find empirical support that alliances are preferred as an organizational structure in the presence of asymmetries of information and suggest the concept of JVs as uncertainty resolution devices. Nanda and Williamson (1995) take this argument one step further and report several cases in

[1] Kogut (1988) also claims that JVs are favored over contracts in the presence of high uncertainty and a high degree of asset specificity.

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