



# Managing opportunism in international joint ventures: The role of structural and social mechanisms



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## ABSTRACT

Building on transaction cost economics (TCE) and social exchange theory (SET), we develop an integrated framework in which reducing opportunism requires two sets of mechanisms: (1) structural mechanisms of symmetric dependence, symmetric equity share and resource complementarity, and (2) social mechanisms of trust, communication and cultural adaptation. The framework is tested empirically using web-survey data collected from 89 IJVs established by Nordic firms in Asia, Europe and America. Empirical data analysis based on structural equation modelling shows that TCE proposed mechanisms of symmetric dependence and resource complementarity, and SET proposed mechanisms of trust, communication and cultural adaptation reduce opportunism. Contrary to expectation, the structural mechanism of symmetric equity share does not reduce opportunism. In addition, interesting results are found related to interaction effects between social and structural mechanisms in relation to reducing opportunism.

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## 1. Introduction

International joint ventures (IJVs) are among the most prominent modes of international business today (Madhok, 1995; Mainela & Puhakka, 2008; Park & Harris, 2014). Yet IJVs have been reported as having a high rate of failure (Hsieh, Rodrigues, & Child, 2010; Kobernyuk, Stiles, & Ellson, 2014). This has led researchers to investigate the factors that enhance or impede their performance (see Ren, Gray, & Kim, 2009 for a review). In particular, inter-partner opportunism has been proposed in the literature as a major cause of unsatisfactory IJV performance, because it hampers inter-partner confidence, commitment and reciprocity; impairs collaborative effects and synergy creation; increases transaction costs; and impedes IJV evolution and growth by increasing uncertainty (Hennart & Zeng, 2005; Luo, 2007a). Researchers have identified various sources of inter-partner opportunism in IJVs. These sources include: weak property rights of invested resources in IJVs (Hennart & Zeng, 2005), external uncertainty, inter-partner goal disparity, resource misfit, cultural dissimilarity, bargaining asymmetry, and internal uncertainty (Luo, 2006), external uncertainty and inter-firm psychic distance (Katsikeas, Skarmeas, & Bello, 2009), inter-partner asymmetric dependence, payoff inequity, cultural diversity, goal

incompatibility and pressures for quick results (Das & Rahman, 2010). These investigations advance our understandings of the sources of inter-partner opportunism, however we have limited understanding of the mechanisms that reduce opportunism in IJVs (Hennart & Zeng, 2005).

The study of IJVs has been a prolific area of research, even though there are different interpretations of IJVs. Hennart (1993) points out that IJVs are joint hierarchy, and therefore require many structural factors to curb opportunism. Ouchi (1979) suggests that IJVs are 'clan-like' organizational forms that require many relational qualities to curb opportunism. Corresponding to these interpretations, two different research streams have emerged (see Hennart & Zeng, 2005 for a literature review). One stream, rooted in transaction cost economics (TCE), is mainly concerned with examining the underlying structural characteristics of IJV as an explanation for reducing opportunism in IJVs. For instance, Parkhe (1993) and Zhang and Rajagopalan (2002) empirically verify the important role of inter-partner dependence in curtailing opportunism. Hennart and Zeng's (2005) theoretical study proposes dependence and resource complementarity between IJV partners as potential solutions to opportunism. Luo (2007a) empirically validates the importance of contract and equity share between IJV partners in reducing opportunism. Das and Rahman's (2010) conceptual study suggests inter-partner equity share and dependence as structural solutions to opportunism. Hence, in this stream, the various structural characteristics of IJV are considered to be mechanisms that reduce opportunism in IJVs.

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The other stream, rooted in social exchange theory (SET), is mainly concerned with examining the underlying social characteristics between IJV partners as an explanation for reducing opportunism in IJVs. For example, [Wathne and Heide \(2000\)](#) introduce the notion that inter-partner socialization efforts, which are based on cultural adaptation and trust, can be potential deterrents to opportunism along with monitoring and control. [Kale, Singh, and Perlmutter \(2000\)](#) empirically show that relational capital between partners, which is based on trust and interaction, deters opportunism. [Deeds and Hill \(1998\)](#) find significant evidence that a strong relationship between partners is a more effective deterrent of opportunistic behaviour than hostages or rigorous contractual arrangements. Hence, in this stream, the various social characteristics between IJV partner firms are considered as mechanisms that reduce opportunism in IJVs. Rarely have the two streams been combined in order to provide a comprehensive understanding of social and structural mechanisms that reduce opportunism in IJVs ([Luo, 2007a](#)). Further, a growing number of studies share the view that the economic structure of IJV exchange is socially embedded, and therefore social and structural mechanisms jointly improve IJV performance (e.g., [Luo, 2002a, 2002b, 2008](#); [Yan & Gray, 1994](#)). These scholars have views that both social and structural mechanisms have some weaknesses and when used together complement each other's weaknesses and enhance IJV performance. However, prior research has not investigated the interactions between structural and social mechanisms in reducing opportunism. [Hennart and Zeng \(2005\)](#), [Luo \(2006, 2007a\)](#) and [Jiang, Li, Gao, Bao, and Jiang \(2013\)](#) maintain that future study is needed especially to investigate the interactions between structural and social mechanisms in reducing opportunism because understanding the way these mechanisms interact in curtailing opportunism is very important.

Thus, to provide further insights, the objective of our study is to combine the elements from the two research streams of TCE and SET in an attempt to gain understanding of the mechanisms that reduce opportunism in IJVs. We have carefully gone through the two research streams of TCE and SET in order to develop understanding of the mechanisms that reduce opportunism in IJVs. We identified three mechanisms grounded in TCE: namely, symmetric dependence, symmetric equity share and resource complementarity between IJV partners ([Das & Rahman, 2010](#); [Hennart & Zeng, 2005](#); [Luo, 2007a](#); [Parkhe, 1993](#); [Zhang & Rajagopalan, 2002](#)). These mechanisms are considered as key structural mechanisms that reduce opportunism in IJVs. On the other hand, we identified three mechanisms grounded in SET: namely, trust, communication and cultural adaptation between IJV partners ([Deeds & Hill, 1998](#); [Kale et al., 2000](#); [Wathne & Heide, 2000](#)). These mechanisms are considered as key social mechanisms that reduce opportunism in IJVs. The hypotheses developed in framework are tested using a sample of 89 IJVs established by Nordic firms in Asia, Europe and America.

A priori contribution of the present study is that it develops and tests a comprehensive framework of reducing opportunism that comprises three structural mechanisms of symmetric dependence, symmetric equity share and resource complementarity from TCE and three social mechanisms of trust, communication and cultural adaptation from SET. We consider this an important contribution because prior studies are fragmented, as they have mainly focused on either the structural or social mechanisms (e.g., [Kale et al., 2000](#); [Zhang & Rajagopalan, 2002](#)) and have analysed limited number of mechanisms. Furthermore, a key feature of prior studies has been that they have analysed only the main effects of mechanisms on opportunism, but the interactions between social and structural mechanisms in their influence on the opportunism in IJVs have not been analysed. Our study extends the prior research on opportunism in IJVs by specifying how different

structural (symmetric dependence, symmetric equity share and resource complementarity) and social mechanisms (trust, communication and cultural adaptation) interact in their influence on the opportunism in IJVs.

The remainder of this paper is organized as follows. In the next section, the theoretical background to the research is presented, along with the development of specific research hypotheses. This is followed by a description of the research methodology and results. After presenting the discussion and implications of the results, the paper concludes with some managerial implications, limitations and suggestions for further research.

## 2. Theoretical background and research hypotheses

### 2.1. Opportunism in IJVs

Opportunism is one of the central assumptions of TCE, where it is believed that there is risk of opportunism from economic actors whenever such behaviour is feasible and profitable. In [Williamson \(1985, p. 47\)](#), opportunism is defined as “self-interest seeking with guile”, and it is manifested in acts like “incomplete or distorted disclosure of information, especially in calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse”. In the same work, the author further argues that if the underlying attributes of the transaction, namely, asset specificity and uncertainty, are high for recurrent transactions, the risk of opportunism will be great enough to warrant replacing the market with a hierarchy. However, [Hennart \(1993, p. 531\)](#) articulates that when the output of agents becomes difficult to measure, the risk of opportunism will be great enough to warrant replacing the market with a hierarchy.

This topic of opportunistic behaviour has also been associated with participation in IJVs. While the formation of an IJV reduces the incentives of agents to behave opportunistically by giving them residual rights to the profits of the IJV, the problem is only partially solved because partners suffer only partial penalties for their opportunistic behaviour due to the nature of their partial ownership ([Hennart & Zeng, 2005](#); [Zeng, 1998](#)). Therefore in IJVs, the risk of opportunistic behaviour of partner firms is considered as pertinent rather than the exception. In IJV literature, opportunism is defined as “an act or behaviour performed by a party to seek its own unilateral gains at the substantial expense of another party and/or the JV entity” ([Luo, 2007b, p. 41](#)), and it is manifested in acts like withholding critical information, misrepresenting facts, shirking obligations, failing to keep promises, exploiting the partner dependence, contributing less than promised in IJVs, and stealing partner contributions ([Hennart & Zeng, 2005](#); [Luo, 2007a](#)).

Thus, TCE suggests that a partner firm in IJVs might pursue its own unilateral gains at the substantial expense of another partner and/or the JV entity ([Luo, 2007b](#)) and that the possibility of opportunism among IJV partners always exists ([Zeng, 1998](#)). Therefore, the risk of opportunism of IJV partner firms should be handled effectively to materialize the benefits of the IJVs ([Hennart & Zeng, 2005](#))

### 2.2. Transaction cost economics and structural mechanisms to reduce opportunism in international joint ventures

According to TCE, IJVs are formed: (1) to bypass the inefficiencies of intermediate markets with respect to providing raw materials and components, tacit knowledge, loan capital and distribution systems; and (2) when there are high fixed and low marginal costs with greenfield investment, and when assets sought are an inseparable part of total assets held by target firm ([Brouthers & Hennart, 2007](#); [Hennart, 1988](#)). Theory suggests that while the formation of an IJV offers joint benefits to the partners, it

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