

The evolution and internalization of international joint ventures in a transitioning economy

H Kevin Steensma^{1,2},
Jeffrey Q Barden¹,
Charles Dhanaraj³,
Marjorie Lyles³ and
Laszlo Tihanyi⁴

¹University of Washington, Seattle, USA;

²Grenoble Ecole de Management, France;

³Kelley School of Business, Indiana University,
Indianapolis, USA; ⁴Texas A&M University,
College Station, USA

Correspondence: H. Kevin Steensma,
University of Washington, Mackenzie Hall,
Box 353200, Seattle, WA 98195, USA.

Tel: +1 206 543 4897

Fax: +1 206 685 9392

E-mail: steensma@u.washington.edu

Abstract

Although international joint ventures (IJVs) may mature over time and develop competitive viability, they maintain some risk of instability owing to their shared ownership. Such instability can ultimately lead to their internalization by one of the partners. In this study, we consider factors that influence (1) whether IJVs evolve toward becoming a wholly owned subsidiary, and (2) which parent (foreign or local) gains ownership of the venture. We use a sample of Hungarian joint ventures, and find that only when there is both a power imbalance between the parents and high levels of conflict is the likelihood that the joint venture converts to a wholly owned subsidiary enhanced. The extent to which the joint venture has learned from the foreign parent indirectly determines which parent gains full ownership. Extensive knowledge transfer to a joint venture in a transitioning economy combined with high levels of conflict increases the likelihood of the foreign parent gaining full ownership. In contrast, when there is extensive knowledge transfer and low conflict between the parents, the local parent is more likely to internalize the venture. Our results suggest that the relationship between partner power and outcomes in ventures is more complex than originally believed, and is contingent upon the level of conflict between the parents of the IJV.

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INTRODUCTION

Despite the tremendous growth in the formation of cross-border joint ventures over the course of the past two decades, international joint ventures (IJVs) have been shown to be relatively unstable (Inkpen & Beamish, 1997). Indeed, some have argued that IJVs are merely a temporary organizational form (Porter, 1990; Williamson, 1991). This instability, leading to either termination or changes in the ownership structure (Yan & Zeng, 1999), has been attributed to the inherent liability of being a new venture (Singh, House, & Tucker, 1986), relational problems due to opportunism (Parkhe, 1993), and the unequal pace of learning (Hamel, 1991; Larsson, Bengtsson, Henriksson, & Sparks, 1998).

Because of the increase of joint ventures in general, there has been extensive research on their failure (Gomes-Casseres, 1987; Kogut, 1989; Mitchell & Singh, 1992; Steensma & Lyles, 2000). However, "failure" depends on one's definition (Yan & Zeng,

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1999). Hennart, Kim, and Zeng (1998) demonstrate that IJVs are no more likely to *liquidate* than wholly owned foreign affiliates, as both forms are equally subject to normal business risk and the liability of newness. In fact, most exits by IJVs occur not through liquidation but through their sale to one of the partner firms (Hennart et al., 1998). In essence, one partner - foreign or local - "internalizes" the joint venture. The interesting question regarding the evolution of relatively mature joint ventures is not what determines their survival *per se*, but rather what determines their transformation to a wholly owned subsidiary (Hennart et al., 1998; Kogut, 1991; Reuer & Miller, 1997). Indeed, this question is particularly relevant in the current international business environment because many of the multinational companies that initially invested in joint ventures in transitional economies during the late 1980s and early 1990s are now restructuring those investments to reflect their growing strategic importance (Luo, 2007).

Of further interest is *which* of the two parent firms retains ownership of the joint venture once it converts to a wholly owned subsidiary. The foreign parent can buy out the local parent and maintain a foreign-based wholly owned subsidiary. Alternatively, the local parent can attain full ownership by purchasing the interest of the foreign parent. Despite the call to understand better how IJVs evolve (Inkpen & Currall, 2004), little is known regarding when it is that local parents or foreign parents render full ownership of transitioning joint ventures. Data on the evolution of joint ventures in this regard are quite rare.

We address two questions:

- (1) What influences whether an IJV remains a joint venture or converts to a wholly owned subsidiary?
- (2) Of those that convert, what determines whether the local partner or foreign partner takes control of the venture?

Internalizing a joint venture at the wrong time or under the wrong conditions can adversely affect the overall value of the parent firm (Kogut, 1991; Reuer & Miller, 1997). Understanding what provokes IJVs to "tip" and be internalized by either the foreign or local parent can provide insight on how managers might develop their joint venture portfolio and take adaptive actions as the ventures evolve (Van & Zeng, 1999). The extent of control by foreign or local entities also has important economic implications, particularly in emerging

economies that rely heavily on foreign direct investment. We focus on factors associated with the challenges of shared ownership and that are potentially controllable by management.

THEORY AND HYPOTHESES

Theoretical Perspective

We rely on the complementary perspectives of social exchange and organizational learning because they highlight key aspects of IJVs. The social exchange perspective attends to relationship and power issues within the joint venture. The learning perspective attends to knowledge flows, which can ultimately alter joint venture partners' interdependence and relative power (Haniel, 1991). Past research has focused on three possible mechanisms for joint venture instability:

- (1) the distribution of power - the relative influences that parent organizations have on important practices and technologies in the IJV (Dhanaraj & Beamish, 2004; Killing, 1983; Makhija & Ganesh, 1997);
- (2) parent conflict - tensions arising from differing goals and expectations (Hennart & Larimo, 1998; Park & Ungson, 2001; Yan & Zeng, 1999); and
- (3) the flow of knowledge from the parent firms to the IJV (Arino & de La Torre, 1998; Hanel, 1991; Steensma & Lyles, 2000).

A comprehensive understanding of joint venture evolution requires exploring the interactions among power distribution, relational context, and IJV learning (Inkpen & Currall, 2004). We argue that conflict, power, and learning interact to create conditions of instability that ultimately leads to the internalization of the joint venture favoring one partner over the other.

One of our objectives is to provide clarity on the role that parent conflict plays in the evolution of joint ventures. In general, partners are motivated by reciprocity to form a joint venture, such as realizing synergies in technology or learning (Oliver, 1990). We define conflict in the context of joint ventures to be the "overt behavior arising out of a process in which one unit seeks the advancement of its own interests in its relationship with the others" (Schmidt & Kochan, 1972: 363). Various factors have been found to influence the level of conflict between parent firms, including cultural distance and previous collaborative history (Luo, 2006). However, the influence of conflict on

IJV outcomes is somewhat mixed. Some joint venture studies have found parental conflict to hamper stability (e.g., Ding, 1997; Steensma & Lyles, 2000). Others have not (e.g., Yan & Gray, 2001). Conflict can have both positive and negative effects on stability (Jehn & Mannix, 2001; Roehl & Truitt, 1987). Thus we make no *a priori* predictions about the direct effects of conflict. We argue that, under certain conditions, conflict is detrimental. Conflict between parent firms acts as a catalyst that interacts with power imbalance and knowledge acquisition to influence conversion to a wholly owned subsidiary and which partner takes full ownership.

Others have speculated how learning within a joint venture relationship might lead to instability and internalization as one partner may no longer need the other (Hamel, 1991; Inkpen & Beamish, 1997; Reich & Mankin, 1986). Although Hennart, Roehl, and Zietlow (1999) found little support for the general notion that Japanese firms partner with US firms, learn what is necessary, and overtake their partners, they lacked highly specified variables (e.g., learning, power, conflict) and a causal model. We suggest that learning does not cause instability *per se*, but does play an indirect role in determining ownership after instability arises.

By using a longitudinal design, we track the evolution of 124 Hungarian IJVs. Joint ventures between local and foreign partners have been a central organizational form in the successful transition of former centrally planned economies, including Hungary (Lyles & Salk, 1996; Peng, Lu, Shenkar, & Wang, 2001). The rapidly changing environment of transitioning economies presents a unique setting in which to examine the evolution of joint ventures (Peng, 2003; Steensma, Tihanyi, Lyles, & Dhanaraj, 2005).

We extend previous research that looks solely at survival (e.g., Kogut, 1989; Mitchell & Singh, 1992; Steensma & Lyles, 2000) by using a two-stage analysis. We first evaluate factors influencing the stability of the ownership structure of those that survive. Second, we explore factors influencing whether the foreign or local partner gains full ownership. We find that merely an imbalance in power between the parents does not lead a joint venture to tip toward becoming a wholly owned subsidiary. Only when this power imbalance is combined with conflict between the parents do we see an increasing likelihood that the joint venture will convert to a wholly owned subsidiary. Similarly, knowledge acquisition by the joint venture

from the foreign parent by itself does not influence whether the local or foreign parent ultimately renders full ownership of the joint venture. However, we do find that when the joint venture has acquired extensive know-how from the foreign parent, and there are high levels of conflict between the parents, full ownership of the joint venture is more likely to be acquired by the foreign parent (the original source of the knowledge). However, when there is limited conflict, and extensive knowledge has been gained from the foreign partner, the joint venture is more likely to be acquired by the local parent. Figure 1 depicts the overall model.

Power Imbalance and the "Tipping" from Shared Ownership to Wholly Owned Status

One of the distinguishing aspects of joint ventures relative to wholly owned affiliates is that it is generally easier to sell a stake in a joint venture to an existing partner than to sell such a stake to an outside third party (Nanda & Williamson, 1995). Most IJVs have an exit clause (Hennart et al., 1998). Typically, the partners have the first right of refusal to buy out the stake in the JV. Thus there is often not an "open market" for control over IJV stakes. Moreover, IJV partners have an advantage in terms of valuation information. Each of the joint venture parents is relatively aware of the value of the overall operation, as compared with outside parties not directly involved in the IJV. Information scarcity makes individuals risk-averse and less likely to pursue risky actions (Fox & Tversky, 1998). Thus, when competitively viable IJVs become unstable, they generally tip toward one of the existing partners as opposed to being sold to an outside party or even liquidation (Hennart et al., 1998).

IJVs do not necessarily have to tip toward a solely owned affiliate of a local or foreign-owned partner. Joint ventures can potentially maintain their stability and remain a jointly owned venture. Indeed, there are numerous examples of long-lived joint ventures with shared ownership and power (Inkpen & Beamish, 1997). However, IJVs are characterized by a set of relational dynamics that inherently push them toward instability (Park & Ungson, 2001). The potential for opportunistic behavior on the behalf of one of the partners¹ is one of the most significant destabilizing factors in alliances (Park & Russo, 1996; Parkhe, 1993; Young-Ybarra & Wiersema, 1999). Opportunistic behavior by local firms in transition economies may be enhanced by a history of socialism. For instance,

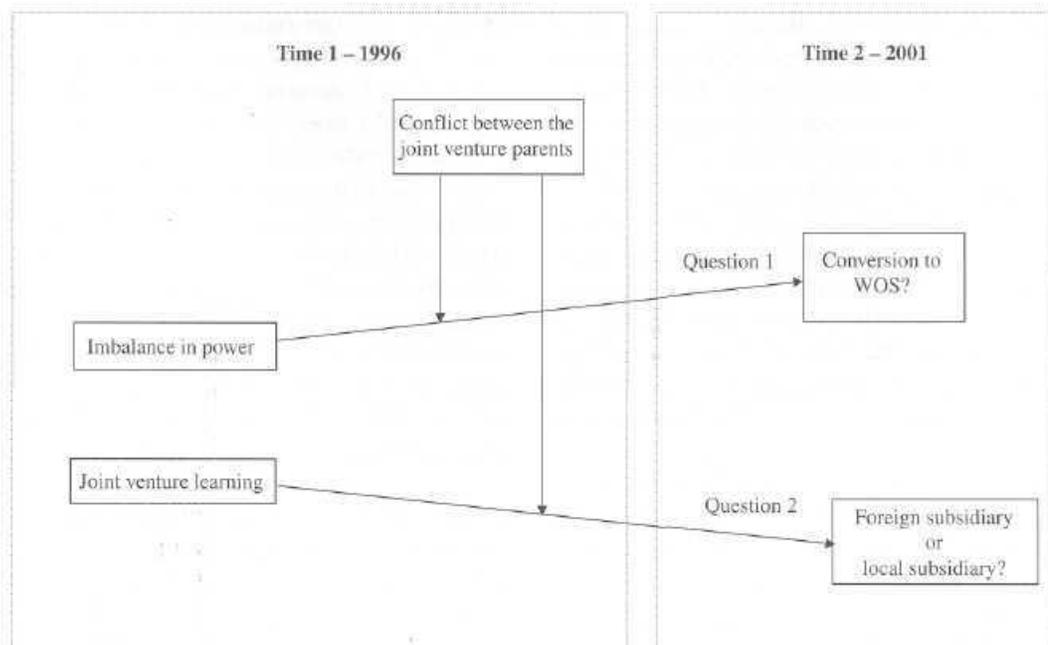


Figure 1 Theoretical model.

the chronic shortages due to central planning increased bargaining and distrust among firms, elevating opportunism in business relationships (Kornai, 1992). When one joint venture partner is threatened by the opportunism of the other, it has an incentive to protect itself by terminating the relationship.

Although the potential for opportunism can be dampened by *ex ante* and *ex post* deterrents (Parkhe, 1993), differences in power between exchange partners can lead to opportunistic behavior (Emerson, 1972). In the context of IJVs, power is the influence each parent has in determining how an IJV's resources are allocated. Power distribution can be multidimensional, spanning influence over financial resources, technology and operations, and marketing. The relative power that parties have is determined in part by resource contribution (Pfeffer & Salancik, 1978; Thibaut & Kelley, 1959). Simply put, parent organizations in possession of valuable resources and knowledge, which cannot be provided by others, can have greater power over the IJV. However, power can also be determined by institutional forces such as culture and law (Scott, 2001). Thus power that parent firms have cannot always be easily equated with relative stocks of resources and knowledge.

Power differences in relationships can create a virtual cycle of exploitation and subsequent retribution. In this view, "To have power is to use it"

(Emerson, 1972: 67). Frazier, Gill, and Kale (1989) found that manufacturers with a power advantage over their dealers were more prone to use coercive strategies in these exchange relationships than were manufacturers without a power advantage. Furthermore, the low-power firm often behaves opportunistically to rectify its power handicap, further aggravating the exchange relationship. For example, Provan and Skinner (1989) found that the greater the supplier's control over the dealer's decisions, the more likely the dealer was to act opportunistically toward the supplier.

Power imbalance is especially salient in IJVs operating in transition economies. On the one hand, local parents may gain power from their knowledge of the special institutional conditions. As former communist countries, most transition economies operated under isolation before the 1990s and offered little opportunity for foreign parents to learn about the local environment. On the other hand, foreign parents' power in transition economies is increased by their business skills, experience with developed market institutions, and capital resources (Steensma et al., 2005). While the differences in these parent characteristics generally lead to power imbalance in IJVs, the gap between local and foreign parents of transition economy IJVs tends to be wider. The power of local parents is reduced by their inexperience in managing privatized business firms, lack of marketing,

finance, and accounting skills, and lack of available local private investments.

Opportunistic tendencies by the weak partner do not go unnoticed by the dominant partner. Indeed, alliance partners that have dominant control have been found to have lower levels of trust in their alliance partners (Young-Ybarra & Wiersema, 1999). From a social exchange perspective, a power imbalance provides the potential for partner exploitation and an environment that fosters instability. In contrast, equally divided power over the joint venture cultivates an environment of respect, trust, symmetric cooperation, and stability (Steensma & Lyles, 2000; Yan & Gray, 1994). Each party is mutually dependent on the other and feels less threatened by possible exploitation, resulting in the longevity of the joint venture.

Hypothesis 1: A power imbalance between the parents will increase the likelihood that the IJV will be internalized as a wholly owned subsidiary.

Although a power imbalance provides the *potential* for exploitation and retribution leading to instability, such behavior need not *necessarily* occur. In an experimental study, Molm (1990) found little evidence of a relationship between power structure and strategic action in repeated exchange relationships. Indeed, it has been argued that a power imbalance may even contribute to the stability and performance of cooperative inter-organizational relationships (Ding, 1997; Killing, 1983; Young-Ybarra & Wiersema, 1999). A dominant power structure can minimize coordination costs and outperform those joint ventures where the parents share power and control (Killing, 1983). After evaluating the overall inconclusiveness of previous research, Yan and Zeng (1999) argue that the relationship between power distribution and performance outcomes may be contingent on other inter-organizational variables.

When is a joint venture hampered by a power imbalance, and when might it derive the benefits of a power imbalance? The level of conflict between the parents may explain when power imbalance is more likely to lead to instability and the internalization of a joint venture. Conflict is a complex construct that has multiple interrelated causes, forms, and outcomes (Qehn & Mannix, 2001). Conflict in a cooperative relationship results from perceived discrepancies, irreconcilable desires (Boulding, 1963), and a general sense of injustice (Qehn & Mannix, 2001; Ring & Van de Ven, 1994).

Joint ventures are particularly ripe for inter-parent conflict because of variance in parent motives (Oliver, 1990) and asymmetric resource flows among parent firms and the joint venture entity (Das & Teng, 2000). Indeed, volatile market conditions and broad differences in capital resources between foreign and local parents such as those found in transitional economies provide a fertile ground for conflict for joint ventures operating in transition economies. When conflict does arise, mistrust and relational instability often follow (Lind, 1995; Tyler & Smith, 1997). Yet the effects of conflict on group and organizational stability are not always negative (Jehn & Mannix, 2001). Some types of conflict can spur productive discussions about functional issues and lead to stability. A more sophisticated model of both power structure and conflict in IJVs is needed.

The cycle of exploitation and retribution that can arise from a power imbalance is generally set off by some specific behavior of one of the partners (Blau, 1964; Homans, 1974; Thibaut & Kelley, 1959). The heightened mistrust, which can cause and result from inter-parent conflict, triggers enhanced scrutiny of the IJVs power structure by the parent organizations (Inkpen & Curtail, 2004). When conflict occurs, joint venture partners are likely to turn their attention from using power in the relationship to generate cooperative synergies to using it to consolidate control over the alliance and protect their own interests. Furthermore, such behavior will likely be met by retribution from low-power partners (Provan & Skinner, 1989).

In sum, it is conflict that catalyzes the potential for destructive opportunism resulting from a power imbalance. A power imbalance apart from conflict may remain relatively benign and lead to instability only when conflict comes into play for one reason or another (Young-Ybarra & Wiersema, 1999). Moreover, conflict between parents is more likely to be resolved amicably when power is divided equally, and when a sense of mutual forbearance exists. It is the combination of conflict and an unequal power distribution that will enhance instability.

Hypothesis 2: There will be a stronger positive relationship between power imbalance and the likelihood of a conversion to a wholly owned subsidiary when there are high levels of conflict between the parents as compared to when there are low levels of conflict.

Direction of "Tipping": Foreign or Local Acquisition?

While an imbalance of power in conjunction with parent conflict may lead to instability in general, what determines the direction in which the venture tips? The answer may lie in part in the flow of knowledge. Joint ventures have been conceptualized as a race to learn (Gulati & Singh, 1998; Hamel, 1991; Larsson et al., 1998). Whether the venture ends up being locally or foreign-owned will depend to some extent on the degree to which the venture has learned necessary skills from the parents.

There has been extensive work examining the transfer of knowledge from foreign partners to IJVs in transitioning economies. This work has focused largely on the type of learning (Tsang, 2001) and on factors that enhance learning, including human resource management activities (Cyr & Schneider, 1996), various contextual factors (Lyles and Salk, 1996), and institutional conditions (Geppert, 1996; Steensma et al., 2005). Others have found that knowledge transferred from the foreign parent to the venture enhances the performance of the venture (Lyles & Salk, 1996). For example, Luo (1999) finds that the financial returns of Chinese ventures are positively related to the flow of knowledge from the foreign parent. However, little is known regarding how the flow of knowledge from the foreign parent might influence future control over the IJV.

In general, the primary knowledge contribution of foreign parents in transition economies entails technology, management expertise, market knowledge, and global support (Inkpen & Beamish, 1997; Steensma & Lyles, 2000; Van & Gray, 1994). In return, the local partner provides the knowledge of local institutions and insight into dealing with various governmental bureaucracies and local culture. As the joint venture learns from the respective parent, its dependence on that particular parent decreases." At the extreme, these ventures become highly autonomous and operate virtually independent of the parent firms. However, once the joint venture becomes unstable, the learning that has occurred within the joint venture can alter the relative bargaining power of the parent firms and the extent to which the venture can function without the assistance of a parent (Inkpen & Beamish, 1997).

For instance, the acquisition of knowledge from the foreign parent enables an IJV to be competitive while being independent of the foreign parent. This is common in transitioning economies. Joint ventures tend to remain local players and thus

benefit from the knowledge of local market conditions. Successful acquisition of technological expertise and managerial skills from the foreign parent, coupled with local market knowledge, can help to sustain the competitiveness of IJVs. If the joint venture has failed to acquire critical knowledge from the foreign parent, the conversion of the joint venture to a locally controlled wholly owned operation is generally not viable. Indeed, the sustainability and competitiveness of the venture in transition economies without the foreign parent would be tenuous at best. When left alone, local firms tend to fail owing to their lack of business and technological knowledge. Such knowledge becomes even more critical as institutional conditions improve and new competitors and more sophisticated customers emerge in transition economies (Peng, 2003).

Only if the joint venture has acquired the foreign know-how will the local partner be able to take full ownership over the venture and have the venture remain competitive. Thus, if the joint venture is unstable, the higher the degree to which knowledge from the foreign parent has been transferred to the joint venture, the greater the likelihood that the venture will become locally owned.

Hypothesis 3: A joint venture's acquisition of knowledge from the foreign parent will increase the likelihood that the local parent will internalize the unstable venture as opposed to the foreign parent.

However, this general relationship may depend in part on the level of conflict between the parents. Conflict between foreign and local parents in transition economies often emerges from the parents' different views on local business conditions, and the unclear ownership of assets by local parents. For the joint venture to be internalized by the local parent, not only must the local parent be motivated to acquire the foreign parent's equity share, but the foreign parent must also be willing to sell. However, foreign parents, fearing that the local parent could misappropriate valuable proprietary knowledge transferred to the joint venture or could become a potential competitor, often have a strong interest in retaining control of that knowledge.

Knowledge transfer in alliances can present a prisoner's dilemma, and highlight the fragile nature of cooperation (Gulati & Singh, 1998; Hamel, 1991, Larsson et al., 1998). Although foreign parents have an interest in the success of their IJVs in transition

economies, and may wish to transfer proprietary knowledge, foreign parents may also be justifiably nervous over local parents' access to their proprietary knowledge. The acquisition of proprietary knowledge may not only lead to reduced opportunities in the local market, but, as transition economies develop, local firms are increasingly becoming global players and threaten the market positions of multinational firms in their home markets. As the possibility of opportunism is introduced, partner transparency and knowledge transfer to the joint venture rapidly shift from being welcomed as a necessary component of synergistic collective action to being seen as giving away the basis of competitive advantage to a deceptive rival (Dhanaraj & Parkhe, 2006). Thus, where a harmonious relationship exists between joint venture partners, knowledge transfer from the foreign parent provides a means for the joint venture to be self-sufficient, and increases the likelihood that the local parent will acquire the foreign parent's share.

On the other hand, if the foreign parent has reason to believe that the local parent may behave opportunistically with the foreign parent's proprietary knowledge in hand, then the foreign parent will have incentive to acquire the local parent's share of the joint venture in order to protect its competitive advantage. Thus conflict between parent firms - an indicator of mistrust -- will moderate the relationship between the level of knowledge acquired from the foreign parent and the likelihood that the joint venture will become wholly owned by the local or foreign parent.

Hypothesis 4a: When there are low levels of conflict, there will be a positive relationship between knowledge acquired by the joint venture from the foreign parent and the likelihood that the joint venture will become locally controlled.

Hypothesis 4b: When there are high levels of conflict, there will be a negative relationship between knowledge acquired by the joint venture from the foreign parent and the likelihood that the joint venture will become locally controlled.

METHODS

Sample Selection

The large-scale socio-economic transition in Hungary since the early 1990s has led to the emergence of new organizational forms, including joint ven-

tures. Hungary is perhaps an ideal emerging economy context to study the dynamics of joint ventures, in part because there were no restrictions in terms of foreign ownership. In contrast to many transition economies, Hungary's relative openness to foreign direct investment was due to three main factors. First, the country's transition from 1989 to the time of our first survey resulted in a mass privatization, leaving limited room for government interventions (e.g., only 22% of our sample had any state ownership). Second, government policies were rewritten to facilitate free capital allocation, a requirement for European Union membership. Third, Hungary's indebtedness in this period required the local governments to improve the country's balance of payments through foreign capital inflow.

Our sample was taken from the *Hungarian Joint Venture Association Directory*. Through the early 1990s it was mandatory for firms with foreign participation to be members of this joint venture association. Although it was no longer mandatory in 1996, most existing joint ventures were still members as of 1996. We also purchased the membership lists from various embassies, including Germany, Austria, Great Britain, and Italy, to verify the completeness of the Hungarian directory. We randomly sampled from the Hungarian directory of joint ventures such that the original sample was consistent with the distribution of all firms in Hungary in terms of industry. Sample stratification was based on statistics provided by Hungary's Central Statistical Office. We called each firm to verify that it was a joint venture. On a number of occasions, it was learned that the venture was in fact a wholly owned subsidiary. We then replaced this firm with another randomly sampled IJV from the same industrial category.

The IJVs that participated were identified through directories, contacts, and the Hungarian joint venture database. Each participating joint venture had to employ between 15 and 500 employees. The general managers of joint ventures were then contacted and asked to participate in the study. By constructing the listing of joint ventures in this manner, we came as close to sampling from the full population as possible. The final usable sample was composed of 150 IJVs involving a partnership between a local Hungarian firm and a foreign firm. Industry sectors that were most represented in the sample include chemicals (8%), electronics (10%), financial services (11%), construction (11%), machinery and auto components (11%), food processing (7%), and textiles (7%).

Data Procurement

To establish causality in the model, data were collected in two stages. Data used to construct the independent variables were collected in 1996. Data on alliance outcome (i.e., conversion to subsidiary, foreign or local ownership) were collected in 2001. We chose a 5-year time interval to allow enough time for possible conversions to wholly owned subsidiaries to occur.

Because mail and telephone surveys were likely to have a poor response rate, we conducted personal interviews to gather the data for our first stage. We minimized the chance of interviewer bias by using a structured and standardized interview process, and Likert-type scales for responses whenever possible. In brief, the structured interviews yielded survey data on each joint venture's founding, parental involvement, and success. In 2001, we established the current status of the IJV via follow-up phone calls. Our data are unique because we can determine whether the IJVs from 1996 sustained as an IJV or evolved into wholly owned subsidiaries, and the partner that gained control.

The development of the survey instrument began with qualitative interviews with joint venture managers. From these interviews, basic constructs were identified and items were developed. US and Hungarian managers were then asked to review the instrument. Prior to data collection, the instrument was translated, back-translated, retranslated back into Hungarian, and reviewed by the Hungarian project manager to ensure appropriate meanings of the questions. The instrument was also pre-tested, and survey items were modified and improved. We trained the interviewers and developed detailed instructions for the project manager at the research institute. The interviewers were bilingual and could conduct the interviews in the language most suitable to the joint venture manager, but virtually all interviews were done in Hungarian or English.

The informants were joint venture presidents or general managers. The average tenure of our respondents in their executive position was 5.2 years with a standard deviation of 2.4. Ideally, multiple informants would have been used and would have included representatives of parent firms as well as the joint venture, but the size and nature of the study precluded such an approach. Previous research provides support for relying on the joint venture general manager for reliable data. Geringer and Hebert (1991) found a significant correlation between the parent's assessment of IJV performance and that of the joint venture's general

manager. Peng and Luo (2000) found a high correlation between self-report data and archival data in China. Child, Van, and Lu (1997) also found significant inter-rater reliability among IJV managers for the assessment of parental influence.

Joint venture status was first verified by telephone, followed by a letter to the general manager requesting that he or she participate in the study. The response rate for the sample was 44% (n=150). As of 2001, 61 remained operational as joint ventures, 63 had converted to wholly owned subsidiaries, and 26 had been liquidated at the time of the second survey (i.e., 2001). Of those that had converted to wholly owned subsidiaries, 32 were controlled by the local parent and 31 by the foreign parent.

Our analysis is on the 124 IJVs that remained viable as of 2001. The average number of employees across this sample of IJVs was 111. The average age of the sample of joint ventures was 7 years as of 1996. Ninety-two percent were 4 years or older in age. Forty-two percent of the ventures had been a pre-existing business at the time of formation, and 58% were greenfield operations. Twenty-two percent had partial state ownership. These IJVs fall into a broad array of industry groups, including chemicals, electronics, construction, machinery/components, financial services, food processing, textiles, construction, and energy.

There is likely to have been some survival bias in our sample. Our sample is made up of somewhat mature IJVs, most of which have survived the liability of newness. However, the nature of this sample is appropriate for the phenomenon being studied. We are examining the evolution of viable IJVs: do they transform into wholly owned subsidiaries, and, if they do, are they controlled by the primary foreign parent or local parent? Thus a sample of IJVs that have survived the liability of newness is appropriate.

The type and extent of information collected in our project is unavailable elsewhere because joint ventures, particularly in transitional economies, did not have stringent reporting requirements in terms of detailed information. Our survey therefore created a unique database documenting the evolution of IJVs in Hungary during a period of transition.

Dependent Variables

Our dependent variables are dichotomous and were measured by observing the state of the joint ventures surveyed in 1996 as of 2001. For the first

regression, the dependent variable is coded as 1 if the joint venture converted to a wholly owned subsidiary between 1996 and 2001 and is coded as 0 if it remained an IJV. For the dependent variable in the second analysis, local ownership is coded as 1 if the wholly owned subsidiary was internalized by the local partner and 0 if it was internalized by the foreign partner.

Independent Variables

Conflict. Parent conflict is composed of five 5-point Likert-type items (1 to 5, little to a great extent). The items were designed to capture the extent of:

- (1) mistrust among the partners;
- (2) conflict over the original agreement;
- (3) conflicting goals of partners;
- (4) cultural differences in expectations of the partners in dealing with the joint venture; and
- (5) tensions between local and expatriate managers in the joint venture.

Cronbach's-alpha for the measure is 0.80.

Decision power imbalance. We collected measures of control over specific areas and issues of joint venture management (Child et al., 1997; Lin, Yu, & Seetoo, 1997). The joint venture managers were asked to evaluate the influence that the dominant Hungarian parent, dominant foreign firm, and joint venture managers had over eight issues by dividing 100% influence across the three groups. The issues included are:

- (1) product technology;
- (2) process technology;
- (3) operations;
- (4) sales/marketing;
- (5) management decisions;
- (6) administrative support; and
- (7) pricing decisions.

Similar to a measure used by Steensma and Lyles (2000), we created a difference score as follows:

Decision power imbalance

$$= \left| \sum (\text{foreign influence}_t - \text{local influence}_t) \right|$$

The Cronbach's alpha of the difference scores was 0.87. Each dimension was equally weighted. A logarithmic transformation was taken to normalize the distribution.

Learning from foreign parent. We measured joint venture learning with a six-item scale (Lyles & Salk, 1996). The questions appraised "to what extent have you learned from your foreign parent": technological expertise, marketing expertise, product development, foreign cultures and tastes, managerial techniques, and production processes. The reliability was 0.84.

To assess discriminant validity of our core constructs, we conducted a factor analysis of the various items associated with the constructs. Table 1 provides the factor loadings.

Control Variables

New IJVs, like other start-up enterprises, face an inherent liability of newness that creates significant coordination pressures. We control for *joint venture age* in two ways. First, joint ventures had to be at least a year old, not including the time needed to negotiate the original contract in order to participate in the study. Second, we include a control variable in the regression analysis equal to the IJVs age in years as of 1996.

We also control for whether the IJV began as a partial acquisition of an existing operation or as a greenfield venture (*acquisition/greenfield*). We expect greenfield joint ventures to face a systematically different set of start-up and coordination challenges than joint ventures formed by the foreign parent's investment in an existing operation. Whereas greenfield joint ventures generally represent a fresh start with impressionable new employees, existing joint ventures are more likely to be characterized and influenced by an established organizational culture. The foreign parent may have a lower degree of attachment to a venture that was established through a partial acquisition of an existing operation (Hennart et al., 1998). We control for the initial state of the joint venture by including a dummy variable in the regression analysis (0=acquisition, 1=greenfield). We further control for whether or not the joint venture has any *state ownership* (0=no, 1=yes).

Performance was used as a control because of the predicted bidirectional causality (Koza & Lewin, 1998) that gives rise to the relational capital-performance cycle. Survey data on performance generally show high validity (Venkatraman & Ramanujam, 1987), and subjective measures of joint venture performance have been found to be highly correlated with other measures (Geringer & Hebert, 1991). Thus we measured market performance with a multiple-item survey measure. The

Table 1 Factor analysis of core constructs

Construct/items	Factor 1	Factor 2	Factor 3
<i>Power imbalance</i>			
Product technology	0.87		
Process technology	0.89		
Operations	0.92		
Sales/marketing	0.88		
Management decisions	0.86		
Administrative support	0.89		
Pricing decisions	0.91		
<i>Learning from foreign parent</i>			
Technological expertise		0.78	
Marketing expertise		0.80	
Product development		0.80	
Foreign cultures and tastes		0.63	
Managerial techniques		0.77	
Production processes		0.77	
<i>Conflict</i>			
Mistrust among parents			0.80
Conflict over the original agreement			0.78
Conflicting goals of partners			0.76
Cultural differences in expectations of the partners			0.72
Tensions between local and expatriate managers			0.77

respondent was asked: (1) to rate the joint venture performance (1 to 5, poor to excellent); (2) to rate their joint venture's performance as compared with other firms in their industry in Hungary (1 to 5, much poorer than average to better than average). A third item was an aggregate measure of performance, where the respondent was asked to rate the IJV's performance during the year preceding the survey in the following seven activities: increase business volume, lower unit costs, increase market share, increase employee productivity, lower overhead costs, achieve planned goals, and make profits (1 to 5, poor performance to excellent performance) (Cronbach's $\alpha=0.68$). Each of these three items was standardized and combined. The Cronbach's alpha of the three items was 0.77.

We assessed the possibility that the sample was somewhat biased in the direction of better-performing joint ventures. This is a potential bias in all studies where responses are not received from the entire population. Because of social desirability, the higher-level performers may be more willing to participate than the lower-level performers. If our sample were biased toward higher-performing firms, our performance measure would likely be skewed toward that direction. That is not the

case. The distribution of our performance variable is very much bell-like, with a Shapiro-Wilks value of 0.97 (1.00 is perfectly normal). The skewness of that measure is -0.59, which is far from the > 2.5 range that signifies psychometric and statistical trouble.

We controlled for *foreign equity control* because it has been found to influence the likelihood of conversion to wholly owned subsidiary (Gomes-Casseres, 1987). The percentage of foreign equity for each IJV was entered in all empirical models.

We also controlled for whether the IJV was a *multiparty alliance* involving more than two partners. Multiparty alliances entail enhanced complexity, and may hamper the ease with which an IJV converts to a wholly owned subsidiary. We created a dummy variable such that 0 indicated a two-party alliance and 1 indicated a multiparty alliance.

The raw level of decision power held by the foreign parent(s) and local parent(s) was determined based on the measures used to calculate decision power imbalance. Cronbach's alpha for the decision power of the foreign parent was 0.71. Cronbach's alpha for the decision power of the local parent was 0.69.

Table 2 Inter-correlation matrix for dependent, independent and control variables

Variables	Mean	s.d.	1	2 ^a	3	4	5	6	7	8	9	10	11	12	13
1. WOS vs IJV	0.51	0.50	—												
2. Foreign subsidiary vs Local subsidiary	0.25	0.43	0.57**	—											
3. Age	6.59	2.57	-0.04	0.12	—										
4. Acquisition/Greenfield	0.58	0.51	0.24**	-0.04	0.18*	—									
5. State ownership	0.22	0.41	0.05	0.05	0.23*	0.05	—								
6. Performance (1996)	0.42	2.22	-0.08	0.16	0.14	0.02	0.05	—							
7. Multiparty alliance (>2)	0.48	0.50	-0.12	-0.13	0.11	-0.03	0.24**	-0.02	—						
8. Foreign equity control	54.32	24.33	-0.7	0.43**	-0.19	-0.01	0.00	0.10	-0.13	—					
9. Cultural distance	1.75	1.78	0.05	0.05	-0.22	-0.10	-0.06	0.08	0.07	0.12	—				
10. Decision power of foreign parent	3.42	2.22	-0.05	0.67**	0.01	-0.04	0.02	0.05	-0.01	0.27**	0.18*	—			
11. Decision power of local parent	2.51	2.55	-0.28	-0.10	0.03	-0.14	-0.08	0.00	-0.07	-0.06	0.07	0.08	—		
12. Power imbalance	3.94	2.53	-0.08	0.41**	-0.19	-0.14	-0.14	-0.14	-0.22*	0.19*	0.08	0.39**	0.28**	—	
13. IJV learning	17.41	6.29	-0.04	0.23	-0.02	0.00	-0.20*	0.06	-0.08	0.19*	-0.01	0.25**	-0.13	0.15	—
14. Parental conflict	16.91	7.92	0.12	0.23	-0.10	0.01	-0.10	-0.29**	-0.08	0.10	0.16	-0.01	0.26**	0.14	0.14

*p<0.05; **p<0.01. n=124.
^an=63.

We computed and controlled for the *cultural distance* between the primary foreign parent and the Hungarian parent using the measure developed by Kogut and Singh (1988). Because Hofstede's cultural values do not include Hungary, we relied on the work done by Brouthers and Brouthers (2001) for the specific values for Hungary.

To determine whether there were differences across industry or sector in terms of instability and ownership, we performed some preliminary chi-square tests. Our joint ventures were categorized in two ways. First, we categorized them into broad sectors (manufacturing, service, wholesaler, construction, other). Second, we categorized them into 13 industry categories (chemicals, electronics, transportation, forest products, construction, financial services, computers and software, machinery, auto components, food processing, energy, textiles, tourism). Because our sample size is somewhat limited, we were reluctant to enter a series of dummy variables into our models. We ran chi-square tests to see whether joint ventures in certain industries or of certain types disproportionately converted to a wholly owned subsidiary. We also checked to see whether joint ventures in specific industries or types disproportionately became foreign owned. In no case was the chi-square test significant. This suggests that, in our data set, neither industry category nor type of firm significantly influenced the outcome of the joint venture.

RESULTS

Table 1 reports the means, standard deviations, and correlation coefficients between the dependent, independent, and control variables. We used hierarchical moderated logistic regression models to examine the hypothesized interaction effects. Table 2 reports the results of the hierarchical logistic regression models used to test the moderating effects (Table 3).

In Hypothesis 1, we suggest that a power imbalance between the parent firms will increase the likelihood that the IJV will convert to a wholly owned subsidiary. The coefficient decision power imbalance in the restricted model (Model 1) is not significant. Hypothesis 1 is not supported.

In Hypothesis 2, we argue that parental conflict will enhance the relationship between a power imbalance and the conversion of an IJV to a wholly owned subsidiary. Model 2 (full model) includes the interaction term between conflict and power imbalance. The coefficient is positive and significant (p<0.01). To gain further insight into the

Table 3 Empirical results

Constant	Wholly owned subsidiary (n=63) vs remaining an IJV (n=61)		Foreign ownership (n=31) vs local ownership (n=32)	
	Model 1	Model 2	Model 3	Model 4
	-0.17	2.96	-4.57	5.70
Controls and direct effects				
Age	-0.05	-0.07	0.26	0.23
Acquisition/Greenfield	0.97*	1.04*	-2.58*	-3.37*
State ownership	0.46	0.58	2.57 [†]	5.01*
Performance (1996)	-0.06	-0.08	0.56*	1.09*
Multiparty alliance (>2)	-0.73 [†]	-0.92*	-0.97	-1.11
Foreign equity control (1996)	-0.01	-0.01	0.01	0.02
Cultural distance	0.15	0.19	-0.23	-0.19
Decision power of foreign parent	-0.01	0.01	1.21**	2.17**
Decision power of local parent	-0.24**	-0.28**	-0.48 [†]	-0.85*
Decision power imbalance	0.01	-0.59*	-0.02	-0.26
Learning from foreign parent	-0.02	-0.03	0.14	-0.59 [†]
Conflict between parents	0.03	-0.16*	0.04	-0.78 [†]
Interaction effects				
Decision power imbalance × conflict		0.04**		
Learning from foreign parent × conflict				0.05*
Chi-square	22.34*	31.94**	51.76***	57.53***
Change in chi-square		8.60**		5.77**
Pseudo-R ²	0.23	0.30	0.75	0.80

[†]p<0.1; *p<0.05; **p<0.01; ***p<0.001.

nature of the moderation effects, we plotted the interaction effect using one standard deviation above and below the mean level of conflict. As seen in Figure 2a, there is a stronger positive relationship between power imbalance and the likelihood of an IJV converting to a wholly owned subsidiary when parental conflict is high as opposed to when it is low. We calculated the significance of the simple slopes (Aiken & West, 1991). Under conditions of high parental conflict, there is a positive relationship between power imbalance and the conversion to a wholly owned subsidiary (p<0.01). In contrast, under conditions of low conflict, there is a negative relationship between power imbalance and the conversion to a wholly owned subsidiary (p<0.1). Hypothesis 2 is supported. Moreover, it appears that a power imbalance may increase stability when there are low levels of conflict.

Hypothesis 3 argues that joint ventures' acquisition of knowledge from the foreign parent will increase the likelihood that the local parent will internalize the joint venture when it converts to a wholly owned subsidiary. In Model 3 (restricted model), the coefficient associated with learning

from the foreign parent is not significant. Hypothesis 3 is not supported.

In Hypotheses 4a and 4b, we consider the interaction between conflict and learning. We suggest that when there are low levels of conflict, learning from the foreign parent will increase the likelihood that the local parent will internalize the joint venture. In contrast, when there are high levels of conflict, learning from the foreign parent will increase the likelihood that the foreign parent will internalize the joint venture. Model 4 (full model) includes the interaction term, which is significant (p<0.05). Figure 2b depicts the effect of the interaction of learning and conflict on the likelihood of foreign parent and local parent control. Based on the simple slopes, when there are high levels of conflict, increasing levels of knowledge transferred from the foreign parent to the joint venture lead to a greater likelihood that the foreign parent will internalize the joint venture (p<0.05). We see the opposite effect when conflict levels are low. Higher rates of learning increase the likelihood that the local parent will internalize the joint venture (p<0.1). Hypotheses 4a and 4b are supported.

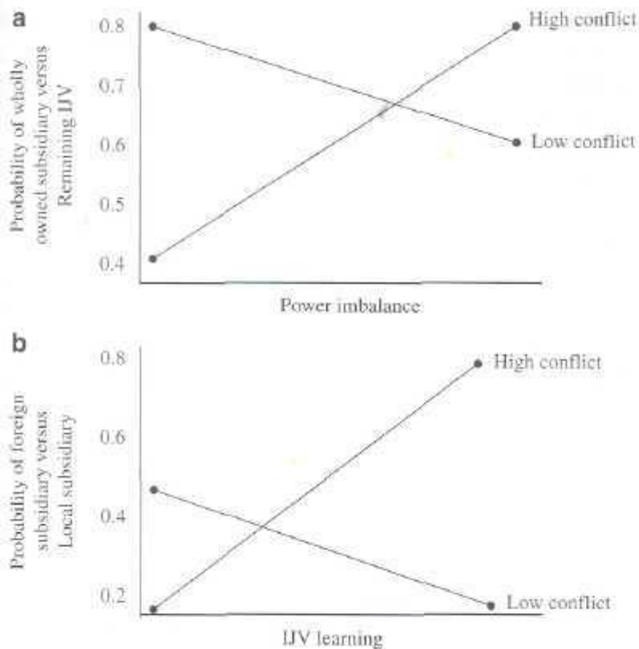


Figure 2 Interaction effects.

DISCUSSION

In this study, our objectives are to understand better the factors that influence when an IJV evolves into a wholly owned subsidiary and which partner (local or foreign) gains control. We find that conflict between the parents plays an important and indirect role for both questions.

Our results affirm those who have speculated that the relationship between partner power and outcomes in ventures is more complex than originally believed (Molm, 1990; Yan & Zeng, 1999). A power imbalance in cooperative relationships does not necessarily lead to dissolution, as some have suggested. On the contrary, some unbalanced alliances remain stable over time. What we do find is that the relationship appears to be contingent upon the actions and mindsets captured by our measure of parent conflict. Partner conflict and associated beliefs about the fairness and trustworthiness of ongoing exchange partners determine the effect that power differentials have on stability. We conceptualize a power imbalance as setting the stage for a cycle of exploitation and retribution. Parental conflict sets these wheels in motion. If conflict can be avoided, ventures that have a power imbalance can remain stable. Conflict apart from a power imbalance also does not lead to instability. We speculate that conflict is more likely to be resolved harmoniously when there is mutual

forbearance through relatively equal power distribution. Moreover, we find some support for the contention that a power imbalance may actually stabilize joint ventures when relatively low amounts of conflict are maintained between the parents (Killing, 1983).

On the second question, we find no support for a general direct relationship between knowledge transfer from the parent organizations to the IJV and the likelihood that a particular parent will acquire the venture. However, this relationship does appear to be contingent on parent conflict. High levels of knowledge transfer to the venture from the foreign parent combined with high levels of conflict significantly increase the likelihood of the venture being acquired by the foreign parent. However, when parent conflict is limited, high levels of knowledge transferred to the venture from the foreign parent increase the likelihood that the local parent will acquire the venture.

To delve a bit deeper, we ran separate analyses using the individual dimensions of our IJV learning measure and creating separate interaction terms with conflict. Our overall analysis shows that higher IJV learning combined with conflict leads to a greater likelihood of the joint venture being internalized by the foreign partner. However, further analysis using the individual dimensions showed that the interactions between conflict and (1) learning new technological expertise from the foreign partner ($p < 0.05$) and (2) learning production processes from the foreign partner ($p < 0.05$) was driving our overall effect. It appears that foreign parents are particularly concerned about losing control over the technological and production expertise that had been transferred to the joint venture.

Our findings build on existing learning race literature that highlights the direct effects of knowledge transfer on alliance stability. This literature's premise that the proprietary knowledge of alliance partners is a primary determinant of power in the relationship is directly applicable to IJVs. Multinational firms that transfer proprietary knowledge to their joint ventures in transitional economies risk having it appropriated by local partners. Conventional learning race theory suggests that self-sufficient local parents will then seek to acquire legal rights to the entire joint venture in order to capture its full rents.

We argue that the likelihood that the local parent will take full ownership of the joint venture is contingent on the nature of the relationship

between the parents. In relatively harmonious relationships, conventional wisdom seems to prevail. In a transitional economy, knowledge transfer from the foreign parent tends to lead to local parent acquisition of the joint venture. However, in the midst of a contentious relationship, foreign parents appear more motivated to retain control of the venture. Thus it appears that suspicions of opportunism related to partner conflict drive foreign parents to redouble their efforts to buy out local parents to avoid proprietary knowledge being misappropriated.

Implications for Practitioners

Our results showing the role that conflict plays in the evolution of IJVs have important implications for practitioners. While a joint venture's transition to a wholly owned subsidiary does not necessarily mean the failure of a strategic alliance, partners may no longer receive benefits from cooperating with their international counterparts. Contrary to conventional wisdom, however, joint venture dissolution is not the sole outcome of power imbalance and the "race to learn". The effects of these factors are greatly enhanced by conflict in the joint venture. To sustain their collaboration, foreign and local parents in transition economy joint ventures need to be actively involved in conflict resolution techniques. Most importantly, perceived injustice needs to be communicated and disputes resolved. IJVs should also be viewed as dynamic relationships, in which new conflicts between partners can emerge beyond the differences associated with the initial contractual agreement. Such dynamic relationship is also the result of the constantly changing local business environment in transition economies. As they develop the government regulations toward a more market-friendly economic system, local policymakers may also influence the evolution of joint ventures by improving their communication with foreign investors interested in establishing joint ventures and, later, providing forums for the resolution for operating conflicts.

Limitations and Future Research

Although our study provides insight into the evolution and internalization of IJVs, it has some limitations. For one, we relied on data from one type of inter-organizational exchange relationship in one transitional economy. Thus the generalizability of these results to forms of cooperation outside of IJVs in Hungary remains to be established. Other transition economies may evolve

through different mechanisms or reach different levels of market development. For example, some transition economies (e.g., Russia) are characterized by more restrictions on foreign ownership or higher regulatory uncertainties than Hungary over the time frame of our surveys. Researchers in other settings should consider whether the internalization of the IJV by the foreign parent is an available option based on the development of local market institutions and the regulatory environment for foreign direct investment. Moreover, transitional economies represent a special group of emerging countries. While our one-country, two-period design provided certain advantages, a multi-country study examining how the foreign parent involvement-joint venture success relationships vary depending on national context would be particularly provocative.

Although we control for whether or not the joint venture was multiparty our study does not delve into the complexity of multiparty relationships. Modeling complex multiparty relationships can provide nuanced insights that go beyond more simple analyses (Luo & Park, 2004). Future research on the evolution of IJVs might consider the dynamics of multiple-partner relationships. Joint ventures that have more than two partners, each with their own goals and relationship with the venture, may be more or less stable in terms of their conversion to wholly owned subsidiaries.

Our study was also limited in terms of the time decrements of data collection. We rely on a two-period study. Although this enabled us to collect relatively rich data in the first period, researchers may want to pursue a longitudinal panel design collecting data on conflict, learning, and power over multiple time periods to determine how these dynamic measures influence stability and ownership. Moreover, our study has all the limitations consistent with survey research. We rely on one respondent for each IJV, who may have been susceptible to memory decay and other biases.

Despite these limitations, this study provides insight into the role of power in learning in the evolution of IJVs. We contribute to the social exchange and learning perspectives on IJVs by showing the catalytic function that conflict plays in its interaction with the distribution of power and knowledge transfer in a joint venture relationship. In today's global environment, understanding how IJVs evolve and the factors leading to instability and internalization is not only interesting from an

academic perspective but has practitioner implications as well.

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NOTE

¹ Consistent with Williamson (1975), we define opportunism as self-interest seeking with guile. This is distinct from simple instrumental self-interest in that it involves the use of false, self-disbelieved promises or threats to gain unfair, asymmetric advantage over another party. As such, we recognize the conceptual parallels between opportunism and injustice, which has been thoroughly investigated at the inter-personal level (see Tyler & Smith, 1997, for a review) and identified as a meaningful construct at the inter-organizational level (Ring & Van de Ven, 1994).

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ABOUT THE AUTHORS

H Kevin Steensma is Professor of Management at the University of Washington. Born in the United States, he is an American citizen and a US permanent resident. He received his doctorate at Indiana University in Strategic Management. His research interests include international strategic alliances and knowledge spillovers. He can be reached at steensma@u.washington.edu.

Jeff Barden is an Assistant Professor of Management at the Michael G. Foster School of Business at University of Washington. Born in the United States, he is a United States citizen. He received his doctorate in management from the Fuqua School of Business at Duke University. His research interests include inter-organizational strategy and relations, exchange and risk behavior. He can be reached at barden@u.washington.edu.

Charles Dhanaraj is Associate Professor of Management and Schmenner Faculty Fellow at Kelley School of Business, Indiana University. Born in India, he is an Indian citizen and a US permanent resident. He received his doctorate in business from Ivey Business School, Canada. His research interests are: management of international joint ventures and strategic alliances, knowledge acquisition and evolution of organizational capability, networks management of multinational corporations and intellectual property regime and its impact of firm innovation. He can be reached at dhanaraj@iupui.edu.

Marjorie Lyles received her doctorate from the University of Pittsburgh and is a US citizen. She holds the OneAmerica Chair and is Professor of International Strategic Management at the Kelley School of Business Indiana University. Her interests are in emerging markets, alliances, organizational learning, and international strategies. She can be reached at mlyles@iupui.edu.

Laszlo Tihanyi is Associate Professor and Mays Research Fellow at Texas A&M University. Born in Hungary, he is a US citizen. He received a PhD in strategic management from Indiana University and a Doctorate in business economics from Budapest University of Economic Sciences. His research interests include international strategies, corporate governance in multinational firms, and organizational adaptation in emerging economies. His e-mail is ltihanyi@tamu.edu.

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