Corporate Governance in IJVs - An Investigation of Foreign Equity Ownership Strategy

Chun Jiang*

Although a plenty of studies on international joint ventures (IJVs) has been done by previous scholars, investigation from corporate governance perspective is still preliminary. It is supposed that governing IJV will be more problematic since there is a double-accountability in IJV’s management, i.e. the management need to be accountable to at least two owners/parent companies. Considering the weakness of foreign owner’s governing capability affected by the remoteness, using equity ownership control would be a optimal choice. Therefore, this research has empirically investigated the foreign equity ownership in IJVs within Chinese business environment. After investigation, this paper proposes that IJV dominantly owned by one partner will be prevail in its governance practice, and in fact the majority owner of successfully operated IJVs in China is always attributed to the foreign partner. The author used ‘transaction cost approach’ and ‘bargaining power theory’ to explain such phenomenon. The research method employs a qualitative approach, i.e. in-depth interview and substantive case study.

1. Introduction

Since the start of its economic reform in 1978, China has made worldly outstanding achievements. In 2004, through measuring on the purchasing power parity (PPP), China has become the second largest economic power in the world, which is only next to USA. China’s total GDP equals to US$ 7.262 trillion and the GDP growth rate is 9.1% in 2004 (CIA, 2005). After stride into this new century, China has encountered a variety of new opportunities for strengthening its transition, such as China’s accession of World Trade Organization (WTO), Beijing becoming the host of the 2008 Olympic games, etc. In the meantime, the improvement of advanced technologies in China also shows to the world with an active image. For instance, China successfully entered into intergalactic elite in 2003, which is the third country after Russia and USA to achieve such incredible brilliance.

E-mail address: cjiang@une.edu.au
Being a predominant component of China’s economic reform, foreign direct investment (FDI) has played a significant role in terms of accelerating national economic growth, developing emerging market economic system, and propelling the China’s globalization process within the last twenty-eight-years. In accordance with statistical data, P.R.C has already surpassed the USA to become the world’s largest recipient of FDI (The Economist 2nd October 2004, pp. 3-24). In addition, China’s foreign exchange reserves have reached US $ 403 billion, which is the second largest reserves in the world after Japan (The Economist 28 February 2004, p.72). All of those achievements provide China with strong confidence about the future.

International joint ventures (IJVs), as one of the most important FDI modes in China, have received progressively attention from academia and practitioners. A plenty of studies in international joint ventures have identified that IJV is a difficult organization form to manage because they involve shared ownership and control, and cross cultural effects, etc (Beamish, 1988; Hennart, Roehl, and Zietlow, 1999; Inkpen and Beamish, 1997; Parkhe, 1993). The differences in relation to national culture backgrounds, languages, long-distance organizational culture, and management styles accentuate the inherent conflicts of interest between IJV partners; between the parent companies with IJV managers; and between host country nationals and expatriates, etc (Hennart et al., 1999; Inkpen and Beamish, 1997).

The rise of corporate governance (CG) in China begins in the 1990s. Chinese government realized that an effective corporate governance system in ‘state-owned enterprises (SOEs)’ would enhance their competitiveness in accessing global market. Hence, study of corporate governance inevitably becomes a hot issue in China. As indicated by literatures, directly transplanting existing corporate governance mode into an emerging and transitional economy would not work. It is supposed to be no universal corporate governance model can be generally applied across national settings. However, the current studies of corporate governance in China have been largely concentrated on unitary companies, such as state-owned enterprises and public-listed companies. There are a variety of studies in this regard, such as Wong in 2005, Sun in 2005, Chen, Firth, Gao, and Rui in 2005, Qiang in 2003, Xu in 1999, etc. Other studies have been focused on the institutional environment development in China, such as Liu in 2005, Bai, Liu, Lu, Song, and Zhang in 2004, and Chen in 2003, etc.

In conjunction with the globalization and market liberalization, IJVs in China are emerged as one of the most popular organizational form and hence inevitably involve into the requirement of healthy corporate governance system (Dussauge and Garrette, 1999). Nevertheless, there is a lack of empirical study of how corporate governance works in IJVs within this worldly largest emerging economy. Consequently, study of
CG in IJVs will offer us with an opportunity of extending our current understanding and application of corporate governance in many layers. Because of the equity ownership distribution implies the governing power owned by each partner, corporate governance in IJVs mainly correlates to equity ownership control. In the meantime, since IJV is a cross-country arrangement and the foreign partner encounters many difficulties in governing its joint venture that is caused by remoteness, equity ownership control in IJV is supposed to have more importance than normal organizations. This study tries to explore whether or not the foreign partners/owners acquire controlling equity ownership for exercising their governing power in IJVs and how such governing approach is affected by the ongoing operations of IJVs.

2. Literature Review

Over the past three decades, the global revolution in terms of Hi-Tech and internationalization dramatically changes business environment. For enhancing their competitiveness, companies are encouraged to form international/domestic strategic alliance for achieving some economic goals, such as reducing investment risks, sharing technology and expertise, improving operational efficiency, and strengthening global competitiveness, etc (Harrigan, 1988).

Williamson (1991b) extends the explanation of transaction cost approach into strategic alliances domain, in which he calls this organization form as “hybrid form” (Williamson, 1991b). According to transaction costs theory, because of much uncertainty involved, the ownership selection of foreign firms will depend on the costs and benefits of sharing ownership (i.e. equity joint ventures) relative to those of full ownership (i.e. wholly foreign owned enterprises) (Hennart, 1988; Contractor, 1989). Transaction costs occur in forming strategic alliances due to human behavior factors such as opportunism, bounded rationality, lack of trust, and other environmental factors such as a lack of alternative partners due to a small number of bargaining firms (Kogut, 1988a, 1988b; Parkhe, 1993a).

There are two factors affecting the transaction costs when firms make a decision in terms of entry new country. Firstly, the uncertainty of economic and political conditions and the government policies in host country are regarded as crucial to the survival and profitability of a foreign investor’s operations in that country (Agarwal, 1992). Second, cultural distance many affect the control mode selected by the firm. For example, Anand and Delios (1997) found that high level of cultural difference will increase the management costs in terms of communication and negotiation within alliances, and therefore the foreign firms may pursue high level of ownership and
control in their alliances (Anand and Delios, 1997).

As an international arrangement of equity strategic alliance, IJVs represent an effective way to cope with the increasingly competitive business environment. In accordance with transaction cost theory, the need for formatting international joint ventures will be particularly strong in four instances. The first is when the joint venture’s operation represents a diversification for the parent firms, i.e., the joint venture may manufacture a product that is not produced by the parent firms. This situation has been evidenced by Stopford and Haberich’s study (Stopford and Haberich, 1978). The second situation might exist when a firm enters into a foreign country for the first time. Because such firm may lack the knowledge of local political, economical, institutional and sociological conditions and consequently its transaction will subject to high costs. Therefore, it would expect to form joint venture in order to acquire such knowledge (Inkpen, 1998). Thirdly, foreign firms may also engage in forming joint ventures to obtain access to the local resources that have been controlled by local firms. This is mostly to be the case in natural resource industries. Gomes-Casseres’s (1996) study of ownership policies of US firms showed that local government policies discourage or prohibit full ownership by foreigners in those industries (Gomes-Casseres, 1996). Thus, if these resources are necessary for the foreign companies, the best economic way is to cooperate with the local firms (Gomes-Casseres, 1996). Finally, international joint ventures can provide a vehicle for the parent firms to combine complementary inputs (for instance, know-how, management or market expertise) held by two separate firms. So when the market for both of these inputs is subject to high transaction costs, formation of joint ventures is emerged as appropriate way (Tyebjee, 1988).

In addition, culture distance may also lead the foreign firms to choose joint venture as an entry mode. Wada (2001) found that culture distance between Japan and United States is very large, consequently, Japanese investor have avoided full acquisitions, preferring entry through joint ventures or partial acquisition, because of the high transaction costs of merging the acquired firm’s past management practices (Wada, 2001).

There are many advantages of IJVs’ formation reported by previous scholars, such as Harrigan (1988) indicates that joint venture is a better way for firms to enter a highly uncertain environment (Harrigan, 1988: 145); Hamel (1991) proposes that joint venture provide a platform for organization learning (Hamel, 1991); etc. In the meantime, researchers also point out that IJV is a difficult form of strategic alliance to manage because it involves shared equity ownership and control (Beamish, 1988; Inkpen and Beamish, 1997; Hennart, Roehl, and Zietlow, 1999; Parkhe, 1991; Geringer, 1991).
As proposed by the transaction costs theory, the transaction costs may increase due to partners' opportunistic behavior. Joint ventures' formation and performance are obstructed by perceptions of opportunistic behavior by participating firms (Parkhe, 1993a). Opportunism refers to the tendency of partner firms to maximize their gains at the expense of other partners or the joint ventures. When a foreign firm possesses the ability to develop new products, it may have the risk of losing long-term profits if it shares this knowledge with host country firms. The reason is that the host country firms may acquire this knowledge and decide to operate as a separate entity in the future (Agarwal, 1992). Therefore, the foreign partners will rely on the legal system in host country to protect their benefit. It will require the host country to enhance its institutional environment for corporate governance. In transitional or emerging market, such as China, this requirement may become more critical for the success of IJVs since the foreign investors will face the challenges of national structural reform, imperfect market system, poor intellectual right protection, and institutional uncertainty (Luo, 1997: 649).iii.

As a destination of foreign direct investment, China has a particular combined economic system, which consists of a market economy and a centrally planned economy. There are some disadvantages of centrally planned economy, such as weak capital market structure, poorly specified property rights, and institutional instability (Li, 1998). Meanwhile, China's industrial structure is unbalanced and some of the Chinese enterprises still receive protection from the government, especially for the firms in 'Pillar Industry', which means such enterprises will directly affect the national strengths in China. Therefore, the institutional environment in China provides a difficult situation for foreign owners to govern their IJVs.

For attracting more overseas investment, the Chinese legal regime for foreign investment has been significantly changed since the China implements its state policy of opening to the outside world. The development of Chinese laws and regulations on foreign investment in China over the past twenty years reflect a balance between encouraging foreign business investment and the desire to maintain state controls (Yan, 2000)iv.

Control is an important issue in the capability of an organization to achieve its goals, therefore it represents a large issue in IJVs' literatures. Many researchers conducted a plenty of studies in this area, such as Geringer and Hébert in 1989, Yan in 1994 and 1996, Glaister in 1995, Child in 1997 and 1999, Ding in 1997, Makhija in 1997, Mjoen in 1997, Wang in 2000, Yan in 2000, Luo in 2001, and Fryxell in 2002, etc. In respect to the relationship between control and performance, Killing (1983) asserted that among his three JV categories (majority ownership control, shared ownership control, minority ownership control), dominant partner JVs are more likely
to be successful since the IJVs' activities dominated by a single parent will be easier to manage and consequently more possible to be successful (Killing, 1983). Meanwhile, in accordance with transaction costs theory, dominant control can reduce the risks of coordination, potential conflicts and disclosures. As a result, it can minimize transaction costs and stabilize the IJVs (Beamish, 1995).

The issues about IJVs' control become more complicated in China due to its economic and political conditions. In Sino-foreign joint ventures, technology in research and development (R&D), expertise in management, marketing, and finance are mostly to be occupied by the foreign partner. In order to improve their competitiveness or market power, foreign partners need to control some major functional areas (Beamish 1993; Ding 1997; Child, Yan, and Lu 1997; Osland 1994; Vanhonacker and Pan 1997). The introduction of relevant standards in the areas of technology, marketing and finance, together with the imposition of foreign reporting mechanisms, often means that the foreign partner in a Sino-foreign joint venture has greater influence over its management.

At the same time, the Chinese partners have some priorities in their local knowledge, such as unstable political and economic environment, and which is often perceived to influence the Chinese market. Thus, many foreign investors rely on their Chinese partners to help them to reduce risk (Osland, 1994). Also, to take advantage of local resources, the foreign partners will depend on the Chinese partners to negotiate with the local governments, to provide access to local resources and manage local labor, etc (Makino and Delios 1996; Osland 1994). The Chinese government makes it clear that it intentionally to supervise the foreign business activities in Chinese domestic market. For instance, the approval of joint ventures formation represents a significant level of state control. The contract of foreign investment indicates that the formation of a joint venture must receive approval from the Chinese Ministry of Commerce.

In the context of international joint ventures, national differences between partner firms in respect to customs and culture, law, politics, and trade policy will highlight the significance of trust that exists in normal inter-firms collaborations. Fichman and Levinthal (1991) as well as Bromiley and Cummings (1993) suggested that mutual trust is advantageous for the reason that it will strengthen inter-firms ties, improve communication and negotiation, and reduce transaction costs (Fichman & Levinthal, 1991; Bromiley & Cummings, 1993). In IJVs literatures, cultural diversity has been investigated both from national level and organizational level. Some scholars, such as Kogut and Singh in 1988; Erramilli in 1991 and 1996; Erramilli and Rao in 1993; Shane in 1993; Agarwal in 1994; Barkema, Bell and Pennings in 1996, Pothukuchi in 2002 have studied that the national cultural difference will influence the ownership strategy of partners. Some research findings support that IJVs between culturally
similar partners are more likely to be successful than those between cultural dissimilar partners (Pothukuchi, 2002). Some other researchers conducted their investigation in examining the organizational cultural difference from some organizational behavior perspective, such as management practices, decision making process, and learning capabilities between partners (Killing, 1983; Makhija and Ganesh, 1997; Pearce, 1997).

Because people living in a same country tend to have similar values, and thus they will bring these values to the organizations for which they work, including international joint ventures. As a result, firm’s values are largely reflected by its national culture. Therefore, IJVs’ parents based in different countries will tend to have different values. Those differences will make it more difficult to achieve common goals, to solve problems, and to handle conflicts (Hofstede, 1980 & 1997). Similarly, Park and Ungson (1997)’s study shows that values and behavioral differences between culturally different partners will affect the interpretation and responses to strategic and managerial issues, and thus increase transaction costs in international joint venture (Park and Ungson, 1997).

In summary, a plenty of literatures identify the difficulties faced by the foreign partners, and hence increase the costs for them to govern the performance of IJVs. To minimize the costs in relation to monitoring the joint ventures, foreign partners is supposed to adopt majority equity ownership. The following hypotheses are derived from literature review:

1) For minimizing the transaction costs, dominant ownership control will be a preferred governance mode for the foreign partners in international joint ventures; and

2) The foreign partners’ strong bargaining power in terms of management and technology, as well as their advantages of capital availability will support them to achieve the dominant equity ownership in IJVs through the initial and ongoing stages of IJVs’ operation.

3. Methodological Approach

Yin (1994) identified a variety of research methods that have been used by pioneers in investigating issues in social science. See table 1 as an illustration
Table 1 Justifications of Different Research Methods

<table>
<thead>
<tr>
<th>Method</th>
<th>Form of Research Focus</th>
<th>Need Behavioral Control</th>
<th>Focuses on Contemporary Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experiment</td>
<td>How &amp; Why</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Who, What, Where,</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>How many, &amp; How Much</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Survey</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Archival Analysis</td>
<td>How many, &amp; How Much</td>
<td>No</td>
<td>Yes/No</td>
</tr>
<tr>
<td></td>
<td>Who, What, Where,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Historical Analysis</td>
<td>How &amp; Why</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Case Study</td>
<td>How &amp; Why</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>


Since this research involves ‘How’ and ‘Why’ issues, it seems only experiment, historical analysis, and case study methods can be applicable. However, the experimental strategy is not available in this research since the experimental situation is difficult to be controlled in this study. Meanwhile, the historical approach is also not appropriate. Therefore, the case study method becomes the optimal choice. The case study method has been widely employed in conducting scientific research in the field of social phenomenon (Mintzberg & Walters, 1982; Pettigrew, 1992). Some scholars advocate that researchers directly involve in investigations within firms are absolutely essential if they intend to do contextually plenteous research (Daft, 1983; Gummesson, 1991; Yin, 1994). The case study approach will be particularly applicable when the research attempts to cover the contextual conditions that are highly complicated to the phenomenon under investigation. Hence, the research methodological approach of this study employs a qualitative approach, namely through field observation and individual interview, a theory-guided exploratory multiple-case study method has been applied.

4. Analysis of Results

The data collection consists of two stages. During the first stage, which took place in the autumn of 2004, the author conducted a pilot study through telephone interview with five Sino-foreign joint ventures’ senior executives. The author discussed the intention of conducting field study into their joint ventures and explored some basic open-ended interview questions. The primary purpose of this phase is to deepen the understanding of the research context and develop and refine the interview framework as well as
establish personal relationship (Guanxi) for further field study. The second stage of 
the fieldwork, an in-depth interview, has taken place during the spring of 2005 and it 
spent about three months. More focused semi-open and open-ended questions were 
adopted to investigate the research focus. A checklist of the topics in the interviews has 
been prepared and used as an instrument to control the body of the interview. 
Meanwhile, interviews were designed to cover the research constructs and implemented 
from half hour (minimum) to one and a half hours (maximum). Some interviews were 
recorded using tape recorder (with consent from participants) and later transcribed and 
some only recorded by scripts. Some interviewees have been interviewed more than 
once for clarifying some issues.

There were fourteen international joint ventures that had been investigated. Interviews 
were conducted with forty-two interviewees within fourteen international joint 
ventures. Each of the fourteen joint ventures was selected in accordance with the 
criteria of successfully operated and having long-term operational longevity in China. 
Because IJVs with successful performance and long-term operation in China can 
representatively show how foreign partners govern the joint ventures. Meanwhile, IJVs 
with long-term operation can provide the comparability in relation to the initial stage 
and ongoing operation. All cases were selected from Tianjin Economic Development 
Area (TEDA), China. The reasons of choosing this area as a research location are 
because: Tianjin Economic Development Area (TEDA) is one of the first fourteen 
developed areas in Chinese coastal regions. From 1979 to 2003, about 85.3 per cent 
of cumulative FDI has flowed to such area. Meanwhile TEDA is one of the best 
investment destinations in China and listed the first place in all developed areas. Up to 
the end of 2005, there are 3,300 foreign invested enterprises located in TEDA, in 
which forty-four foreign investors are from world top 500 enterprises with 
ninety-three invested enterprises. Among all foreign invested enterprises (FOEs), 
international joint ventures are occupied 41.3 per cent and the foreign invested capital 
equals to 65.8 per cent of the total capital.

Through analyzing the empirical evidence, the first hypothesis has been proven. In the 
fourteen joint ventures that I investigated, foreign investors trend to expand their 
shareholding through continuously investment and some of them apparently tend to 
transfer to wholly foreign owned enterprise. These findings are consistent with the 
research hypothesis. (Table 2)
The investigation shows a very popular phenomenon that after several years’ operation, foreign partners unilaterally aggrandized their investments in joint ventures (8 out of 14) and even some joint ventures have transformed from IJVs to wholly foreign owned enterprises (WFOEs) (4 out of 14). This equity ownership changes becomes more common in Sino-Japanese (3 out of 6) and Sino-Korean (2 out of 3) joint ventures. This trend can be demonstrated by following cases:

<table>
<thead>
<tr>
<th>Code</th>
<th>National Characteristic</th>
<th>Initial Ownership Percentage</th>
<th>Current Ownership Percentage</th>
<th>Current Characteristic</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Sino-Korean</td>
<td>F: 50% C: 50%</td>
<td>F: 91.5% C: 8.5%</td>
<td>IJV</td>
</tr>
<tr>
<td>02</td>
<td>Sino-French</td>
<td>F: 51% C: 49%</td>
<td>F: 99% C: 1%</td>
<td>IJV</td>
</tr>
<tr>
<td>03</td>
<td>Sino-Japanese</td>
<td>F: 50% C: 50%</td>
<td>F: 80% C: 20%</td>
<td>IJV</td>
</tr>
<tr>
<td>04</td>
<td>Sino-American</td>
<td>F: 55% C: 45%</td>
<td>F: 55% C: 45%</td>
<td>IJV</td>
</tr>
<tr>
<td>05</td>
<td>Sino-Australian</td>
<td>F: 60% C: 40%</td>
<td>F: 100% C: 0%</td>
<td>WFOE</td>
</tr>
<tr>
<td>06</td>
<td>Sino-Japanese</td>
<td>F: 90% C: 10%</td>
<td>F: 100% C: 0%</td>
<td>WFOE</td>
</tr>
<tr>
<td>07</td>
<td>Sino-Japanese</td>
<td>F: 82% C: 18%</td>
<td>F: 82% C: 18%</td>
<td>IJV</td>
</tr>
<tr>
<td>08</td>
<td>Sino-Korean</td>
<td>F: 80% C: 20%</td>
<td>F: 80% C: 20%</td>
<td>IJV</td>
</tr>
<tr>
<td>09</td>
<td>Sino-German</td>
<td>F: 20% C: 80%</td>
<td>F: 100% C: 0%</td>
<td>WFOE</td>
</tr>
<tr>
<td>10</td>
<td>Sino-Japanese</td>
<td>F: 60% C: 40%</td>
<td>F: 60% C: 40%</td>
<td>IJV</td>
</tr>
<tr>
<td>11</td>
<td>Sino-American</td>
<td>F: 50% C: 50%</td>
<td>F: 50% C: 50%</td>
<td>IJV</td>
</tr>
<tr>
<td>12</td>
<td>Sino-Japanese</td>
<td>F: 95% C: 5%</td>
<td>F: 95% C: 5%</td>
<td>IJV</td>
</tr>
<tr>
<td>13</td>
<td>Sino-Japanese</td>
<td>F: 70% C: 30%</td>
<td>F: 95.1% C: 4.9%</td>
<td>IJV</td>
</tr>
<tr>
<td>14</td>
<td>Sino-Korean</td>
<td>F: 90% C: 10%</td>
<td>F: 100% C: 0%</td>
<td>WFOE</td>
</tr>
</tbody>
</table>

F: Foreign Ownership  C: Chinese Ownership

The investigation shows a very popular phenomenon that after several years’ operation, foreign partners unilaterally aggrandized their investments in joint ventures (8 out of 14) and even some joint ventures have transformed from IJVs to wholly foreign owned enterprises (WFOEs) (4 out of 14). This equity ownership changes becomes more common in Sino-Japanese (3 out of 6) and Sino-Korean (2 out of 3) joint ventures. This trend can be demonstrated by following cases:
Case One:

A Sino-Korean Electronic Joint Venture was formed as one of the biggest Sino-Korean joint venture in China at April 1993. The foreign partner is a well-known Korean electronic company and Chinese partner is a state-owned company. This joint venture’s initial registered capital is US$ 50 millions. Its products are videocassette recorder, VCD & DVD player. All products use Korean parent company’s brand names. So it actually operates like a processing manufacturer of the Korean parent company. The initial ownership percentage of the two partners was equally split by 50: 50. In 1996, Chinese domestic market demands of videocassette recorder were declined and many inventories on hand. To avoid the risk, Chinese partner sold its partial equity ownership to the Korean partner. Then in the following years, Korean partner continuously reinvested into this joint venture through capital or equipment injection. But Chinese partner did not accordingly reinvest corresponding percentage. These actions diluted Chinese partner’s equity ownership percentage. Up to now, the ownership percentage of foreign partner becomes 91.5 per cent and the Chinese partner only keeps 8.5 per cent of total equity ownership in this joint venture. Hence, the Korean partner dominantly controls this joint venture and it currently operates as a WFOE.

Case Two:

A Sino-German Detergent Joint Venture has the similar situation. This Sino-German joint venture was established in Dec 1992. It mainly focused on manufacturing and selling detergents and household cleaning products. The Chinese partner was established in 1958 with a brilliant history in 1970s and 1980s. But starts from 1990s, its performance became unsatisfied due to the lack of marketability and old-fashioned products. Then forming a joint venture with a multinational company became a better choice. The German partner is a German manufacturer specializing in applied chemistry. It has more than 40,000 employees worldwide and was initially founded in 1876 as a powder detergent company. This Sino-German detergent joint venture was one of the biggest detergent factories in China and the leading force in Northern China. All production technologies were supplied by German partner. The registered capital was USD 29.99 millions with initial ownership percentage of German partner with 20 per cent and Chinese partner with 80 per cent. In 1994, German partner used US $ 7.5 million to purchase 25 per cent ownership from the Chinese partner. In 1996, German partner reinvested US $12 million to purchase another 25 per cent equity ownership from the Chinese partner. Through this ownership transfer, Chinese partner’s ownership reduced to 20 percent. In 2001, after renegotiated with Chinese partner, German partner purchased all shareholdings from its Chinese partner. Hence, this company has transformed from a Sino-German joint venture to a wholly German owned company. This case shows that foreign partner’s advantages in terms of technology and
capital provide the German partner with greater bargaining power in the renegotiation.

**Case Three:**

A Sino-American Chemical Joint Venture also proved that the American partner intentionally wants to achieve overall governing power in conjunction with the good joint venture’s performance. On May 12, 2004, the American partner established an issue that they would invest USD 1.8 billion to purchase the rest 20% shares in their Chinese joint venture from its Chinese partner. And since then this American partner owned 100% shareholdings in the company and in fact it became a wholly American owned enterprise. This action has been premeditated by the American partner since the beginning of joint venture’s operation. Historically review indicates that this American partner invested 10 projects in China. Except a Beijing branch has been initially formed as a wholly American owned enterprise; others are all used joint ventures as initial market entry format. Then since those IJVs’ establishment, The American partner gradually increased their ownership percentage through capital investment and eventually all joint ventures were transformed into WFOEs.

During my study, I found that foreign partners normally adopted dominant equity ownership for providing them with the control power in the board governance. Usually, the member of board is correlated with partners’ equity ownership in IJVs. When foreign equity ownership increased, the percentage of foreign director in total directors was also increased. This empowers the foreign partners to exert more power in making strategic direction. If the Chinese partner has different opinion regarding some issue and they cannot get compromise, then the foreign partner might select to wholly take over the IJV and operates as WFOE. Case two is this regard. Before German partner purchased the equity shareholdings from Chinese partner, Chinese partner had different viewpoint in terms of marketing strategy. They could not reach an agreement, the German partner eventually decide to gradually buy this joint venture from its Chinese partner.

In the meantime, for some joint ventures with non-changed ownership structure, the stability of ownership structures does not necessarily mean the foreign partners are not willing to pursue more ownership percentage, but might partially because of they have already possess the dominant power in governing the joint ventures and making strategic decision. Sometimes, it may due to the unsuccessful renegotiation with their Chinese partners or for the reason of obtaining some local advantages.
Case Four:

A Sino-American Pharmaceutical Joint Venture is an example in terms of foreign partner’s failure of increasing its ownership due to the partners’ disagreement on renegotiation. This Sino-American joint venture was founded in 1984 by two Chinese partners and one American partner. It was formed to manufacture and sell finished pharmaceutical products for human use and bulk chemical. The initial capital is US$ 17.94 million with an equity split of 45 per cent to 55 per cent between the Chinese and American partners. The term of the joint venture’s duration is valid for 40 years. The annual manufacturing capacity is 1.7 billion units. This joint venture achieved great success and become one of the biggest pharmaceutical joint venture in China. It has been successfully awarded the following honors since its establishment: One of the 500 biggest enterprises with the best economic benefits in China; one of the 500 biggest industrial enterprises with foreign investment in China; one of the 100 best industrial enterprises in Tianjin; and one of the 10 best joint ventures with foreign investment in China. In 1994, the US partner has proposed to expand their shareholdings in this joint venture. But the Chinese partners did not agreed with this proposal because they would not loss the great profitability potential of this joint venture. In addition, the local government also wished to keep this typically successful joint venture for political reason. Due to the failure of renegotiation, the American partner established another joint venture in TEDA at 1995. In the new joint venture, the US partner owned 90 percent and only 10 percent owned by the local partner. This new joint venture initially supplied 70 percent production to the Chinese market and 30 percent for export. Now both of them are operated very well.

Case Five:

A Sino-Japanese joint venture shows another reason of keeping minor Chinese ownership (5%) instead of transfer to WFOE. The Japanese partner of this joint venture is a well-known automobile tire manufacturer. Its initial investment is USD 50 millions with split ownership of Japanese Bridgestone Corp: 95% and Chinese partner: 5%. The reason of remaining 5% ownership to Chinese partner was that IJVs characteristic would help this joint venture for receiving industrial protection because such protection would not exist if it is a WFOE.

The trend of foreign company preferring WFOEs instead of IJVs is also evidenced by other scholars, such as Prof. Lee in an interview with ‘Chinese Economy Weekly, he stated that ‘The trend of forming Wholly Foreign Owned Enterprise in all foreign investment becomes more and more obvious (Chinese Economy Weekly, 2002).’ In his investigation of foreign investment in Tianjin Economic Development Area, he
pointed out that the foreign capital individually occupied an average of 65.8% and 69.9% in all equity or non-equity joint ventures and the number of Wholly Foreign-Invested Enterprise is exceed joint ventures (Lee, 2002). Meanwhile, Mr. Yaping Wu – an officer of Chinese National Development & Reform Committee also indicated that the situation of joint venture will become more embarrassing after China joined WTO due to the multinational companies do not necessarily using this format to access in Chinese market (Cui, 2004).

All of the investigated IJVs are successfully operated since the formation. During the interviews, both Chinese managers and foreign expatriates all agreed that dominantly governing by one partner, here is the foreign partner is a vital factor for the success of joint ventures. For example, a Sino-French hydropower Joint Venture that was formed by the Chinese partner and French partner in July 1995 with registered capital USD 29.5 millions. At This Sino-French joint venture is specialized in producing hydropower generator. At the initial stage, the ownership percentage is foreign partner (51%) and Chinese partner (49%). Accordingly, shared ownership control was adopted. Every department has a Chinese manager and a French manager. They were directly responsible to their individual parent company and not accountable for the counter parent firm. This situation led to many management problems, such as overlapped responsibilities, duplicate instruction to subordinates, inefficiency in management, etc. Accordingly it heavily affected the performance of joint venture. Then the foreign partner decided to take up the dominant governing power in this joint venture through buying the equity ownership from Chinese partner. After the reinvestment by French partner, the percentage of foreign equity ownership has been changed from 51% to 77% in 1998 and from 77% to 99% in 2004. So at present, the French partner own 99% ownership in this joint venture and its operation is like a wholly foreign owned enterprise. The Chinese partner does not participate in joint venture’s management. Consequently, after the French partner has obtained the dominant ownership, the joint venture’s performance turned better. For instance, only in 2003, the revenue of this Sino-French joint venture was RMB 2 billions.

5. Discussions and Conclusions

Overall, this empirical study presents two propositions: (a) dominantly governing by one partner is better than shared governance mechanism; the foreign partners’ advantages in capital and technology will lead to the dominant governing power exerted by foreign partner. This is particularly applicable for successfully operated Sino-foreign joint ventures; and (b) WFOEs present competitive advantages in terms of minimizing governing cost, therefore wholly foreign owned enterprise became preferable FDI entry mode and IJVs’ ongoing transformation mode.
Through applying ‘Transaction Cost Theory’ and ‘Bargaining Power Theory’, the first proposition can be explained as: Firstly, at the initial stage, foreign enterprises came to China for pursuing some advantages, such as cheaper land, materials, labor cost and huge market potential. However, they were lack of the understanding of local market, cultural, and environmental conditions, and forming a joint venture can facilitate them with such knowledge acquisition. In balancing the transaction costs and governing cost in relation to the shared ownership (i.e. IJVs) Vs sole ownership (WFOEs), they preferred IJVs. Following the ongoing operation, they gradually absorbed such knowledge from the IJVs’ operational practice and consequently became confident to independently operate the business. Then the costs relevant to governing or monitoring the joint ventures seem to be prevailing. Hence, achieving dominant control or even transfer to sole ventures (WFOEs) becomes optimal.

In the meantime, even if for some foreign investor, the initial transaction cost related to local disadvantages was not higher than the cost arisen by remoteness governance, temporarily using IJVs for accessing Chinese market is the only way. Although China liberalized its FDI policy since 1979, wholly foreign owned enterprise was only emerged after 1990s and it is still limited in some industries. For instance, currently the wholly owned foreign enterprises are still not allowed in automobile industry by Chinese government. Therefore, IJVs becomes a convenient vehicle for foreign companies to access into Chinese market at the initial stage. After a decade development, their technical advantages have been widely accepted in Chinese market. Then they began to expand in China by using more profitable and low governing cost approach, such as WFOEs.

In term of why foreign investors can achieve dominant equity ownership and in the extreme case the Chinese partners are squeezed out from ownership structure, i.e. IJVs transform to WFOEs. Such phenomenon can be expressed by using ‘Bargaining Power Theory’. The Chinese partners’s advantages, such as local expertise, network, government relation (Guanxi) can be gradually grasped by foreign partners through learn-by-doing approach. But their disadvantages, such as lack of capital, technological weakness, and management skills are difficult to be made up. It is especially the case when the foreign partners intentionally protect/hide the use of technologies for avoiding ‘knowledge spillover’ in relation to shared management. Then unbalanced bargaining power exists following the ongoing operation, and eventually leads to foreign partners’ advantages in achieving dominant equity ownership control.

Throughout analyzing the cases, some implications for the future IJVs’ governance can be reached as:

1) Followed the highly developed Chinese economy and continuous foreign direct
investment, IJVs will consistently present an adoptable approach as the first-time market entry mode, but to avoid governing weakness, a dominant or majority foreign equity ownership will be preferable;

2) The successful joint ventures’ practice will accelerate the foreign partners’ eagerness of pursuing dominant power in corporate governance at IJVs; and their advantages in capital and technology will encourage them to achieve such goal;

3) Wholly foreign owned enterprise (WFOE) will become more preferable FDI mode instead of joint venture mode due to its advantages of avoiding duplicate accountability; and some successful IJVs will continuously to choose transforming to WFOEs;

4) Following the market economy system deepening, state-owned enterprises (SOEs) in China will gradually loss their advantages in government protection; accordingly they will loss ongoing bargaining power when they renegotiate with foreign partners. Hence, such situation will continuously discourage SOEs to achieve the dominant governing power in IJVs.

6. Further Research

Several limitations are inherently existed in this research. Firstly, due to its small sample size and geographical limitation, the generalizability of this research needs to be further confirmed. Secondly, foreign directors and managers in IJVs are still sensitive for accepting interview by a Chinese, therefore unbalanced interviewees representing different partners exist. Although the author minimizes the biased opinion from Chinese interviewees, it might still limit the findings as the foreign partner’s viewpoint may not be sufficiently stressed. Thirdly, this research is focused on investigating successfully operated IJVs with comparatively long-term operation in China. The findings may not be applicable to all IJVs in China. For those new established IJVs or those IJVs with unsatisfied performance, there might be a different way of governance, such as Chinese partner dominantly controls IJV, etc. Further research opportunities may involve in the configuration of corporate governance in IJVs or extending the investigation to CG in new-established IJVs or underperformed IJVs in China.
REFERENCES
Cui, s. (2004. 05. 31). Chinese Economy Weekly.


