6 Risk and Motivation in Sino-Austrian Joint Ventures in China

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Introduction

This paper analyses different models of external trade and their implications for joint ventures of partners from both developed and emerging economies. A pattern of complementary cooperation is combined with that of substitutive competition. The experiences of a small sample of Sino-Western joint ventures are discussed as a structural consequence of the simultaneous occurrence of both patterns. Finally we will pose the question whether those partly culture-based experiences can be relevant to Japanese companies about to enter partnerships in China.

International joint ventures in the literature

While theory and common sense maintains that in a country with considerable businesses distance (Luostarinen 1989), great internal variety and the importance of strong relations to central, regional and local governments (Welge, Holtbrügge and Berg 2001), partnerships are the appropriate form of market entry, many Western firms have failed to use this approach. Nevertheless, a large number of international joint ventures are operating in the People's Republic of China. According to MOFTEC statistics there are more than 200,000. Quite a large number, if one considers that the business environment in China is uncertain and anything but transparent.

We define joint ventures, following Hellwig (1989), Szymanski and Rigler (1995) and Fuchs, Schneider and Dawei (1997), as an investment across borders with the intention of founding an autonomous (common) enterprise with one or more partners. The ideal state of affairs is to reach compatible and complementary goals.

Although international joint ventures often experience severe difficulties, foreign investors are attracted by the huge market potential. The main causes of difficulties are high uncertainty and instability in the Chinese business environment. Koot (1988) mentions performance problems in less-developed countries, reluctance to share profits, lack of trust in the business partner and the difficulty in directing joint ventures towards one's goals. According to Nyaw (1995), difficulties can be traced back to organisational problems caused by misunderstanding and mutual incomprehension of the other's objectives and methods. Park and Ungson (1997) consider aspects of multiculturalism and its impacts on the dissolution of joint ventures.

Hence, undertaking a joint venture involves problems one would not have to face if a company was on its own. Importance must therefore be placed on how a firm organises its boundary activities with other firms (Kogut 1988, p. 320). The reasons and motivations for undertaking a joint venture are discussed below.

Contractor and Lorange (1988) elaborated seven reasons for forming cooperative ventures: risk reduction, economies of scale and/or rationalization, technology exchanges, co-opting or blocking competition, overcoming government-mandated trade or investment barriers, facilitating initial international expansion of inexperienced firms and vertical quasi-integration advantages of linking the complementary contributions of the partners in a 'value chain'.

In R&D joint ventures, Hladik (1988) argues that the benefits are the ability to spread costs and risks and the pooling of complementary resources provided by the different partners. Pfeffer and Novak (1996) consider technological risk and capital requirements to be too high for a single organisation to handle. The combined strengths of two organizations in developing a new product or service, or entering a new market, are considered reasons for undertaking a joint venture.

According to Root (1994), in developing countries and formerly communist countries, the prohibition or discouragement of sole venture entry by governments is the most common reason for joint ventures. The entry strategy is thus not determined by business policy but is rather a government-dictated form of market entry, making joint ventures the only feasible form of investment entry in such countries.

Where host-government restrictions on foreign ownership do not exist, Gomes-Casseres (1988) suggested that joint ventures were created when contributions were needed that are costly to acquire contractually. This is the case when a multinational enterprise has little previous experience in the subsidiary's country or industry. Kogut (1988, p. 320) explains that joint ventures are formed because of diseconomies of acquisition or higher costs of internal development, if for at least one of the partners, production costs are significantly higher than external sourcing. The motivation for international joint venture formation is described as the evasion of small-number bargaining, enhancement of market power and mechanisms to transfer organisational knowledge. The minimising of production and transaction costs is a possible criterion for how firms choose to transact. A spirit of cooperation has been discussed by Buckley and Casson (1996), who noted that transaction costs would be reduced in the long run, arising from an improved climate of trust in joint ventures. Without trust, transaction costs are likely to be high due to the need for more safeguards and monitoring to protect against opportunistic behaviour.

One point which is especially interesting is associated with the problem of finding an ideal partner for an international joint venture (e.g. Blodgett 1991; Goldenberg 1990; Trommsdorff and Wilpert 1991). Key issues regarding partner selection in Japanese joint ventures were presented by Makino and Beamish (1999). Pan and Li (2000, p. 180) examined characteristics of international joint ventures based on differences between firm size. A number of studies elaborated on these difficulties: Beamish (1985), Geringer and Hebert (1989) and Schaan (1983) all focused on the issue of control and arising conflicts, while Anderson (1990), Gomes-Casseres (1987), Parkhe (1993), Yan (1998), Makino and Beamish (1998) and Yan and Zeng (1999) evaluated stability and performance. Root (1994, p. 153) also stressed the question of control, in particular taking into account how a minority partner can exert dominant influence. Inkpen and Beamish (1997) considered the question of instability of international joint ventures, while Reuer (2000) focused on shareholder wealth effects and termination of international joint ventures in his empirical research. Although the literature is extensive, the research has not yet been integrated into a single conceptual framework.

Parkhe (1993) highlighted this lack of conceptual work associated with a general theoretical deficit in international joint venture research. In his influential article entitled 'Messy research, methodological predispositions and theory development in international joint ventures', important steps were taken and a unifying conceptional approach was offered. Parkhe criticised the dominance of 'hard' quantitative empirical research over 'soft' behavioural variables, which inhibits – as he stated – the study of other crucial aspects of international joint ventures. The dominance of quantitative research has resulted in individual pieces of research on only a small set of variables, and causal links that hamper overall understanding. Theoretical approaches such as the property rights approach, transaction costs economics, and the principal agent approach highlight the importance of trust, reciprocity, forbearance and the controversial issue of opportunism from a different angle, but share the common assumption that these variables fulfil a unique function in the running of an economic system.

As Parkhe (1993) maintained, reciprocity, forbearance, opportunism and trust are crucial elements in understanding and explaining the cooperative behaviour of economic agents. From his specific pessimistic perspective, Williamson assumed that trust was rarely transparent ex ante and that 'trust and good intentions […] are very fragile' (1985, p. 64). Nevertheless, the essence of a joint venture is usually based on cooperation between two or more different partners (Buckley and Casson 1988). Joint should be read as commonality, mutuality and reciprocity as a concept that is important because it stresses the notion of what each partner offers in exchange, such as knowledge, assets and skills each partner contributes to the joint venture. The simple consequence means operating together and not against each other. Hence, cooperation is a process based on reciprocity. Cooperation and reciprocity allow partners to share tacit knowledge and to access the organisational knowledge of other firms. This can only be achieved if the relationship is based on trust. Trust and credibility are crucial elements that allow independent reciprocal transactions to take place (Fuchs, Schneider and Dawei 1997).

Any successful cooperation and any appropriate relationship between people in a joint venture is based on trust, it depends on the degree of reciprocity and it is enhanced or hampered by the degree of opportunism and forbearance. Perhaps the most difficult part of the analysis is how these variables interact in day-to-day behaviour among members of international joint ventures, which strongly shapes future expectations. There is also the dimension of time involved in joint ventures. Static models need to be complemented by a historic perspective that accounts for different paths of development when examining mutual trust.

Experience gained from Sino-Western joint ventures

Several studies, though still explorative, shed some light on the reasons for success and failure of partnerships as the appropriate form of market entry, with the following findings on the macro and micro levels (see Schneider and Fuchs 1999; Welge, Holtbrügge and Berg 2001).

Macro-level reasons

David Ricardo's theory of comparative cost advantage still inspires progress in liberalising trade (and FDI) in goods, services and intellectual property. But Ricardo's theory is static, assuming the immobility of labour and capital. Furthermore, it focuses on factor conditions mostly supplied by nature (Ricardo 1971).

Michael Porter (1990) has provided a more differentiated model of factors of production to explain the competitive advantage of nations.

Generic factors, such as raw material or physical labour are still important, but competitive advantage is constituted by progressive factors such as knowledge and entrepreneurship. If those progressive factors are specified – specific to a certain industry – they may enhance the formation of local clusters. Thus a modern version of Ricardo's theory starts from the assumption of an international division of sophisticated labour, where each region supplies to the rest of the world what it can produce best.

Overcapacities would only appear as an exception and oscillation around market equilibrium in this model. Intra-industry trade, on the other hand, is competition based on either cost-advantage or differentiation in the production of similar goods. It contributes to consumers' choices by way of a wide variety of goods such as cars, computers, fashion, detergents and food. In this model considerable overcapacity may arise and give way to harsh price competition.

Both models would suggest innovation as a strategy of individual companies to survive and take a competitive lead. In Ricardian-type models, innovation allows competitors to be attractive as an exchange partner; in intra-industry models it allows higher margins until the competition has caught up. Product innovation is closely linked to (high) technology as we move into the digital age.

With exploding costs for R&D and shorter life cycles of products, innovation and/or simultaneous market entry to several markets can hardly be achieved alone. The processes of liberalisation, deregulation and privatisation have allowed companies to loosen their ties with former home countries and to search for alliances all over the globe.

They follow strategies of 'coopetition', which rely on a delicate balance of knowledge exclusion and knowledge sharing, depending on the complementary or substitutive character of goods and services they supply in their programmes.

A static Ricardian model would suggest that developed countries exchange technology-based goods for manufactures with a high content of raw material and physical labour from developing countries. A dynamised Porterian model, on the other hand, recommends that all countries build up progressive and specified factors as fast as possible. The same strategy is implied in intra-industry competition.

On a macro-level, we also see a scenario of coopetition that requires delicate balances between technology transfer and technology holdback. As the capacities for certain mature consumer goods are underused rather than stressed, countries with advanced technology show a vested interest in accessing promising markets. Their partners in developing countries may be more interested in technology transfer than in establishing the foreign partner's strong brands in their home markets, so that they can upgrade their contributions to the international division of labour and production and compete with their former partners either on the home or on third markets.

These unavoidably differing interests seem to be aggravated by cultural differences and the speed with which East Asian countries have moved from agrarian to industrial and even post-industrial structures. Whereas knowledge was a by-product, embedded in the main product or service delivered during the first two stages, it trades as a good of its own in a 'light' post-industrial economy (Drucker 1994).

With the help of the Internet and the vast potential of highly trained researchers in emerging markets, such as China and India, knowledge travels fast. Ricardian patterns of trade are complemented and sometimes even substituted by Porterian or intra-industry patterns.

Macro-level conditions, therefore, suggest that only such partnerships will survive where motives are clear and complement each other and where institutional arrangements assure that both market entry and technology transfer will occur.

MICRO-LEVEL REASONS

On the micro-level the studies found that joint ventures had a higher expectation of success if partners had selected each other carefully and if they had invested time and effort in a feasibility study. Hurried-up investment without sound preparation, on the other hand, was connected with a high probability of failure.

Secondly, joint ventures had a higher tendency to succeed if they were run by managers with high intercultural competence on both sides. Those Western managers who speak the language and have learned the history of the country understand its business models and the relationship to different authorities much better.

Thirdly, a firm commitment to the Chinese venture by the Western partner also contributes to success. A longer-term relationship can develop and establish the necessary trust or cooperational strategies; game theory suggests the usefulness of multiphase games (Axelrod 1997).

These findings are not surprising, since common sense would lead to very similar results. What could be considered a counter-intuitive finding was that the length of a joint partnership had a negative correlation with trust in one study (Schneider and Fuchs 1999). In these cases euphoric mutual expectations were disappointed by real behaviour. Managers on both sides tended to interpret their disappointment in terms of cultural factors and intercultural prejudice.

Implications for Japanese multinational enterprises

If foreign enterprises assist in establishing production capacities, in the long run they will contribute to creating competition, provided that Chinese partners behave in an opportunistic way. This development will be accelerated if China continues its offensive export policy and hence becomes a fierce competitor in technologically advanced industries. The underlying hypothesis of the Schneider and Fuchs (1999) research work on Sino-Austrian joint ventures assumes that with respect to motives and interests, there is a fundamental tension between Western and Chinese partners. While the aim of Western enterprises is to gain access to the market, the Chinese are mainly interested in taking advantage of Western technology. Hence, Western multinational corporations' interest in joint ventures may be primarily influenced by the possibility of getting a foothold in the Chinese market. The study reveals that the main areas of concern are interpersonal relations, implementation of laws, changing regulations concerning imports and the achievement of targeted productivity. It is argued that the source of tension lies in the variety of misunderstandings Western partners' experience in China.

The same scenario will probably apply to Japanese corporations. Consequently, Japanese firms will face problems similar to those experienced by Austrian investors. All foreign companies must follow regulations and laws. Productivity depends to a great extent on the diligence of the work force and trust is fundamental for the functioning of a joint venture. Inkpen and Beamish (1997) argue that trust is required for the functioning of international joint ventures. A trust-based society such as Japan may have lower transaction costs, which might result in a competitive advantage for Japanese enterprises over their competitors. A detailed economic analysis of trust in joint ventures has been provided by Dolles (chapter 8).

If a trustful relationship between joint venture partners exists, possible opportunistic behaviour of partners will more likely be avoided. Chinese business behaviour is difficult to assess. With an awareness of tensions and cross-cultural misunderstandings in Sino-Western relations, Westerners might be more careful in dealing with Chinese partners. Based on interviews with a Japanese manager with experience in European business, a possible hypothesis could be that Westerners with an interest in business will more likely be successful than the Japanese in adapting to cultural aspects and accept cooperation by agreeing on compromises. However, for Westerners business will be less profitable than for the Japanese, who are known to be tough negotiators (Hodgson, Sano and Graham 2000). Japanese tend to exercise more patience in accomplishing the goals of a joint venture due to a longer time horizon than their

Western counterparts. Nevertheless, if the Japanese cannot see an opportunity to push their interests through, they will abruptly terminate business relations, as harmony cannot be achieved. However, if negotiations are successful, tight agreements will also make the business itself successful. Consequently, one can argue that the Chinese will feel more comfortable in a Sino-Western business relation and hence be more willing to work for Western than Japanese enterprises.

Regarding market share, trends in Japan's foreign trade with China indicate motives for a strong presence in China. From 1998 onwards the total value of Japan's exports and imports decreased, mainly due to the slump in the Japanese economy and the yen's appreciation. However, the total value of exports and imports to and from China increased in 1999 as against 1998 by 1.4% and 0.6% respectively, while foreign trade with the US, EU and Middle East decreased (WTO 2000, p. 12). An upward tendency of Sino-Japanese trade has also been confirmed by the Japan External Trade Organization, showing solid growth for the third consecutive year. Although the rates of increase were slower than in 2000, China was among Japan's top-five trading partners and succeeded as the only one to raise both exports and imports. Of the world's leading markets for Japanese exports China holds second place, and is also the second-largest supplier of exports to Japan. China's share of Japan's global trade recently increased to 11.8%, exceeding 10% for the first time (JETRO 2002).

Technical progress results in competition between national economies in overlapping markets. It is not to be denied that competition exists between Japan and China. In the past the success of Japanese firms was dependent on imitation and improvement of imitated products. Precise mass production and continuous improvement of products and production processes helped the nation become a leader, especially in the production of electronic components. However, technology transfer usually carries the risk of imitation. As Chinese production facilities are suitable for mass production, Chinese enterprises might follow the same strategy that made Japanese enterprises successful. Akin to Japanese firms, China has the ability to develop precise mass production but with the advantage of producing at lower wages, hence causing fierce price competition.

The presence of multinational firms in the local market and the control exercised by Japanese enterprises can counteract this development. Isobe, Makino and Montgomery (2000, p. 478) stressed the importance of timing of entry and resource commitment to technology transfer of Japanese enterprises in the Chinese market. They distinguish between firms that explore potential market opportunities before competitors enter the market – early movers – and firms that wait until uncertainties in the regions are resolved by earlier entrants – late movers. The findings of their study show that in the case of Sino-Japanese joint ventures in emerging economic regions early movers and technology leaders are likely to attain superior economic performance relative to technology followers and late movers. Boulding and Christen (2001) discussed the concept of first-mover advantage in relative terms. Introducing the concept of first-mover disadvantage, their research showed that being a pioneer can incur surprisingly high costs.

According to Fuchs, Schneider and Dawei (1997), management competence, production know-how and access to Chinese authorities are essential motives in Sino-Western joint ventures. Japanese enterprises have developed their own management techniques and have implemented them successfully. In accordance with their claim to uniqueness, it is not likely for Japanese enterprises to leave management up to their Chinese counterparts. In particular this holds true for human resource management. Japanese enterprises rely on their own expatriates as an effective control mechanism to exert influence on overseas operations. The decision to use local managers or expatriates depends on the type of activity in China. The preference for Japanese expatriates in China can be explained by the fact that many Japanese plants in China are subcontractors for Japanese-based headquarters. They are not aimed to target the local market and hence return most of their output to Japan. In such a scenario there seems to be little place for Chinese managers. The situation is different for enterprises targeting the Chinese market. Although a reduction in expatriates is being considered by Japanese companies, a radical change is not to be expected soon (Legewie 2000).

Another reason for not taking advantage of Chinese management competence might be seen in Japanese enterprises' concern for their worldwide reputation. In the case of a Chinese manager behaving opportunistically, a bad reputation for the globally operating Japanese enterprise might develop. Upholding one's good reputation is considered to be essential when operating with partners in a global economy. Japanese managers are subject to several shared values like group identification, collective responsibility and a sense of reciprocal obligation that have to be consistently complied with in Japanese culture. Fundamental research in the field of obligations has been conducted by Benedict (1993). In a Western environment, one will easily perceive an unreasonable sense of duty as a constraint. The contrary may be found in Japan, where the sense of obligation is embodied in society so that an impediment to offer resistance prevails. Hence, misbehaviour by a Japanese manager can probably be excluded.

The transfer of production know-how will challenge Japanese enterprises in particular. When partners cooperate at an early stage in order to anticipate benefits, they must be aware of the fact that they may become competitors at some later stage. Opportunistic behaviour like providing false information, cheating each other or withholding important information can occur once the early stage is passed. Opportunistic behaviour is likely in a Sino-Western joint venture if the actual interests of the joint venture partners differ too much or are incompatible. This can be a result of poorly prepared or simply bad negotiations, or badly chosen partners (Fuchs, Schneider and Dawei 1997). Difficulties in establishing and maintaining trustful relations will have a negative impact on the extent that know-how can be transferred. Once the know-how is transferred, the risk of acting opportunistically cannot be excluded.

Strong personal connections with local key players and recognition from the local business community are keys to successful market entry. In business it is essential to be well connected. The Japanese maintain their social networks by *ningen kankei*; Chinese are embedded in *guanxi*. In simplified terms, informal relationships determine just how much or how little can be accomplished. This is true for all kinds of business. Factories supplying a product are dependent on transportation, customs and other export-related organisations; raising funds requires connections to banks. Even if all requisite permits and approvals from authorities are obtained, not having relations to the relevant supply channels will cause difficulties. One can assume that if both cultures are familiar with the strong importance of relationships, a smooth course of interaction between Japanese and Chinese enterprises can be taken for granted.

These webs exist primarily within the same cultures and are not comprehensive. Ties between Japanese and Chinese webs hardly exist. The Chinese prefer to do business with people they have relationships with, just like the Japanese. But *guanxi* connections in China are not the same as *ningen kankei* in Japan, and these differences make interaction in the foreign market difficult. The Japanese web of relationships will be of little use in China except within the Japanese *keiretsu*, which is the company network itself. Japanese subcontractor networks are often established to supply the Japanese headquarters and this may result in poor *guanxi*. However, if Japanese enterprises succeed in establishing *guanxi*, business will become easier. For instance, *guanxi* with higher level officials can give Japanese enterprises the influence needed to pass through bureaucracies.

Since the Japanese and Chinese networks of relationships differ, the prerequisites for Westerners and Japanese in China appear to be similar. An exception is the handling of written documents. The use of similar characters in Chinese and Japanese can be of advantage to Japanese enterprises. Even if the language is different, the meaning of characters can be interpreted and thus facilitate dealing with Chinese authorities.

The higher the compatibility of interests, the greater the possibility that joint venture partners will develop a trustful relationship, enabling them to exchange assets and capabilities that both can profit from (Fuchs, Schneider and Dawei 1997). Common interests are certainly necessary for cooperation, but they are not sufficient in themselves for building trust in Sino-Japanese relationships. As stated above, in Chinese joint ventures, market access and technology transfer are two different interests, but the common interest will be to make profit. In China profit counts in business relationships. If Chinese see a chance to make money, relations with business partners become less important, except within family businesses. This is in opposition to the Japanese way of thinking, where the tendency is to stick to the same partner once a commitment has been made. This is a result of norms and unwritten laws that are still essential for doing business (Hodgson, Sano and Graham 2000). Negotiating with the Japanese takes time; they often insist on developing strong personal relationships before establishing business ties. Unless a feeling of trust exists between business parties, the Japanese are apt to feel uncomfortable. Hence, the interest in making profits is to be evaluated differently in Japanese and Chinese enterprises. Even if motives are compatible, greater trust is not automatically the result, as the possibility of suspiciousness and opportunistic behaviour of the Chinese partner always exists.

Conclusion

The present paper focused on reasons and the importance of the selected motives in joint ventures. The topic was approached by reflecting on existing theoretical literature and different models of external trade. Experiences from a small sample of Sino-Western joint ventures and implications for Japanese multinational enterprises were discussed, in particular with regard to their relevance for Japanese companies engaging in Chinese partnerships. In general, the findings are applicable to Western as well as Japanese enterprises. The dominating motive for Western or Japanese partners is to get access to the Chinese market, while Chinese partners are interested in the transfer of technological know-how and obtaining foreign currency. In this context the importance of personal relationships should not be neglected. In particular for Japanese corporations the question of how to deal with *guanxi* and further how to gain authority to cope more easily with the Chinese bureaucracy when establishing joint venture partnerships is a topic for elaboration in further research. Joint ventures are likely to be successful if there is not only compatible but also complementary interests between the partners. Reliability, credibility and trustworthiness of the joint venture partner are essential for minimising difficulties and risks in forming and operating the joint venture. In addition, a thorough selection of the partner and a well-conducted feasibility study as well as high cultural competence of managers contribute to minimising the risk of failure. The balance of risk and investment benefits involved with partnerships in emerging markets, predominantly in the Chinese business environment, is another interesting point to look into more closely. As far as China is concerned, cultural distance, language barriers and complicated relations to authorities speak well for a joint venture as market-entry strategy. Nevertheless, many enterprises still have difficulties or fail to turn this strategy into a success.

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