**Corporate Governance in International Joint Ventures:
Toward a Theory of Partner Preferences**

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Abstract

Corporate governance has been relatively neglected in the analysis of international joint ventures [IJVs]. This paper aims to suggest key elements in such an analysis, focusing on partner governance preferences. It adopts a relatively broad definition of corporate governance as the process of control over and within the firm (in this case the IJV) that aims to reduce risks to its owners and to ensure that its activities bring a stream of acceptable returns to those owners in the long term. This definition draws attention to the behavioural and internal aspects of governance in addition to the purely structural and external aspects that have historically commanded most attention in the governance literature. Four types of risk and their implications for partner preferences for IJV governance modes are identified. The paper then offers an analytical framework in which context dependency, risk and partner preferences for IJV governance modes are linked, and accompanies this with propositions suggested by the framework. It concludes by suggesting a typology of IJV partner governance preferences.

The formation of joint ventures [JVs] has become an increasingly popular means for companies to realize their strategic objectives (Doz and Hamel, 1998). As a result, the field of study known as cooperative strategy came into fashion during the 1990s, following the attention that had been accorded to competitive strategy during the 1980s (Faulkner and de Rond, 2000). The crossing of organizational boundaries through partnership was regarded as a particularly promising way for companies to secure a competitive advantage through enhancing market power, realizing economies, overcoming market entry barriers, achieving technological synergy or other benefits (Dussauge and Garrette, 1999). Many joint ventures today also cross national boundaries, being formed between partners from different countries (Beamish and Killing, 1997).

JVs have been characterized as 'hybrid' organizations (Borys and Jemison, 1989) in the sense that both their ownership and management is typically shared between two or a small number of partner firms. This complication introduces a new theoretical challenge (Parkhe, 1993) that has elicited a response from many perspectives (Ramanathan, Seth, and Thomas, 1997; Faulkner and de Rond, 2000). Important contributions to the analysis of JVs have been offered from market power theory, transaction-cost economics, agency theory, increasing returns theory, game theory, strategic management theory and organizational theory (Child and Faulkner, 1998). Yet despite the scope of this list, one significant aspect of this new organizational form continues to be almost totally neglected, namely the corporate governance of JVs. The significance of JV corporate governance is indicated by the fact that the relatively high failure rate of this organizational form is usually ascribed to precariousness in relations between their owning partners (Singh and Mitchell, 1996). The governance of *international* JVs [IJVs] formed between partner firms from different countries, is likely to be even more precarious due to cultural differences and to potential dissonance between the governance regulations of the host country location and the preferences of the foreign partner. Although some IJVs are formed to operate in a third country, it is more usual for them to be located in one of the partner's home country, with the other partner(s) in this sense being 'foreign'.

The aim of this paper is to suggest key elements in a theory of corporate governance in international joint ventures. Given the nature of IJVs as a subject, it is appropriate to adopt a relatively broad definition of corporate governance as the process of control over and within the firm (i.e. IJV) that aims to reduce risks to its owners and to ensure that its activities bring a stream of acceptable returns to those owners in the long term. This definition draws attention to the behavioural and internal aspects of governance in addition to the purely structural and external aspects that have historically commanded most attention in the governance literature (e.g. Monks and Minow, 2001).

The paper begins by extending the central role of agency within corporate governance discourse to the IJV case by developing the concept of multiple agency. The problems posed by multiple agency are seen to be dependent on the particular context in which an IJV is located, particularly the institutional and economic environment. Environmental and agency considerations establish conditions that bear upon the nature and degree of risk perceived by a partner investing in an IJV. Four types of risk and their implications for partner preferences for IJV governance modes are identified. The paper then offers an analytical framework in which context dependency, risk and partner preferences for IJV governance modes are linked, and accompanies this with propositions suggested by the framework.

1. Multiple agency

Agency theory is concerned with the ability of 'principals' to ensure that their 'agents' are fulfilling their objectives. Applied to corporate governance, equity owners are regarded as the principals. Their vulnerability stems from their position as residual claimants in the sense their returns depend upon all other contractual claims that have to be satisfied first (Shleifer and Vishny, 1997). This means that self-serving or ineffective agents could respectively appropriate or dissipate such returns. Agency theory assumes that agents cannot necessarily be trusted, and that this creates a serious risk for principals when there is an asymmetry of information in favour of their agents. It is therefore concerned with the governance mechanisms that limit agents' self-serving behaviour (Berle and Means, 1932; Jensen and Meckling, 1976). The necessity to introduce such mechanisms and other actions to reduce the risk of agents' opportunism incurs 'agency costs'.

The agency issue can also involve relations between shareholders themselves. Ideally, dominant shareholders will have regard for the interests of the minority, and managers will look after the interests of both. Evidence provided by some authors, such as La Porta et. al. (1998) and Claessens et. al. (1999), suggests however that wherever there is a dominant shareholder there is a tendency for minority shareholders to be sidelined. Lazonick and O' Sullivan (2000) also suggest that institutional investors will emphasize short term returns, at the expense of those investors who seek to develop the intrinsic worth of their companies through, for example, investing in innovation.

Multiple agency refers to a situation in which there is more than one party in agency relationships, either as principals, agents or both. The formation of equity joint ventures is an important instance of multiple agency. This form of strategic alliance involves a pooling of ownership assets and usually a degree of joint management between partner firms.

The multiplicity of agency relationships in equity joint ventures arises from three of their salient characteristics. First, there are several but few owners, often only two. They have to be regarded as multiple principals because each has its own rationale for entering into the alliance and each is sufficiently salient to require its interests to be respected. If one partner decides to withdraw, the alliance usually breaks down. Second, because the owner-partners normally contribute complementary tangible and intangible assets to the joint venture (Geringer, 1991), they also in effect become agents for each other in ensuring its viability. In other words, a joint venture cannot survive without the contributions of each partner, which places one partner in the role of acting as an agent for the fulfilment of the objectives that the other(s) invests in the venture. Third, the managers of the joint venture act as agents for its owners. The presence of multiple owners can complicate this agency role if each places its own expectations upon venture managers. Further problems can arise if the joint venture is managed by a mix of personnel who are supplied or appointed by the different partners, especially if they come from different national cultures and traditions of practice (Shenkar and Zeira, 1992).

This potential for conflicting interests between owners is a serious concern for joint ventures. Even when the partners have completely compatible objectives, issues of fairness often arise with respect to the relative contributions to and benefits from the joint venture on the part of each partner. These problems are exacerbated if one partner is able to tip this cost-benefit balance in its favor through, for example, acquiring an advantage over the other partner in technology and other knowledge through superior learning (Hamel, 1991).

A lack of symmetry between partners in the effective influence they can exercise over their JV can pose a serious corporate governance problem in terms of the principal-agent issue. If, for example, two JV partners each subscribe 50 percent of its equity, but one of them enjoys greater influence and effective control, the other partner is vulnerable in terms of protecting its interests. Whether this is actually perceived as a problem by the weaker partner cannot be determined *a priori* because it depends on its motives for joining the venture. If that partner were content to secure the 50 percent of return that is legally due to it and to leave the initiative in running the JV to the other partner because of its superior or less costly capabilities, this could constitute a viable situation at least in terms of meeting the passive partner's expectations. The perception of risk may also be mitigated if an initially weaker partner estimates that it can progressively secure greater control through learning faster than the other partner(s) (Makhija and Ganesh, 1997).

2. Risks and context dependency

2.1. risks

Four types of risk are identified: financial, resource, market opportunity, and agency. We later argue that each is likely to impact on IJV partners' preferred governance and control solutions. IJV partners can incur a *financial risk* over and above normal commercial uncertainties. The additional financial risk stems largely from the possibility that their investment could be eroded by specific administrative factors in the host country that reduce the level of return on the investment or the ease of repatriating it, and even by threats to their ownership rights. These risks are liable to be greater in emerging economies because of their institutional limitations. These include less adequate legal regulations and provisions for the protection of intellectual property, as well as greater political risk (Peng, 2000). Moreover, the risks attaching to asset specificity of investment may be increased by the absence of well-developed secondary markets for the disposal of assets in the event of IJV termination. Additional financial risk can also result from governmental actions such as devaluation and changes in interest rates. For example, the uncertainty created by such actions discouraged foreign investment into Brazil before the stabilization reforms of the 1990s (Barros, 1993).

A *resource-deficiency risk* arises if the resources available to an IJV are inadequate for it to operate as a viable business, including the inability to make best use of some resources due to skill or motivational deficiencies. Again, this risk is more likely to arise for an IJV based in an emerging economy, where resources may be in short supply and the relevant markets imperfect, than in a developed country (Rodrigues and Child, 2001).

Thirdly, *market opportunity risk* concerns the possibility that firms may enter new markets with an inaccurate appraisal of the opportunities these offer for achieving an acceptable return on the investment incurred. This is a particular risk for companies lacking international experience, which may underestimate the strength of local competition or the advantages already enjoyed by first-mover entrants (Lieberman and Montgomery, 1988). Local partners may fail to deliver the market access they promised, perhaps because their distribution networks are too local or ineffective. This has been a common complaint of foreign-investing firms in China (EIU, 1999).

Agency risk is a broad category referring to a range of possible moral, legal and managerial failures in an IJV relationship that can give rise to default, non-delivery and inadequate commitment. Agency risk is attached to the problems that arise if other partner(s) or IJV managers are not competent or willing to meet a partner's formal and informal expectations. As already noted, competency limitations are more likely to arise when the host location of an IJV is an emerging economy. Opportunistic behavior by another partner is always a danger in joint ventures, including attempts to expropriate key resources from the first partner purposely, to overtake it or to drive it from the market (Doz and Hamel, 1998). In emerging economies, institutional authorities sometimes condone opportunistic behavior by local IJV partners and managers, which is justified on the grounds of catching up with an economically privileged partner. Multinational corporations [MNCs] can themselves demonstrate opportunistic behavior towards local companies, using various devices to enhance their power such as placing key departments under their management even when they only have a minority holding. In order to prevent opportunistic behavior by either party, some countries like Brazil have devised shareholders' agreement instruments that define the special powers of the partners.

IJV owners have to face additional types of agency risks. A partner with a minority holding can be more vulnerable wherever the governance system favours concentration without appropriate protection of minority investors. If the proportion of equity held by an owner is large enough to ensure control of the company, there is incentive for that owner to reduce the return to the minority partners (La Porta et al., 1998; Valadares and Leal, 2000). A further common problem of agency in IJVs concerns the loyalty of its managers. IJVs involve partners of different nationality and cultural identity. Even when a foreign owner nominates them, local managers can feel their loyalty divided between demands of this principal, on the one side, and the local partner and community, on the other.

Financial, resource-deficiency and market opportunity risks are primarily associated with conditions in the IJV's host country. They therefore reflect the *macro* context, the institutional and macro-economic conditions a foreign partner can find in the IJV's particular environment. While agency problems can be traced to macro level factors, such as differences in culture and an underdeveloped legal system, they arise primarily at a *micro* level, that of the firm (IJV). Agency risk arises from the relations between partners as well as between the partners and their managerial agents. They may therefore be amenable to initiatives at the micro level such as enhanced internal controls, and the building of trust.

Following Dunning (1998), the first set of risks involve relationships between the venture and the local environment and are linked to 'locational' disadvantages, while agency risks stem primarily from relationships intrinsic to the IJV itself.

2.2. context dependency

The risks facing an IJV partner are dependent on the institutional and economic context in which the venture is located. The impact of the *institutional context* on partner risks becomes particularly apparent in the international context where many IJVs are formed between MNCs and local firms. Here the effectiveness of the host location's legal system and the attitude of regulatory authorities are crucial. For instance, the level of protection afforded to corporate investors has been found to vary significantly between countries (La Porta et al., 1998). Protection can be assessed in terms of various measures including legal recourse for the non-fulfilment of contracts, mechanisms to safeguard minority shareholders, risk of expropriation of assets, and accounting standards. Insofar as many IJVs are vehicles for technology transfer, the extent to which intellectual property is effectively protected from the risk of leakage is another major concern to 'foreign' investors.

Local regulations, as well as norms of custom and practice, will define the formal corporate governance options that are available to IJV partners. These institutional features are likely to be "cultural" in the sense of being historically embedded, and thus to display a high degree of path dependence (North, 1990). At the same time, as Porter's (1990) analysis suggests, institutional and legal development is itself a function of level of economic development and progress towards modernization. National institutions are expected to moderate both the possibilities of choice among corporate governance structures for firms located there, as well as the corporate governance preferences of local owners and other local stakeholders. Thus the possible choices of governance in strategic alliances are shaped by institutional factors through the intermediation of national regulations and formats for corporate governance. An example is the shift towards a policy of economic liberalization in Brazil during the 1990s, which was reflected in changes in rules governing business ownership, including privatisation. This in turn encouraged the formation of majority foreign-owned IJVs as well as outright acquisitions.

Moreover, some of the institutional restrictions found in situations like China are applied informally, such as when local government agencies refuse business licences to foreign-funded ventures in order to protect local firms from competition or when product piracy and leakage of technology by local IJV partners are condoned as 'patriotic acts'. Informal institutional behavior of this kind can clearly present a risk both to the achievement of market opportunities and in terms of agency costs. It impacts upon agency risk, in that opportunism on the part of a local partner and/or local managers might be encouraged by a legal regime that fails to support redress or an administrative regime that protects such behavior on the part of local actors. In this way, the institutional regime can lend different degrees of support for trust between local and foreign partners (Child and Möllering, 2003).

The level of development of intermediate institutions impacts on the risk of deficiency in the resources required to operate an IJV successfully. Such institutions supply necessary business support services. If, for example, banking, legal, market research, technical consulting, and basic utility services are not readily available or are unreliable, this will either hamper the efficiency of the IJV directly or incur additional costs of supplying these resources from outside the country or region.

In these ways, the institutional context in which an IJV operates has a direct bearing on the level of risk incurred by an IJV partner, especially the ‘foreign’ investing from outside the host country, in respect of financial, resources, market opportunity and agency costs.

The *economic context* in which IJVs are located also impacts on the level of risk in each of these four areas. A shortage of working capital and liquid funds within the economy can add to the financial risk that an IJV faces. Similarly, if the instability of the local economy places an IJV’s local partner under financial stress, this is likely to encourage opportunistic behavior on its part. For example, the high level of inflation that characterized the Brazilian economy in the 1980s encouraged companies there to engage in opportunistic behavior which exploited profits from price rises rather than from efficient production. Major shifts in government policy in respect of exchange rates, taxation, interest rates or governance regimes both increase the level of risk and encourage defensive behavior of an opportunistic kind. A relatively low level of economic development, combined possibly with a lack of experience in joint venture partnering, is also likely to limit the capabilities of a local partner to act as an effective agent for the other partner to achieve the objectives it seeks from the IJV.

The major risk impacts of the economic context are, however, likely to fall in the areas of resource deficiency and market opportunity. Some IJVs are formed to permit MNCs to take advantage of access to cheap local resources, as in Central and Eastern Europe and parts of South-East Asia. On the other hand, the lack of other resources in the IJV context, such as capital, managerial and technical expertise and business support services, can pose a threat to the IJV’s viability. Resource deficiency can, however, provide an opportunity for foreign partner dominance and this may be regarded as essential to overcome inadequacies of experience and even trustworthiness among local managerial agents. For the level and quality of resources available to the partners of an IJV can affect their mutual dependency (Pfeffer and Salancik, 1978). The degree of agency dependence between partners can be asymmetric if one of them possesses superior resources and capabilities. MNCs typically possess superior technological and managerial capabilities that provide them with sufficient influence to exercise considerable control, especially in the early years of IJVs with local firms (Child and Yan, 2003). MNCs can also benefit from an accumulation of political capital if they are early entrants or are willing to locate in priority areas designated by host governments (Frynas et al., 2003). Nevertheless, in contexts where government involvement in the conditions for doing business (such as the granting of land, the right to access working capital, and trading licences) remains high, a local JV partner may retain considerable influence if it enjoys substantial political capital in that context (Peng, 2000).

The other significant aspect of the economic context lies in the market opportunities that it offers. Its combination of high growth rates and a huge population is the prime reason why China has attracted so much foreign direct investment despite the other contextual difficulties that have operated there in the past. Market risk in China has arisen mainly as a result of institutional constraints, such as difficulties of securing licences for distribution, rather than from insufficient or volatile market demand. By contrast in other countries such as Argentina, uncertainties regarding the stability of the market per se have presented the greater risk. The instances mentioned of how institutional intervention over licences or access to local sources of capital can impact on economic conditions serve to remind us that in practice, economic and institutional contexts interact.

3. Risk and partner preferences for IJV governance

This section identifies the forms of IJV accountability and control that are likely to be favoured to deal with the four different categories of partner risk. The following section then offers an analytical framework for IJV governance preferences and supports this with propositions to guide future research.

The focus of most discussion about corporate governance has been on what the OECD (1999) has characterized as the 'outsider' system of governance. Here, owners have to rely on external levers and mechanisms, such as boards of directors, in order to ensure that their agents will act in accord with their interests. Organization theorists have referred to this as 'strategic control', which is concerned with the means and methods on which the whole conduct of an organization depends. The key assumption in the governance literature, that owners or their supervisory agents have the capacity to make sure that companies are conducted to serve their interests, is however premised on the assumption that such control extends to the use of resources and the conduct of operations. This means ensuring a level of operational effectiveness that will provide a good return to shareholders and a way of conducting operations that will not jeopardize proprietary rights over technologies, brands or other assets. Operational control is therefore also vital to protect owners from risks, and has to be included within the scope of corporate governance. For 'control loss' within organizations means that corporate intentions may not be realized (Williamson, 1970). These considerations call for attention to 'insider' controls that complement and support 'outsider' governance.

This broader perspective can be used to indicate the IJV governance and control mechanisms available to a partner for the purpose of limiting each of the four types of risk that we have identified. Some elements of financial risk can be reduced through taking a majority share of IJV equity so as to control the use of surplus funds and other strategic decisions through having a majority of IJV board members. The active presence of a partner's own managers within the IJV may also help to reduce those financial risks arising from misadministration of accounts, and this is the prime reason why many foreign partners insist on appointing the chief financial officers of their IJVs (Child, 2000). Even in circumstances where an IJV partner can only secure a minority equity share, recommendations have been made on ways in which influence over financial and other strategic decisions might be secured through other means such as the appointment of able people to the IJV board and informed preparation before board meetings (Schaan, 1988).

The reduction of resource-deficiency risk through the provision of compensatory resources of a physical, informational and human kind to an IJV also carries control implications. Consistent with the resource dependency perspective, it has been found that an important source of influence over IJVs can arise from the authority and goodwill attaching to the partner who provides such key resources (Rodrigues and Child 2001). While it is unlikely that resource provision will be made primarily with the enhancement of IJV control in mind, this is a useful by-product. Similarly, market opportunity risk can be mitigated by a partner taking control over key IJV appointments concerned with developing market research, distribution, product promotion and other activities essential for securing market penetration. Market opportunity risk often arises when a local IJV partner lacks relevant market knowledge or marketing skills even in its 'home' market, possibly because its distribution has been effected only through middlemen and/or has been purely local in scope.

Agency risk, as we have noted, takes on a multiple nature in IJVs. It extends both to the possible failure of other partners to deliver on their commitments to an IJV and to the risk that its managers may be self-serving or serving primarily of other partners' interests. The primary 'external' control that a partner can exercise over agency risk is that applying to all companies, namely having sufficient equity for an effective voice in the board of directors. Also through the IJV's board, the partner can endeavour to control the appointment, and removal if necessary, of its key managers. These managers in turn are then in a position to exercise control down through the organization through personal involvement and supervision. Thus the monitoring of middle managers and employees is a further governance-support mechanism open to an IJV partner who has a sufficient equity stake and supplies key members of the IJV's management.

4. Context, risk and partner preferences for IJV governance modes

4.1. Analytical framework

The above review of context dependency, risk and partner preferences for IJV governance modes suggests the components of the analytical framework depicted in Figure 1. For purposes of simplicity, the framework focuses on IJV governance from the standpoint of a 'foreign' partner rather than the host country IJV partner. It also takes account of the fact that the options available for IJV governance will be constrained by institutional provisions in the host country, including regulations about permissible governance formats.

Figure 1 about here

The left-hand side of Figure 1 indicates that a country's institutional and economic context establishes certain conditions for, and constraints upon, the corporate governance situation that prevails in an IJV host country. These were discussed in section 2.2. Institutional factors impact on the risks faced by foreign IJV partners primarily through the legal system and the attitude of regulatory authorities. Macro economic factors bear upon the risks faced by IJV partners in areas such as market opportunity, resource availability and the financial pressures that influence the behavior of local partners. The quality of the other IJV partner(s) enters into the multiple agency risks arising from the dependence of an IJV partner on the other's competence and goodwill. Although the relationship between partners is a micro-level feature, the available choice of local partners in the first place, and their capabilities, are features of the host country macro economy.

The level of risk in different areas (financial, resource, market opportunity, and agency) is expected to impact on partners' policies on the equity capital and non-capital inputs to invest, and the control deriving from these, as well as policies on structuring control through board membership and key appointments (see section 3 above). The corporate governance provisions established for IJVs, especially equity share, are seen to reflect an assessment of risks and opportunities in the host environment (cf. Pan, 1997), though the degree of choice may be limited by host government policy and regulations. Such regulations and approved formats become templates for governance at the firm (IJV) level. This limitation is indicated by the dotted line from "regulations and formats for corporate governance" to "IJV partner's corporate governance policies".

Third, the formal ownership structure of an IJV, in terms of partner equity share and appointment of directors, is seen to impact directly upon the strategic control each IJV partner actually exercises, in line with the legal rights of corporate governance. We have noted, however, that there are other control levers available to owners or managers additional to the equity rights stressed in legal theory and in most discussions of corporate governance. Thus the provision by an IJV partner of non-capital, and even non-contractual, support may well enhance its operational control. The availability of competent managers who can be trusted by one or more IJV partners may also facilitate the delegation of operational control and even of some influence over IJV strategy. The interplay between these levers is likely to give rise to a range of control solutions at the micro level.

The framework is not intended to be either static or to imply contextual determinism. Thus, over time IJV partners may be able to take collective action to develop and shape institutional policies in the host country. Also a policy of technology and knowledge transfer can enhance the level of managerial competencies available in the local environment and so reduce one of the economic foundations for resource-deficiency risk.

4.2. Propositions on IJV partner governance preferences

The strands of the argument we have advanced are now brought together in a set of 11 propositions intended to provide guidelines for further investigation. The propositions refer to the main sources of risk that have been identified and postulate their implications for the preferences likely to be held by *foreign* partners for IJV governance modes. The sources of risk are categorized into institutional, economic and partner (agency) related. They refer to the host country in which an IJV is located. The rationale for each proposition draws upon previous discussion in this paper, and is therefore summarized only. Propositions are identified by a capital "P" and the summary rationales by a capital "R".

<u>Institutional sources of risk</u>

P1. The lower the level of legal protection for contract fulfillment, the lower will be the level of capital and other contractual investment in an IJV by a foreign partner, and hence the greater the probability of that partner being in a minority equity position.

R1. Lack of adequate legal protection raises financial risk, thus discouraging significant commitment of capital, technology or other contracted resources. This reduction of financial risk is traded against weaker governance rights and may therefore increase agency risk.

P2. The lower the protection for minority equity holders, the more importance will a foreign IJV partner attach to holding a majority share of IJV equity.

R2. This proposition may counteract P1. If it is decided to form an IJV in a context that offers low protection for minority shareholdings, a foreign partner is likely to favor offsetting this risk by securing majority control.

P3. If there is a low level of legal protection for minority IJV shareholders combined with regulatory restrictions preventing foreign majority equity holding, the foreign IJV partner will attach greater importance to using non-equity forms of control.

R3. Faced with risks to equity and restrictions on IJV governance through conventional external mechanisms, a foreign IJV partner can only resort to the non-equity based approaches to governance (making key appointments, direct involvement of its personnel, non-equity resource provision, and managerial monitoring). It will thereby attempt to retain some control over at least the implementation of IJV strategy through building up its operational control by these means.

P4. The lower the protection for intellectual property, the more importance will a foreign IJV partner attach to securing a majority share of IJV equity and to involving its own personnel in the management of the IJV.

R4. The significance of intellectual property varies between sectors, and even firms. Assuming, however, that proprietary rights over hard technology (such as products and processes) and/or soft technology (such as brand names and software systems) are an important issue for the foreign IJV partner, then if the host context offers inadequate protection for those rights, the partner will be motivated to secure direct strategic control over the IJV's technology policy via a majority on the IJV board, and to appoint its own managers and experts to monitor the operational use of the technology.

P5. The more that laws and regulations are open to interpretation by local officials, the greater the importance that a foreign IJV partner will attach to establishing direct relations with them.
R5. This proposition concerns the conditions under which a foreign partner is likely to perceive the need to build political capital in the host country environment with the formal representatives of community stakeholders in order to reduce uncertainties surrounding its rights of governance over the IJV. It assumes that the foreign partner has the resource and international prestige to exercise influence with local officials, which is the case for most MNCs but not necessarily for small and medium sized enterprises [SMEs]. SMEs are more likely to have to rely on their local partner(s) to manage this aspect of the institutional context, which in turn depends on the quality of the relationship between them.

P6. The less developed are intermediate institutions in the host country, providing support for business, the more will a foreign IJV partner be obliged to supply this support itself, thus enhancing its operational control in the areas of IJV activity concerned.
R6. Intermediate institutions supply business support services such as market research, education and training, consultancy, and technical advice. If the foreign partner is obliged to supply these directly, or from abroad, rather than securing them from within the host country, it will assume the initiative in the activities concerned through non-equity resource provision. This should enhance its governance over the IJV in terms of operational control.

Economic sources of risk
P7. The more limited the availability of investment capital in the host country, the more likely is the foreign IJV partner to become a majority equity shareholder in order to provide adequate capitalization for the venture.
R7. This proposition suggests that limited external resource availability can have direct consequences for IJV governance arrangements. When opportunities exist for rapid growth, as in China, the inability of local partners to finance their share of capital expansion has often provided an opportunity for foreign partners to increase their equity shares and thus to take strategic control.

P8. The more limited the availability of managerial resources in the host country, the more likely is the foreign IJV partner to supply people to key appointments, offer non-equity resources such as management systems, and hence to gain operational control of the venture.
R8. Similar to R6, this proposition suggests that when the economic context presents a resource-deficiency risk in terms of capable management for the IJV, the foreign partner is likely to compensate in a way that also strengthens its operational control.

P9. The greater the market opportunities open to the IJV, the greater will be the preferred level of involvement of the foreign partner in IJV strategic governance.

R9. Good market opportunities are a major driver encouraging substantial foreign investment. They increase the attraction of taking up a large share of IJV equity in order to secure the right to a corresponding share of the expected favorable returns on investment. This larger stake will in turn enhance the foreign partner's formal rights to govern the IJV through a majority on its board and thus to assume strategic control.

Risks arising from the relationship with partners (agency risk)
P10. The lower the local partner's managerial and technical capabilities, the greater will be the preferred level of involvement of the foreign partner in IJV operational governance.
R10. The more that the local IJV partner lacks capabilities necessary for the success of the venture, the less reliable it is to serve as an agent for the foreign partner to attain its objectives through the partnership. The foreign partner will be encouraged to reduce this agency risk through taking on wider responsibilities and assuming greater operational control of the IJV.

P11. The higher the opportunism displayed by the local partner, and the lower the trust accorded to that partner, the greater will be the preferred level of involvement of the foreign partner in IJV governance.
R11. In circumstances of suspected opportunism by the local partner, and low trust in its goodwill, it is rational for the foreign partner to respond in several ways, all of which enhance its control of IJV governance both strategically and operationally. For example, it may decide to protect its interests through insisting on a larger equity share, on the right to determine key IJV appointments, and on mutually signed contractual safeguards. It may also decide to invest additional person-hours in social contact with the local partner's personnel, in training and development, in the formulation of IJV normative and control systems, and in other activities intended to promote trustworthiness (Child and Möllering, 2003). This additional involvement in the internal affairs of the IJV amounts to a centralization of control by the foreign partner with the aim of enhancing its overall influence in the governance process.

5. Conclusion: a typology of IJV partner governance preferences

The above propositions suggest that different types of IJV governance preference are likely to arise with different levels of risk, moderated by the quality of the other partner(s) including the relationship with them. The propositions suggest that the choice of governance in international joint ventures is not simply determined by the institutional and economic environment of the host country, but also derives importantly from a perception by foreign investors of various risks. Many of these risks are associated with the host country environment, but some are linked to the quality of other partners.

The combination of risks perceived by a partner is likely to shape its IJV governance preferences. Table 1 identifies four broad categories of IJV governance preference, again with reference to *foreign* partners. The four are (1) concentrated personal control (2) concentrated specialized control, (3) delegated managerial control and (4) and delegated financial control. These four types are located with reference to the interaction between risks deriving from the institutional and economic environment and from the quality of other partner(s).

Table 1 about here

Preference for a *concentrated personal* type of governance is likely if the institutional and economic environments present high risk because they offer insufficient protection to foreign and minority holders, and if the quality of the local partner is poor. The tendency in this case is for a foreign IJV partner to favor concentrated personal control based on a strong equity position. A substantial personal presence of expatriate managers from the foreign partner will be perceived as necessary to negotiate with local institutional agencies in the uncertain environment. The main exception may arise in circumstances where the host country environment offers only limited protection for contract fulfillment, in which case the perceived level of risk to foreign capital may be such as to discourage its commitment.

A preference for a *concentrated segmented* type of governance and control is likely when the institutional and the economic environment provides sufficient protection for the foreign investor, but when at the same time the quality of the local partner is mixed at best. There may also be competition and low trust between the IJV partners. Here the tendency is towards the adoption of segmented control, reflecting the areas of relative partner strength and weakness. In this situation, control over selected areas of IJV activity can be secured through appointments of key executives or gatekeepers who retain technology or other key resources in the hands of the partner providing them. These arrangements are intended to reserve access to some activities to the foreign partner so as to prevent technology leakage and to maintain standards, effectively confining knowledge transfer to the limits specified by contract and by that partner. When this situation occurs in a developing country, the local partner is typically confined to operational and personnel issues, with strategic planning and control of technology reserved to the foreign partner.

Preference for *delegated managerial* governance increases when there is high risk in institutional and/or economic terms, but where the partners' strategic intentions are complementary, the local partner can offer good managerial competencies, and the quality of relations between them is good. The high level of risk from the environment encourages the foreign partner to limit its equity stake. Examples of delegated managerial governance have been found with 50/50 IJV ownership, where governance rights are balanced and both partners agree on the choice of the chief executive officer to ensure unified control (Child, 2002). The level of agency risk cannot be so high as to prevent a delegation of operational and even some strategic issues to the other partner and/or to IJV managers. This form of IJV control requires the existence of managerial skills and the willingness of local managers to commit their loyalty to foreign owners as a necessary condition for delegation. In IJVs, this situation becomes riskier when there is inter-cultural hostility. If, as happens frequently in Brazil, the foreign partner does not participate in IJV operations but controls the venture through the setting of objectives and monitoring results, it is left to a local CEO to mediate most of the relations between the partners.

Delegated financial governance by the foreign partner focuses on the monitoring of financial returns from its IJV investment without other active involvement. It is likely to be preferred when that partner perceives IJV-related risks to be low and the quality and trustworthiness of local partners to be good. In this approach, the foreign partner engages in the IJV primarily as a financial or speculative investment without any managerial involvement. This mode of governance is ideal for a foreign partner when the IJV is not highly integrated to its core activities, or even related to them at all. In general, this kind of investor is concerned with the maximization of shareholder value, and does not necessarily have a long-term interest in the venture. This can result in unfocused and sporadic governance in the sense that the partner can withdraw from the business if it becomes financially advantageous to do so. From the local investor’s point of view, the foreign investor fulfills the role of fund raising rather than a supplier of technology or source of learning.

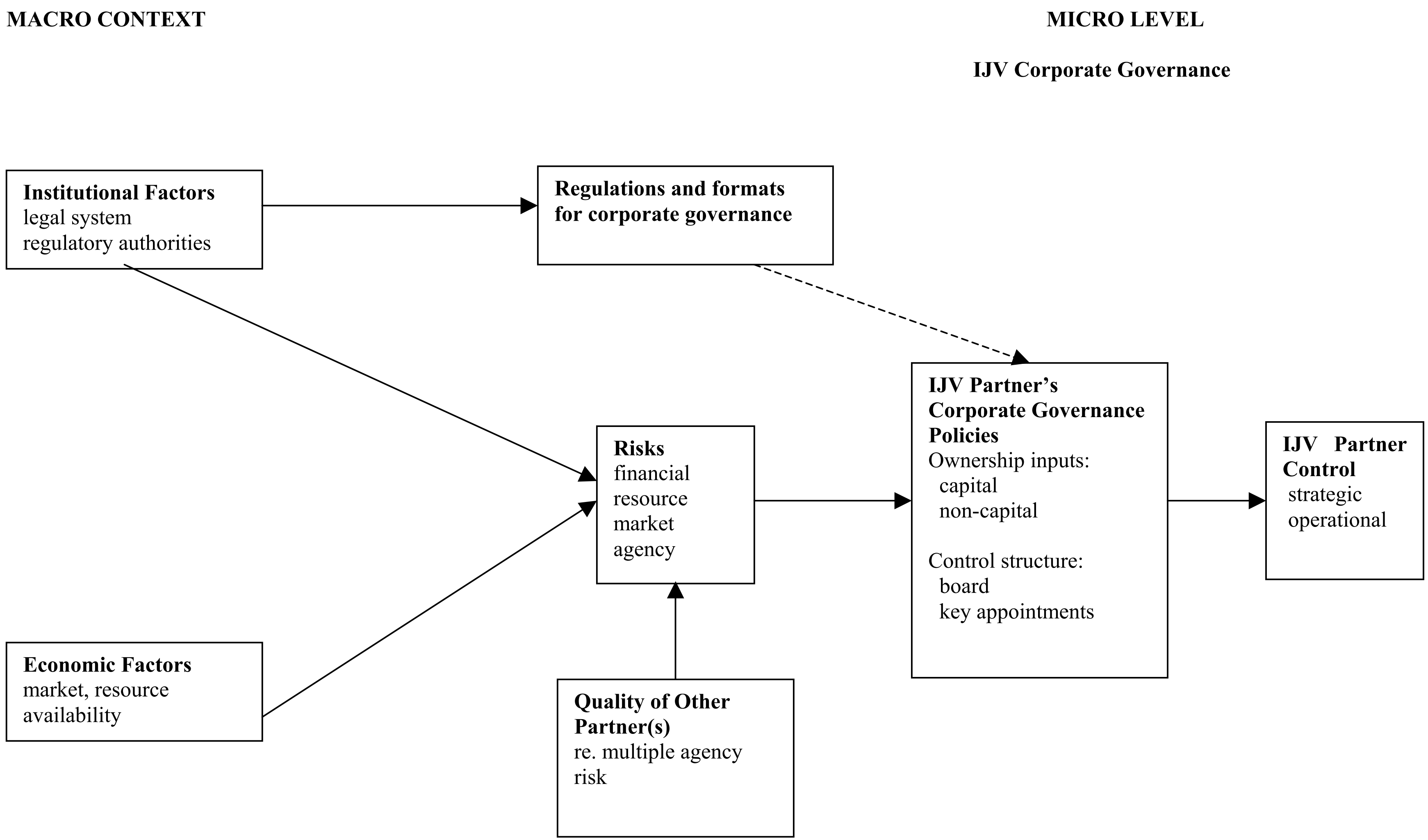
A preliminary comparison of IJV governance in Brazil and China suggests that this typology has sufficient utility to warrant its exploration in further research (Rodrigues and Child, 2001). It was found that in China, foreign partners tended to exercise concentrated personal governance with an active involvement in operational decision-making. Brazil, by contrast, appears to be in transition primarily from a concentrated segmented model towards greater delegated control in which local managers are gradually accorded more responsibilities in the venture. The more effective institutional context for corporate governance in Brazil, and the greater sophistication of managerial competencies in that country, would appear to provide some explanation for the contrasts between the two countries in line with the argument we have presented.

The typology also suggests that different modes of IJVs governance can suit different types of foreign investor, subject always to prevailing environmental conditions. If the foreign investor adopts a long-term horizon and intends to expand to markets where the economic and institutional environment provides low risk, then the ideal model is delegated managerial governance. However, it can be problematic to apply this mode to those developing economies that are characterized by instability and limited managerial competencies. If, on the other hand, the foreign investor’s interest lies in the generation of rapid and high returns, the favored approach might be one of delegated financial governance that permits easy withdrawal if either the external or internal environment becomes unfavorable. However, the delegated financial mode requires an environment less prone than are most contemporary developing countries to contextual uncertainties.

Table 1. A Typology of IJV Partner Governance Preferences Associated with Level of Risk

		Risks from Institutional &Economic Sources	
		High	Low
Quality of Other Partner(s)	Poor	**Concentrated** Personal Governance	**Concentrated** Segmented Governance
	Good	**Delegated** Managerial governance	**Delegated** Financial Governance

Figure 1. Analytical Framework for Corporate Governance in IJVs



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