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JOINT VENTURES SUCCESS IN INTERNATIONAL MARKET: HOW EMERGING-MARKET FIRMS IMPROVE VALUE IN DEVELOPED-MARKET FIRMS

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Abstract

Strategic alliances, joint ventures (JVs), and other cooperation agreements between firms operating in developing countries and those in emerging countries, represent a privileged instrument for accessing in the foreign market and for activating greater competitiveness of companies in the worldwide markets. For many years, strategic alliances have seen firms operating in developed-markets as their main subject. Lately, emerging economies are increasingly involved in JV operations as buyers: all these have occurred as a consequence of the phenomenon of globalization, and the drive towards liberalization processes.

The paper analyzes the reaction of 120 firms listed on the stock market in developed countries in response to joint venture announcements of emerging-market partners, in order to understand whether JV processes are drivers for value creation. Other determinants of value creation are also explored by multivariate regressions, including a battery of covariates related to industry-wide, countrywide, and firm-specific factors. The results express a positive and significant reaction to the market in response to the announcements of international JV. In our case, we see that the exogenous shock of emerging-market liberalization has a positive impact on the stability of international JVs in developed-markets; in addition, international JVs show a high complementarity of partner resources, which are able to alleviate some of the stability problems.

1. INTRODUCTION

Joint ventures are an option for international expansion in response to future technological and market developments because joint ventures reduce the risk of entering a new market or technology. In this sense, joint ventures are a useful alternative to mergers and acquisitions (M&A) in volatile and uncertain markets. Kogut (1991) found that M&As become a subsequent choice when a firm is confident with the new market and has acquired sufficient information from its initial venture.

The JVs were the forms of business combinations most used for penetration in developing countries. In fact, they allow the foreign partners (generally coming from industrialized countries) to acquire knowledge and experience of markets without fully supporting the risk. For years, international negotiations between developed countries have dominated the market for JV agreements. Moreover, until recently, technological innovation, transport, and communications did not allow easy, fast and cheap combination between firms located in countries geographically and culturally distant. This context is going to change: in fact, new technologies and new processes have evolved at surprising rates in the last few decades. Almost all exclusively buyers in developed markets, who have acquired minority or majority holdings in emerging market targets, have initiated few transactions involving developed and emerging economies (Hoskisson et al., 2000).

The current context is going through a constant transition, with ever more global connotations, and this requires firms to react quickly to exogenous impulses and innovative skills, on pain of losing competitiveness (Lee & Peterson, 2000). The JV represent an answer to these needs, as they allow a faster achievement of common objectives, through a sharing culture and know-how beyond the national borders for the achievement of strategic synergies, increasingly indispensable in highly competitive markets. This stimulated not only the agreements originated by buyers in developed markets, largely through JVs and purchases of minority stakes, but also the offerings of developed market firms by emerging market firms.

The potential of this tool is also expressed in terms of organizational learning, not only in technical terms, but also at a strategic level (Hagedoorn, 1993; Hennart & Reddy, 1997; Rajan, 2000).

By relying on the event study methodology, we analyzed the stock market reaction of developed market companies in response to JVs announcements with emerging market partners and found a positive and significant reaction to the market in response to joint announcements. We are also committed to providing and analyzing the results obtained from the analysis of the market trend of investments in JVs between emerging and developed market firms. We are also interested in exploring the determinants of value creation through multivariate regressions, including a battery of covariates related to sector factors.

The aim of the paper is to provide a general picture of the aspects affecting the firms involved in JV processes, and to analyze how the JVs create value for the firms involved.

The paper is organized as follows: Section 2 is dedicated to reviewing the literature on international JV assumptions, and to introducing the differences in international markets and partners. Section 3 presents the development of research hypothesis of the model, and the variables selected for the study. Section 4 includes the methodological approach. Section 5 identifies the results and the evidence of the study, and Section 6 is dedicated to the final conclusions.

2. LITERATURE REVIEW

The JVs are not part of those ties that are established for the development of production, but are part of those deliberate links, aimed to achieve strategic objectives, through an integration of efforts (Balakrishnan & Koza, 1993). In particular, the JV processes are an intermediate tool, able to satisfy a double need: on one hand, the possibility to derive the benefits deriving from the strategies of cooperation and sharing of resources; on the other hand, they allow the partners to maintain their organizational individuality. The JVs, in fact, differ from licensing because the latter do not provide the sharing of capital or investments by the actors involved (Pastor & Sandonis, 2002).

The JV is configured as a particular form of economic group where two or more production companies give life to a joint economic combination, keeping the other economic combinations relatively autonomous (Luo, 2007). The peculiarity is a partial and not total commonality of the economic subject. Basically, it is characterized by the decision of several firms to form a common body by combining their skills for a given period of time.

Friedman and Kalmanoff (1961) conceive the JVs in a strategic perspective as long-term collaboration, defining them as forms of association between companies, involving collaboration for a limited period of time. Indeed, the temporal factor is not decisive, since what characterizes is precisely the temporariness for the achievement of objectives that can be achieved even in the short term.

The JV proves, therefore, for its intrinsic characteristics, an extremely flexible instrument, suitable above all for highly dynamic sectors, and characterized by high levels of innovation, which, as such, require speed of adaptation and response to exogenous changes imposed by the environment (Lane et al., 2001). Precisely this ability to adapt to different contexts also reduces the time for the achievement of certain objectives.

The transaction cost theory is widely cited as a possible theoretical explanation of the JVs (Hennart, 1991; Makino & Neupert, 2000). Hennart and Reddy (1997) argue that JVs are preferred over acquisitions when the desired activities are "indigestible", that is when they are mixed with unwanted assets. The institutional context is combined with transaction cost theory (North, 1990). For example, the institutional structure can provide barriers to entry as legal restrictions on ownership. JVs can help overcome these constraints. The JVs should therefore be more common when a firm enters a country with relatively difficult legal barriers such as those found in emerging countries (Chang et al., 2015).

Another determining factor in the choice to start JV processes is a cultural context, which includes the investment risks associated with the different economic, legal, political, and cultural systems of the host country, as well as the attractiveness of the market (Khan et al., 2015). With increasing investment risks, businesses tend to seek local knowledge through JVs with local companies. In high-risk countries, JVs provide businesses with lower long-term costs due to information sharing. In addition, firms which enter markets with a high investment risk may prefer that JVs reduce their exposure to such risks by reducing their resource commitment.

Another peculiar characteristic of the JV is the choice of partner (Westman & Thorgren, 2016). The creation of a JV also implies the search, negotiation, and monitoring of a partner and these activities can be costly for a firm because of the information asymmetry and difficulties in estimating and including all the contingencies of the agreement (Makino & Neupert, 2000). The lower the cost of finding, negotiating, and monitoring a partner, the greater the firm's propensity to enter a market through JVs; conversely, as these transaction costs increase, companies tend to change their preference to more hierarchical arrangements such as wholly owned subsidiaries (Brouthers, 2002). The role played by partners (including international ones) defines the JV as the partnership whose participants all intervene in the definition of strategic lines (Hitt et al., 2000).

3. DEVELOPMENT OF RESEARCH HYPOTHESES

The type of internationalization that is most often used by firms today is the JV. The global context to which many companies are going is often very uncertain and variable (Inkpen & Beamish, 1997). These seem to be the main causes for the coordination of businesses; the global context in which companies find themselves competing, moves the point of observation, no longer at the national level but at the international one. This provides a new cause to explain the attempt to organize greater coordination between firms: the increase in competitors (Van der Meer-Kooistra & Kamminga, 2015).

From a strategic point of view, international JVs are interesting not only because they reduce the risk of survival in a competitive and ever-changing environment, but also because they allow partners to access strategic opportunities by gradually expanding. These advantages are greater for firms in developed markets, which creates a JV with partners in emerging markets in order to:

1) Challenge the convention of incremental internationalization, expanding globally at a dizzying rate;

2) Gain access to strategic assets such as natural resources, product differentiation, patented-protected technologies, superior managerial and marketing skills, as well as achieving economies of scale;

3) Access the new marketing network and potential customers, reduce the costs of searching, negotiating and enforcing a cooperative agreement.

Therefore, we formulate our central hypothesis by analyzing the performance of firms listed on Stock Exchanges developed in the form of abnormal returns on the Stock Market in response to announcements of joint ventures:

H1: Firms listed on developed stock exchanges are expected to show a positive and significant stock market reaction in response to announcements of international joint ventures between developed and emerging-market firms.

In accordance with existing research, we focus on three groups of determinants to formulate our hypotheses.

Size. We analyze the emerging-market firm size (measured by the number of employees). Larger firms tend to have more international JV portfolios and may have more resources available for investment in growth opportunities.

H2: The larger the partner in emerging markets, the greater the reaction of the Stock Market to the developed market firm.

Diversification. Diversified firms can benefit from the so-called co-insurance effect in the sense that they can offset gains and losses of different business units leading to cash flow stabilization. They can further reduce external funding constraints by creating an internal capital market (Stein, 1997). Another strand of literature focuses on inefficient internal capital markets and the rise in agency costs stemming from diversification (Shin & Stulz, 1998; Rajan et al., 2000). We expect that diversified international JVs will have a greater positive impact on stock returns as growth options become more salient in new and exploratory activities (Folta, 1998; Hurry et al., 1992; Vassolo et al., 2004). Secondly, JVs are more often used to diversify into new businesses (Balakrishnan & Koza, 1993; Reuer & Koza, 2000), and such ventures are interesting because they can help the firm overcome "local research" and achieve new and more distant capabilities (Ireland et al., 2002; Rosenkopf & Almeida, 2003).

Finally, Kim and Kogut (1996) found that diversification helps build "knowledge platforms," permitting a firm to leverage a wider array of distant market opportunities, allowing a firm to experiment with new capabilities, limit its exposure and exploit new opportunities.

H3: Developed-market firms involved in unrelated international joint ventures are expected to show greater stock returns.

Governance quality. The corporate governance quality of emerging-market partners is generally weaker than that of developed-market ventures (Djankov et al., 2008) and this may negatively affect procedures and relationships between the two partners. If so, developed-market firms may be forced to bear the poorer routines of the other firms thereby deteriorating the success of the joint venture. This is a sort of negative spillover effect (Martynova & Renneboog, 2008).

H4: we expect lower stock returns in response to announcements of international JVs if the partner comes from emerging countries and has a lower governance quality.

The corporate governance quality of the emerging-market is measured by using the anti-self-dealing index that measures the protection of minority shareholders against expropriation by insiders (Djankov et al., 2008).

4. METHODOLOGY

4.1. Sample and data collection

Our sample consists of 113 JVs announcements which have the following characteristics: a) the deals include international joint ventures; b) all deals are cross-border; c) a firm comes from developed countries (US, UK, Germany, France, Italy, Spain, The Netherlands, Belgium) and the others come from emerging countries (Brazil, Russia, India and China); d) firms from developed countries are listed on developed stock exchanges (British, German, French, Belgian, Dutch, Italian, Spanish and US); e) sample firms are non-financial firms; f) the deal is announced during the period 2003-2012.

Table 1. Number of joint ventures by country

	Austria	*Belgium*	*Denmark*	*Finland*	*France*	*German*	*Italy*	*Luxembourg*	*Netherlands*	*Norway*	*Spain*	*Sweden*	*Switzerland*	*UK*	*US*	*Total*
Brazil							1		1						2	4
China	1		1	2	12	6	3	1	2	2	1		4	8	26	69
India		3	1	1	3	2	4		1	2		1		2	11	31
Russia		1		1	2	1					1			1	2	9
Total	1	4	2	4	17	9	8	1	4	4	2	1	4	11	41	113

Information concerning internationalization announcements has been collected from Bloomberg; data related to stock returns and market indexes have been collected from Datastream Thomson Financial.

The distribution of announcements by country is shown in Table 1.

4.2. Research design and measurement model

The analysis of the stock price reaction to the announcement of an event involving a firm's international expansion is carried out through two steps according to the event study methodology (Brown & Warner, 1985):

1) Estimation of abnormal returns in the period around the event announcement.

2) Analysis of the statistical significance of abnormal returns (Mikkelson & Partch, 1988; Boehmer *et al.*, 1991).

Specifically, the abnormal returns are assessed by the difference in the CAAR average (+1; -1).

Table 2 summarizes the variables analyzed and the respective number of observations.

Table 2. Variables and number of observations

Grouping Variables	*Number of events*
All sample	113
Size	High (55)
	Low (58)
Diversification	Unrelated (30)
	Related (83)
Level of Governance	High (51)
	Low (62)

5. RESULTS

Stock markets seem to appreciate international JV between a developed-market and emerging-market firm. In fact, the JV allows the resource sharing among the partners, favouring development and growth processes. This thanks to the possibility of producing a combination of resources and the ability to generate overall value that is greater than the simple sum of the individual elements. In other words, JVs allow mutual benefits and synergies to be achieved.

The Hypothesis 1 is supported (Table 3) in the case of a short event window (-1, + 1) with a positive and significant abnormal return of 0.735%. The JVs represent mechanisms able to aggregate and divide resources among the partners, concentrating them in the areas where the strengths are found. Moreover, they can be the tool with which it is possible to obtain those necessary resources and capacities, which otherwise would not have been acquired due to their high cost.

Also Hypothesis 2 is supported. The larger the size of the emerging market company, the greater the abnormal return (1.609%). This confirms that the market assesses the visibility of a large emerging partner who also has resources available for investment in growth opportunities.

Hypothesis 3 is not supported. The purpose of the JV can explain this unexpected result. In future research, we will try to discriminate between market seeking JVs and efficiency-seeking JVs. We believe that market seeking joint ventures may be associated to higher market reaction if they are of a related-type, according to our results.

Hypothesis 4 is supported. The result shows that stock markets seem to prefer joint ventures between countries with similar level of governance quality, which can be explained in terms of lower investment risks.

The results of the analysis are shown in table 3.

Table 3. Cumulative average abnormal returns results

Grouping Variables	*Number of events*	*CAAR (+1;-1)*	*t-student*	*Diff means*	*t-student*
All sample (H1)	113	0.00735	2.878		
Size (H2)	High (55)	0.01609	3.731	0.017	1.840
	Low (58)	-0.00094	0.384		
Diversification (H3)	Unrelated (30)	0.00659	1.765	-0.002	-0.269
	Related (83)	0.00945	2.650		
Level of Governance (H4)	High (51)	0.00659	2.326	-0.001	-0.146
	Low (62)	0.00797	1.776		

6. CONCLUSION

From the observed results, the motivations underlying the positive responses (CAAR) to the announcements of international JVs (between emerging and developed-market firm) can be found primarily in government pressures, not so much through legislative formalities, but through cultural or industrial norms; these include, for example, those with China (Mohr et al., 2016). Furthermore, the results show that international JVs are being developed because there is a possibility of accessing new markets, such as the raw materials market, but also the technological one, of specific knowledge for particular applications in certain sectors and managerial skills. Access to know-how or R&D carried out by the partner avoids all costs incurred by a single firm.

By analyzing the firm's size, the results suggest that one of the main reasons for the start-up processes of international JVs is precisely the pursuit of a common goal, otherwise inaccessible to the individual partners involved that are too small. In this way, instead, the international firms involved in the JV achieve economies of scale, cooperating, and sharing their financial resources.

These reasons, already examined in the literature, find full quantitative foundation, brought back to the results obtained in this study. These results are also linked to the theory of transaction costs and organizational and strategic aspects. According to the transaction cost theory of (Williamson, 1991), the criterion for choosing governance structures is to minimize these costs. To this end, hybrid structures such as JVs are more elastic, thus allowing the fulfilment of the condition of minimizing transaction costs (Hennart, 1991).

Concerning the competitive advantages, the JVs allow to transmit the experiences of firm partners in mature sectors in emerging sectors and vice versa, accelerating the pace of development. In addition to an active response, JVs also meet a defensive need, as a combination of international partner resources can turn into a competitor's most competitive fearsome.

From these fundamental motivations comes the analysis of responses to JV announcements by emerging-market firm towards developed-markets. As confirmed by the research results, the abnormal returns from firms operating in developed-market economies are generally justified by JV announcements by emerging-market firms. The choice of the partner is therefore fundamental for the financial and strategic results of the companies belonging to the international JV. The choice of partners from developed-market therefore increases the value created by the international JV, as well as the value of the international partner.

The results provide guidance for further studies, in both academic and market side, and act as warning signs for firms that are starting internationalization processes. In fact, through this work, firms can have a reference model to be applied in order to determine which are the convenient market features to start international JV processes, and in particular among those countries very different from each other, in order to understand whether JV processes are drivers for value creation.

One of the main limitations to the study international JV is that the developing countries analyzed are not very stable even at the political level (for example, Brazil or India). For this reason, we cannot base the convenience or the value of making an investment only by analyzing some financial variables, but we should see what are all the limitations (political, social, governmental, financial) that a particular country (or market) is afflicted.

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