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# REVISITING MULTINATIONAL FIRMS' TOLERANCE FOR JOINT VENTURES: A TRUST-BASED APPROACH

Anoop Madhok\*  
*University of Utah*

**Abstract.** In spite of the increasing popularity of international joint ventures, managers express a high level of dissatisfaction with them. This paper argues that overemphasis on the outcome has resulted in a neglect of the social processes underlying the outcome. The paper elaborates upon the rationale for a cooperative approach towards interorganizational collaborative relationships based on trust, and discusses it in the context of joint ventures. This is then applied towards understanding multinational ownership preferences and tolerance for joint ventures. It is argued that trust-centered logic is largely consistent with approaches that emphasize the issue of ownership, and deepens and enriches the insights provided by the latter. A shift in focus from ownership to relational dynamics is encouraged.

International joint venture activity has been increasing in recent years, both in terms of frequency and strategic importance [Geringer and Hebert 1991]. In spite of the rising popularity of joint ventures (JVs), there is significant dissatisfaction with their performance [Beamish 1988]. This is intuitively inconsistent and indicates that, though firms perceive the need for JVs, they find them difficult to manage. Considering their increasing popularity, it is important to address this inconsistency.

Investigation of JVs has tended to stress the outcome of collaboration (e.g., survival, control, performance) and does not adequately recognize the inseparability of the outcome from the process [Parkhe 1993a; Hebert and Geringer 1993]. Parkhe [1993a] has criticized past empirical work on JVs for being haphazard in that researchers have not effectively built upon each other's work if the outcome being investigated was different. He argues that such an orientation ignores critical issues pertaining to the relationship process that have the potential to link and bridge disparate work on JVs through core concepts like trust, reciprocity, opportunism, and forbearance. These concepts, which are interrelated, encompass behavioral variables at the heart of voluntary interfirm cooperation, and have a significant influence on the dynamics and eventual performance within interorganizational collaborations like JVs. In this regard, Beamish [1985]

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\*Anoop Madhok (Ph.D., McGill University) is an Assistant Professor of Management at the David Eccles School of Business, University of Utah, Salt Lake City, UT 84112. His primary research interests are global strategic management, transaction cost economics, international strategic alliances and management of interfirm collaborations.

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found that the social dimension governing JV relationships was instrumental in explaining part of the dissatisfaction that managers experience with JVs.

### **OWNERSHIP AND RELATIONSHIP-CENTERED APPROACHES TOWARDS JOINT VENTURES**

A major cause for dissatisfaction with JVs is that a dual hierarchy, arising as a result of shared ownership, results in a high potential for conflict. Conflicts of interest due to divergent objectives and operational asymmetries may adversely affect a firm's flexibility in decisionmaking and its ability to coordinate globally [Harrigan 1985; Berg and Friedman 1980; Porter and Fuller 1986]. This hampers the efficient conduct of its operations. One approach towards overcoming the difficulties inherent in managing JVs is oriented primarily towards the issue of formal control through ownership [Stopford and Wells 1972; Franko 1971; Gomes-Casseres 1989]. In this paper, this approach is referred to as the ownership-centered approach. It suggests that a wholly owned subsidiary provides the firm with the desired flexibility to coordinate activities globally and facilitates decision-making through more direct means of control, such as hierarchical fiat [Williamson 1975], available as a result of ownership. In this way, it avoids the problem of managing conflict in JVs. Stopford and Wells [1972] refer to this as unambiguous control.

Other studies [Beamish 1985; Schaan 1983; Tomlinson 1970] focus more closely on the social dimension within which the relationship is embedded in order to attain the desired flexibility. This approach, referred to as the trust-centered approach in this paper, revolves primarily on the notion of trust, and related issues such as reciprocity, commitment and mutual forbearance. Here, ownership and control are not viewed as commensurate with one another. Beamish and Banks [1987] argue that the ownership-centered approach tends to neglect the social context surrounding the JV relationship. This prevents the exploitation of the full potential benefits of shared resources, and hampers recognition of the potential for effective reduction of the costs inherent in shared ownership through nurturing the social quality of the relationship. Furthermore, it also hinders the attainment of coordination efficiencies. These efficiencies are facilitated by a mutual orientation towards one another, which is based on trust [Johanson and Mattson 1987; Jarillo 1988]. Furthermore, a cooperative attitude manifests itself in a higher level of flexibility within the relationship [Beamish 1985; Tomlinson 1970]. These arguments suggest that, even in the case of majority ownership, the dominant partner would be better off paying attention to the venture's social relations and gradually building up trust since forcing decisions by virtue of sheer ownership would be a Pyrrhic victory and ultimately threaten the venture [Friedmann and Beguin 1971; Killing 1983].

Although their focus differs, the common factor underlying both the ownership-centered and the trust-centered approaches is the objective of flexibility and efficiency in the conduct of the operation [Madhok 1995]. One emphasizes the attainment of flexibility and efficiency through hierarchical relations while the other emphasizes this through social relations. Given this commonality of interest, it would be useful to understand how the two approaches inform one

another. That this has not been done may reflect the different orientations of the two approaches. Ownership-centered approaches are outcome oriented, relatively static and do not address the critical role of social phenomena in interorganizational relationships [Parkhe 1993a; Hébert and Geringer 1993; Ring and Van de Ven 1992]. Furthermore, ownership-centered approaches are primarily investigating phenomena from within a more structural framework. An overemphasis on the structural features of interorganizational exchange results in a neglect of important process issues which add value to the exchange [Zajac and Olson 1993]. For example, Stopford and Wells [1972] and Franko [1971] investigated multinational strategy, structure and consequent control and coordination requirements and related these to ownership preferences and tolerance for JVs. In studying the issues at this more macro strategy-structure-ownership level, some of the subtle and fine-grained insights that can be obtained from more in-depth studies are difficult to capture. Such in-depth studies [e.g., Schaan 1983, Beamish 1985] investigated specific JV relationships with a micro-level orientation towards control and coordination. For example, in his clinical study of ten JVs in Mexico, Schaan [1983] found that a fit between the objectives of the multinational firm, the focus of control, and the mechanisms to operationalize this control was critical for JV success.

The purpose of this paper is to show how the trust-centered approach can provide additional insight and enrich current understanding of multinational ownership preferences and the tolerance for JVs. The paper first examines the dynamics of trust, which is crucial to the trust-centered approach, and then discusses it in the context of JV relationships. Following this, some of the key findings of Stopford and Wells [1972] and Franko [1971], two influential and insightful early studies which systematically examined multinational ownership preferences and the tolerance for joint ventures, are reexamined. In the subsequent section, the need for greater attention to the social dynamics of the relationship is reemphasized, and some research implications are discussed.

Two points need to be made clear at the outset. Firstly, it is not the intention in this paper to single out Stopford and Wells' and Franko's studies (hereafter referred to as the SWF studies) but, rather, to refer to them in the sense of an especially lucid representation of the arguments of the ownership-centered approach. Secondly, the scope of the paper is explicitly limited to multinational firm-local partner JVs. The reason for this is that the paper purports to reexamine the ownership-centered approach, as represented by the findings of the SWF studies. These dealt specifically with multinational-local JVs. However, the issue of collaborations between multinational firms for global markets is addressed later on in the paper. These are too important today to be ignored.

## **TRUST AND ITS ROLE IN JOINT VENTURE RELATIONSHIPS**

### ***The Structural and Social Dimensions of Trust***

In order to explore the dynamics of trust in explaining the tolerance for JV relationships, it is important to understand what trust is and why actors would have a trusting orientation towards each other. Trust is based on a set of mutual

expectations or anticipations regarding each other's behavior and each actor's fulfillment of its perceived obligations in light of such anticipation [Thorelli 1986]. Trust does not mean the "naive belief in the honesty of other actors but rather the probability of violation of implicit or explicit agreements" [Bromiley and Cummings 1993:10]. In other words, trust is the perceived likelihood of the other not behaving in a self-interested manner.

Trust has two components – the structural and the social – each of which reinforces the other. The structural component refers to the complementarity of the resources contributed. Synergy through resource complementarity provides the value added and the consequent inducement to contribute toward the relationship.

With regard to the social component, the quality of the relationship has a strong impact on the nature and value of exchange within it [Jones 1983]. Ouchi [1980] argues that trust, arising from the perception of long-term equity within the relationship, is essential for continued benevolent exchange. This perception of equity, by increasing overall goal congruence, induces behavior in the interest of the relationship and reduces the need for monitoring. Trust is especially important in situations of uncertainty since, in its presence, less stringent contracting can occur in the expectation that the social dimensions of the relationship will occasion mutually desirable behavior. Where performance is difficult to measure, as in the team production characteristic of many JVs, trust becomes critical to the relationship since performance need not be so directly measurable in a situation of mutual trust and commonality of interests.

The pattern of interaction provides the social "glue" within which economic exchange occurs. By providing the motive to cooperate and the mutual orientation that determines which action is in the best interest of the relationship, a regime of trust induces reciprocity and coordinates action [Blau 1964; Ouchi 1980]. Investment in building trust through mutually oriented actions can then be interpreted as the creation of a stock of goodwill from which an actor can draw when the need arises. Such action also signals a commitment to the relationship [Camerer 1988]. It conveys a long-term intent and creates reciprocal obligations. Such reciprocal obligations encourage flexibility within the relationship, although an approximate balance is required over the longer term for its sustenance [Blau 1964; Ouchi 1980]. Here, each round of interactions need not be equally satisfactory to both parties provided that, on average, both actors are satisfied by the general pattern of interaction within the relationship over time. Since overall goal congruence facilitates the tolerance of both partial goal conflict and temporary periods of inequity within the relationship, trust creates flexibility within a relationship and has efficiency implications [Wilkins and Ouchi 1983]. It reduces friction and is "the behavioral lubricant that can improve a system's operating efficiencies" [Parkhe 1993b: 307].

It is important to recognize the difference in orientation between the structural and social dimensions of trust within a relationship. For the former, the incentive to abstain from behaving in a self-interested manner, i.e., to mutually forbear [Buckley and Casson 1988], is that it would be costly to do otherwise. Here, both firms are in a mutual hostage situation. Opportunistic behavior would deplete the

potential value added arising from the partners' complementarities to the detriment of both parties. On the other hand, from the social perspective, mutually oriented behavior is more positive in nature and occurs not to prevent value depletion but to enhance the relationship's value. The two together lower the perceived probability of opportunistic behavior or, conversely, increase trust.

The structural dimension is essential for the creation of the relationship but not sufficient for its continuation. It is necessary since, unless both parties are benefiting from the relationship, it is inherently unstable. It is not sufficient for two reasons. Firstly, a weak social foundation undermines the potential value of the synergy that can be gained by two firms pooling their assets together, since contributions become much more tentative. The partners would also tend to discount the future stream of benefits from the operations more heavily. Furthermore, the cost of the operation increases since greater expectation of opportunism by a partner causes the other to bear higher costs of installing safeguards against opportunism [Parkhe 1993c; Hill 1990; Ring and Van de Ven 1992]. A breakdown of the regime of trust and a consequent increase in uncertainty therefore weakens the mutual orientation and diminishes the perceived value of the relationship, making it unsustainable.

Secondly, contributions cannot be continuously evenly matched. This is where the social dimension stabilizes the relationship. It cements the relationship and provides the tolerance through the social "glue" to tide over temporary periods of disequilibrium.

A strong social foundation enhances the potential value of the synergy that can be gained by two firms pooling complementary assets. Where the structural basis of trust is weak, the relationship becomes unstable. The social basis of trust does not play the role of a "super glue" to patch together all differences but, rather, facilitates the continuation of the relationship during intermittent periods of inequity. It makes the relationship more resilient and, consequently, durable. The critical notion here is that inequity is often temporary, and the durability of the relationship is dependent on the social quality within which it is embedded. Therefore, during a period of flux in a relationship, the social aspect of trust acts to prevent a hasty or premature rupture that would sacrifice significant potential future benefits. In other words, the band of tolerance for inequity is wider in the presence of more deeply embedded social relations.<sup>1</sup>

However, the social basis of trust is not adequate in and of itself. Tomlinson and Willie [1978] distinguish between the existence of compatible capabilities and the willingness to provide them, with both being critical to the success of a relationship. These, in our terms, are parallel to the structural and social aspects of a relationship. The social aspects facilitate the attainment of the objectives of the collaboration through more sustained and higher quality inputs and lower conflict and coordination costs. Therefore, investment in trustbuilding becomes important. The underlying synergistic potential, however, lies in the structural aspects. Tomlinson [1970] found a high correlation between the motivation underlying the formation of JVs and partner complementarities, even amongst partners where there had been a history of successful cooperation. This suggests that, just as the

structural component is necessary but not sufficient, neither are the social aspects sufficient in and of themselves. The two do not substitute for one another but rather supplement and reinforce one another.

***Proposition 1:*** *The structural component of trust is necessary but not sufficient for the sustained continuation of interfirm relationships.*

***Proposition 2:*** *The social component of trust is necessary but not sufficient for the sustained continuation of interfirm relationships.*

***Proposition 3:*** *A relationship will be more durable when the social component is strong than when it is weak.*

***Proposition 4:*** *Where the structural component is equally strong, differences in the social foundation underlying relationships will result in differential rates of stability.*

A trustful relationship does not just happen. It evolves gradually over time through repeated successful interaction and has to be carefully nurtured through various forms of hard and soft commitments. A major implication of this is that creating a foundation of trust is a slow, time-consuming and expensive process [Ouchi 1980; Jaeger 1983; Ring and Van de Ven 1992] requiring a significant investment of resources – financial, temporal and managerial. In this regard, the structural and social components of trust have the potential for a positive feedback effect upon one another. As mentioned, successful interfirm cooperation requires a relationship that has both a potential for synergistic creation of value and a more mutually oriented behavior in order to tap and enhance this potential. This value outcome provides the ability or means to invest in the value creation process while the social component provides the willingness to do so.

***Proposition 5:*** *Interfirm relationships characterized by both a strong structural and a strong social component of trust will be characterized by a greater investment in trustbuilding expenditures than those relationships that are not so characterized.*

The presence of both the components of trust is therefore important. The positive feedback effect between the two components of the relationship, by influencing the ability or means and the willingness to invest in the relationship, builds resilience into a relationship and strengthens it by making it more self-sustaining.

An effective collaboration smoothes the interface between partners and is characterized by trust and understanding. In this way, it confirms the partners' importance to one another. A couple of prominent examples are illustrative. One is the GE-Snecma JV. Originally brought together by product-market complementarities in jet engine technology, this JV enjoyed strong top-level commitment. When lower level personnel in GE would attempt to engage in self-interested behavior, these issues were always resolved at a higher level in the spirit of the

partners' mutual commitment [Lewis 1990]. Success in the initial phase of the relationship resulted in continued cooperation over a family of engines that has lasted to the present. Such cooperation has been facilitated by a demonstration of flexibility over the duration of the relationship. For example, in order to be fair, GE and Snecma have periodically readjusted their contractual revenue-sharing formula due to unexpected changes in inflation and exchange rates [Lewis 1990]. This is not to suggest that the relationship has not been occasionally stormy. However, due to their structural complementarities and the social quality of the relationship, the arrangement has survived these moments. Such conflict, if handled properly, plays a positive role in that it tests the resolve and strengthens the resilience of the relationship. In discussing the GE-Snecma JV, Roehl and Truitt [1987] argue that such conflict results in better "real" relationships and provides the experience and sophistication to deal with dynamic environments characterized by uncertainty without destroying the commitment to the venture.

Another example is the collaboration between Boeing, the dominant partner, and a Japanese consortium for the development of jet aircraft. The two sides needed one another to share massive development costs and to realize synergies between the design experience of Boeing and the manufacturing efficiencies of the Japanese. In this venture, the Japanese had to undertake a significant degree of risk, in terms of loss of income should the expected sales of the 757 fail to materialize. When this happened, Boeing allocated some work on other planes as a compromise gesture, even though there was no contractual commitment to do so. This gesture of integrity created a level of goodwill that facilitated resolution of later conflicts [Moxon, Roehl and Truitt 1988]. The collaboration has now lasted into the next generation of aircraft with the Japanese being permitted a much more constructive role than in the earlier phase of the relationship.

### *Application to the JV*

Partner commitment and compatibility is a critical issue in JV relationships. Friedman and Beguin [1971] argue that ownership arrangements are not as important for successful JV performance as the similarity of outlook and objectives, i.e., compatibility. Greater compatibility increases the probability of balance between inducements and contributions with temporary imbalances being smoothed by trust. Greater compatibility manifests itself in greater commitment to the JV, which enables broader "bands of tolerance" and makes the partners more flexible with respect to the JV's operations. In such cases, they would be more willing to accept minority ownership, adapt products to local markets, accept the partner's personnel in important positions, adapt systems to accommodate the partner's needs, etc. [Beamish 1985]. Such ventures are characterized by a greater allocation of time and effort towards trustbuilding and knowledge transfer, greater interaction through more regular meetings and visits, and an open communication system [Schaan 1983], all of which results in clear mutual expectations and enables more efficient coordination.

Beamish's [1985] identification of a positive correlation between commitment and need for the partner, and a negative correlation between commitment and extent of control desired, reflects both dimensions of trust in a JV relationship. The



former addresses the mutual complementarities which underlie the structural dimension of trust while the latter addresses the social aspects, where the existence of commitment mitigates the desire for formal control measures. Tomlinson [1970] and Beamish [1985] argue that the extent of concern over control reflects the nature of a firm's attitudes toward the partner's contributions, with lower concern being symptomatic of a more positive evaluation of the relationship and a lower tendency to act solely in one's own interest. Such a positive evaluation, and consequent commitment, is facilitated by a high level of structural compatibility between the partners' inputs. Positive attitudes result in a greater ability to tap and benefit from partners' resources [Beamish 1985; Tomlinson 1970].

The implicit assumption by authors such as Davidson and McFetridge [1985] that wholly owned subsidiaries are more efficient than JVs is not necessarily true. Depending on the nature of resources needed, the initial stock of commitment and the interaction between these two factors, JVs can be both a revenue enhancing and a more efficient mode of organizing [Beamish and Banks 1987]. In this respect, mutual need for the partner's resources makes shared ownership more conducive towards encouraging participation while the presence of commitment curbs the transaction costs arising from opportunism, small numbers bargaining and uncertainty, and also facilitates information sharing. Under these conditions, the additional costs faced in the management of JVs can be contained at a level where benefits are greater than the costs. Development of the relationship over time leads to lower costs of transacting [Jarillo 1988; Ring and Van de Ven 1992].

Arguments against the use of JVs due to the associated problems of coordination and control imply that internalization would solve these problems. However, this does not recognize that headquarter-subsidiary relationships are also mixed-motive dyads similarly characterized by independent and interdependent interests [Ghoshal and Nohria 1989]. Accordingly, depending on the role and strengths of different subsidiaries, the multinational firm faces governance problems and related costs in control and coordination of different operations, even when fully owned. Therefore, the assumption of such a direct inverse relationship between ownership and coordination and control costs is questionable, and it would be more appropriate to approach the issue in a comparative manner, where the coordination and control costs of JVs are compared with those of wholly owned subsidiaries [Gomes-Casseres 1987].

The incremental costs of managing JVs arise partially from the costs of maintaining safeguards against the possibility of self-seeking behavior arising from divergent objectives. As noted above, ownership-centered approaches inadequately recognize the scope for reduction of opportunistic behavior which is available through addressing the social context of the relationship. A positive social dynamic between partners is important, since it facilitates the building of trust within a relationship. Jarillo [1988] argues that where a relationship is value laden due to its social properties, it can manifest the advantages of hierarchies identified by Williamson [1975]. According to Jarillo [1990], neither pure market nor pure hierarchical relations are critical for sustaining a relationship: trust is.

The argument that nurturing the social dimension increases flexibility and tolerance, especially in a situation of ambiguity, is especially relevant in entities such as JVs, which involve team production by two actors contributing their respective inputs for mutual benefits. Here, Beamish's [1985] observation of dissatisfaction with the JV's performance in cases where one partner had greater than two avenues over the other for earning income is significant. This shows that the perception of equity within the relationship does not automatically arise from the formal aspects of ownership. The alignment of incentives through the sharing of ownership is not adequate to ensure desirable action by the partner. Through income earning avenues like royalties for technology supplied, monopoly over the supply of inputs, management fees etc., the multinational firm can capture the bulk of the value added prior to the formal sharing of gains through the ownership structure. Therefore the critical issue is not that of the formal distribution of the residual income in line with the percentage of equity ownership but, rather, that of equity and fairness with respect to the process of the relationship itself. This perception of equity is important to encourage mutually oriented action, beyond the very minimum under the terms of the agreement. Without it, the base of trust would be violated.

In this regard, Cory's [1982] statement that JVs are a mixture of contract and commitment is relevant. Here, the critical initial decisions are agreed to contractually in the negotiation phase, but sustenance of the relationship is based on trust and commitment. This commitment develops through interaction, and results in a trust-based relationship that more closely resembles an internalized mode than a contractual one [Cory 1982]. This implies a shift from control through the ownership structure to influencing behavior through interaction and the nurturing of relationships [Beamish 1988].

The need for control is positively correlated with lack of information which then heightens the level of risk perceived by an actor and consequently affects the choice of governance structure [Ring and Van de Ven 1992]. A successful pattern of interaction results in not only a trustful orientation, where relationship-specific routines as a result of greater experience with each other facilitate coordination and lower the proclivity to be opportunistic, but also greater knowledge about each other as a result of a more open sharing of information. This lowers information asymmetries and consequent scope for opportunism and perceived risk. This then lowers the perceived probability of opportunism and, combined with a lower perceived necessity for maintaining safeguards, explains why a successful cooperative history was found to be the most important criterion in the selection of JV partners [Tomlinson 1970].

The various propositions by Ring and Van de Ven [1992], and the support for various hypotheses by Parkhe [1993c], regarding the impact of the perceived level of opportunism or trust within an interfirm relationship upon the nature of behavior and performance are in line with the arguments discussed in this paper. For example, Ring and Van de Ven [1992] proposed that reliance on trust emerges gradually through repeated rounds of interaction by both parties observing the norms of equity. Similarly, they proposed that the perceived level of risk is lower

where a relationship is characterized by greater trust, and that this has direct implications for the elaborateness of safeguards. Parkhe found support for his hypotheses that (i) the elaborateness of safeguards and the perception of opportunistic behavior are directly related, (ii) the extent of commitment that a firm is willing to make is directly related to the perception of opportunistic behavior, and (iii) the perceived level of opportunistic behavior is negatively related to the history of cooperation between two actors.

In concluding this section on trust, trust has efficiency implications, and its potential cost reduction and value enhancing properties need to be recognized. Trust is dynamic in nature and changes over the life of the relationship. It is both input into and output of a relationship and infuses the relationship with value. Creation and sustenance of trust in a relationship requires a significant commitment of hard and soft resources. The cost reduction and value enhancing properties of trust make available valuable resources for investing and reinvesting in the relationship for its continued sustenance. Opportunistic behavior, or expectation of such by the other, depreciates this asset of trust while mutually oriented behavior leverages it.

### **REVISITING THE MULTINATIONAL FIRM'S TOLERANCE FOR JOINT VENTURES**

So far, the dynamics of trust and the importance of paying attention to the social dimension in JV relationships has been discussed. This section reexamines the key ownership-centered arguments regarding multinational ownership preferences and the tolerance for JV relationships, most lucidly explained by Stopford and Wells [1972] and Franko [1971].

#### ***Product and Market Standardization Strategies***

The extent of ownership has always been a critical issue in multinational operations. Stopford and Wells [1972] and Franko [1971] argued that market or product standardization strategies, occurring in the mature stages of an industry when there is greater homogeneity of tastes and stiffer competition, are characterized by pressures to lower both production and administrative costs through consolidation and rationalization. This increases the desirability of tighter coordination between units and, by centralizing the locus of decisionmaking, results in a lower tolerance for JVs. JVs increase the potential for friction and adversely effect the flexibility in decisionmaking required for overall system optimization. In other words, strategies requiring centralized control result in a more cautious attitude towards JVs. On the other hand, a strategy based upon product diversification or market expansion results in a higher tolerance for JVs since, when a firm's resources are allocated towards introduction of new products rather than cost minimization and strategic coordination, JVs provide a desirable complementarity.

These arguments can be interpreted in a different light. JVs by definition are more complicated to manage because of dual hierarchies. One way to manage the greater potential for friction is to influence the social context of interaction. As

mentioned earlier, creating a foundation of trust is a slow, time-consuming and expensive process. Creation and sustenance of trust requires both structural compatibility as well as the willingness to invest in the relationship to enable more effective realization, on a continual basis, of the potential benefits of such compatibility. The requirements for investment in trustbuilding are greater in the formative period of a relationship in order to absorb the initially higher costs of creating commitment, including any possible losses from self-interested behavior in the initial stages. However, once the foundation has been secured, extraordinary expenditures for relationship sustenance are minimal, though normal expenditures are still necessary to enable continued enhancement and realization of value from the relationship.

One principal source of resources for investment into the relationship is above-normal returns. Greater competition during the more mature stages of an industry, when firms pursue standardized strategies, makes the attainment of above normal returns difficult. This is not the case in an earlier stage characterized by less competition. This argument addresses the issue of scarcity and munificence of environments [Aldrich 1975] where, in lean environments characterized by more intensive competition and dissipation of excess rents, there is less slack and coordination and cost minimization become more important. Furthermore, in cases where the scope of the operation is global, as is often the case in worldwide consolidation and rationalization strategies, while the JV partner is strictly local, coordination at a more centralized level is preferred by the multinational firm and communication flows at a local level are largely of an implementing nature. The weaker structural foundation, due to relatively insubstantive inputs from the local unit, results in lower commitment towards building a long-term stable relationship. Therefore, both the structural and the social basis of the relationship are undermined. In such environments, firms are less able to undertake, and less tolerant of, the investments necessary for trustbuilding in JVs.

### ***Product Diversification***

With respect to product diversification, the SWF studies found that most product diversification strategies were in related products. According to them, product diversification strategies involved uncertainty for multinational firms since these firms were usually product oriented and lacked the market orientation that was equally important for the success of such strategies. These strategies required greater decentralization and flexibility to adapt to local markets, which increased the tolerance for JVs. In such cases, the need for complementary resources was greater than the cost of reduced levels of control. Stopford and Wells [1972] argued that the provision of an ownership stake in recognition of the partner's contribution was expected to provide incentives to the partner to act in the interest of the JV.

The argument was made earlier, however, that a mere ownership stake is not sufficient in a JV, and needs to be supplemented by a belief or trust that each partner is acting in the best interest of the relationship. A perception of equity, aside from the ownership structure, is all the more important in strategies of related product diversification. This is because the relatedness makes it difficult for the value of

the firm's contribution to be accurately measured and reflected in a contract [Jones and Hill 1988], since shared activities are difficult to disentangle and cost separately. This increases coordination costs and opportunities for conflict [Jones and Hill 1988].

In a situation characterized simultaneously by the desirability of the partner's contributions and greater scope for conflict, investment in trustbuilding expenditures is critical in order to exploit more effectively the synergies due to product-market complementarities. Under related diversification strategies, economies of scope arising from the relatedness between products result in more efficient utilization of firm resources [Teece 1982]. Such economies are unlikely to be available in the case of single or unrelated products [Mahoney and Pandian 1992] where there is little scope for sharing costs across activities. Moreover, first mover advantages of new product introduction into new markets provide scope for initial monopolistic rents. This first mover advantage is further enhanced in the case of JVs oriented towards local markets of limited capacity. All these factors enable the firm to undertake the investments necessary to create and realize a more sound relationship with their JV partners.

### ***Product Innovation***

Stopford and Wells [1972] found that product innovation strategies, being dominated by fears of technology leakage, free riding, and problems of technology pricing, were characterized by a desire for greater control. This resulted in a strong apprehension regarding JVs and a preference for subsidiaries over JVs.

Product innovation strategies are characterized by a high degree of uncertainty due to the technological and task complexity and the uncertainty of returns. Furthermore, product innovation mostly occurs in the early stages of the product life cycle when the environment is more volatile [Harrigan 1985] and the routines less codified. Greater complexity and a more volatile environment in these stages lower firms' ability to respond to situations through a fixed set of routines [Aldrich 1975], and consequently increases the scope for conflict. This lowers the tolerance for decisionmaking through JVs. In situations characterized by such uncertainty and ambiguity, the contract would be increasingly incomplete, consequently heightening the firm's concerns regarding opportunistic behavior by a partner. In such situations, a high level of trust would be required to mitigate such concerns. The resources required, whether temporal, managerial or financial, for creating such a high level of trust would make the firm reluctant to enter into a locally oriented JV, which provides limited scope to generate a sufficiently high level of gain. Furthermore, as in the case of product and market standardization strategies, a local partner's contribution is not so significant. This weakens the commitment toward building a long-term stable relationship. All these factors undermine the relationship and result in a lower tolerance for JVs.

Briefly speaking, the SWF studies found the highest tolerance for JVs when the strategy and the scope of the operation was local in nature. Here, both partners were able to make valued contributions. Where the JV is such that the local partner does not make a significant contribution, there is little incentive to enter into a

JV except for defensive or passive reasons, such as financing needs or benefits of local identity. Here, the partner's contribution is valued more as a convenience than a contribution, resulting in little commitment on both sides and a greater incentive to free ride by the local partner. Furthermore, any opportunistic behavior by the local partner is less likely to be tolerated by the multinational, since the asset contributed by the partner to the venture is not so firm-specific. In other words, a small numbers situation does not exist, resulting in a lack of incentive to nurture the relationship and, simultaneously, little patience for shirking and free riding by the local partner [Beamish 1988]. A weak structural foundation and such a negative social atmosphere lowers tolerance for JVs and makes sustenance of the relationship improbable. This further explains the SWF studies' finding of low tolerance for JVs in the case of product innovation, marketing standardization and production rationalization.

### *Ability to Manage Change*

From the above discussion, it is clear that the scope of a particular operation, deriving from the multinational firm's strategy, is critical to the tolerance for JVs. Franko [1971] observed a peaking in JV instability in line with changes in strategy and accompanying changes in structure, though there were differences in the lags between the change and the instability, as well as differences in stability rates. For example, with increasing significance of international operations and other exogenous environmental changes, like demand convergence and technological developments, a shift from a decentralized strategy through an international division to a more centralized one through worldwide product divisions or geography-based regional structures resulted in a lack of tolerance for existing JVs and consequent increase in failure rates.

This can be understood more clearly when one considers Granovetter's [1985] argument that it is the nature and pattern of interaction within a relationship, rather than its institutional properties, which are critical for the efficient conduct of an activity. We argued earlier that trust is a dynamic concept and that the structural and social aspects underlying the relationship strongly influence the nature and pattern of interaction. A major cause of conflict in JVs is that the relative contributions and comparative advantages of the venture partners change continually, whether due to exogenous events or due to internal dynamics, for example differential rates of learning by both partners [Hamel 1991]. This influences the evaluation of a firm's contributions.

Regarding Franko's finding of a peak in JV instability, the change in strategic scope or purpose of the operation and concomitant change in structure and systems changed the nature and desirable pattern of interaction within the relationship. The perceived propensity for trust or opportunism depends upon the nature and pattern of interaction [Jones and Hesterly 1993]. In this case, the need for strategic coordination and control of the operation increased and the locus of strategic decisionmaking moved to a supranational level. Consequently, the role of the local operation changed from a relatively substantive one to that of an implementor, where the erstwhile contributions of the JV partner are less valued, reducing the structural bonding properties of the relationship. In other words, the

structural foundation of the relationship became weakened in a manner creating not a temporary but a long-term disequilibrium. Furthermore, increased interdependence among various units under such closely coordinated strategies increased the negative externalities of self-interested behavior. In a relationship with a more tightly coordinated and interdependent system, where the structural foundation of the relationship is weakened and, simultaneously, there is a greater potential for negative externalities, the potential for, and probability of, self-interested behavior is perceived to be higher, i.e., lower trust. This in turn influences the evaluation of the relationship and destabilizes it [Parkhe 1993c], since there is a lack of correspondence between the incentive or payoff structure and the new reality. Such a correspondence between the relatively inflexible incentive system and the variable importance of partners' respective inputs is difficult to maintain, and is a major source of strain in the relationship [Berg and Friedman 1980].

Structural changes in firm complementarities can therefore strain a relationship and consequently influence tolerance for JVs. Where the basis for such conflict is long-term structural disequilibria in contributions, the bonding properties of the social dimension become inadequate. Clearly, there are limits to trust. At the same time, the underlying social properties of the relationship would be manifest in different degrees of flexibility in managing these strategic disjunctures, and would be reflected in differences in lags before failure and differential survival and failure rates in the face of similar strategic changes.

The above discussion of the peaking phenomenon noticed by Franko suggests that comparative costs need to be evaluated not just against another governance structure, for instance a subsidiary versus a JV, but also with regard to costs within the same form before and after a change in strategy that alters the scope or purpose of the activity to be undertaken. It is worth mentioning, however, that where the social foundation of a relationship is strong, a demise of one venture due to structural weaknesses need not equate with the end of the relationship between two actors. There are numerous instances of partners being engaged in multiple partnerships, simultaneous or sequential, which have been built around a successful cooperative history. Here the relationship, the process and not the outcome, is viewed as a value-bearing asset in its own right [Jarillo and Stevenson 1991].

The ability to build and maintain trust is a critical component of understanding tolerance for JVs. Clearly, however, there are differences in actors' abilities to invest in trustbuilding expenditures and to pursue a cooperative strategy. In the presence of significant size asymmetries, it is easier for a larger firm, being less dependent on the venture, to nurture a positive atmosphere. This is due to both a higher tolerance for losses, in case of opportunistic behavior, and to the normally higher stakes and greater vulnerability of the smaller partner. Such would be the case in many of the multinational operations studied by Stopford and Wells and Franko. Similarly, a well-diversified firm has a greater ability to make trustbuilding gestures, since resources from other activities can both be tapped for investment in trustbuilding as well as provide the firm with the buffering capacity to absorb violations of trust in any single activity. This is much more difficult

for firms with more limited sources of income based on a single critical sphere of activities. This reinforces Franko's findings that undiversified firms pursuing functional strategies had a lower tolerance for JVs.

## DISCUSSION AND RESEARCH IMPLICATIONS

The stability of cooperative agreements is a combination of the structural and social aspects of a relationship. The structural dimension underlying interfirm relationships is necessary but not sufficient, and needs to be complemented by a greater attention to the social component within which the relationship is embedded. The SWF studies were most original and insightful, and have made major contributions towards our understanding of multinational ownership preferences, especially in the environment of that time. Their focus, however, is primarily on the formal and structural aspects of the relationship and, consequently, the informal and social dimension is neglected.

Both these dimensions have the common objective of obtaining flexibility and efficiency in the conduct of the multinational firm's operations. The important issue perhaps is *not* that of ownership per se but, rather, that of superior coordination and conflict resolution. Refocusing the pivotal issue away from ownership has important implications. The core of the argument shifts the emphasis from hierarchical governance mechanisms to "relationship management". It extends the extant strategy-structure-ownership approach towards multinational operations to include the process of coordination and conflict resolution through microlevel and process-oriented mechanisms. Furthermore, by deemphasizing ownership (the distinctive feature of JVs vis à vis other collaborative forms), and by encouraging a deeper appreciation of relational dynamics, the basic underlying arguments, revolving around notions of trust, reciprocity, forbearance, and opportunism, can be extended beyond JVs and applied to all collaborative relationships, such as strategic alliances. This takes on added importance in today's business environment where, in the face of the exigencies of technological complexity and global competition, firms are increasingly engaging in a wide variety of collaborative agreements.

The shift in focus from ownership to relational dynamics has a number of important research implications. One potentially fruitful area of research would be the nature and mechanisms by which firms build and maintain a relationship characterized by trust. For example, do firms invest more resources in trustbuilding in the initial stages of a relationship, when mutual trust is usually lower? If so, how? An example would be staffing policy. The multinational firm may initially choose to rotate personnel less frequently so that social relationships have greater continuity and boundary personnel can acquire greater mutual confidence. Another significant gesture would be the secondment of a more prominent person, which would signal a higher level of commitment to the operation. What is the nature and pattern of interaction in relationships characterized by trust? Is it more personal and more dense in the initial stages? This has the potential both to generate greater confidence and to enable the formation of norms, which would facilitate coordination and lower the need for interaction later. In an ongoing relationship,



is the pattern dynamic, for example a flurry of interaction during periods of conflict in order to demonstrate commitment and contain it? What are the differences in trustbuilding expenditures and mechanisms between firms that are satisfied and those that are dissatisfied with their JV relationships? Under what circumstances are firms willing to commit to such investments? What characterizes more durable relationships and makes them more resilient? Is there a difference in the emphasis on ownership versus relationship dynamics? How do conflict resolution mechanisms differ between satisfied and dissatisfied firms? In this regard, how dominated are the partners by the contract in contrast to the ongoing relationship? Research into such process issues would be fruitful since they are inextricably intertwined with the outcome.

In line with the scope of the SWF studies, this paper has primarily addressed multinational-local JVs. Another important area of research is that of collaborations, both JVs and strategic alliances, between two multinational firms. Such collaborative activity has become increasingly popular in global and knowledge-intensive industries, where firms encounter high uncertainty and limits to their capabilities. Such collaborations, especially those with a broad scope, in terms of product-market coverage and a multiplicity of objectives and functions, and a more volatile environment are confronted with increased task complexity and uncertainty of returns. In such operations, potential for both conflict and contribution is high. The ample scope for a wide range of behavior, both positive and negative, then influences each other's evaluation of the relationship [Buckley and Casson 1988]. Such collaborations, if successful, require flexibility in conduct and would be expected to be characterized by both high levels of risk and trust [Killing 1988].

It would be naive to overemphasize trust and to neglect the competitive elements of the interaction between two partners. Interfirm collaboration is clearly a mixed motive game where the relationship is characterized by a spirit of collaboration (for creation of the pie) and competition (for distribution of the pie). It is important to know when to collaborate and when to compete. An important research issue would be that of the strategies pursued by firms to manage different combinations of risk and trust. Firms may undertake a strategy of complexification [Schoemaker 1990] through continuous investment in knowhow in order to make the source of advantage less transparent. Firms may resort to more complex governance structures to manage the risk [Ring and Van de Ven 1992]. An example would be nested arrangements where a core technology is licensed within a JV, e.g., the collaboration between Ericsson and Honeywell, as described by Kogut [1988]. In this case, joint research and development in the JV, drawing on the expertise of both the firms, not only resulted in sharing risk, but also through shared research efforts enabled coordination and was instrumental in building trust [Kogut 1988]. Through cleverly crafted agreements, safeguards can be maintained, even if there is trust. Firms may choose to maintain selective control over critical activities, rather than overall control through equity. This also provides scope for economizing on coordination and control costs, as well as signalling an intention or commitment not to dominate all aspects of the relationship. These issues, and others related to the process and mechanisms for managing risk and building trust, need to be researched.

If the conceptual framework discussed in this paper holds across different kinds of interfirm agreements and across different kinds of partners, then the implication would be that it is fairly robust. For example, Hladik [1985] found a number of R&D-driven JVs between two multinational firms where greater information sharing occurred due to first mover advantages (e.g., setting of technological standards), since the benefits of joint technological development and rapid market penetration were greater than the negative externalities from leakage. In line with the underlying logic of this paper, it can be argued that the monopolistic advantages, along with the low price elasticity characterizing new products, generate excess rents in the short term. Such potential rents are enhanced by the global scope of the operation. Thus, value creation through complementary capabilities can be used to enhance the relationship and absorb any additional costs of collaboration, with the excess resources generated being used for investments in building trust. Moreover, where complementary capabilities are mutually valued, the possibility of future team production would curtail opportunistic behavior. The examples of the GE-Snecma and the Boeing-Japanese consortia relationships clearly illustrate this.

Basically, careful attention needs to be paid to the process of the relationship with the partner in order to reduce the costs and increase the gains from the collaboration, and issues such as control and leakage may need to be managed and, at times, traded off against the benefits of complementary resources [Mody 1993]. For example, on one hand may be the risk of unintended technological spillovers [Hamel 1991] while, on the other, concomitant with the greater risks may be the potential for greater returns. When do managers decide to make such trade-offs? Under what circumstances? How do they manage them? These are issues that are ripe for further research.

## CONCLUSION

The simultaneous popularity of international JVs and dissatisfaction with their performance indicates the need for greater attention to, and a more sophisticated understanding of, the process of governing them. "Relationship management" is increasingly important in today's business environment where the forces of global competition and technological dynamism compel even the strongest firms to enter collaborative relationships in order to remain competitive. This paper elaborated upon a trust-centered perspective and discussed key process issues pertaining to relational dynamics, embedded in notions of cooperation and opportunism, which Parkhe [1993a] has suggested are critical to theoretical development and a more complete understanding of JV relationships. We also reexamined the structural arguments of the ownership-centered approach by revisiting Stopford and Wells' [1972] and Franko's [1971] studies of multinational firms' ownership strategies and tolerance for JVs, and showed that relationship-oriented reasoning, revolving around trust, is largely consistent with their ownership-centered arguments. This then links strategy-structure-ownership issues with more dynamic social exchange issues. A focus on dynamic processes underlying the relationship provides additional insights into multinational ownership preferences and the JV process. A structural orientation treats interfirm relationships as largely

predictable [Zajac and Olson 1993]. Greater attention to the social dimension not only enriches understanding but, additionally, can explain some of the variance in JV instability rates that ownership-dominated approaches are not able to capture.

I would like to conclude with a caveat. This paper has focused on the social dynamics underlying the tolerance for JVs. However, I fully recognize that there are other reasons why JVs may continue to exist even when the structural and social foundation is weak. These include, among others, legal restrictions on ownership, government incentives and disincentives (e.g., tax breaks) and high exit costs making the reversal of the JV decision difficult. All these would distort the cost-benefit calculus and result in continued tolerance for JVs, at least in form if not in spirit.

## NOTES

1. The structural and social components of trust are somewhat analogous to the two types of diversity within firms identified by Parkhe [1991]. Type I referred to the "harder" differences in the complementary contributions that occasioned the relationship in the first place, or what we refer to as the structural component of trust. Type II referred to the "softer" differences that arose from differences in firms' culture and systems. Broadly speaking, the role of the social component of trust is that of smoothening the relationship by reducing the disruptive influence of Type II diversity through a more developed mutual orientation, while making it more resilient in the face of temporary fluctuations in Type I diversity.

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