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# Performance Issues in U.S.–China Joint Ventures

Gregory E. Osland  
S. Tamer Cavusgil

China has long fascinated businesspeople and researchers with the grandeur of its several millennia-old civilization, the huge size and market potential of its population, and the dramatic changes in its political and economic scene. In the 1980s, its manufacturing output expanded by 14.4 percent a year—the fastest rate among the world's 50 largest economies.<sup>1</sup> The stunning transformation of China's economy in the last fifteen years—from an impoverished agrarian society to the third largest economy in the world—has attracted an increasing amount of foreign direct investment (FDI). While the total contracted FDI in 1986 was U.S. \$3.3 billion, it had grown to \$58 billion by 1992.<sup>2</sup>

The primary form of foreign investment has been equity joint ventures, such that more international joint ventures were formed in China than in any other nation in the 1980s.<sup>3</sup> International joint ventures (IJVs) offer foreign firms a strategic means to gain access to China's domestic market, reduce costs, acquire legitimacy, learn about the Chinese environment, and gain power vis-à-vis their competitors. At the macro level, equity joint ventures offer China a way to help develop its economy through the transfer of technology, the acquisition of managerial skills, the influx of capital, the development of its infrastructure, and access to export markets that can provide foreign exchange. With the exception of Hong Kong and Taiwan, the U.S. represents the largest source of foreign investment in China through IJVs.<sup>4</sup> Most large, multinational, manufacturing firms have developed joint ventures in China, ranging from consumer personal

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care companies such as Johnson & Johnson and Unilever to auto manufacturers such as General Motors and Volkswagen to computer manufacturers Hewlett-Packard and DEC. IJVs with small foreign firms are even more numerous.<sup>5</sup>

Despite the increased frequency and strategic importance of international joint ventures in China, little is known about the performance of these ventures, nor the factors that affect the outcomes. International joint venture research is at the pre-paradigmatic stage of theory development. The core concepts and their relationships are still not well understood,<sup>6</sup> particularly the issue of IJV performance.<sup>7</sup> Even though IJVs represent the efforts of at least two parent companies and usually include managers at the operating levels from foreign and host companies, these multiple perspectives have rarely been analyzed in previous research. Chinese managers' perspectives, in particular, have not been well understood.<sup>8</sup> The present study centers on performance issues of U.S.-China IJVs, comparing and incorporating the responses from foreign and host parents and from both sets of IJV operating managers.

### **What Do We Know about Joint Venture Performance?**

Studies on IJVs in China have produced mixed findings on performance outcomes. Dynamic changes in China's political and economic conditions over the last fifteen years have undoubtedly affected the results. Only a few researchers have investigated the relationships between certain variables and performance.

#### *Performance Outcomes*

Performance outcomes in IJVs have been analyzed in terms of managerial satisfaction, financial results, instability, technology transfer, and exports. The use of a subjective measure reflects difficulties in obtaining "objective" data, and awareness that measures such as profits are not directly comparable across different industries and stages in IJV life cycles. There are no published results of random samples of the equity joint venture population. However, some surveys and case studies provide indications of performance outcomes.

#### *Satisfaction*

Most studies using satisfaction as a measure of performance have centered on foreign managers' perceptions and provide mixed and inconclusive results. Campbell<sup>9</sup> reports mild dissatisfaction, while Davidson<sup>10</sup> concludes that managers were satisfied with the performance of IJVs in China. Similarly, Stelzer et al. found in their 1991 survey that approximately two-thirds of U.S. parent companies reported that their ventures in China met or exceeded expectations.<sup>11</sup> Those that have been operating the longest report the highest levels of satisfaction. Pearson's interviews of Chinese and foreign managers suggest that most managers were positive about the performance, and optimistic about future prospects.<sup>12</sup> Her interviews were conducted before the Tiananmen Square

Incident of 1989. In contrast, Beamish, who researched IJVs shortly after the Tiananmen Incident when the money supply was very tight, reports that over half of the Chinese and foreign managers in his interviews reported dissatisfaction with the performance of their joint ventures.<sup>13</sup> No data are provided in these studies that might suggest differences in responses by type of informant (e.g., foreign or host manager, parent company or operating manager). Nor do the authors uncover the criteria that are used to indicate relative satisfaction.

### *Financial Results*

Two measures have been used to evaluate financial results: ROI and parent company stock price. Campbell found eleven IJVs that reported "good" ROI, while three classified their results as "poor, low, or below expectations."<sup>14</sup> Stelzer et al. indicate in their 1991 study that 60 percent of the U.S. parent companies reported a five-year average ROI of 10% or higher.<sup>15</sup> The overall average was 11.6 percent, with twelve percent of the companies seemingly losing money in their IJVs in China. The majority of the companies that responded to both surveys appear to be profitable to their U.S. parents. (The results of the U.S.-China Business Council's survey of whether the IJV is profitable is of little use since it combined prospective and operational IJVs.)

Hu et al. found that for U.S. firms with IJVs in China, companies with low international involvement enjoyed a positive reevaluation of their stock price at the time of the IJV announcement.<sup>16</sup> Firms with a large multinational network saw no statistically significant change in their stock values.

### *Instability*

Instability refers to major changes in ownership shares of a joint venture, including foreign ownership crossing the 50 percent line, a partner selling out, and liquidation of the venture.<sup>17</sup> Both the National Council on U.S.-China Trade<sup>18</sup> and Beamish<sup>19</sup> observed relatively stable IJVs in China. Beamish explains that this stability may be due to such factors as the short duration of the IJVs and the bureaucratic difficulties in adjusting ownership levels.<sup>20</sup>

One of the few researchers to evaluate performance outcomes from Chinese perspectives is Pearson.<sup>21</sup> Among the outcomes she examined are technology transfer and exports.

### *Technology Transfer*

Technology has two levels in PRC IJVs: hardware and management skills.<sup>22</sup> Pearson found that government officials were not satisfied with the level and amount of hardware flowing into China.<sup>23</sup> In two IJV case studies, this dissatisfaction was also evident.<sup>24</sup> Laws to provide greater protection of foreign technology and incentives to introduce both "state-of-the-art" and "appropriate" technology further reflect the desire of government leaders for more technology transfer. Pearson also uncovered little evidence that Chinese managers were

acquiring management skills, especially decision-making skills, from their foreign partners.<sup>25</sup> Explanations include foreign managers' reluctance to train the Chinese and the lack of incentives for Chinese to learn and adopt innovative behavior. The limited learning by Chinese may also be due to the transfer of superfluous and less-qualified personnel to IJVs who have less aptitude to learn.<sup>26</sup>

### *Exports*

In the early to mid-1980s, manufacturing joint ventures were required to export a certain percentage of their output—typically 20 to 100 percent.<sup>27</sup> This requirement was intended to protect domestic companies and to help China accumulate foreign exchange. However, many joint ventures, particularly those producing relatively sophisticated products, were unable to meet the export targets and were allowed to sell in the domestic market. This failure was due to the lack of global competitiveness of the products in price and quality. In 1988, IJVs producing consumer foods and personal care products were allowed to make domestic sales and were not burdened with large export requirements.<sup>28</sup> It appears that Chinese leaders have compromised on one of their performance criteria for joint ventures.

### *Determinants of Performance*

Many variables have been suggested in the popular literature as potentially important to IJV success in China. These include several partner and task-related variables, as well as factors such as acquiring financing and foreign exchange.<sup>29</sup> However, only a few variables have been researched systematically in China. Two of the latter are the effects of control, and parent company involvement.

### *Control*

Beamish concludes that IJV performance in China is enhanced when control is divided along functional lines.<sup>30</sup> He argues that the Chinese culture, economy, and politics are so far removed from the experience of most Westerners that dominant control is risky. Meanwhile, the lack of managerial skills by the Chinese makes dominant control by them similarly risky. Teagarden and Von Glinow observe that IJVs in China that split the control of management functions become profitable faster than passive alliance forms.<sup>31</sup> However, they report that satisfaction levels are lower in IJVs than in passive alliances. Neither study investigates how the control is split.

### *Internationalization of Parent*

Hu et al. found that U.S. parents of IJVs in China with low levels of international involvement enjoyed increased valuations of stock prices during the week when an announcement of their new IJV in China was made.<sup>32</sup> They conclude that for firms with limited overseas activity, the addition of an IJV in

China represents a major step in the development of a multinational network that is viewed positively by investors.

In conclusion, although research on IJVs in China has been ongoing for the last decade, it is still at a stage of infancy. Descriptions and prescriptions dominate the literature. Several significant gaps exist in our understanding. We do not know the criteria that Chinese managers use in evaluating performance in the 1990s nor the processes by which these criteria are developed. Most importantly, there has not been a comprehensive explication of the relevant variables that affect performance, nor has a nomological net of hypotheses been developed to explain and predict performance. In particular, the perspectives of Chinese partners need to be incorporated into the research. The exploratory research reported here is an attempt at providing a more comprehensive explanation of performance in IJVs. A discussion of the research methodology is found in Appendix 1.

### **Findings on Performance Outcomes**

Based on interviews with 43 managers and government officials representing eight U.S.-China joint ventures, there is evidence in every IJV in the sample that both sides of the joint venture are satisfied with the performance of the venture. Managers report that most of their goals for the IJV are being met. Profit is a dominant goal and source of satisfaction; it has been important to U.S. managers and is becoming increasingly more important to the Chinese. In contrast to findings from the 1980s,<sup>33</sup> operating managers from both sides of the IJVs and from both U.S. and Chinese parents employ profit as the primary performance criterion. At the time of data collection, each IJV in the sample appears to have been profitable. In seven of the eight cases, the profit levels throughout the history of the JV exceeded both parties' expectations. Managers of each IJV also express positive expectations about future outcomes; every one of the eight IJVs intends to expand its manufacturing capacity and increase the total equity in the IJV.

However, there are sources of dissatisfaction. Furthermore, the level of satisfaction varies between the participants for a few specific performance criteria. U.S. managers generally feel that the product quality is less than desired. Some Chinese feel similarly, although the U.S. partners have higher quality standards than the Chinese. U.S. managers in two joint ventures also express significant dissatisfaction with the lack of control over the venture. Chinese managers appear to seek a faster pace of technology transfer than the U.S. managers. The U.S. partners prefer to provide the IJV with older technology, and with types that are not easily counterfeited. Chinese seem less satisfied about the level of exports than are their partners. But, the issue of export levels is diminishing. A Chinese parent company director, involved with a consumer foods IJV since its inception, observed:

We [the parent company] now see the value in generating dividends and focusing on profits. The government is also more interested in the profits that the joint venture generates. These profits provide tax money.

Contrary to earlier findings,<sup>34</sup> the equity shares have not been stable recently. A pattern of U.S. parent companies increasing their ownership shares is apparent. Chinese authorities now seem willing to allow foreign companies to acquire majority share of IJVs that are not under the National Five-Year Plans. It appears that large U.S. MNCs have used relatively small capitalized joint ventures as a means to enter the China market. When these IJVs become profitable, the U.S. parents attempt to acquire a larger share of the operation.

Managers from both sides of large, established U.S.-China joint ventures were generally satisfied with the performance of their ventures. Benefits were being received by both sides, and future prospects for profitability appeared positive. U.S. managers expressed somewhat more dissatisfaction with the IJV and their partners than did their Chinese counterparts.

### **Towards an Integrative Paradigm**

An integration of the diverse research streams used to analyze IJVs is desirable, so that the results and perspectives can be viewed as complementary, rather than as contradictory. One way to accomplish this synthesis is to utilize the contingency theory.<sup>35</sup> Combining the rational and open systems perspectives, this "theory" is guided by the view that organizations whose internal features best match the demands of their environments will achieve the best adaptation.<sup>36</sup>

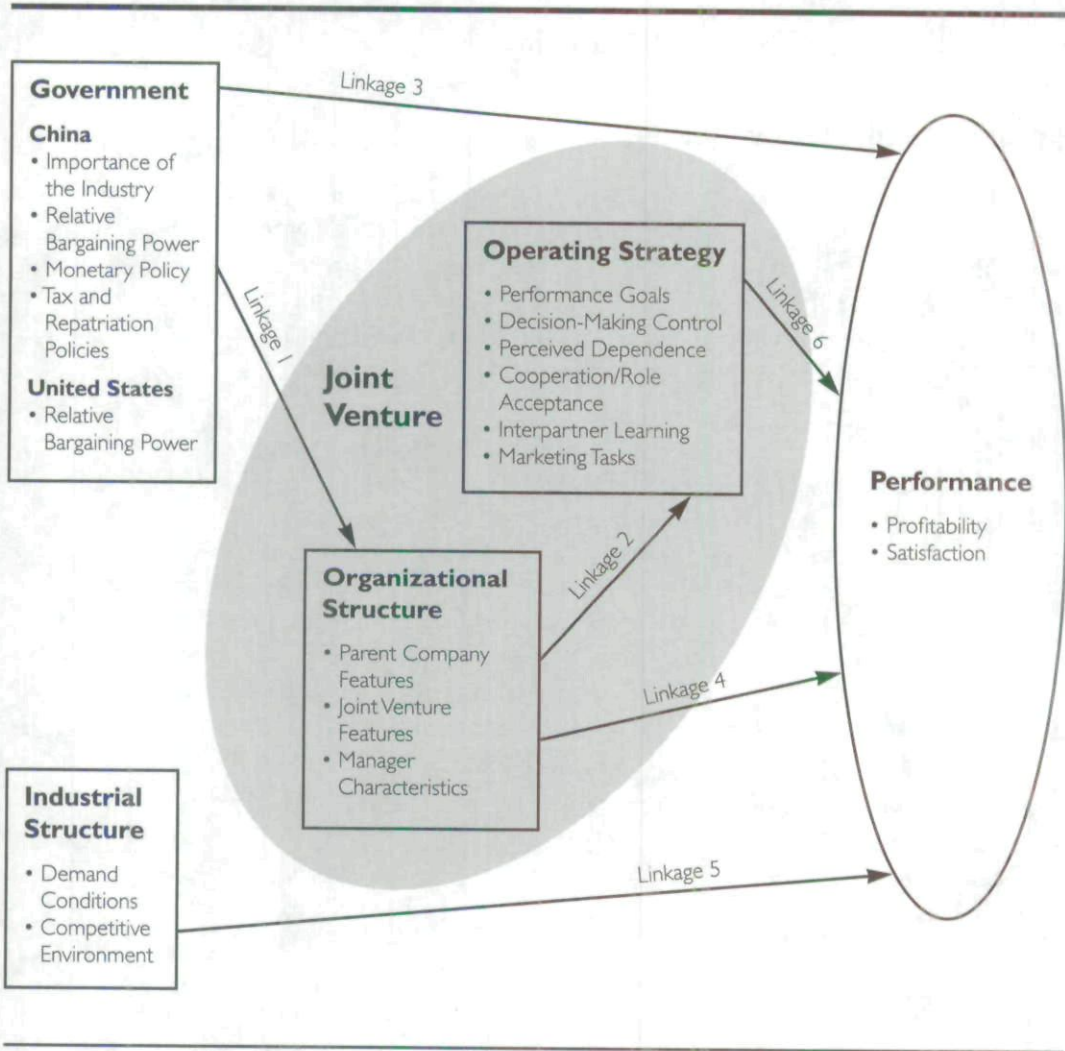
In contrast to advocates of population ecology models, contingency theorists do not view organizations as entirely passive, nor as incapable of affecting their own fate. According to the contingency framework, managers are viewed as able to influence actors and forces that are outside of their firm, as well as those within their organizations. Those who use a contingency approach attempt to identify characteristics of the environment, organizational structure, and strategy that are most relevant in a particular situation, including individual managers' characteristics.<sup>37</sup> Structural characteristics of the organization may include size, scope of business, and extent of internationalization.<sup>38</sup>

However, researchers utilizing a contingency perspective are skeptical that international marketers are primarily engaged in the systematic, proactive decision-making processes that are implicit in Chandler's<sup>39</sup> strategy-structure-performance (SSP) paradigm.<sup>40</sup> Reactive, intuitive aspects of decision making are acknowledged, as managers respond to existing structures and environmental factors.

A reformulation of the SSP paradigm integrates the economic and organizational behavior perspectives and the rational and open system approaches. The results of our exploratory research, combined with a synthesis of the literature

on IJVs, led to the formulation of an integrative model of performance in U.S.–China joint ventures. This framework moves beyond the time-dependent findings of much of the previous research. Figure 1 identifies the primary elements (government, organizational structure, operating strategy, industrial structure, performance) and their relationships. Six linkages are examined in the following sections: government-organizational structure, organizational structure-strategy, and the relationship of government, organizational structure, industrial structure, and organizational strategy with performance. For each of the linkages, at least one hypothesis is developed and discussed below.

**FIGURE 1.** A Proposed Integrative Model of Performance in U.S.–China Joint Ventures





### ***Linkage 1: Government-Organizational Structure***

Performance of IJVs in China begins with a discussion of the role of government. Because IJVs involve companies from two or more nations, at least two national governments may influence the actions of IJV parents and organizations. Governments are more than a contextual variable in this model: they can function as policy-makers, buyers, suppliers, and partners, directly and indirectly affecting structure, strategy, and performance. The important role of government on IJVs is not unique to a command economy. Governments in developing countries typically place restrictions on ownership by foreign corporations, production capacity, imports, and price increases.<sup>41</sup>

#### *Importance of the Industry*

Since IJVs were legalized in China in 1979, the role of government on IJV structure has diminished somewhat, as economic reforms transform the Chinese economy from centrally planned to mixed-planned/market-regulated. In the first half of the 1990s, the term "socialist market economy" was officially used by Chinese leaders and managers to describe the attempts to blend economic systems while maintaining the political leadership of the Communist Party. Within mixed economies, certain sectors of the economy face more government influence. Government leaders' perceptions of a particular industry are a key to understanding the formation of an IJV, parent company characteristics, the IJV's size, equity shares, and other structural features.

In China, the defense, transportation, communication, energy, and "heavy" industries are directly controlled by central government ministries, with production levels included in the National Five-Year Plans. These industries are considered critically important to the maintenance of China's sovereignty and self-defense. In addition, regulations do not allow foreign direct investment in telecommunications and publishing.<sup>42</sup> These two industries are important to China's government as means to control communication and channel propaganda for the masses.

Simultaneously, U.S. laws restrict the types of technologies that can be transferred to China. A director of a U.S.-based pharmaceutical company claimed that U.S. laws prevented them from investing in China in earlier periods. COCOM (The Coordinating Committee for Export Controls) limits the kinds of technology from U.S.-based companies that may be sold to China or used in the PRC. High-technology industries, including telecommunication and computers, are most affected.<sup>43</sup> COCOM seeks to restrict technology transfer to nations where the technology may be used for military purposes that are not in the best interest of the United States.

Two of the IJVs in the sample operate in highly controlled industries (transportation and electricity generation) and, as such, their production levels and organizational sizes are controlled by government bodies. Furthermore, U.S. partners of IJVs in these industries have not been allowed to own a majority

equity. A U.S. manager in a transportation IJV reported that as majority owner, the Chinese side maintains the power to appoint the chairperson of the IJV and the Chinese general manager without any input from the U.S. partners. "They'll never let us become majority owners," he concluded.

In contrast, "light industry" (consumer products) is much less regulated by the Chinese government. U.S. partners may become majority owners in these IJVs. The distinguishing feature is how important the particular industry is to the government leaders. For example, personal care products and canned beverages are not considered to be as important to China's modernization and national goals as are electricity generation and vehicle production. Based on this discussion, the following hypothesis is proposed:

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**Hypothesis 1: The more important the industry to the central government leaders, the more that the central government determines the structure of the IJVs in the industry.**

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Government influence helps ensure that China's objectives will be accomplished in the IJV and that foreigners will not control vital industries. Chinese partners in IJVs in important industries usually come from one of the central ministries, rather than from provincial organizations. For a high-technology IJV in the computer industry, the central government created a new corporation from the Ministry of Machinery and Electronics Industries to serve as the Chinese parent company in the IJV.

#### *Relative Bargaining Power*

Another important variable is the relative bargaining power of the two governments. Since 1989, it appears that the relative bargaining power of the Chinese government has diminished. China's government has loosened some of its restrictions on IJVs and made a series of concessions to foreign investors in an attempt to keep foreign capital flowing into China, to prevent existing firms from leaving the country, and to maintain access to the U.S. market. One of the structural variables that has changed is fewer nationality restrictions on IJV parent companies. South Korean and Taiwanese companies may now become joint venture parents in China. Equity ownership restrictions have diminished—evidenced by five of the eight JVs in the sample increasing their share of equity recently. IJV contracts are no longer limited to fifteen years. Moreover, some contracts are being renewed. Industries that had been closed to foreign investment are now opening, including service industries, such as accounting and banking.

Reasons for the diminished bargaining power are many. Importantly, China wishes to enhance its reputation and become integrated into the world economy by joining the World Trade Organization. In order to be admitted into this economic body, China must reduce the role of its government on the

economy and open up its markets. Recognizing the importance of U.S. support in the admission process, China's government has been more willing to make concessions to U.S. government negotiators and to U.S. IJVs.<sup>44</sup> Its bargaining power vis-à-vis the U.S. has further decreased as China's dependence on U.S. imports of Chinese goods has increased. In 1992, 37 percent of China's GDP came from exports, with 25 percent of these exports going to the U.S.<sup>45</sup> China's desire to join the World Trade Organization serves as a "carrot" that the U.S. can use to gain important concessions from China. A second hypothesis follows:

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**Hypothesis 2: As China's bargaining power vis-à-vis the U.S. diminishes, U.S.-China IJV structures become less regulated and influenced by the Chinese government.**

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### *Linkage 2: Organizational Structure-Strategy*

Several structural characteristics of the parent companies and of the IJV appear to be important factors in the strategies and performance of IJVs. Since this research centers on IJVs that have been manufacturing for at least three years, organizational structures are already in place. Existing structures are internal to the organizations and, in large part, determine the range of operating strategies that can be exploited in the near term. One critical element of operating strategies in U.S.-China IJVs is decision-making control.

#### *Decision-Making Control*

Control is the ability to influence systems, methods, and decisions.<sup>46</sup> The importance of control on performance increases as organizational size and complexity increase.<sup>47</sup> IJVs, as a complex organizational form, require the close attention of managers to monitor, coordinate, and integrate the activities of the organization. Dominant control is a mechanism for reducing the risks associated with coordination and opportunistic behavior, and, consequently, for minimizing transaction costs.<sup>48</sup> This research differs from previous conceptualizations of control by classifying control as a strategy variable, rather than a structural variable. Three dimensions of control have been identified—mechanisms, extent, and focus.<sup>49</sup> Share of ownership of the IJV is perceived as a *mechanism* of control in this model and, as such, is a part of the organizational structure. The *extent* of control exercised over the IJV is the center of attention as a strategy variable. The locus of price decision making is chosen as an indicator of the extent of control that a particular interest group holds over the IJV. A measure of extent of control is the determination of who makes the final decisions about prices of the IJV's output. Pricing is an important strategic variable because it directly affects financial performance measures, which both sides of the IJVs consider as the most important criterion. In addition, the ability to make pricing decisions seems to have an effect on U.S. managers' satisfaction with the IJV.

Among the eight IJVs, five loci of price decision making emerge—the U.S. joint venture marketing manager, the U.S. joint venture general manager, the U.S. parent company, the IJV Board of Directors, and the PRC pricing bureau. Although each IJV is required to report its prices to a particular pricing bureau, a governmental pricing bureau directly sets the prices for the IJV's output in only two of these IJVs. In none of the IJVs does a Chinese IJV manager make the final price decisions.

Transportation and power generation industries are directly managed by government agencies as part of Five-Year National Plans. Thus, IJV participants are not allowed to set prices. IJVs attempt to influence government pricing bureaus to agree to certain price levels; but the central government makes the final decisions. U.S. managers are not even allowed to go before the National Pricing Bureau with cost data and price proposals. The Chinese finance director performs the role of representing the IJV to the central government. The finance director of a transportation IJV appeared to be on the government's side, defending government control of pricing with the comment, "If [the pricing bureau] did not set the prices, then the joint venture would make excessive profits." Yet, the U.S. managers desperately wish to have the freedom to adjust prices upward or downward in response to changing market conditions. They also seek pricing options for accessories, but so far have been unable to do anything other than sell one basic model for each of their two vehicle types.

In the pharmaceutical industry, the National Pricing Bureau occasionally vetoed price proposals from IJVs. However, the companies selling consumer products in our sample did not experience any rejections of their pricing requests. The potential of rejection did put a damper on price increases, however. Based on our findings, we hypothesize:

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**Hypothesis 3: As the importance of the industry to government leaders increases, government control over IJV prices increases.**

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### *Linkage 3: Government-Performance*

Government regulations and policies have a direct effect on IJV performance in China. As in other countries, tax rates directly influence profitability measures, such as dividends. Even though standardized tax policies have been developed, tax rates on U.S.-China IJVs vary from case to case, and even within each case. For example, in 1989 a personal care products IJV paid a tax of 30 percent in Guangzhou. After a year of negotiations between the IJV and government agencies, the rate was lowered to 22 percent. Since moving production to an economic development zone outside of Guangzhou, the IJV has received a tax holiday for its first three profitable years. After eight profitable years, the tax rate is scheduled to go up to 15 percent. Generally, the tax rates for IJVs are lower than those paid by state companies or wholly owned foreign corporations.

This provides IJVs with a competitive advantage. Evidence from all of the IJVs in the sample lead to the following hypothesis:

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**Hypothesis 4: Low tax rates, resulting from special economic zone policies or particular negotiated agreements, lead to higher IJV and U.S. parent company profitability and satisfaction with the IJV.**

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#### *Linkage 4: Organizational Structure-Performance*

Two important patterns that emerged in our research are the effects of foreign parent company nationality and parent company size on performance.

##### *Foreign Parent Company Nationality*

Discussions with Chinese parent company managers and government officials uncovered an unexpected "country-of-origin" effect on Chinese managers' satisfaction with the IJV. A leading Chinese business professor suggested to us that Chinese rank-order nationalities according to a generally agreed-upon set of national/racial prejudices. McGuiness et al. also found evidence of national biases among Chinese buyers of machinery.<sup>50</sup>

In this research, several Chinese informants made unsolicited and frank comments about their preference for partnering with U.S. companies rather than with Japanese firms. Pointing out of a window in his office, a 65-year old Chinese official in Tianjin declared, "Japan has been bad with China. The U.S.A. has been pretty good . . . Japanese bombed that entire section of the city when I was a college student." Distrust, and even hatred, of Japanese still runs deep among many of those who experienced the Japanese-Chinese War in the 1930s and 40s, and who are largely the ones representing Chinese parent companies of IJVs. Many Chinese still fear economic imperialism from Japan.

Yet, the greater levels of satisfaction in working with Americans go beyond historical reasons. Another Chinese manager observed that in Chinese culture it is important to have good feelings between people. But, he perceived:

Japanese managers are over strict [sic]. They have no harmony and the workers resent them. [Chinese workers] feel that in Japanese joint ventures they are treated as robots...Japanese managers lack respect for the workers.

He observed that in U.S.-China IJVs, the feelings are different:

U.S. managers are not so proud. Many seem to want to have friendships with Chinese. They also treat Chinese with more respect and fairness.

A Chinese business professor who has done extensive consulting work for Chinese IJV participants also believed that Chinese are more satisfied with Caucasian managers than with overseas Chinese managers:

Overseas Chinese know our weaknesses better and exploit these. We don't like this... Chinese also perceive that Western managers are better at managing than those of the Chinese race. Accurate or not, these national biases affect peoples' satisfaction with the joint ventures.

Although Japanese-Chinese IJVs or Hong Kong-China IJVs were not investigated directly, it is hypothesized that:

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**Hypothesis 5: Chinese parent company and IJV managers are more satisfied with U.S.-China IJVs than with Japanese or overseas Chinese IJVs.**

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*Parent Company Size*

The relative size of the U.S. and Chinese parent companies appears to affect U.S. managers' satisfaction with their partner. What appears to be most satisfactory to U.S. participants is having asymmetrically sized parents. Size is a structural variable that seems to be an indicator in the minds of managers of their partner's influence.

The size of state-owned Chinese firms is difficult to capture, since the boundaries are ill-defined and quantitative data are unavailable or unreliable. U.S. managers use "level in the bureaucracy" as a rough measure of the size and power of a Chinese parent company. These differences in level of the bureaucracy are important, as they may determine the power of these Chinese enterprises to make decisions, influence regulatory authorities, and have access to critical sources of supplies or to buyers.<sup>51</sup> In the present study, six of the primary Chinese parent companies are under the authority of a local, municipal organization, and are thus considered small. For two other cases, the Chinese parents are under the direct supervision of central government ministries, and they are therefore classified as large. Large, U.S. multinational corporations, such as those in our sample, rarely attempt to partner with enterprises that are not state-owned. Privately owned Chinese companies are a relatively new phenomenon and often lack a track record for comparative analysis. Moreover, Chinese private ownership is elusive, since government agencies are usually behind what may seem to be "privately held" Chinese companies.

Annual sales is a frequently used measure of the size of MNCs. Seven of the eight U.S. parents are very large, well-known global corporations with annual sales from \$8 billion to \$35.5 billion. The other U.S. parent company is much smaller and less well-known, although its annual sales are approximately \$1.5 billion.

In five of the eight IJVs, the U.S. managers appear to be satisfied with their partners and indicate that they would select the same partner again. In each of these five cases, the U.S. side is content with the fact that the U.S. parent company is much larger than the Chinese parent company that reports to a

municipal body. A prominent illustration is a consumer personal-care products IJV, where multiple interviews were carried out with both sides of the IJV. Three U.S. managers mentioned that a source of their satisfaction with the IJV and with their partner is the relatively small size of their Chinese partner. This has allowed the U.S. parent companies to become the dominant partner in the IJV and to take control of all management functions. "We didn't want a big and cocky national partner to work with," revealed a U.S. JV manager. Because of the small size of the Chinese company and the large size of the U.S. parent, the U.S. side has been able to take control of all management functions. As one of the largest MNCs in the world and the biggest parent company in the sample, this company did not need a large Chinese company in order to secure influence over the government. Also relevant is the fact that the IJV absorbed all of the Chinese parent company employees at its inception. The small size of the host company made this absorption process easier, and kept the IJV from being overly inefficient. The Chinese managers and parent company managers are proud to be associated with the large U.S. company and express great satisfaction with them.

In contrast, the U.S. general manager of the IJV with a small U.S. parent reported dissatisfaction with his partner because the Chinese company, related to a municipal authority, is too small. If he could do it over again, this manager would select a large partner, related directly to a regional or central government body, that would give the IJV access to more buyers and be a better negotiator in getting critical concessions from the central government. As a small MNC, the U.S. partner feels a greater need for the resources and external influence of a large Chinese partner.

In the transportation joint venture, both partners would choose a different partner if they could do it over again. Both parents are relatively large: the Chinese parent is linked to the powerful central government and the U.S. parent is a \$30 billion company. Neither side is able to take control of the IJV, although each side attempts to do this. The dual structure of the management functions in the IJV reflects the apparently similar size and power of the two partners. Despite the positive financial results of the IJV, managers from both sides express dissatisfaction with their partner. From these contrasting IJV situations, the following hypothesis is developed:

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**Hypothesis 6: U.S. IJV managers in China are more satisfied when their Chinese parent company partner is relatively different in size from their parent company than when the two are of similar size.**

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A possible explanation is that when both partners perceive that one of the partners possesses expert and legitimate power, the other partner is more willing to accept its role as the less influential partner and to rely on this partner.<sup>52</sup> Thus, both partners are satisfied with their relative roles and positions. When

relative size differences are not great, there is less agreement about each partner's role, and neither partner may be convinced of their need for the other. As a result, greater dissatisfaction is expressed about the partner.

### ***Linkage 5: Industrial Structure-Performance***

Industrial structure also appears to affect IJV performance. As discussed earlier, seven of the eight IJVs are clearly profitable, and all of them saw a positive return on sales in 1992. Industrial structure appears to be an important factor in these financial outcomes. Two of the most important elements of industrial structure are supply/demand conditions and type of competition. As a fast-growing developing country, many of the markets in China manifest conditions where the demand is greater than the supply. Four of the IJVs in the sample operate in markets where demand is much greater than supply for their primary product and competition is limited. Well-established microeconomic principles predict that companies operating in this kind of an environment will enjoy profitable outcomes.<sup>53</sup> A corollary to the preceding principle is the hypothesis that:

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**Hypothesis 7: U.S. managers are more satisfied when operating in market structures that are protected from outside competition by the Chinese government.**

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Each of the U.S. companies in this sample is an early-mover in their industry in establishing a manufacturing and marketing operation in China. All experience less competition in China than in their developed-country markets. Most are in a seller's market, where they enjoy above-average profits. These market conditions enable the companies to maintain profitability in spite of relatively high costs of production. All of the U.S. companies remarked that their costs are higher than expected in China. Although several IJVs hope to become a low-cost supplier for the U.S. parent companies in the Asia-Pacific region, relatively low volumes and high inefficiencies constrain the attainment of this goal at present. Competition from companies that would export similar products into China could eliminate existing profit margins and threaten the viability of several of the IJVs. Thus, several managers quietly suggested that they hope the Chinese government will continue to offer some protection to IJVs that are producing within China. It is likely that the current market condition of demand exceeding supply is one of the most important factors in IJV profitability and, hence, managerial satisfaction.

### ***Linkage 6: Strategy-Performance***

As is evident from the preceding sections, IJV operating level strategies are constrained by structural variables at the organization and industry level, and by governmental variables. However, IJV managers are not destined to passivity. Four strategic aspects emerge as salient, likely influencers of IJV



performance. These are controlling decision making, establishing a sales network, retaining interpartner learning, and influencing government officials.

### *Decision-Making Control*

Analysis of the eight IJVs in the sample reveals the pattern that the more control that the U.S. side has over functions that it considers to be critical, the more satisfied are the U.S. participants with the IJV. However, a structural variable, size of the IJV, affects the extent of control that is desired. In two of the IJVs, the control is shared; in three, the U.S. has dominant control; and the control is split in three other IJVs as each side manages the functions that it views as most important.

The most dissatisfaction with the IJV occurs in the two IJVs where control is shared. Significantly, in these two IJVs Chinese governmental bodies control the production and pricing as part of Five-Year National Plans. U.S. managers at both the operating and parent company levels want more control, but have been unable to obtain it. The importance to U.S. managers of having control is particularly obvious in the repertory grid technique interviews. The U.S. executive director of the transportation IJV used one construct (low to high control) to distinguish an extraordinarily high percentage of the sets of performance elements. U.S. managers in other IJVs also used a control construct extensively. In contrast, their Chinese counterparts did not think about performance in terms of control of the IJV. Instead, Chinese managers conceptualize performance criteria more in terms of an exchange. Culture, technology, and management skills are three elements that Chinese believe are exchanged between partners.

Even though the transportation IJV is profitable, the lack of control frustrates the U.S. managers, who place a high value on freedom of action and the opportunity to coordinate the activities within a business. Moreover, they are accustomed to greater latitude in the U.S. and find the lack of control in China disconcerting and somewhat threatening. Gaining decision making control of critical business functions is also important to U.S. managers because of the perception of a wide gap in experience and ability between Chinese and U.S. parent companies. Chinese managers, unfamiliar with operating a business under competitive market conditions or current global business standards, are seen as ill-equipped to compete against global companies that are far more experienced in designing effective marketing strategies and in manufacturing high-quality products efficiently. Moreover, many of the Chinese parent company partners are government agencies that provide capital, but have never managed a profit-oriented business.

Dissatisfaction with the IJV or with the partner company are manifestations of the lack of control. The U.S. managers' dissatisfaction can also affect the Chinese partners. In negotiations and discussions, the U.S. side in the transportation IJV became caustic and attempted to seize control of at least some aspects of the business. This hardened the positions of the Chinese and appeared to increase dissatisfaction among the Chinese as well. All of the Chinese and U.S.

managers admitted to high levels of conflict within this IJV. An extreme example is a Board of Directors meeting that lasted for 33 hours. Intense arguing over a transfer price dominated the entire meeting; no consensus was reached between the two sides.

In contrast, the U.S. side has dominant control over pricing and the other management decisions in three of the IJVs. Expatriates from the parent companies manage each of the primary value-added chain activities carried out by the IJV, plus several support and infrastructure activities. The U.S. parents operate the IJVs as subsidiaries and seek to implement their global policies and procedures for every aspect of the business. The Chinese partners recognize the U.S. side's superior knowledge and experience in management, and allow them to control the business functions. Moreover, the U.S. possession of a majority share of the equity was acknowledged by both sides as a basis for the U.S. side to control the IJV. Thus, the U.S. side holds both expert and legitimate power, enabling it to control the IJV. Managers at all levels are very satisfied with the IJV. China business experts and the researchers, using a variety of performance criteria, all concur that the IJVs in the sample that are managed entirely by the U.S. side are some of the best IJVs in China. For each of these IJVs, sales are growing strongly, long-term profitability appears solid, hard and soft technologies are being transferred, the relationships between the partners are harmonious, and the stakeholders are very satisfied with the IJVs.

In three of the IJVs, the management functions are divided between the two sides. For example, marketing is viewed as critical to the U.S. side in each of these consumer foods IJVs; thus, the U.S. manager makes most of the final marketing decisions. Chinese perceive that human resource management is very important; therefore, the Chinese control personnel decisions in these split-control IJVs. Satisfaction is also high among the various participants in this category of IJV.

Previous literature provides conflicting results about the relative effects of dominant, shared, or split control of IJVs on performance.<sup>54</sup> This research uncovers the pattern that a third variable, size of the IJV (measured in annual sales, equity, and expatriate personnel), affects the relationship between control and performance. In each of the three small IJVs, split control is satisfactory to both sides. However, the U.S. side is not satisfied unless it has dominant control in the large IJVs. When more money and personnel are at stake, it becomes desirable for the U.S. side to control more functions of the IJV.

The plans of the U.S. parent for one of the small IJVs lend further support to this pattern. The U.S. company intends to triple its equity in the IJV and increase its share of ownership to 60 percent. Currently, the U.S. side is attempting to gain the contractual right to control more functions in the IJV once this infusion of capital occurs. Thus, it is hypothesized that:

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**Hypothesis 8: U.S. managers may be satisfied with the venture in IJVs with split control if the IJV is small. If the IJV is large, U.S. dominant control is necessary for the U.S. managers to be satisfied with the IJV.**

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## Discussion

This research is significant in that it represents the first systematic, matched collection of data from each of the major players in a U.S.-Sino joint venture: U.S. parent company, PRC parent company, U.S. IJV senior managers, and PRC IJV senior managers. Thus, a complete bilateral perspective of international joint venture performance is introduced to the literature. A more comprehensive analysis is made possible by acquiring multiple perspectives from several levels and sides of the IJV. The Chinese side more willingly discussed financial details and the U.S. side spoke more freely about interpartner conflict. Because of the establishment of trust between researchers and respondents, sensitive data on expansion plans and pricing were also garnered.

Previous research on IJV performance provides limited explanations, isolating certain aspects of interpartner behavior,<sup>55</sup> human resource management,<sup>56</sup> and industrial structure.<sup>57</sup> The study reported here enhances our understanding of IJV performance by synthesizing five major elements (government, organizational structure, interpartner strategy, industrial structure, and performance).

Strategy is affected by government and by existing organizational structures. When power is skewed in favor of a government, as was the general situation in China until at least the early 1990s, foreign companies are forced into national responsiveness strategies rather than proactive global integration strategies. As several hypotheses indicate, structural characteristics of the partners and the IJV, with government as a quasi-partner or at least a major stakeholder, affect what an IJV can do at the operating level in terms of human resource management, marketing, and other task-oriented aspects of strategy. Moreover, decision-making control, perceived dependence, conflict, and other partner-related variables are also affected.

For U.S. managers, having dominant control is important for psychological and economic reasons. U.S. managers revealed a pattern of being more comfortable and more satisfied when maintaining dominant control in large IJVs. From the perspective of efficiency, dominant control can be perceived as more efficient than split control. There is less interpartner conflict in IJVs where one parent makes the business decisions. This minimizes the transaction costs associated with opportunistic behavior and uncertainty.<sup>58</sup> Coordination and monitoring costs are lower when one party manages the business functions. Furthermore, in large IJVs more money and personnel are involved and, hence, the risks of improperly managed activities are greater. Control is a means to

reduce the risks associated with the uncertainty of a relatively unknown, potentially ill-equipped, developing-country partner managing an activity.

### ***Managerial Implications***

The bilateral approach allows U.S. and Chinese managers to better understand each other's perspectives on the operation and performance of joint ventures. The identification and elucidation of important factors that affect IJV performance, and the provision of managerial guidelines, may lead to improved performance of U.S.-China joint ventures.

One key area is the designing of relative ownership shares. Relative ownership share of an IJV has great symbolic significance to Chinese. When one partner holds more than 50 percent of the shares of the equity, they are perceived to have legitimate authority to lead the IJV. If dominant control is desired, it is important to negotiate a contract that allows majority share of the ownership. For existing IJVs, incremental increases in equity to garner majority share should also be attempted. Reinvesting profits in the IJV is a method to accomplish this. Current tax laws provide incentives to foreign companies to reinvest their profits rather than to repatriate them.

The type of partner that is selected is also a critical decision. Our research suggests that the sizes of the U.S. and Chinese parent companies appear to affect U.S. managers' satisfaction with their partner. What appears to be most satisfactory to U.S. participants is having asymmetrically sized parents. Size is a structural variable that seems to be an indicator in the minds of managers of their partner's influence. U.S. managers can use level in the bureaucracy as a rough measure of the size and power of a Chinese parent company. Chinese companies under the authority of a municipal government are considered to be small, those under provincial authority are medium-sized, and those under a central government authority are large-sized. These differences are important, as they may determine the power of these Chinese enterprises to make decisions, influence regulatory authorities, and have access to critical sources of supplies or to buyers.<sup>59</sup>

For large U.S. parent companies, a source of satisfaction with the IJV and with their partner is the relatively small size of their Chinese partner. This has allowed the U.S. parent companies to become the dominant partner in the IJV, taking control of all management functions. Small U.S. companies may do better with a large partner that is related directly to a regional or central government body. This partner would give the IJV access to more buyers and be a better negotiator in securing critical concessions from the government. Partners of a similar size are more prone to have inter-organizational problems. Neither side is able to take effective control of the IJV, although each side attempts to do so.

Four strategic tasks are particularly critical for effective IJV performance in the current Chinese environment. These are: gaining decision-making control of critical business functions, developing an effective sales force, retaining

trained IJV managers, and influencing government officials. Gaining decision-making control of critical business functions enables one side of the IJV to be able to coordinate and implement its strategies.

### *Decision-Making Control*

Even when one side does not possess a large share of the equity, a partner may still take actions to gain control of the areas that it feels that it must dominate. Formal and informal control measures can be implemented that help each partner to fulfill its own performance criteria goals. Contracts may stipulate which functions each partner will control, particularly under the ideal situation when the partners possess complementary skills. Promoting ideas informally with the Chinese side was practiced in every IJV in this research, even when the U.S. side had formal decision-making authority over an activity. Convincing partners about the effectiveness of a certain strategy is best done in the context of a good working relationship. Sponsoring Chinese partners and managers for trips to the U.S. has proven to be effective in demonstrating what works well and in building friendships. These visits involve formal meetings at corporate headquarters, including board meetings, as well as informal touring and visits to homes of U.S. managers.

Appointing general managers and directors who are older and experienced has been consciously practiced by the U.S. parents who dominate their IJVs successfully. Chinese show greater respect for older personnel and more willingness to allow them to make key decisions. Credible board members who are empathetic with the partner's culture and situations are best able to influence the other side's board members on important issues. Control can be established by their side in the critical areas and harmonious relationships can be sustained.

### *Sales Force Development*

Establishing an effective sales force is one critical task that the U.S. side is generally in the best position to control. Chinese have little experience with the principles and methods of personal selling and sales promotion. Providing after-sales service is an effective marketing innovation, especially for high-value products. However, once a sales force is trained and established, the U.S. side should be careful to allow Chinese in the field to adapt the principles they have learned to design tactics that are most appropriate for the local culture. The potential to create barriers to entry through an effective sales force is strong in the current economic and legal environment, and among most of the industries represented in this research.

### *Retaining IJV Managers*

Chinese partners attempt to control personnel decisions in each IJV; however, U.S. managers have learned that the U.S. side must take greater control of compensation and motivation issues in order to retain the best Chinese

managers in the IJV. Most of the U.S. IJV participants bemoan the loss of outstanding, trained Chinese managers to other organizations. Remaining Chinese managers seem less concerned about the problem and do not appear eager to take proactive steps. Traditional practices and government policy, based on Communist ideology, lead to similar salaries for all employees. Thus, nonmonetary compensation and motivation methods must be identified and implemented. Ideas for consideration include: provision of attractive housing, use of chauffeured, prestigious automobiles, large, well-furnished offices, long-term contracts, and restructured job responsibilities that are desired by the individuals. Training programs in the U.S. for high-potential Chinese employees must be reevaluated. One parent company found an unanticipated problem with their training program: of the thirty-five Chinese who were trained in the U.S., only one returned to the IJV! Managers are also realizing that the best place to do training is in the situation where the learning will be applied. Giving a person more responsibility is not necessarily an effective method of retention either. Current Chinese personnel practices and perceptions discourage a manager from accepting more responsibility since risks exceed rewards.

### *Influencing Government*

A final important area of operational strategy on performance is influencing government. When government policies play an important role in IJV structure, strategy, and performance, it is important for IJVs to understand and be able to influence government decisions. Having a local partner can enable an MNC to develop close connections with government decision makers. Chinese partners are likely to have intimate contacts and connections with critical government officials, and thus they should have a major role in influencing government for firm-level issues. Furthermore, many government officials are concerned about not allowing foreigners to exploit China and thus are more trusting of Chinese representatives. However, the U.S. side may need to work carefully with its partners to help them take a more aggressive stand in influencing government and in developing coherent strategies. This need is primarily due to the Chinese heritage of centralized planning and unchallenged adherence to government policies. Chinese partners in the southern provinces, where businesses and government leaders have a history of more freedom from Beijing, are better able to control this area of the IJV by themselves. For issues that extend beyond the firm, such as macro-economic policies and national laws, cooperative efforts by U.S. investors and nation-to-nation negotiations are necessary.

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## **APPENDIX I**

### **Research Methodology**

This exploratory study of U.S.-China joint ventures utilized in-depth case studies with an interpretivist perspective. This approach is particularly effective

in investigating dynamic organizational processes,<sup>60</sup> such as performance evaluation, and in creating theory with rich data that incorporates the participants' constructs and frameworks, rather than the researcher's.<sup>61</sup>

Judgmental sampling, based on the objectives of the research and on accessibility, was used. Criteria for site selection included US-PRC nationality, large size (over \$5 million capitalization), and at least three years of manufacturing history. Access was granted to eight IJVs in Guangzhou, Beijing, and Tianjin in China and to a total of eighteen organizations in the U.S., PRC, and Hong Kong. Open, trusting relationships were developed with the respondents by communicating in the informant's language, providing assurances of anonymity, taking notes rather than using tape recordings, offering report of key research findings, communicating an understanding of the informant's situation from the researchers' first-hand experience with U.S.-China IJVs, and using the researchers' network of corporate, governmental, and academic connections with IJV participants. These methods also provided an incentive for informants to give accurate and complete responses.

Multiple methods were used to collect data, including in-depth interviews, follow-up clarification interviews, secondary data in China and the U.S. to evaluate the accuracy of data provided by IJV informants and to expand the information about each case, an indirect data collection method (Kelley's repertory grid technique),<sup>62</sup> and two researchers' observations/ judgments. Open-ended, semi-structured questionnaires were used to allow the respondents to provide *their own* performance criteria, outcome conclusions, and factors that affect performance. Adler, et al.<sup>63</sup> called for the use of open-ended techniques to improve validity since Chinese managers often do not use the same constructs that Western researchers employ.

A subjective measure of performance, satisfaction, was measured as a global construct by asking each informant these questions: "Overall, how satisfied are you with the joint venture?" "Overall, how satisfied do you think your partner is with the joint venture?" Open-ended probes were then used. The researchers also asked how satisfied each manager was with each of their two most important performance criteria. Another indicator of satisfaction was the question "Do you have any plans for expansion of this JV?" In the interpretivist tradition, the researchers also made judgments about the relative satisfaction of each of the respondents and of each set of managers.

The forty-three initial interviews averaged about two hours in length and included seven U.S. parent company managers, six PRC parent company managers, fourteen U.S. JV operating managers, thirteen PRC JV operating managers, two U.S. government officials, and one PRC government official.

Two major analyses of the interview data were completed at two different times, providing evidence of consistency (a "test-retest"). ALSCAL, a multidimensional scaling algorithm, enabled the repertory grid technique data to be analyzed. Analytical generalizations, based on a convergence of evidence, rather than statistical inferences, were used in forming conclusions. Within-case and across-case analyses were performed, using a replication logic that is analogous

to multiple experiments. Each hypothesis that emerged was examined for each case, and similarities and differences between cases were investigated. Results were thus grounded in their context.<sup>64</sup> The major findings were discussed and confirmed with outside experts, lending additional confidence in the results.

Thus, several methods and sources of data were triangulated in order to generate valid and reliable conclusions. Convergence was evident. Conducting this particular research for six months at the end of 1992 in China, Hong Kong, and the U.S., allowed the lead author to include observational data that extended beyond the interviews. Three years of experience in working for a joint venture in China in the late 1980s helped substantiate the competence of the primary researcher to make informed judgments on the data that were uncovered in this research.

The conclusions from the case studies in this research are stated as hypotheses. The researchers do not attempt to make generalizations that apply to all IJVs. Statistical tests of large, random samples will allow the generalizability of the hypotheses to be investigated.

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