Control of International Joint Ventures in China - A Case Study Investigation

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Abstract

Changes in the world economy and industrial structures have transformed the patterns of international competition (Porter, 1986). The trend indicates that most firms prefer to take the short route when approaching overseas markets and present themselves directly through foreign direct investment (FDI) (Julius, 1991; Turner, 1991; United Nations 1991).

Following the FDI development, a second wave of change in the 1980s and 1990s was the surge of strategic alliances and joint ventures (JVs), the so-called new forms of organisations (Hennart, 1989; Franko, 1987; Buckley & Casson, 1985). The rapid growth of the new forms is at one level a response to the threats and opportunities presented by the shift in patterns of competition, and a driving force which accelerates further changes at the other level. These developments have inevitably raised new contracting and management control issues.

The rise of China is another feature highlighting the world economy in the later part of the 20th century (The World Bank, 1997, 1997a). Since China opened up in 1978, the country has undergone a major transformation and changed from "being an economic backwater to a hot spot of investor interest" (Tretiak & Holzmann, 1993:vii). The nation has captured one third of all FDI flows to developing countries between 1970 and 2000 (Independent, 11/11/2001), the majority of which arrived in JV form and from the sources of overseas ethnic Chinese. All these changes and features have added further questions and requirements to contracting and management control of international JVs (IJVs[1]).

Both the topic (IJV control) and the location (China) are of paramount importance to practitioners and academics alike. This study has made two major contributions to knowledge of IJV control in China. The first contribution is the use of a middle-range thinking research approach (Laughlin, 1995) and the case study method. Control is seen as a wider package, which consists of four contingency factors (environment, IJV mission, ownership and bargaining power structure, and control in terms of focus, extent and mechanisms), that is used to articulate strategies and achieve the desired results. Control as a holistic concept is empirically examined in this study.

The empirics revealed a web of complex interactions and delicate relationships between the hard/economics and soft/behavioural elements underlying a holistic control package. The analysis also discovered that the contingency variables comprising a holistic control package are influenced by, and at the same time influence, other variables through changing the enacted settings that other factors created. This process is circular and creates multiple layers of interactions between the environments and different contingency elements.

The in-depth understanding and the establishment of an integrative theory of IJV control highlighting the unique environments in China at the current stage of development is the second major contribution that this research has made. Moreover, this case-based study is set out to fulfil a middle-range role in changing some aspects of the status quo by informing managers and fellow researchers of the significant subject of IJV control in China. In summary, these are the main contributions of this research.

[1] A JV is considered to be international if at least one of the partners is headquartered outside the JV's country of operation, or if the JV has a significant level of operation in more than one country (Geringer & Herbert, 1989:235).

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Chapter 1

Introduction and chapter summaries

1.0 Introduction

Changes in the world economy and industrial structures have transformed the patterns of international competition (Porter, 1986). The trend indicates that most firms prefer to take the short route when approaching overseas markets and present themselves directly through foreign direct investment (FDI) (Julius, 1991; Turner, 1991; United Nations 1991). Today, FDI complements and to an extent replaces free trade, which was once considered as the engine of growth (United Nations, 1991; Nicolaides, 1992).

Following the development of FDI, a second wave of change in the 1980s and 1990s was the surge of strategic alliances and joint ventures (JVs), the so-called new forms of organisations (Hennart, 1989; Franko, 1987; Buckley & Casson, 1985). The rapid growth of these new forms is at one level a response to the threats and opportunities presented by the shift in patterns of competition, and a driving force which accelerates further changes at the other level. These developments have inevitably raised new contracting and management control issues.

The rise of China is another feature highlighting the world economy in the later part of the 20th century (The World Bank, 1997, 1997a). Since China opened up in 1978, the country has undergone a major transformation and changed from "being an economic backwater to a hot spot of investor interest" (Tretiak & Holzmann, 1993:vii). The Chinese economy expanded more than fourfold in the first two decades of the opening up, and was the fastest-growing economy in the world (The World Bank, 1997). The nation has captured one third of all FDI flows to developing countries between 1970 and 2000 (Independent, 11/11/2001), the majority of which arrived in JV form and from the sources of overseas ethnic Chinese. All these changes and features have added further questions and requirements to contracting and management control of international JVs (IJVs[1]).

[1] A JV is considered to be international if at least one of the partners is headquartered outside the JV's country of operation, or if the JV has a significant level of operation in more than one country (Geringer & Herbert, 1989:235).

Although control is considered as a key determinant for IJV success or failure, a relatively small proportion of IJV-related research has focused on the heart of the control issues (Geringer & Hebert, 1989; Parkhe, 1993; Lyles & Reger, 1993; Glaister, 1995; Groot & Merchant, 2000). There is a gap between the demands of practice and the focus of existing literature that requires urgent attention. Being an ethnic Chinese researcher in the field of management control, I am attracted to IJV, control of this new form of organisation and the emerging Chinese economy. This research aims to fill the gap in the existing literature and make contributions towards understanding of the holistic control packages that are applied by parent firms to their IJVs located in the unique context of China.

1.1 Research objectives

There are four objectives for this study. The **first** objective is to study the overall changes in patterns of global competition, and to understand the factors driving the rapid growth of the JV form of organisation. **Secondly,** to identify the essential elements that comprise a holistic control package in an IJV context. The **third** objective is to understand and critically discuss the design and implementation of control packages that the sample firms applied to their IJVs in China. The **fourth** ultimate aim of this research is to develop an integrative theory of IJV control, which highlights the specific context in which the control strategies operate and from which the theory is derived.

In the following section, I will highlight my philosophical standpoint underlying the design of a two-stage theory development process to achieve the objectives set for this research.

1.2 A two-stage theory formation process

This part makes public my philosophical standpoint, followed by a justification of using a two-stage theory development process.

1.2.1 The ontological and epistemological commitments of this research

Gill and Johnson (1991:21) describe human beings as "theory-dependent" in the sense that we routinely engage in the creation, application, and evaluation of theories. People behave and make decisions in accordance with their conjectures about what will happen in a particular circumstance, and these expectations are often derived from what have previously happened in some similar situations. Through the process of making sense, experience that is different from our expectations or which proves our current predictions wrong will reflect upon recent events and begin to stimulate new webs of explanations and expectations that help us to understand various natural and social phenomena. As a result, new theories emerge to explain some previously "unconsidered anomalies" (Gill & Johnson, 1991:27). There is an inter-changing relationship between theory and experience, and we constantly go round a cycle of learning through the process of making sense (Kolb, Rubin & McIntyre, 1979).

Burrell & Morgan (1979:4) stated that "the individual is seen as being born into and living within a social world which has a reality of its own". "Social reality has a concrete existence independent from human consciousness and cognition, which is in many respects empirically indefinable and presumably measurable in some way" (Gill & Johnson, 1991:128). Reality and human actions are mediated by social actors' subjective process of attaching meaning to and interpreting reality. Thus, any explanation of social behaviour indeed reveals both the external material conditions that predict certain social actions, and the subjective human interpretation (Gill & Johnson, 1991).

Management control practices are designed and implemented by various organisation actors. To study "managers in their everyday activities relies upon both theories deriving from their 'common sense' and theories deriving from social science research" (Gill & Johnson, 1991:27). Any organisational studies which aim to investigate the acts and/or decisions of organisation actors, theory plays a crucial role in the design of research approach.

1.2.2 Justification of using a two-stage theory formation process

The decision to adopt a middle-range thinking (MRT) approach advocated by Laughlin (1995) corresponds to my philosophical engagement, which assumes that there are structural and subjective elements in any theories. From the theoretical perspective, MRT suggests that it is possible to make generalisations and learn from other situations. The medium stance allows both learning and subjective diversity.

Although JV has been used as a mode of investment for decades, the field of IJV and its control remains in its infant stage (Geringer & Hebert, 1989; Parkhe, 1993; Glaister, 1995; Groot & Merchant, 2000). Undertaking a research project in IJV control with no integrative theory to lean on inevitably causes a steep learning process. The concept of flexible thinking highlighting MRT inspires me to become more creative. The main ideas of a "home-made" approach is to use existing "ingredients" to tailor-make theoretical models to fit the specific needs of our studies. I have borrowed valid ideas from relevant literature, then extended and integrated these inputs with my subjective views on the topic. It is an effective way to solve the problems of not having existing stock of theories in the market that fully fits my requirements. The tailored-made theory better serves my specific purposes.

Searching for ideas and building the "home-made" theoretical framework comprises **Stage 1** of the formation process. It needs to be stressed that this theoretical model is only of skeletal nature to guide the empirical discovery and interpretation of empirical data (Laughlin, 1995). It is the empirics that complete and inform the skeletal model. The theory-empirics dialogistic exchange enables the initial conceptualisation to be developed into an integrative theory of IJV control that characterises the specific environment in China from where the theory is derived. This interactive mechanism and refining process forms **Stage 2** of the theory formation process.

The following section provides chapter summaries. A map, which illustrates the two-stage theory formation process, is given in section 1.4 to give an overall view.

1.3 <u>The structure of this thesis - Chapter summaries</u>

This thesis is structured into ten chapters, each of which contains work and findings related to objectives that this research is set to achieve.

First, **Chapter 2** makes public the ontological and epistemological commitment of this research. Laughlin's (1995) three-dimensional choice model is adopted to organise the various thoughts on the research approach. The process of locating choice in "theory", "methodology" and "change" of this study is based on the middle-range thinking (MRT) approach advocated by Laughlin. The essence of MRT is to take a balanced and distinctive position on each perspective in empirical investigation. It is believed that a more prominent theoretical development in IJV control will be achieved under a climate of freedom of choice and flexible thinking. Indeed, the characteristics of a middle-range thinker have driven the development of this research.

The key assumption underlying the "theory" aspect is that skeletal generalisation about reality is possible. It is the empirical details that complete and on some occasions enrich the skeletal theories. "Part-constrained and part-free" is the specific nature of the methodology choice adopted by this study (Laughlin, 1995:84). Accounting and control are social phenomena and therefore a more contextual approach is required (Scapens, 1990, Otley & Berry, 1994; Spicer, 1992; Dent, 1991). These considerations have informed my decision to use case study as the research method. The medium "change" stance reflects that this research is not set out to strive for perfection, but to develop a less imperfect theory to help managers and academics alike to understand more the complex concept of IJV control.

The last section of this chapter provides a reflexive account of how access was obtained and how empirical investigation was conducted. The chapter concludes with a self-assessment of this case study research based on the objectives that it is set out to fulfil.

Chapter 3 begins an extensive literature review. The chapter illustrates the way in which the reduction and removal of national and international trade barriers have opened up previously protected industries to international competition (Julius, 1990, 1991). Rapid technological advancement has enabled many products and services to become tradeable or more tradeable internationally (United Nations, 1989). The trend shows that many firms have responded to the changing environment and widened opportunities by accelerating their FDI activities, and increasingly these activities are taken in the form of JV.

The rise of China is another feature highlighting the world economy in the later part of the 20th century (The World Bank, 1997, 1997a). Since China opened up in 1978, the country has undergone a major transformation. The nation has captured one third of all FDI flows to developing countries between 1970 and 2000 (Independent, 11/11/2001), the majority of which arrived in JV form and from the sources of overseas ethnic Chinese. What are the explanations for these phenomena? The two characteristics of China's FDI have added extra questions to the research - "do these two features bear any relevance to the reasons why and/or the ways how JVs are formed and controlled?" Before explanations are found for the main research questions on IJV and its control, an understanding of firms and their FDI behaviour needs to be firstly established.

Chapter 4 begins the process of understanding why firms choose to engage in FDI rather than organise their cross-border activities in a different way. Economics based 'internalisation theory' was the first model used to explain the area of inquiry. The theory recognises that market imperfections prevent efficient operation of international trade and equity investment (Rugman, 1980). Whenever the transaction cost of using the regular market is excessive, and/or when the market of trade does not exist, firms have the motives to bypass the externality by creating internal markets, which means FDI (Hymer, 1976; Buckley & Casson, 1976; Hood & Young, 1979; Rugman, 1981, 1982; Dunning, 1981). Control, the ability to transfer, protect and appropriate full return on the ownership of firm specific assets (FSA) is the central consideration and motive of FDI (ibid.). Internalisation theory has provided some persuasive explanations for the surge of worldwide FDI activities.

Chapter 5 reveals that characteristics of China's inward FDI refute the assumptions of internalisation theory in two fundamental ways. Internalisation theory posits that full control to protect FSA and return is the major motive driving firms to go abroad via FDI in wholly owned format. Contractual arrangements are commonly seen as risky choices (Rugman, 1982). How can these assumptions explain JV domination in China? The contradictions prompted further investigations. The chapter then includes a brief literature review of prior research in JVs. Results of these studies indicated that wholly owned investment needs not be the only or the best alternative to an arm's length market exchange (Contractor & Lorange, 1988, 1988b; Beamish & Banks, 1987; Franko, 1971, 1989; Shan, 1991). Under the right conditions, JV can actually provide a better solution to problems that are caused by different types of market imperfections.

Opportunism is commonly seen as the most significant transactional contingency facing firms when they consider using JV (Williamson, 1985; Beamish & Banks, 1987). However, some JV research (such as Contractor & Lorange, 1988; Beamish & Banks, 1987; Franko, 1989; Casson, 1990; Shan, 1991) revealed that opportunism is not an inevitable part in all co-operative relationships. JVs, which are established in a spirit of mutual trust and interdependency, serve to eliminate opportunistic behaviour. With a reciprocal foundation, JV partners are likely to pool resources and commit themselves to the success of the JVs. In approaching China, foreign investors from developed countries may well be confronted with higher adaptation and information requirements than they are accustomed. The situation reinforces the appropriateness of forming JVs with firms who possess country-specific knowledge.

The second part of Chapter 5 looks into the sources of China's inward FDI. Trust, a crucial factor which significantly affects decisions on ownership structure of FDI, is considered as the central theme of JV operation. Under the Confucius' influences, the Chinese are used to placing great value on human relations. The analysis reflects that with their culture, linguistic knowledge and personal connections, overseas ethnic Chinese (OEC) have enjoyed a ready access to market intelligence and an ability to find their ways through the unique political and business systems that exist in China. Also, because of their advantages, many foreign investors have partnered OEC to invest in China. OEC's personal and cultural links have proved to be commercially valuable. The analysis has disclosed the intertwined relationships between financial and cultural/behavioural factors on FDI decisions and the subsequent ways in which these operations are being formed.

Findings in this and the previous chapters provide the "soft" type of reasoning that was widely neglected by economics theories, such as internalisation theory. This analysis has explicitly hinted that FDI, JV investments and accounting and control are not simply economic phenomena but are socially constructed (Dent, 1991; Gill & Johnson, 1991; Daft & Lewin, 1990; Bettis, 1991; Scapens, 1990; Otley & Berry, 1994; Otley, 1999). Therefore, the "human" side of organisation economics needs to be included in any meaningful analysis (Boyd & Richerson, 1990; Donaldson, 1990; Barney, 1990; Casson, 1990; Griesinger, 1990; Van Der Meer-Kooistra & Vosselman, 2000). Having obtained an understanding of the reasons behind FDI decisions and the JV phenomenon, the following two chapters focuses on "control" at inter-firm, intra-firm and JV contexts.

Chapter 6 begins with a review of management control literature. The analysis reveals a swing in research approaches, which was initially from mainstream accounting to social/behavioural studies, and subsequently to a contingency-based approach. The review also discovers a shift in research focus from an inter-firm to intra-firm context. The key assumptions of contingency theory best fit the middle-range approach of this research, and they have a significant impact on the building process of the skeletal theory.

Some prior contingency research extended the concept of strategy-structure-control (SSC) fit from an inter-firm (individual firms) (notably Chandler, 1962; Miles & Snow, 1978) to an intra-firm level (subsidiaries/strategic business units (SBU)) (notably Simons, 1987; Govindarajan & Gupta, 1985; Govindarajan, 1986). However, the momentum has halted and there are very few contingency studies (notably Franko, 1971) devoted to further exploring the potential of applying the SSC concept to a context of JV, an increasingly popular new form or organisation. The gap represents a valuable research opportunity that this study aims to address. The limitations of traditional contingency theory are recognised by this study. Provisions are made at various stages of the research development in order to address some of the weaknesses.

Strategy, structure, control and environment are four contingency elements that comprise the foundation of a three-tiered theoretical framework of this research. Moving forward from what previous contingency research has already done, this study injects into the SSC concept some specific IJV details. Nowadays many IJVs are likely to be subsidiaries which are established to fulfil some specific purposes given by their parents. The strategic mission of why an IJV is formed will shape the environment of which the subsidiary has to deal with (Miles & Snow, 1978; Govindarajan & Gupta, 1985; Govindarajan, 1986; Simons, 1987). Facing an enacted environment that is created by the investment objectives, the IJV needs to carefully structure itself through deliberate strategies on the choice of partners and ownership/bargaining structure in order to create the preconditions for robust co-operation (Parkhe, 1993). From individual partners' point of view, establishing the right structure is crucial in the implementation of strategies and control, as well as the subsequent achievement of their objectives (Parkhe, 1993; Geringer & Hebert, 1989).

Chapter 7 continues the conceptualisation of IJV control. The chapter contains a review of the existing JV/IJV literature, which reveals that despite its importance, issues of control are not popular among existing literature and have only received scant and unsystematic attention (Geringer & Hebert, 1989; Lyles & Reger, 1993; Glaister, 1995). From their review of prior research in the field, Geringer and Hebert (1989) identified that control in an IJV context comprises three key dimensions - mechanisms, extent and focus. However, most of the previous studies largely examined one or two of these control parameters. No explicit attempts have been made to adopt an integrative approach to study the subject.

Indeed, these prior research studies can only provide practitioners and academics alike with fragmented or even distorted findings.

Geringer and Hebert's insights strengthened my belief that control is not an independent activity, which operates in an isolated context. Any meaningful investigation needs to examine the holistic concept of control as a package. Through blending various valid ideas together, such as the SSC relationship advocated by the contingency literature, the three-dimensional concept of IJV control hinted by Geringer and Hebert, with my subjective views, a three-tiered integrative theoretical framework of IJV control is established (see Figure 7.3) This model is of skeletal nature, which will be used to guide the empirical investigation and the interpretation of empirics (see Chapters 8 and 9).

Chapter 8 includes four in-depth case studies, which contain details of the empirical investigation conducted in China. The case materials reflect a high level of complexity of parental control in IJVs. The stories tell the intertwined relationships among key elements that build up, and roles and personalities of various parties involved in, each control package. In addition, the interchanging forces between control packages and their environments are also revealed. The four case studies provide interesting accounts of the four focal parents' experiences in forming and controlling IJVs in China.

In **Chapter 9**, materials from the four case studies are analysed using the skeletal model of IJV control established in Stage 1 of the theory formation process. The comparisons disclose similarities and differences of control packages adopted by the four focal partners in their IJVs in China. Focus is placed on findings that support or refute the original set of presumptions highlighting the skeletal framework. Further attention is given to those unexpected discoveries that have not yet been acknowledged by the existing JV/IJV literature.

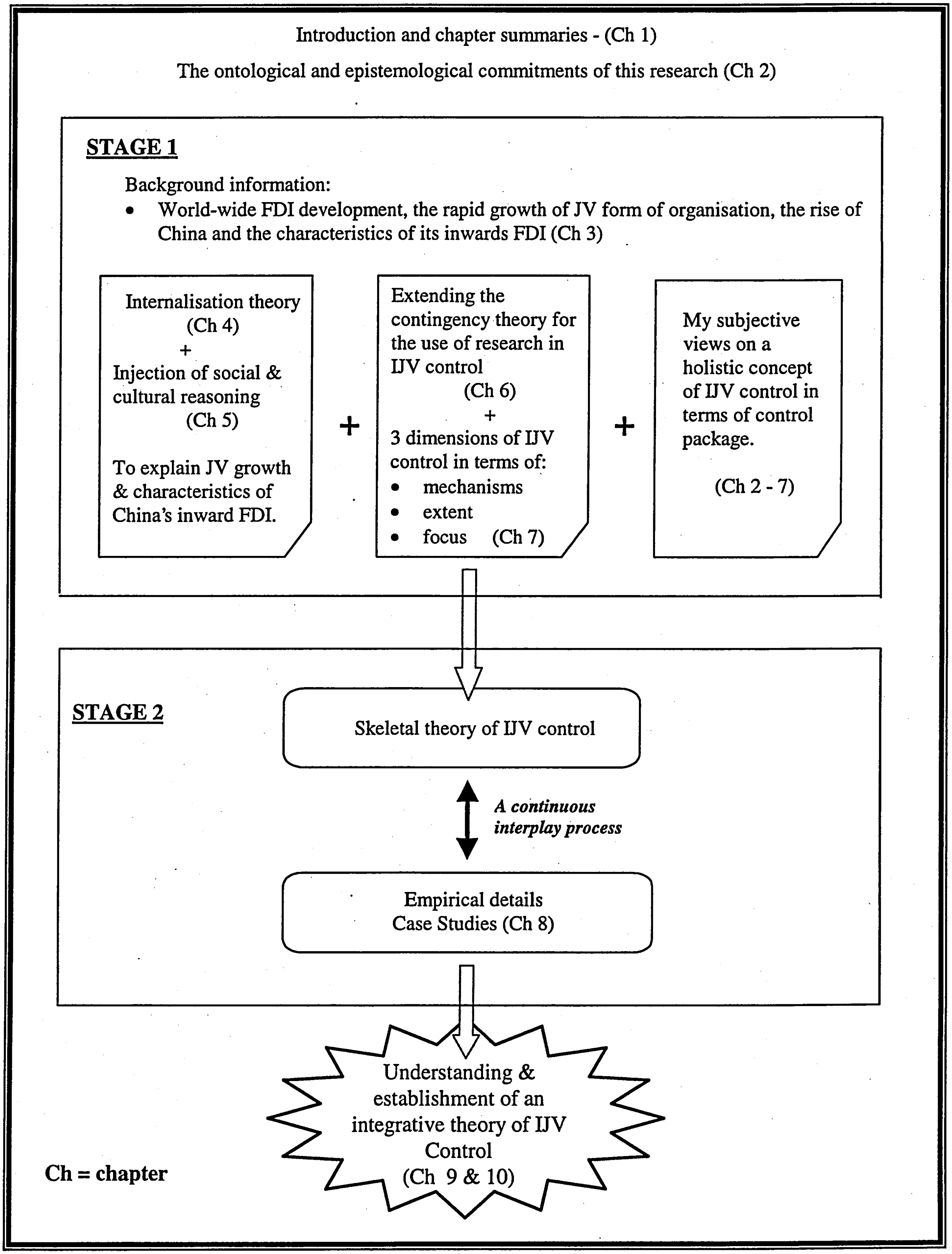
The whole analytical process illustrates an interactive relationship between theory and empirical details. While the skeletal model provides guidance to the understanding and interpretation of the empirics, the empirics provide flesh to complete the skeletal framework (Laughlin, 1995). Contradictions identified at different stages of the sense-making process supply new ideas to refine the conceptualisation (see modifications demonstrated in Figures 9.3, 9.6 & 9.7). The continuous interplay mechanism allows the skeletal model to gradually arrive at its final form (see Figure 9.7) that is characterised by the unique context in which the control packages operate and from which the theory is derived. The fruitful results also confirm the appropriateness of the case study method, which enabled a deeper understanding in the holistic concept of IJV control to be established.

Finally, **Chapter 10** provides a conclusion to the research. It begins with a recapture of the key research objectives. It then revisits the two-stage theory formation process. Major findings generated by this study and their implications are discussed. The chapter includes a self-assessment of the extent to which the four research objectives are met. It is followed by an analysis of the strengths and weaknesses of the chosen research approach and method. Also, recommendations for further research are outlined. Limitations of the contingency theory which underlines the skeletal model of this study, and the provisions made during the theory building process will be summarised and discussed. The chapter ends with a reflexive account of personal experience gained throughout the project.

1.4 Map for the intellectual journey

Summaries, which show the essence of discussion and key findings in each chapter, are outlined above. This section presents a map (as Figure 1.1) to guide readers through my intellectual journey of building the skeletal model and developing the integrative theory of IJV control. Full details of the journey are illustrated in the following chapters.

Figure 1.1: A map for the two-stage theory formation process



Chapter 2

The ontological and epistemological commitments of this research

2.0 Introduction

Following the introduction in Chapter 1, this second chapter aims to make public the ontological and epistemological commitments of this research. The first part serves to outline the philosophical and methodological engagement of this study. Following this is an explanation of why a case study survey method is chosen. The final part attempts to account for the process of gaining access and conducting the empirical investigation.

2.1 Methodology

Burrell and Morgan (1979) advocated a pioneering two-matrix scheme (as shown in Table 2.1), which aimed to assist researchers to understand a wide range of methodological approaches of social science. The bipolar framework has provided some basic typology for different views held by social scientists about the nature of human beings, society and the world. A spectrum of social thoughts is reflected in the methodological continuum, which has subjectivist and objectivist approaches at the two ends of the scale.

Burrell and Morgan (1979) and Morgan and Smircich (1980) suggested that all approaches to social science are built on the foundation of a set of interrelated assumptions regarding ontology[1] and epistemology[2]. Research studies which are built on various ontological underpinnings would imply some very different epistemological views on what constitutes knowledge and also how this knowledge relates to the phenomena to be investigated (Burrell & Morgan, 1979; Morgan & Smircich, 1980; Laughlin, 1995). These views will fundamentally influence our choice and understanding of the problems to be studied.

On the other hand, it is indicated that any given set of ontological and epistemological assumptions held by a researcher in each individual circumstance projects a specific methodological position (Burrell & Morgan, 1979; Morgan & Smircich, 1980; Scapens,

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[1] Ontology is defined as the researchers' views about the nature of human beings and their world. These assumptions imply the fundamental elements comprising the reality of which the research is embedded (Burrell and Morgan, 1979; Gill & Johnson, 1991; Parkhe, 1993). It is suggested that the ontological position of a research reflects what it aims to study. This set of preconditions forms a basis against which the extent of validity of the research will then be cross-examined.

[2] While the term epistemology is concerned with the suppositions of the researchers on the grounds for knowledge about the human world (Burrell and Morgan, 1979; Morgan & Smircich, 1980; Parkhe, 1993). This type of presumptions projects the expected extent of truth, or how far the knowledge generated from a study can be applied to other situations, populations or to the world as a whole. These conceptual grounds then form the basis upon which the reliability of the research is judged.

1990; Johnson, 1989). Each type of methodology reflects a specific context of assumptions, and this context in turn influences the choice and use of research techniques to approach the phenomena of study.

Although Burrell and Morgan's (1979) model[3] is more recently subjected to criticisms of over-simplifying the complex organisation world (Willmott, 1993; Laughlin, 1995) and not explicitly tackling the relationship between ontology, epistemology and method (Johnson, 1989), it helped me to understand various approaches of social research. It was a very useful tool for the initial jump-start of this study. It was only at a later stage that Laughlin's (1995) three-dimensional choice model of accounting empirical research and middle-range thinking came into place to assist me in locating and interpreting my philosophical and methodological commitments.

Two of the key objectives of this study are to investigate the reasons why firms prefer JV, and the systems and processes MNE partners adopted to control their IJVs located in China. The scope of this study is broad. The whole process of research development was far from systematic, and was somewhat of a "trial–and-error" type of knowledge formation process. Marshall and Rossman (1989:21) observed that "quite unlike its pristine and logical presentation in journal articles, real research is often confusing, messy, intensely frustrating, and fundamentally non-linear". Laughlin's model was useful in helping me to organise my various thoughts on different aspects of IJV control, each of which consists of an amalgam of complex variables, into a more cohesive whole when presenting my philosophical commitments in this chapter.

[3] Also the subsequent work conducted by Morgan & Smircich (1980) and Morgan (1983).

Table 2.1

Continuum of approaches of social science

Subjective Approaches ⟵⟶ **Objective Approaches**

Core Ontological Assumptions	Reality as a projection of human imagination	Reality as a social construction	Reality as a realm of symbolic discourse	Reality as a contextual field of information	Reality as a concrete process	Reality as a concrete structure
Assumptions about Human Nature	Man as pure spirit, consciousness, being	Man as a social constructor, the symbol creator	Men as an actor, the symbol user	Man as an information processor	Man as an adapter	Man as a responder
Basic Epistemological Stances	To obtain phenomenological insights, revelation	To understand how social reality is created	To understanding patterns of symbolic discourse	To map contexts	To study systems, process, change	To construct a positivist science
Research Methods	Exploration of pure subjectivity	Hermeneutics	Symbolic analysis	Contextual analysis of Gestalten	Historical analysis	Lab experiment, surveys

Source: Morgan and Smircich (1980:492).

2.2 Theory-Methodology-Change Model of alternative accounting approaches

Having criticised the simplistic bipolar dualism introduced by Burrell and Morgan (1979), Laughlin (1995) extended and related their ideas to his three-continuum framework. As Burrell and Morgan's schema was used at the beginning of this research, I found Laughlin's model fits in nicely to the next step of the approach formation process.

Laughlin stated that it is possible to express various approaches to empirical research in the context of choice with regard to theory, methodology and change. According to the author, the aspect of "theory" is concerned with the researchers' views on the nature of the world (Burrell and Morgan's assumptions in ontology) and the constitution of knowledge in relation to the focus of their studies (Burrell and Morgan's epistemology). Assumptions in this dimension reflect a choice of the extent of prior theorisation to be brought into the research.

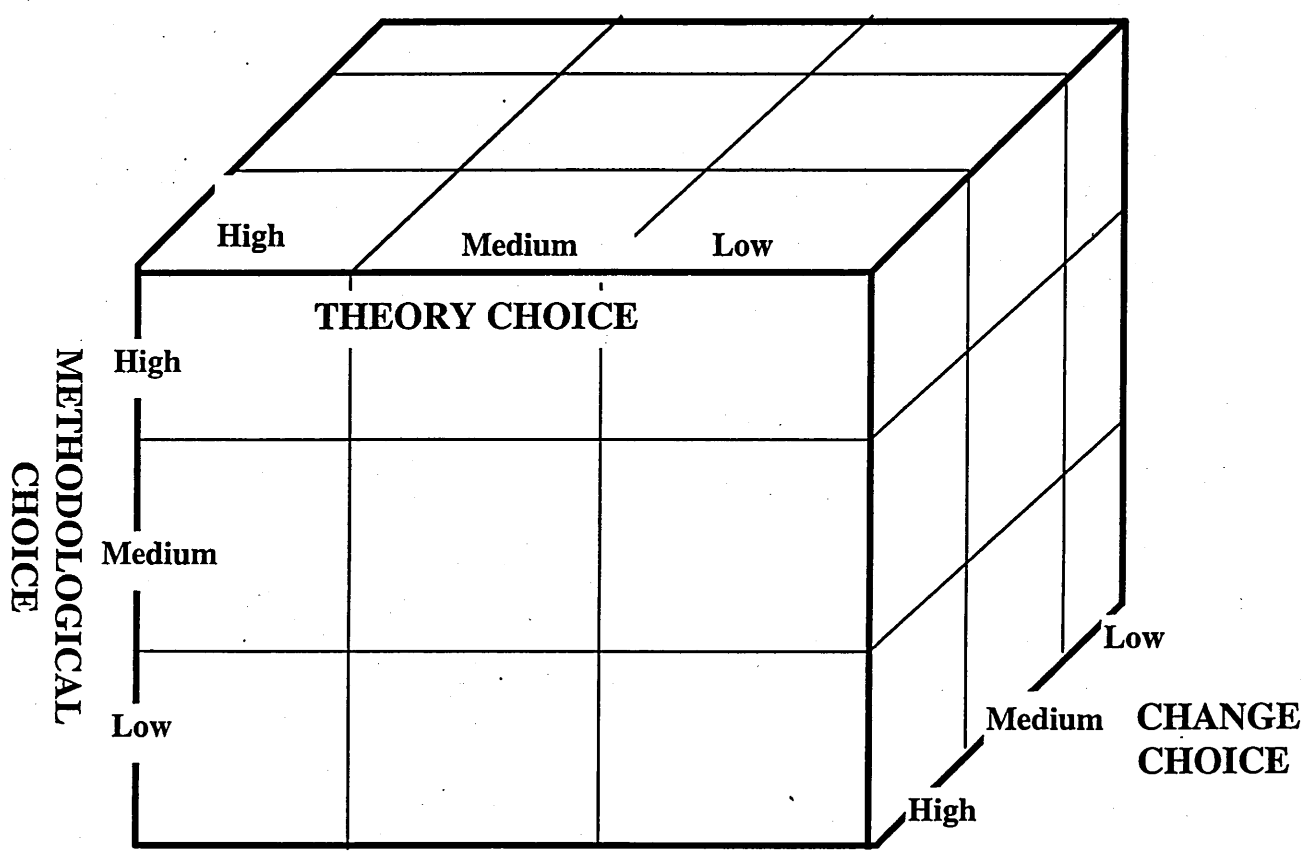
The "methodology" dimension is related to the choice of the level of theoretical closure on the methods of investigation (Burrell and Morgan's method assumptions). The final aspect "change" involves a choice with regard to the degree of change in the phenomena of study that the researchers would like to achieve (Burrell and Morgan's society nature suppositions).

In order to indicate our positioning on each of the three perspectives, we can think of the choices on three different scalars ranging from high, medium to low. The theory dimension is related to introducing high to low level of prior theorisation into a research. The methodology perspective is concerned with high to low extent of theoretical closure on the research methods. Finally, the change dimension refers to high to low degree of need for change in the phenomena being investigated.

There are interrelationships highlighting the choices on the three dimensions for a research approach. Further discussion of their relationship is recorded in Section 2.4 and in here a three dimensional plane which graphically illustrates choices under various combinations of assumptions is shown on Figure 2.1.

Figure 2.1

The Choice Process for Empirical Research in Accounting



Source: Laughlin (1995:68)

2.3 Middle-range thinking

The meaning of "middle-range thinking" (MRT) is demonstrated by taking a medium position on each of the three identified continuums - theory, methodology and change. The terms middle range, mid-point and medium position do not mean a precise measurable middle point from both ends of each individual continuum. In my opinion, "middle range" denotes a way of thinking and it represents the attitudes of the researchers. I see the essence of MRT is to take a balanced, flexible and distinctive position which does not rely on, and which is not being restricted by, one particular dominant school of thought.

The basic assumptions of the MRT are that there is no one best approach to understand the complex social reality, and all empirical research studies are bound to be incomplete. Therefore, by taking a mid-level standpoint, we are not required to commit ourselves to either one of the two dominant schools of thought occupying two ends of each continuum of measure. Without rigidly constraining our thoughts to one particular approach, we can become methodology pluralists, who are free to choose and comment on, compare and learn from ideas expressed by some antagonistic research communities, which might become rivals simply because of a difference in interests rather than in ontological assumptions (Johnson, 1989). My decision to adopt a middle-range approach was strengthened by a plea made by Burgoyne (1992:13), which was recorded in Whittle (1994:125), that pluralistic tolerance is to be encouraged:

> "Mutual respect, understanding and dialogue...between the different communities engaged in knowledge production and consumption...(and to) move to a more integrated approach to management research".

I believe that a more prominent advancement in the theoretical development of IJV control can be achieved under a climate of freedom of choice and flexible thinking. Once we recognise and accept the high level of human subjectivity involved in all social research, the differences among contributors actually reveal a wider picture of various social phenomena. An example drawn by Smith (1975:253) has nicely captured the essence of my argument:

> "We are really like blind men led into an arena and asked to identify an entity (say an elephant) by touching one part of that entity (say a leg). Certainly we might make better guesses if we could pool the information of all the blind men, each of whom has touched a different part of the elephant".

As Laughlin (1995:65) stated, "all empirical research is partial and incomplete and that theoretical and methodological choices are inevitably made whether appreciated or not". The philosophical and methodological commitment I made for this research is the end product of my subjective interpretation, which is inevitably "theory laden" (Gill & Johnson, 1991:136). Other scholars may refute my ideas and choice. However, it is the ultimate purpose of this research to raise the awareness and stimulate debate on the important topic of IJV control.

2.4 Middle-range thinking + Three-dimension approach in accounting research

According to Laughlin's (1995) model, alternative accounting research can be seen as choices made on three key dimensions – theory, methodology and change. The following analysis aims to reveal the meaning and strengths of the medium position on each of the three continuums, with special reference to the focus of this research about IJV control.

2.4.1 Theory

On the "theory" dimension, it is concerned with choice in regard to the nature of the world that we investigate. Human beings behave and make decisions in accordance with their conjectures about what will happen in a particular circumstance, and these expectations are often derived from what has previously happened in similar situations. Through the process of making sense, experience which is different from our expectations or which proves our current predictions wrong, will reflect upon recent events and begin to stimulate new webs of explanations and expectations that help us to understand various natural and social phenomena that surround us. Thus, new theory emerges to explain some previously unconsidered anomalies and the cycle will continuously revolve (Gill & Johnson, 1991; Kolb, Rubin & McIntyre, 1979; Hopper & Powell, 1985). Theories are indeed enmeshed in practice and they play a crucial role in the design of the research approach. As Gill and Johnson (1991:27) suggested, "managers in their everyday activities rely upon both theories deriving from their 'common sense' and theories deriving from social science research".

The theory dimension of Laughlin's model (1995) is fundamentally concerned with the level of prior theorising that is brought into the empirical investigation. This choice is related to our views about the extent of materiality of the world and the possibility to generalise the phenomena of investigation through previous theoretical studies. If a high level of prior theorising is brought into the research, it is assumed that there is a concrete material world characterised with a high level of generality and order, despite the empirical variety. The high position may also reflect that the phenomenon of study is well researched. Under the views that the external world is uniform and understood, we can therefore learn from previous studies. By the same token, results of the research can be transferred to other similar studies.

As the context is assumed to be understood and fairly uniform to other studies, the actual detail of the empirical process and the differences of contextual variables per se are seen as relatively less important. This ontological stance implies the importance of knowledge rests on whether the current study supports or disagrees with the established theories that are brought into the investigation. The current attempt is seen as an incremental work to the existing theories.

However, if a low level of prior theorising is used, it presumes that the so-called reality is only a projection of individual imagination, and "one's mind is one's world" (Morgan & Smircich, 1980:494). Empirical findings are unique explanations (theories) of the phenomena of study under a specific context, and they cannot be transferred to other studies. Based on the same principles, theories generated from other studies are of no use to the current one, and therefore generalisation and learning via prior studies is impossible. The low stance indicates the uniqueness of the current study and it is not used to confirm or refute prior theories.

It can be seen that both high and low stances attached with them some distinctive assumptions of the world and knowledge. Indeed, their very different views are the reasons driving the historical debate between objective and subjective approaches in social research (Burrell & Morgan, 1979; Morgan & Smircich, 1980; Morgan, 1983; Gill & Johnson, 1991; Parkhe, 1993). From an accounting and control perspective, it can be argued that both schools of thought consist of strengths and weaknesses.

Accounting and control is socially constructed (Scapens, 1990, Dent, 1991; Otley & Berry, 1994; Spicer, 1992). Because of that, understanding of individual situations, and contextual variables and process is important. It sounds even more critical to this research, which aims to investigate parental control in IJVs, a form of organisation which is characterised with multiple motives, nationalities, culture and languages. The low prior theorising position with its respect for contextual detail is its strength when used in accounting and control research. Contextual richness is considered as a vital element of this research into IJVs in China, a special setting for FDI and control. It is the explicit denial of the importance of human subjectivity in understanding and explaining social realities (stimuli) and actions (responses) which is the major problem highlighting the high position on the theory continuum. As Johnson argues that:

> "this understanding is not a luxury but a necessity since human action cannot be conceived in terms of automatic responses to external stimuli unmediated by (subjective) interpretative processes" (1989:49) . "Human action has an internal logic" (1989:49).

On the other hand, I see an emphasis on the extreme uniqueness of each study and the inability to learn from others is the weakness of the low position. Understanding in JVs/IJVs remains in a preparadigmatic stage, although this form of organisation has been widely used by many firms as FDI tools and/or strategic weapons to safeguard their competitiveness (see Chapter 4 and 6 for details). Theoretical development in the field is struggling to catch up with practice (Parkhe, 1993). Consequently, a low position is unlikely to lead to the required theoretical advancement. It is the weakness that this research tries to avoid.

A high position on the theory dimension reflects that some forms of uniformity exist in our societies and everyday lives. Despite the uniqueness of IJV motives, formation and control, there are aspects that may relate to other forms of operations and their control. The characteristics of the high position can reduce a high degree of contextual diversity and enable theoretical refinement to be achieved. These are key merits of the high stance, and they are an important quality that this research needs.

Human action is the outcome of subjective choices made by social actors. Their choices however, are influenced and constrained by the material conditions (Hopper & Powell, 1985; Gill & Johnson, 1991). "The individual is seen as being born into and living within a social world which has a reality of its own" (Burrell & Morgan, 1979:4). "Thus social reality has a concrete existence independent of human consciousness and cognition, which is in many respects empirically indefinable and presumably measurable in some way" (Gill & Johnson, 1991:128). Reality and human actions are mediated by social actors' subjective process of attaching meaning to and interpreting reality. Therefore, any explanation of social behaviour must reveal both the external antecedent conditions that predict certain social actions in a probabilistic fashion and the subjective human interpretation (Gill & Johnson, 1991).

In fact, both subjective and objective thinking have relevant, although not necessary equal, roles to play in the process of generating explanation statements (theories) for various social phenomena. As Parkhe (1993: 238) described, "in a phenomenon as subtle and complex as IJVs, neither objective nor subjective perspective alone can adequately inform theory". The distinctive characteristics of subjective and objective approaches are not "mutually exclusive but mutually reinforcing" (Parkhe, 1993:237).

The MRT approach allows us to preserve the strengths of the high- and low-level of prior theorisation, and at the same time avoid their major weaknesses via taking a medium position (Laughlin, 1995; Parkhe, 1993). The central thrust of MRT is that learning from others is possible, although it is not guaranteed. To middle-range thinkers, empirical detail is of vital importance. Skeletal theory cannot stand alone. It is the empirical detail that completes, and in some occasions enriches, the skeletal theories in particular contexts. The middle position on the theoretical perspective "is arguably a more realistic depiction of the social and technical nature of accounting systems design" (Laughlin, 1995:82) and IJV control. It is the standpoint on the theory continuum adopted by this research.

2.4.2 Methodology

Methodology is defined as "the set of spectacles that form the nature of the methods for the empirical investigation" (Laughlin, 1995:67). The methodology dimension of research approach is concerned with the level of theoretical formality in the methods of investigation. The position also implicitly indicates the role played by human agents in the empirical process, and it reflects the researchers' assumptions on human nature.

If a high methodology stance is taken, it reflects that a high degree of theoretical definition is used to direct the actual way in which the investigation is conducted. This methodological position implicitly assumes that observers' subjectivity either does not exist or has no influence over the empirical process. The high position can also be interpreted as an attempt to minimise human bias during the investigation process by reducing the observers' role. On the other hand, the low methodological position indicates a low level of theoretical formality, which imposes no significant restriction on the method and process of 'seeing'. There is a great extent of openness in the discovery process.

It is suggested that the choices on theory and methodology dimensions have borne a linear relationship (Laughlin, 1995). For example, those researchers, who take a high stance in theory perspective, would tend to adopt a high position on methodology[4]. It is because if one believes that there is a concrete material world existing out there and generalisation and learning from prior studies is possible, s/he is likely to adopt a highly defined method and process of investigation to reduce the influence due to researchers' subjectivity.

Again, both high and low positions on the methodological dimension have their strengths and weaknesses. A high position implies a high degree of definition on the boundary and process of investigation. This particular set of assumptions may be appropriate to certain fields where the areas of study are clear and well researched. Therefore, a more "sophisticated set of spectacles" (Laughlin, 1995:83) can be used to see what needs to be seen in order to answer some unsolved intellectual problems and increase precision (Daft & Lewin, 1990). More objective and reliable findings may be obtained via reducing observers' subjective influence by minimising their roles in the empirical processes (Parkhe, 1993, Laughlin, 1995).

However, if theoretical development of the areas of inquiry is far from unambiguous, such as the fields of accounting (Laughlin, 1995), organisation studies (Daft & Lewin, 1990;), strategic management (Bettis, 1991; Schwenk & Dalton, 1991), international management and IJVs (Parkhe, 1993; Geringer & Hebert, 1994); there is a danger of adopting a high extent of theoretical and rational closure. It is because observers' activities are highly restricted, and flexible thinking for new insights is discouraged. Thus, the convergent thinking would force research into certain conceptual and methodological boxes. If this norm is in place and being accepted as the 'right' way of doing and seeing things, researchers are then "trained to elaborate the tradition rather than to challenge it". (Daft & Lewin, 1990:2). The precise defined boundary and process will hinder theoretical advancement of the fields that are still in their infant stage.

In fact, many disciplines in the field of organisation studies are facing the above mentioned problems due to putting on a pair of unsuitable methodological spectacles. The field is described as being "caught in a normal science mindset" (Daft & Lewin, 1990:2) and "has prematurely settled on a limited set of well defined conceptual topics" (ibid.:7). With a

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4 Likewise, if one believes reality is only a projection from one's mind, s/he would tend to prefer a low level of theoretical and rational closure in order to preserve the subjectivity and variability of perceptual differences of human agents.

conceptual straitjacket self-imposed from an early stage, "it tends to dominate their (social researchers') thinking, bind their judgement, and create a trained incapacity to appreciate aspects not mentioned in the theory" (Daft & Lewin, 1990:247). "Incremental, footnote-on-footnote research" is the norm for the field of organisation studies (Daft & Lewin, 1990:1).

Many social researchers approach their areas of inquiry with in-built bias towards consistency, their contribution is bound to be limited and leave many important research questions which are outside the consistent agenda not addressed (Poole & Van De Ven, 1989; Parkhe, 1993). Moreover, with the preoccupation with methods, researchers might look for research problems, regardless of their relevance, to fit into the chosen techniques (Parkhe, 1993). This situation corresponds to a comment Daft and Lewin (1990:2) made:

> "...in the worst-case scenario a discipline can become marred by a set of bureaucratic techniques that trivialise research by concern with minor problems unconnected with relevant issues".

For example, Parkhe (1993) observes that not all aspects in the field of JV/IJV are in a pre-paradigmatic stage. Much greater scholarly attention has been attracted to, and thus theoretical advancement has been made, in studying outcomes (such as JV performance and stability), rather than processes (such as partner relationship and control). The uneven development might be due to the fact that many researchers have tried to ignore away the complex and messy "soft" issues (such as motives, trust, reciprocity, opportunism and culture, and also the interaction among these factors), and focus on outcomes that are easier to observe and measure. These researchers seem to have forgotten that "observable outcomes are merely the end products of invisible processes (Parkhe, 1993:262). The two are "quintessentially connected" and cannot be treated as "surgically separable" (Parkhe, 1993:247) that can be broken down into individual pieces for "empirical snapshots" (Morgan & Smircich, 1980:498). A high level of prior theorisation and methodological closure is the common standpoint underlying the majority of prior research in JV/IJV.

"As in the natural sciences in their preparadigmatic stage of development, qualitative research tends to precede the discovery of natural laws, theory development, and a field's evolution toward maturity" (Parkhe, 1993:231). Although qualitative methods, like case studies and participant observation, are likely to generate "deeper understanding and sharper delineation of concept domains" (Parkhe, 1993:230), they are not particularly popular among published articles in the fields of organisation studies (Daft & Lewin, 1990), strategic management (Bettis, 1991), or accounting and control (Scapens, 1990; Spicer, 1992; Otley & Berry, 1994; Humphrey, 2001; Scapens & Bromwich, 2001). Bettis (1991:316) observed that "the norms of the field (strategic management) seem strongly biased toward large sample multivariate statistical studies. This leads to a large database mentality, in which large-scale mail surveys and ready made databases.... are often favoured". This trend largely continued in the 1990s, although some development was made in response to the increasing call for the use of case-based research (Humphrey, 2001).

"A source of recurrent disappointment for practitioners and academics alike" (Daft & Lewin,1990:1), and "theory struggles to catch up to practice" (Parkhe, 1993:262) are characteristics highlighting many disciplines of organisation studies and IJV research. As (Parkhe, 1993:247) rightly pointed out, the major barriers hindering theory development in IJV is that prior studies "only skirt around the core concepts in IJV". "Hard data sources are unlikely to capture the soft core concepts" (Parkhe, 1993:230). There are repeated paradigmatic proposals, which call for breaking free from the normal science straightjacket (Daft & Lewin, 1990; Bettis, 1991; Parkhe, 1993), and the use of qualitative approach to focus on the uniqueness of the social research at the current stage of development (Daft & Lewin, 1990; Bettis, 1991; Parkhe, 1993; Morgan & Smircich, 1980; Scapens, 1990; Dent, 1991; Schwenk & Dalton, 1991, Spicer, 1992; Otley & Berry, 1994; Humphrey, 2001; Scapens & Bromwich, 2001).

I strongly believe that the qualitative approach and techniques, which encourage researchers to get inside the phenomena of study, may permit a deeper understanding of the inter-relationships among various contextual variables within the control systems and processes. This logic is the key methodological assumption that this research follows. Parkhe's and other academics' advice have influenced my decision on research technique. Further discussion of the rationale behind my preference towards case study is illustrated in Section 2.5.

Although there are many problems associated with adopting a high stance on the methodology continuum, a high level of transparency, in terms of the design and use of the pair of spectacles to see the empirical world, is considered as the strength of the high position. It is because the high degree of openness not only provides clear rules to observers in the empirical process, but also enables other researchers to learn from that current work. In fact, the lack of clarity is the major shortcoming of the low stance on methodology which imposes a lot of pressure and uncertainty on researchers.

Similar to other fields in their early days of development, the extent of complexity in IJV undoubtedly burdens many social scientists with a sense of insurmountable, uniquely overwhelming complexity" (Parkhe,1993:240). As a result, some researchers might choose to deal with the complexity of IJV research by simply ignoring it (ibid.:239), or by simply copying the whole set of tool-kits from some well-established paradigms (Daft & Lewin, 1990; Bettis, 1991). Thus, an extreme low stance on the methodology continuum is also inappropriate to the field of IJV control, where the theory development is fragmented.

Before our understanding in IJV is advanced to the next phase, we need to break free from the conceptual boxes to encourage reflective thinking, but at the same time accept some rules of knowledge discovery in order to improve clarity and reduce uncertainty. "Part-constrained and part-free" is the unique nature of the middle position on methodology adopted by this research (Laughlin, 1995:84). It is consistent with the medium assumptions on prior theorisation, which on the one hand has respect for contextual details, and on the other hand believes that generalisation is possible, although not guaranteed to exist.

2.4.3 Change

The final dimension "change" is related to the researchers' intention to change or to maintain the status quo of phenomena being investigated. The change perspective has included two aspects. One is related to the researchers' attitude to change, while the other is concerned with their ability of actually changing the present situation that is being investigated. The distinction between the two needs to be fully understood. It is because researchers may not have the ability to achieve the change that they want to achieve.

Laughlin (1995) suggested that despite the choice in the change aspect being independent at one level, it bears some relationship to the researchers' assumptions on theory and methodology at another level. For instance, if a researcher adopts a high level prior theorising and sees the reality as a concrete world and wide generalisation is possible via applying highly defined process of investigation, s/he is likely to be one who aims to achieve change in the current situation. The extent of change desired may vary from one situation to another, the intention to alter the empirical context often follows a high position held in the other two continuums. Whereas, researchers, whose emphasis is on the extreme uniqueness of contextual variables, are likely to be those who prefer to preserve the contextual richness as what it is without any artificial refinement (change).

This research is not set to generate a perfect theory of IJV control that can answer all the queries. Indeed, aiming at perfection contradicts the MRT assumptions on the theory and methodology perspectives. The processes and systems of IJV control are complex and the relationships between various contextual variables may evolve over time. At the present stage, the core concepts of IJV are beyond our researchers' grasp, and I feel that a complete picture may always be out of our reach. It is not my intention, and it is also beyond my ability, to change the whole empirical world. Therefore, my position is not located on the high end of the change perspective.

Nonetheless, our knowledge in the subject area can be advanced via "breaking down (the) complexity into essential components and linking these components to related variables in rigorous theory development" (Parkhe, 1993:243). What this study targets to achieve is to "lessen the gap between the known and the knowable" (Parkhe, 1993:256) and to develop an integrative theory to help academics and practitioners to understand more about IJVs and control phenomena within the complex IJV context. I aim to narrow the difference of interests between the practitioners and academics through the contributions of this research (see Section 2.7 for the role of this case-based research). Accordingly, my standpoint is not located at the low end of the change dimension.

In fact, I do not intend to change the complete empirical reality, as there are many aspects that need to be preserved. They are the information sources from where we build our knowledge. As Otley (1988) and Checkland (1981) stated, each stage in the development of organisation theory has the potential to teach us something about how organisations evolve and adapt to the changing environment over time. However, I also want to challenge parts of the status quo. There are some areas within the empirical reality that need to be further defined before a better understanding in IJV can be achieved. This research targets to establish an integrative theory of IJV control to help practitioners and academics to understand more about the design and implementation of control packages under the unique environment in China at the current stage of social and economic development. Therefore, it is the medium position on the change continuum that this research adopts.

2.4.4 Summary

In conclusion of the research approach formation process of this study, the middle/middle/middle positions on the three dimensions – theory, methodology and change have been adopted. I believe the use of skeletal theory and rules to guide the process of knowledge discovery, together with an open-minded attitude towards changing the status quo, is a more realistic depiction of the "hard" as well as "soft" nature of IJV control.

This set of assumptions becomes the driving force behind the choice of research method to approach the empirical scene in China, which will be further explained in the next section, and the overall development of this research, that is illustrated in the following chapters.

2.5 The choice of case study as the research method for this research

Morgan and Smircich (1980:499) suggested that:

> "The virtues of techniques and methods cannot be determined and categorised in the abstract, because their precise nature and significance is shaped within the context of the assumptions on which the social scientist acts".

The set of middle-range assumptions that I act upon in this research has already been outlined in section 2.4. As was mentioned before, accounting and management control is a social practice conducted by diverse social actors. The practices provide "a structure of meanings which are drawn upon in organisations, but which are themselves the outcome of organisational activities" (Scapens, 1990:268). It is suggested that an understanding of organisational phenomena is difficult to obtain in isolation from the context in which the organisations are embedded (Roberts & Scapens, 1985; Otley & Berry, 1994). Humans and organisations are not completely independent from the outside world. Organisations influence, but on the other hand are influenced by, various social factors.

From a social theory perspective, organisations are variable rich and multi-dimensional. Different human behaviour and phenomena embedded in various organisation contexts can be studied via multiple perspectives (Daft & Lewin, 1990). Our researchers need to choose an appropriate research approach and method that fits the unique nature and the stage of theoretical development of each area of inquiry. In the choice of research methods, Maslow (1971:5) provided some useful guidance:

> "I am convinced that the value-free, value-neutral, value-avoiding model of science that we inherited from physics, chemistry and astronomy, where it was necessary and desirable to keep the data clean......, is quite unsuitable for the scientific study of life".

Indeed, for any organisation research, which aims to investigate the acts and/or decisions of organisation actors, it is in reality a study of the "lives" of the social actors involved. As Maslow suggested, social researchers should not choose a value free or neutral model just for the sake of keeping our hands clean. In addition, some valid points raised by other researchers have further strengthened the decision to adopt case study method for this study:

> "Case study research may perhaps be most appropriate when little is known about a topic and where in consequence there can be little reliance on the literature or previous empirical evidence. Such approach may also be most useful in the early stages of research ...". (Gill & Johnson, 1991:119).

> "... at a stage of development where phenomena are not well understood and the relationships between phenomena are not known, precise experiments that precede rather than succeed field studies amount to being precise about vagueness". (Parkhe,1993:232)

These are the problems facing IJV research, which significantly hinder the knowledge development in the field. Parkhe (1993:232) further suggested that to rectify the current situation "a novel, testable, and empirically valid approach is the use of case studies ...". It is because case studies can be used to accomplish a wide range of aims, such as providing description, and testing or generating theory (Eisenhardt, 1989). These purposes of case studies fit the objectives of this research.

A case study is defined by Yin (1989:2) as an empirical inquiry that (a) investigates a contemporary phenomena within its real-life contexts; when (b) the boundaries between the phenomenon and context are not clearly evident; (c) and in which multiple sources of evidence are used. Eisenhardt (1989:534) hinted that "case study is a research strategy which focuses on understanding the dynamics present within single settings". Spicer (1992) added a case study research involves intensive, detailed investigation that requires commitment of considerable time and effort. This could be a study of a single company, or a number of companies. It can also be a study involving embedded units of analysis, such as profit centres within a firm.

Along with the growth of interest in management accounting practices, there have been increasing calls for the use of case-based research (Scapens, 1990; Spicer, 1992; Otley & Berry, 1994; Humphrey, 2001; Scapens & Bromwich, 2001). The method allows researchers to adopt a holistic orientation when investigating accounting and control phenomena as a part of a unified social system. It is believed that a deeper and wider array of information can be generated via the use of the case study method that allows researchers to get closer to the action. Through the investigation process, theories and hypotheses may be generated and/or modified in light of the empirics. These characteristics of the case study method match with the medium assumptions on prior theorisation and methodology that underline this research.

As Eisenhardt (1989) suggested, one of the strengths of building theory from case studies is that the constant comparison of conflicting realities leads researchers to reframe perceptions into a new gestalt and tends to unfreeze their thinking. This stimulating process has the potential to generate theory with less research bias than theory built from incremental studies. Findings from case research may then be applied to larger samples at a later stage. Thus, case study can be seen as a precursor to scientific research (Scapens, 1990). It is regarded as especially valuable where "existing theories are inadequate or incomplete, or explain only a sub-set of the phenomena of interest" (Otley & Berry, 1994:47), like the current stage of fragmented development in the field of IJV control.

Moreover, case study research is considered as an appropriate strategy for research which focuses on asking "how" and "why" questions about a contemporary set of events that the investigator has no control over (Spicer, 1992; Yin, 1989). They are the objectives of this study, which aims to investigate "why" firms decide to get involved in IJVs, "how" they control their jointly owned subsidiaries, and "what" relationships between motives and control are. This research aims to draw the practitioners and academics' attention to the important subject of IJV control. Again, the middle-range assumptions on changing the status quo confirm the appropriateness of using case study as the main method for the empirical discovery.

2.6 The roles and major categories of case studies

Case studies appear to have many potential roles to play in management accounting and control research (Otley & Berry, 1994). However, according to the primary objectives of various research studies, it is possible to classify case studies into two major categories (Spicer, 1992).

2.6.1 Descriptive and/or exploratory case study research

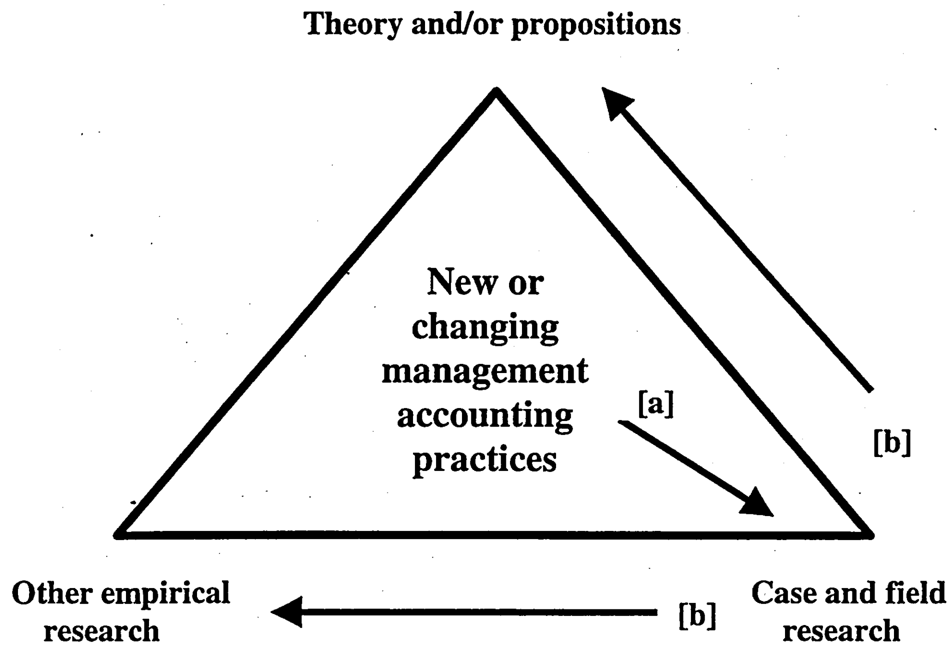
The first grouping includes those studies, which aim to describe and/or explore ideas and hypotheses about the reasons for particular accounting and control practices. It is stated that the descriptive/exploratory type of case study usually takes place in immature subject areas where knowledge base is insufficient to develop good theoretical frameworks to guide and structure research problems (Gill & Johnson, 1991; Spicer, 1992). Some general theories and/or empirical work might be available and being used to help researchers focus on the fields of inquiries. However, they are usually general rather than specific in nature. These points seem to fit into the medium assumptions held by those middle-range thinkers on the prior theorisation perspective in research approach.

In fact, according to Spicer (1992), much recent case study research in changes in cost and management accounting practices in response to innovations in manufacturing is of this kind. It is noticed that this category of studies is commonly used to serve two major groups of objectives. The first type of objectives includes two parts - (i) to describe how and/or explore why practices have changed, and more important, to find out why and how new or innovative practices have been adopted; and (ii) is to develop a taxonomy of successful and unsuccessful practices, as well as the conditions that lead to their success and failure. The arrow marked [a] in Figure 2.2 indicates this first role of descriptive/exploratory case research.

The second objective is to help managers in the design of management accounting systems through developing theories for the observed practices. It can be achieved through either the indirect influence on other empirical work in the same field, or direct contribution from the case study research (as arrow marked [b] shows in Figure 2.2).

Figure 2.2:

The focus of case research with a descriptive/exploratory purpose



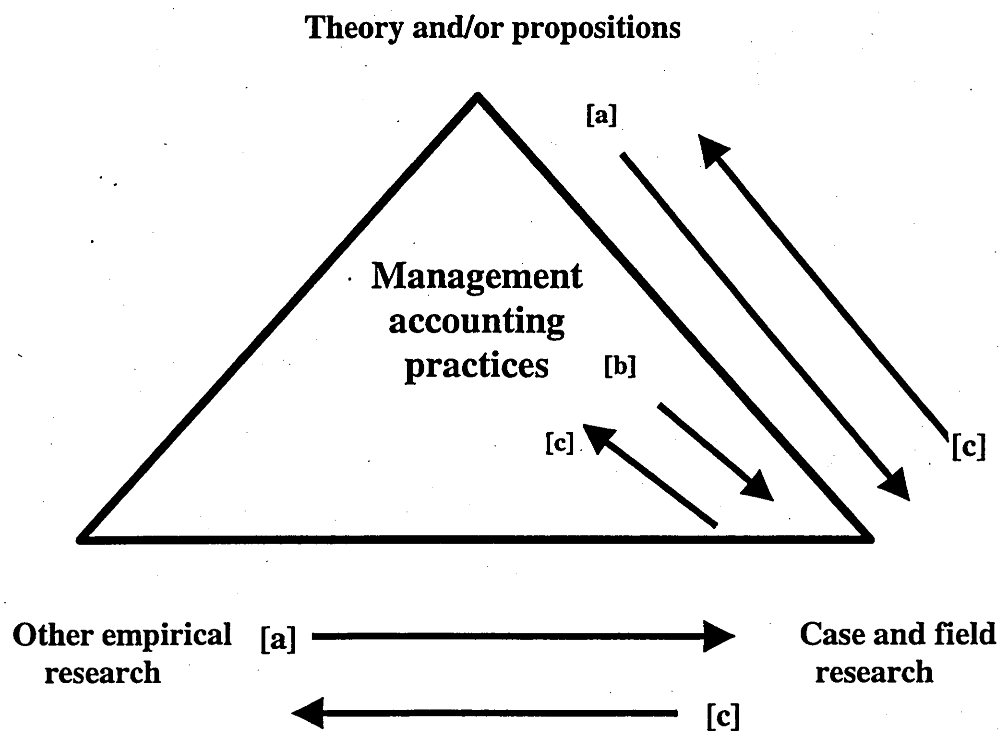
Source: Spicer (1992:14)

2.6.2 Informing and/or explanatory case study research

The second grouping is made up of informing and explanatory case studies, which are used either to directly explain the observed practices, or indirectly to inform other forms of non-empirical research. Figure 2.3 illustrates the role of this category of case studies. It is noted that this type of case study research tends to take place in more developed subject areas. Existing theories and other relevant empirical research are available to help researchers to focus and structure their empirical inquiries (as the arrows marked [a] indicate). The case study can then be used to investigate the relevant management accounting practices (as demonstrated by the arrow marked [b]). Finally, the findings and insights generated from the case study will be fed back into the theory through pattern matching, the designs of future non-case empirical studies, and to practice through explicit and implicit theory (as shown by the arrows marked [c] in Figure 2.3)

Figure 2.3

The focus of case research with an informing/explaining purpose



Source: Spicer (1992:24)

2.6.3 Summary

The roles and distinctions between the two groupings, descriptive or exploratory and informing or explanatory, of case-based research studies are outlined in the above discussion. Despite the apparent clear-cut classifications for the two categories, in practice the separation can be quite ambiguous (Eisenhardt, 1989; Scapens, 1990; Spicer, 1992). In certain circumstances, there is overlapping and interactions among the two groupings. As an example Scapens (1990:266) put forward, an exploratory case research may be used to generate ideas to form the basis for an explanation of accounting practices. Ultimately, I consider that it is the intention of the researchers, not the rigid classifications, that determines the ways in which case studies are being used.

2.7 The role of this case study research - to explore and inform

According to the set of underlying middle-range assumptions on theory, methodology and change, the role of this case study research does not fall entirely into one single grouping out of the two identified by Spicer (1992). This case study research is being used to serve multiple purposes that span across the border between descriptive/exploratory and informing/explanatory case studies. The role this research plays is illustrated as Figure 2.4.

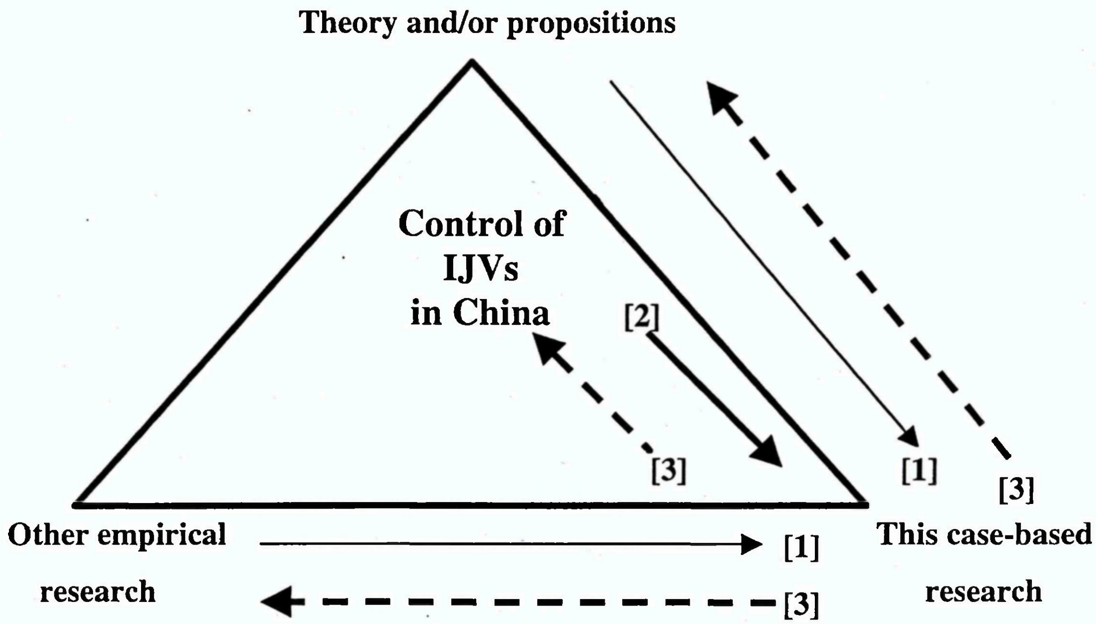
At this preparadigmatic stage, many core concepts of IJV control remain ill defined and relationships among various contextual variables are still unknown (Parkhe, 1993). Current knowledge of the field is insufficient to establish a solid theoretical framework to guide the area of inquiry. Only some general theories, such as those related to firms, multinationals, FDI, transaction costs and control, and some fragmented findings from other prior studies which examine isolated variables of JV and/or IJV control, are available (see Chapters 6 & 7). Nevertheless, it is not my intention to undermine the contributions from these previous studies. Despite their non-specific nature in relation to the focus of this study, I have learnt from their strengths as well as their weaknesses. Arrows marked [1] in Figure 2.4 show this type of input into the building process of the skeletal model.

As Parkhe's (1993:248) suggested, "advancement of IJV theory in its current evolutionary stage may be one inaugurated with exploratory research...". It is because "preliminary models that purport to include essential concepts and relationships in IJVs... can be subjected to in-depth investigation and modified as necessary to fit the empirical reality". Exploration is one of the key roles played by this research. It is set out to explore "why" firms prefer to use JV to approach foreign markets, and "how" partners control their IJVs. The arrow marked [2] in Figure 2.4 shows the exploratory role of this case-based research.

In addition to the exploratory role, this case research is also set to serve an informing purpose and it has a middle-range role to play in changing parts of the status quo. The study aims to close the distance between academics and practitioners' interests. The ultimate objective of this case-based research is to develop an integrative theory of IJV control, which highlights the specific Chinese context in which the control strategies operate and from which the theory is derived. These aims can be achieved through either the indirect influence on other empirical work in the same field, or the direct contributions from the case study research to inform the practitioners (as the dotted arrows marked [3] in Figure 2.4 demonstrates).

Figure 2.4

The focus of this case research with exploratory and informing purposes



2.8 Access

Following my middle-range choice of methodology, a part-constrained and part-free discovery method is adopted in this case research (Laughlin, 1995). I decided to use semi-structured interview as the main instrument to collect empirical information. Parkhe (1993:248) suggested that open-ended interviews with senior management, who have a direct involvement in their IJVs, allow researchers to "get close to the action of the formation, structuring, and stability of IJVs". This type of first-hand information is particularly important in the current stage of theoretical development in the field of IJV control.

However, getting access into appropriate sample firms is by no mean an easy task. Indeed, the difficulty of gaining access in social research has been the primary problem facing social researchers (Gill & Johnson, 1991). As with many social researchers, I experienced a lot of highs and lows in the process of securing access.

My targeted samples were corporations who have JVs located in China. Given that my base is here in the UK, for convenience I started to gather information in this country. From various trade directories, I identified some UK-based MNEs who have subsidiaries in China.

However, the information did not show the nature of these subsidiaries with respect to whether they are wholly or partly owned. The principle of "trial and error" has been used throughout the whole research. Letters requesting interviews were sent out to these companies with the hope that some of them would have JVs in China. After a few months of waiting, no positive replies were received through this channel.

On the other hand, I also visited a number of organisations[5], which were dealing with or related to promoting UK-China trade or Oriental/Asian studies. From this source I identified a number of British firms, who either had already established JVs in China or whom the media claimed would be doing so in the near future. Letters of interview requests were then sent out. Unexpectedly, meetings were obtained from three well-known UK-based MNEs. Two of the MNEs[6] were already involved in IJVs and the other was at that time considering going into China in the near future.

Interestingly, a common atmosphere in these interviews was that the executives were suspicious of my intention and the sources from where I obtained their corporate plans. It seemed to be an understandable reaction. An unknown Chinese researcher who wants to find out "why" they have decided to engage in JVs and "how" they control their subsidiaries in China, my approach might cause their concerns. Groot and Merchant (2000) obtained a similar experience from their study of control in IJVs. The two scholars stated that individual partners and JV managers might be very cautious about what they reveal to researchers and whether they should risk talking to researchers and participating in the research in any form. This comment mirrors my experience. The practice seems to explain why gaining access has been the primary problems facing many social researchers.

Another common feature of the interviews with two of the three MNEs was that owing to their size and complexity of operation, the senior executives in the headquarters could not provide me with much information on how their JV Chinese subsidiaries were formed and being managed. When these executives were requested to introduce me to their colleagues in charge of the Chinese IJVs, they were reluctant to do so. It appeared that they did not want to bother their colleagues whom they might rely on for business. The executives seemed to be

[5] Such as the Great Britain–China Centre, The Chinese Economic Association (UK), The British-Sino Centre, and The London School of Economics.
[6] One of them is Superior, the MNE parent mentioned in the first case study of this research (see Chapter 8).

unwilling to make public their participation in the external research so as to eliminate any suspicion of them disclosing their companies' secrets.

In fact, it is not an uncommon finding. For example, Spencer (1980) conducted her Ph.D. research into the role/relationship of non-executive directors. Spencer's target samples, which included her father who was a non-executive director at that time, were unwilling to introduce her to colleagues owing to some similar reasons cited above. The father-daughter relationship did not bring Spencer the expected advantages. It seemed that bringing in outside researchers has been a sensitive issue in some organisations.

Except the advice given by the Superior group's executive that I should contact his HK office when I visited the city, no solid access for empirical investigation in China was obtained from the two MNEs. Nonetheless, the experience made me realise that I needed to get closer to the scene of operation. Instead of waiting for miracles to happen in the UK, I decided to travel to Greater China[7], where my target samples are located[8]. One of the Chinese traditions denotes that physical presence shows respect and sincerity to the person from whom we ask for help. My physical presence in Greater China improved the situation dramatically.

During my three-month stay (August - November, 1995) in the region, I obtained interviews with five JVs located in Shanghai (including Marlee – Case Study B, Chapter 8). On the other hand, following the advice given by the executives whom I had interviewed before I left the UK for Greater China, I made contacts with their HK/China offices. After several attempts, I obtained a reply from Superior's Hong Kong administrative centre. Two senior executives in the Hong Kong subsidiary agreed to meet me and the meeting led to three subsequent interviews. A lot of useful information was collected from the interviews that allowed me to write up the case study (see Case Study A, Chapter 8).

In addition to the above, I also explored personal and family links. Again, it is a good example to illustrate the importance of "guanxi – personal relationships" in the Chinese

[7] Including Hong Kong, Macau and China.

[8] At that time, the Chartered Institute of Management Accountants (CIMA) announced the official opening of their Shanghai branch. Through our university's professional contact, I was introduced to a manager in charge of research development in the London CIMA headquarters. Since my research topic was highly relevant to their interests, I was assured support from their Hong Kong and Shanghai offices in my forthcoming visit to Greater China.

society. Above my expectations, I received interviews from five companies[9] through this channel (including the case studies of Silky and Pearl - see Case Studies C & D, Chapter 8). Owing to the fact that my colleagues, friends, family or myself knew the interviewees, the formats and locations of some of these interviews were rather informal[10] as compared to the others. Structure and formality of the interviews will be further discussed in the next section.

2.8.1 The structure and formality of the interviews

All the interviews were semi-structured and involved senior executives, ranging from chairmen, financial directors, directors, production managers to JV general managers, who had direct involvement in managing their Chinese JVs. These executives, except in two occasions[11], were appointed by foreign partners. The number of interviews obtained from each firm varies. Specific details about positions of the participants and number of interviews granted by individual firms are described in the case studies recorded in Chapter 8.

In each interview, I brought with me a list of points/questions. These points were derived from the literature review, which underlined the formation of the skeletal theory, and they had the function of a prompt sheet to provide guidelines for the interviews. A great extent of flexibility and diversity was preserved in the discovery process for new insights. My experience has shown that the semi-structured format worked well. Scarcity of time available in each interview was better utilised, and unexpected discussion was prompted by the semi-structured questions. Moreover, the majority of interviews were tape-recorded. Tape recording enabled me to focus on the conversation. The freedom also allowed me to observe the interviewees, other members of staff and activities in the offices. This type of observational information is useful in helping me to understand the companies and discussion, and interpreting the empirics (Dent, 1991).

On a few occasions I noticed that the interviewees were rather conservative, I then abandoned the idea of recording the meeting in order to build up a trusting relationship with the managers. I found this occurred more often in interviews with the local managers of IJVs located in Shanghai. These Chinese managers seemed to be paranoid by the idea of having

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[9] It included a UK based insurance group, who was at that time applying for a license to trade in China. Although strictly speaking they were not a suitable sample for the empirical work, their executives did provide me with some interesting information of why China was strategically such an important territory to their group.

[10] For instance, the interview with Peter Lee of Silky was conducted on a Sunday afternoon in Peter's home. Whilst two of the three interviews with Pearl were held in a restaurant and their China factory respectively.

[11] These local Chinese executives, as a representative assigned by the Chinese partners, provided me with some contrasting information of how they control their JVs.

their opinions formally recorded. This reaction is not difficult to explain. Although China has opened up for FDI since the 1980s, in terms of research it still remains a closed country to outsiders. Also, the communist regime and the long-lasting effects of the cultural revolutions have discouraged Mainland Chinese to express their views publicly. Some JV GMs agreed to meet me mainly because of their guanxi with the senior members of staff from the Shanghai Chamber of Commerce, who set up the interviews. I feel that in Shanghai, or perhaps in other big cities in China, a hidden "class" system exists. The senior managers would see it as "losing face" to meet an unknown researcher with a low business status.

The duration of each interview varied. From my personal opinion, I see the length of interview not always bearing a direct relationship to the volume and quality of information collected. In fact, my experience shows that I collected the least information from the longest interview[12] with a Taiwanese JV GM. That expatriate was very keen on expressing his feelings about the Taiwan-China relationships, his family in Taiwan and his son who was studying abroad at that time. Although I kept trying to steer the discussion back to the research, the conversation slipped back to his favourite topics one way or the other. Although not much information related to case writing was obtained during the day, I learnt an important lesson. The experience made me realise that senior executives are only humans, who also have their passions and bias towards various things. It is a good example to demonstrate the social elements embedded in any control research.

On the other hand, the two executives from Marlee Chinese holding company made it very clear that they could not afford to spend too much time on the interviews. In fact, it was the first time they accepted interviews from a researcher. The financial controller was a very "down to earth" person. He preferred going straight to the main point of each question. I collected a lot of useful and unexpected information from him in a one-and-a-half hour interview. The interview with the controller for sales and distribution was almost the same.

My ethnic Chinese background and linguistic ability were a great help in the empirical work and shortened the time required in each interview. For instance, when I was in the empirical scene, I could understand conversations among administrative staff in the work pools before I entered the interview rooms. During the interviews, I could have direct conversations with

[12] It lasted for almost a whole day. The interview included lunch and ice-cream breaks (the JV's products).

most of the interviewees[13] without using an interpreter. My knowledge of the cultures in the West and the East facilitated my observation and understanding of both the interviewees and other people/activities around the empirical scene.

As discussed earlier, the quality of information collected from individual firms varied. In several circumstances, the data obtained from the samples were insufficient to write up a meaningful case study for each of them (often, no secondary source of information is available to remedy the situation). In addition, owing to the constraints of time and resources, it would be impractical to write up a dozen case studies of various levels of depth, given that the volume of this thesis is already large. Eventually, I decided to adopt a "focus" strategy.

I chose four sample firms from which I had collected the most information (via interviews and secondary sources) as the main case studies, while using information gathered from other interviews as a general knowledge base of "why" and "how" firms form and control their IJVs in China. This type of general knowledge is crucial in helping me to understand, interpret, analyse, and challenge the main case materials.

In addition to the degree of completeness of the collected information, my choice of sample firms to write up for the main case studies was also driven by their contrasting background. Two of the four chosen samples are giant European MNEs, while the other two are Hong Kong-based[14] medium sized firms. Their background represents different geographical locations, culture, as well as size of operation. The two groups of case studies shed insights into the webs of relationships among hard economic and soft human elements embedded within and outside of the control packages. In addition, the differences of design and implementation of control packages between the two sample partners in each case study group disclose further detail of parental control of IJVs under the unique combinations of internal and external environments. Indeed, all four cases add value to one another.

There is a great deal of richness embedded in the case studies. The case materials are consider as a key part of this research, which is used to inform and enrich the skeletal model. As a result, I have taken the decision to include all four of the case studies in the main body

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[13] Shanghaiese is a widely used local dialect in Shanghai, a language of which I have no knowledge of. The local people speak Mandarin with a strong Shanghaiese accent. As a result, I requested a member of staff from CIMA Shanghai office to act as the interpreter in a couple of interviews.

[14] Pearl has moved its country of registration to Bermuda. However, the group was founded in Hong Kong, and up until the time the empirical investigation was conducted its head office and principal place of business remained in Hong Kong.

(recorded in Chapter 8), rather than in the appendices. The consequence of this decision is that the main body of the thesis is inevitably lengthened.

2.9 Judging case study research

Having outlined the rationale behind my choice of using case study, the next important question arises – what are the elements that constitute a good case study, and what are the criteria on which to judge it?

In judging a case study, one needs to assess how well researchers have dealt with methodological issues in relation to the problems of construct validity, in terms of internal and external validity, and reliability (Burns and Kaplan (1987); McKinnon, 1989; Yin, 1989; Eisenhardt, 1989). There are a number of researchers, such as Burns and Kaplan (1987), Yin (1989), Eisenhardt (1989), and McKinnon (1988), who have expressed their views on the criteria for judging good case research.

In Spicer's (1992) review of recent developments in case research methods in cost and management accounting, the scholar particularly recommended Yin (1989) and Burns and Kaplan's (1987) models. Despite the fact that Yin focuses on case studies in general, whilst Burns and Kaplan concentrated on accounting, Spicer (1992:11) observed that their views "overlap and complement each other" and provide some useful guidance on what forms an exemplary case study.

Agreeing with Spicer's opinions, I adopted Yin and Burns and Kaplan's criteria (as Table 2.2) to self examine the quality of this case-based research.

Table 2.2

The characteristics of an exemplary case study

	Yin (1989)	**Burns and Kaplan (1987)**
1.	Case topic is significant: - Of unusual or wide interest - Underlying issues are important in theoretical or practical terms.	Subject matter is important: - Significant to managers - Potential for making advances in conceptual development of a managerially relevant phenomena
2.	Case is complete: - Distinction between phenomena studied is given explicit attention - Demonstration of an exhaustive attempt to collect relevant data	Site and research method appropriate to the topic: - Careful site selection - Appropriate sequence given inquiry - Good interview questions
3.	Case analysis considers alternative perspectives: - Descriptive or exploratory cases consider alternative perspectives - Informing or explanatory cases consider rival hypotheses or propositions	Good data presentation and interpretation: - Researcher understood topic and was careful with interpretation - Linked to established literature
4.	Case displays sufficient evidence: - Critical pieces of evidence are in the case study report	Findings are useful: - Implications for practice are clear - Appropriate qualifications are made - Implications for future study are stated
5.	Case is composed in an engaging manner.	

Source: Spicer. (1992:13)

2.9.1 A self examination of the quality of this case-based research

Having adopted a MRT on the choice of theory, methodology and change perspectives, this case research is not set to strive for perfection. Indeed, aiming to establish an exemplary case study would contradict the philosophical standpoints I hold. Rather, it is carefully designed to fulfil as many criteria of good practice as possible.

Regarding the first criterion, the topic of this case research is evidently important to both academics and practitioners. The rapid changes in competitive environments and industrial structures have brought changes in contracting and new problems for management accounting and control (Spicer, 1992). There has been a surge in inter-firm co-operation in the forms of JVs and strategic alliances (Killing, 1982, 1983; Beamish, 1995, 1998; Contractor, 1985; Contractor & Lorange, 1988; Harrigan, 1984, 1987, 1988; Porter & Fuller, 1986; Beamish & Banks, 1987; Hennart, 1989; Yan & Gray, 1994; Geringer & Hebert, 1989; Glaister, 1995; Glaister et al., 1998; Spicer, 1992; Parkhe, 1993; Groot & Merchant, 2000).

However, theoretical development in the field of IJV control still remains in a pre-paradigmatic stage that is struggling to catch up with practice (Geringer & Hebert, 1989; Parkhe, 1993; Black & Mendenhall, 1990). As Geringer and Hebert observed, there are many firms getting involved in JVs that have been ill prepared or have been forced to bypass the potential of the JV option. There is a clear gap between the needs of the industries and the focus of academic research studies.

Moreover, China, a nation that is predicted to become the world's second largest trading nation around the year 2020 (The World Bank, 1997), has attracted significant foreign interests to the country (see Chapter 3). JV, in equity and contractual formats, has been the most commonly used entry mode chosen by foreign investors (see Table 3.7). Again, this trend has brought new questions to management accounting and control practices under the specific context in China. In sum, the case topic and its location is considered to be of wide interest to the managers and academics alike.

In relation to the second point, the majority of potential sample firms I approached had IJVs established in China. I submit that the final case study sites were chosen opportunistically, and the in-depth interviews arose from what might be termed as "accidental access" (Otley &

Berry, 1994:51). However, one needs to realise and accept that to gain access into IJVs operating in China, a unique and somewhat peculiar transitional economy, is very difficult.

I share the views of Reynolds (1971:127), "good research design and asking important research questions take precedence over tidy statistics in evaluating research quality". The semi-structured questions used in the interviews were derived from the skeletal model of IJV control, which was established through a long literature review process that will be illustrated in the following five chapters. These questions are applied only as skeletal rules to guide the empirical investigation in China. A great extent of flexibility and diversity is preserved in the discovery process for new insights

Gill and Johnson (1991:122) stated that the matter of external validity is often subdivided into two aspects: population validity[15] and ecological validity[16]. This case research, similar to many others, entails intensive study of a small number of cases (Scapens, 1990; Gill & Johnson, 1991). Consequently, it is unable to claim population validity. Nevertheless, as Scapens (1990) correctly pointed out, evaluation of case studies on the aspect of external validity should follow the experimental method's replication logic (rather than the survey method's sampling logic), and the focus should be set on whether theories explain observations.

The empirical investigations of this case research were conducted in the natural settings of the everyday management control activities of the sample IJVs. In addition, interviewees were executives, who were directly involved in the management of their Chinese IJVs. In the interviews, the participants were encouraged to express their opinions on various aspects related to their IJVs. In summary, the natural context, together with the part-free, part-constrained investigation process increases the "ecological validity" of this case based research (Gill & Johnson, 1991).

With respect to the third criterion, Wright et al. (1988) stated that case studies in topics of an international nature require an understanding of and insight into the history, culture and language of the people whom one investigates. For this research, the topic itself and the

[15] This criterion concerns the extent to which it is possible to make a statistical generalisation about the wider population from which the samples are drawn.

[16] "This criterion is concerned with the extent to which it is possible to generalise from the actual social context in which the research has taken place and data are gathered, to other contexts and settings. This is also related to the issue of how artificial the research setting is relative to natural context typical of normal, everyday life".

senior executives involved came from a diverse background, which spans across the geographical and cultural boundaries between the East and the West. As Gill and Johnson (1991:143) described, "interpretations (of observations) cannot escape background preconceptions embedded in the culture, language, and life of their authors". As an ethnic Chinese, I grew up in Hong Kong where I was educated and am now working in Britain. I possess a basic understanding of the cultures, customs, languages and business practices of both the East and the West. The knowledge acts as an internal mechanism to reduce research bias and improve the extent of authenticity in the interpretation. In addition, the majority of interviews were tape-recorded. The richness of the empirical detail is further preserved. Throughout the empirical investigation and the analytical processes, constant references are made to the skeletal theory of IJV control and other relevant studies. There is a link between this case research and the existing literature.

Fourthly, every effort has been made to analyse, interpret and present the empirical information and findings by using a middle-range research approach. The set of objectives and underlying assumptions I act upon have been made public throughout the research process. Implication for practice and future research will be discussed in Chapter 10. This is for the readers to judge the interpretation and findings of this study.

The empirical details are integrated with my subjective and critical thoughts. The four case studies are composed in an engaging manner. The first person (I) is used in this chapter, throughout the four case studies, and in the conclusion chapter in order to show that I am not independent from the research. Again, this is for the readers to decide whether this research has fulfilled the fifth criterion identified by Yin (1989).

2.10 Limitations of case study research

As Parkhe (1993:255) rightly pointed out, the "case study method is not a panacea" to all types of problems facing research in organisations and IJVs. In fact, "no single approach to theory development, including case studies, is self-sufficient and capable of producing a well-rounded theory that simultaneously maximises the research quality criteria of construct validity, internal validity, external validity, and reliability" (Parkhe, 1993:255). Although case study is considered to be the most appropriate method for this research, I have realised that it has a number of limitations.

The first type of weakness involves the difficulty of drawing a clear-cut boundary around the subject matter of the case research (Eisenhardt, 1989; Scapens, 1990; Parkhe, 1993). Having adopted a holistic approach to study control practices as a part of the larger social systems, I found it very difficult to arrive at a decision of where the exact boundary should be set. As Eisenhardt (1989) observed, facing vivid, voluminous empirical data, researchers are tempted to capture everything and led to believe that the majority, if not everything, is relevant to the subject of inquiry. This type of problem has arisen in this research.

The above points lead to the second type of weakness of the case study method, which is researcher bias. As discussed in section 2.4.1 & 2.4.2, management accounting and control are not natural phenomena. Researchers, as interpreters of the observed social reality, cannot be treated as neutral independent observers. There is a certain extent of human subjectivity involved in the process of understanding and explaining social reality and actions. As Scapens (1990:277) suggested, "there can be no such thing as an 'objective' case study", as "observation is neither theory neutral nor theory determined, rather it is theory-laden" (Johnson, 1989:100).

My understanding of the languages and cultures of the East and the West works as an internal mechanism to monitor the collection and interpretation processes. In addition, since most of the interviews were tape-recorded, it helps to improve the accuracy of interpretation and reduce the problems due to poor recall (Yin, 1989). Nonetheless, one has to accept that there is no perfect solution to cure all the weaknesses of bias. The four case studies demonstrate my bias towards the subject, cultures, languages and/or the people involved.

Thirdly, I agree with a comment made by some researchers, such as Parkhe (1993) and Humphrey (2001), that the choice of using case study is risky, costly, and time-consuming. It is particularly problematic to research of international nature, such as this study. The first and foremost requirement of the case study of this nature is to understand the histories, cultures and languages of the empirical context, companies and people whom I interviewed or observed. Fortunately, some of these problems are overcome by the advantages drawn from my ethnic background. However, there remain many other logistical and operational problems stemming from a large geographical distance. For example, the geographical barrier deepened the difficulty of securing access into IJVs operating in China.

Another weakness of using case study is that of confidentiality. Participants of this research were assured that all information disclosed would be treated as confidential. This agreement raises the need to disguise the identities of the interviewees and organisations involved in the case studies. Scapens (1990:277) described this type of ethical obligations "limit(s) an appreciation of the context of the study". Also, the need to keep empirical data confidential may prevent the researchers from checking the validity of the information collected. Other means of checking are adopted in this research, such as annual accounts, Internet home pages, published articles and/or auto-bibliography of the organisations concerned.

A final limitation is that senior executives, who participated in the interviews, were busy people. Often, they agreed to commit themselves to a limited amount of time in the investigation process. Furthermore, these participants might require a high level of flexibility in terms of time and place of interviews in order to fit in their tight schedules. From my experience, these restrictions put researchers under further pressure. Although it is a way to give researchers a feel for how the organisations operate, my experience showed that the flow of interviews was often interrupted by incoming phone calls or other people in the offices, which make the researchers struggle with time even greater.

On the other hand, the time agreement with the executives might prevent researchers from going back to the organisations to check the validity of the collected evidence or to gather missing information that is important to the writing up of the case studies. For this research, secondary information sources were used to remedy some of these problems. However, one has to accept the fact that all empirical research is partial and incomplete, and this study is not an exception (Laughlin, 1995; Parkhe, 1993).

2.11 Conclusion

This chapter has made public my ontological and epistemological commitments, and justified the chosen research approach and case study method. The following five chapters illustrate Stage 1 of the theory formation process to build the skeletal model of IJV control. Four in-depth case studies are recorded in Chapter 8. Chapter 9 demonstrates a detailed analysis of the case materials through using the skeletal model. A continuous theory-empirics interplay process gradually develops the skeletal framework, and the process enables an integrative theory of IJV control to be established.

Chapter 3

A review of changes in patterns of international competition and the rise of China

3.0 Introduction

The steep rise of the multinational enterprise[1] (MNE) is regarded as the most remarkable post-war economic phenomenon (Buckley & Casson, 1976). MNEs have come to take up an increasingly important role in the economic, cultural, social as well as political affairs of the contemporary world. The tremendous growth of foreign direct investment[2] (FDI) in recent decades, particular in the 1980s, has significantly changed the structure of industry and patterns of international competition (Porter, 1986). Traditionally, trade has been considered to be an engine of growth and a driving force of integration bringing national economies closer together (United Nations, 1991; Nicolaides, 1992). Today, however, FDI is often a vehicle for the birth and growth of MNEs (Buckley & Casson, 1976; 1985, 1988; Casson, 1982, 1981; Dunning, 1980, 1981, 1988; Hennart, 1986; Rugman, 1980, 1981, 1982). It complements and, to a certain extent, replaces the roles of free trade (Julius, 1991). The emergence of MNEs is considered to be a crucial factor of the modern world development and reflects a decisive break with the past.

3.1 A review of the changing economic and industrial structures, and patterns of competitions

Worldwide FDI in the 1980s was marked by both an acceleration in size and in the diversity of sources (United Nations, 1991; Julius, 1991). In term of size, MNEs from the G5[3] alone invested over "US$650 billion" between 1980 - 1989 (Julius 1991:4). Moreover, the FDI outflows of the fourteen industrial countries[4] was increased two-fold and amounted in aggregate to over 1% of GNP by 1989, compared with only about 0.5% in the early 1980s (Turner, 1991).

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[1] A MNE is a business, which incorporated in one country but owns and controls outputs of goods or services in other country or countries (Casson, 1982).

[2] A definition of FDI as "an activity to acquire foreign equities by individuals or institutions with ownership, control over or participation in the management of the companies concerned" suggested by Hood and Young (1979:8) is adopted in this research.

[3] United States, United Kingdom, France, Japan and Germany.

[4] Including: United States, Japan, Larger EC Countries, France, Italy, Germany, United Kingdom, Belgium-Luxembourg, Netherlands, Spain, Australia, Canada, Sweden and Switzerland.

The dynamism of FDI can be compared with world exports and output. Outflows of world-wide FDI increased by nearly 29% per annum between 1983 - 1989, three times faster than the growth of exports and four times of growth of world output (United Nations, 1991). The gap between the growth rate of exports and that of FDI outflows has widened dramatically since 1985. In sum, the current phenomenon may indicate that worldwide FDI is in a take-off phase (Julius, 1991; United Nations, 1991).

3.1.1 The growth of "new form" of international industrial co-operation

According to the rapid development of international business and greater integration of the world economy, firms have formulated different types of business strategies in response to opportunities and challenges arising in both domestic and global markets. The second wave of change following the world-wide revolution in patterns of competition is the growth of so-called 'new form' of international industrial co-operation in recent decades (Casson, 1990; Hennart, 1989; Franko, 1987). New forms usually refer to institutional arrangements that are not in a wholly owned format, such as consortia, contracts, alliances and JVs (ibid.). They are modern forms of investments, differing from traditional FDI, which operate primarily through a sole agent of a wholly owned subsidiary (Buckley & Casson, 1985). The contemporary fashion of competition is characterised by a high level of complexity in terms of objectives and thus structures, operation and management.

Several researchers provided empirical evidence, which shows that since the late 1970s/early 1980s there has been an accelerating interest in inter-firm cooperation and alliances (Harrigan, 1984, 1987; 1988; Contractor & Lorange, 1988, 1988a, 1988b; Franko, 1987, 1989; Anderson, 1990; Glaister, 1995; McGowan, 1995; Yan & Gray, 1995; Gomes-Casseres, 1996; Glaister et al., 1998; Groot & Merchant, 2000). As Gomez-Mejia and Lawless (1995:vii) revealed, "measured even in gross terms, like the frequency with which cooperative arrangements are announced in the business press, they are an important phenomenon for managers and scholars alike". According to Contractor and Lorange (1988), for US firms co-operative arrangements outnumber wholly owned subsidiaries by a significant ratio of four to one.

Among a wide spectrum of choice under the theme of new forms, JV is one of the most popular, sometimes the dominant, type of business organisation for MNEs in developing (Dunning, 1981, Beamish, 1985; Beamish & Banks, 1987) and developed countries

(Harrigan, 1998, Contractor & Lorange, 1988, Franko, 1987, Glaister, 1995, Glaister et al., 1998). Firms have demonstrated a growing willingness to become engaged in cross-border JVs (Glaister, 1995; Hergert & Morris, 1998). According to Anderson's (1990) observation, there have been more JV and cooperative arrangements announced since 1981 than in all previous years, despite the fact that JV is a conventional business organisation which has been used for decades.

The phenomenon illustrates that JV has enjoyed a surge of popularity and is being used more widely than ever before. Some possible reasons to explain the trend are that with the quickened pace of globalisation, intensified competition, shorter product life cycles and rapidly enhancing technological complexities, do-it-alone is not only risky, but also difficult for firms with limited resources (Stafford, 1994; Moxon & Geringer, 1985; Porter & Fuller, 1986; Geringer & Hebert, 1989). FDI in the form of wholly owned subsidiary is neither the most feasible nor the best option for parent firms. For example, Maxon and Geringer's (1985) research in commercial aircraft industry showed that high development and launching costs, together with significant market and technological uncertainties, lead to the upsurge of international collaboration in order to share risks and costs.

Indeed, there is an increasing number of international operations employing a mixture[5] of contractual modes simultaneously in order to address the needs of a particular foreign market (Contractor, 1985; Beamish & Banks, 1987; Buckley & Casson, 1985). Beamish's study (1985) of JVs in LDCs discovered that none of his sample foreign partners relied solely on dividends for compensation. The study reflected that foreign partners often negotiate hybrid JV arrangements, which serve to lower their risk as well as taxes and to diversify income channels (Contractor, 1985). Return generated from hybrid JVs is likely to compensate the extra costs involved and may exceed those available through wholly owned subsidiaries. As Beamish and Banks (1987) suggested, not all JVs are unstable or unprofitable.

Besides the above motives, inter-firm co-operation can facilitate the expansion into new markets, which are either impossible due to host countries' legislation, or costly to approach through the full integration track or contracts (Casson, 1990). Although there

[5] Partners may use a combination of equity JV with licensing agreement between foreign partner and the JV as licensee, or contract of material supply from foreign partner to the JV (Contractor, 1985).

would be specific costs and risks associated with writing, executing, enforcing and governing a JV agreement, these can be offset by the potential synergistic effects resulting from combining the foreign partners' assets with those of the local partner and the special resources of the host country (Beamish & Banks, 1987). The forms and structures of competition in today's business world are no longer following the traditional patterns, which were restricted to a single-country boundary. The modern forms of competition are characterised by a high level of complexity.

Summing up the above review, it is fair to say that JV has become a popular new form that is adopted by companies with different size and strategic motives. The recent trend led Kogut (1987) to conclude that JVs are now playing a changing role in the evolution of national institutional structures and international oligopolies. It has reshaped the nature and style of international business (Parkhe, 1993). Under certain circumstances, JV can be a form of organisation by which markets are replaced by organisational co-ordination. "Joint ventures are the wave of the future", as Anderson (1990:19) and some other observers predicted.

√3.2 The rise of China

Apart from the surge of western multinationals and their FDI activities, the other significant feature highlighting changes of the world economy is the rise of the Asian economic power. The growth in real gross domestic product (GDP) per head during 1989 - 1993 in most developing Asian countries was leading the world. As Table 3.1 shows, GDP per capita in all the developing Asian countries taken together was rising far more rapidly than the G7, EC or US during the period between 1974 - 1993 (Financial Times, 10/12/1992). According to the President of the European Commission (Financial Times, 24/5/1994), the G7's share of global output would be seriously threatened by the economic growth in Asia, with it falling dramatically from its current rate at 75% to 50% by the year 2010. According to The World Bank's (1998) estimates, the ratio of FDI to GDP in developing countries grew from 0.80% in 1991 to 2.0% in 1997. FDI flows to Asia constituted 47% of the total FDI flows to the emerging markets in 1996. Nowadays, it is a reality of life that high quality, high-technology and other value for money products that are labeled "made in Asia" have largely replaced domestic supplies and flooded the Western markets (Hofstede & Bond, 1988).

The economic miracle, which has taken place in some Asian developing countries, shows signs of outperforming the Western super states (Financial Times, 10/12/1992). For example Table 3.2 shows that the five "Asian Tigers", which include Singapore, Taiwan, South Korea, Hong Kong and Japan, were the world leaders in terms of the average annual GNP growth per capita over a twenty-year period between 1965 - 1985 (Hofstede & Bond, 1988). Many Asian countries have been suffering from an economic slowdown since the second half of the 1990s. However, four of the five Tigers (except Japan[6]), managed to sustain growth over the difficult period in the 1990s, and Table 3.3 demonstrates their speed of recovery[7] (Asian Development Bank, 2001).

In addition to the five "Asian Tigers", there are other newly rising Asian states also showing signs of an economic takeoff (Hofstede & Bond, 1988). Among this group of potential players, China, the so-called the world's last great market, has gained rapid attention (Samain, 1989; Buckley, 1995). The country has more than one-fifth of the world's population and a vast consumer market that is predicted to become the world's second largest trading nation around 2020 (The World Bank, 1997). In the first fifteen years of opening up, China achieved astonishing progress and up until 1997 the country was already ranked as one of the fastest growing economies in the world (Blackman, 1997; The World Bank, 1997).

Drawing from the Chinese Government publications, the country improved its GNP by over 500% since the door was opened to the outside world in 1979 to the end of 1996 (see Table 3.4). Two more objective studies conducted by The World Bank (1997, 1997a) also reported that China expanded its economy more than fourfold since the early 1980s. The real GDP per capita grew at the blistering rate of 8% per annum between 1979 and 1995. In 1997, The World Bank (1997) estimated that China's expected growth would be about 7% per annum over the following twenty-five years. According to this projection, the country's share of the world trade would more than triple to 10%.

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[6] Japan remains in deep recession and its factory output declines to 14-year low (Time, 30/12/01).

[7] The Asian economies, being trade dependent of America, are adversely affected by the 11 September 2001 incidence in America, which badly hit the country's economy and investors' confidence (Times, 4/11/2001). The long-term effects that this terrorist act brings to the Asian economies are not fully revealed at the moment.

Along with the economic reforms, average living standard of the Mainland Chinese has sharply risen (Shaw & Woetzel, 1992). The improved living standard enables the majority of local people to acquire a range of goods from basic to luxury consumer products. Their combined purchasing power constitutes a huge consumer power. The astonishing transformation undergone in China presents a wealth of business opportunities for both local and foreign investors to seize (Abramson & Ai, 1999; Buckley, 1995), and the trend of "China Fever" started to emerge in the early 1990s (Sender, 1993).

Table 3.1

Average annual growth in real GDP per capita (%) in selected countries 1974 - 1993

Countries	1974 - 83	1983 - 89	1989 – 93
G7	1.4	3.0	1.2
US	0.8	2.7	0.1
EC	1.6	2.7	1.4
UK	1.1	3.2	-0.2
Japan	2.5	4.0	3.4
Asian developing countries	3.2	5.6	4.5
Middle East & Europe developing countries	-0.6	-2.1	2.9
Latin America	0.5	0.4	0.3
Africa	-0.3	-0.4	-1.0

Source: Financial Time (10/12/1992)

Table 3.2

Average growth in gross national product (GNP) per capita in selected countries

1965 - 1985

Countries	Average Annual Growth Rate (%)
Singapore	7.6
Taiwan	7.2
South Korea	6.6
Hong Kong	6.1
Japan	4.7
Brazil	4.3
Austria	3.5
Colombia	2.9
West Germany	2.7
Canada	2.4
Netherlands	2.0
Sweden	1.8
India	1.7
United States	1.7
Great Britain	1.6
Poland	1.5
Switzerland	1.4
Nicaragua	-2.1

Source: Hofstede & Bond (1988:7)

Table 3.3

Four Asian Tigers' GDP growth rates 1995 - 2000

	1995	1996	1997	1998	1999	2000
Hong Kong	3.9	4.5	5.0	-5.3	3.0	10.5
Republic of Korea	8.9	6.7	5.0	-6.7	10.9	8.8
Singapore	8.0	7.6	8.5	0.1	5.9	9.9
Taipei	6.4	6.1	6.7	4.6	5.4	6.0

Source: ADB, Asian Development Outlook 2001 (www.adb.org)

Table 3.4

China's GNP growth Indices 1978 - 1996

	GNP (100 million Yuan)	GNP Indices (1978 = 100)
1978	3624.1	100.0
1980	4517.8	116.0
1985	8989.1	193.5
1987	11954.5	234.1
1988	14922.3	260.5
1989	16917.8	271.5
1990	18598.4	283.0
1991	21662.5	308.8
1992	26651.9	352.2
1993	34560.5	398.4
1994	46670.0	448.7
1995	57494.9	489.1
1996	67559.7	536.5

Source: Statistical Yearbook of China (1997:42).

3.3 Economic reforms and the open-door policy of China

Since the formation of the Peoples' Republic of China in 1949 and up until 1978, China was semi-isolated from the outside world both from a diplomatic and commercial perspective. This isolation has left the country with a level of development that dates largely from the 1950s or even earlier. After the end of the cultural revolution in 1976, China adopted the well-known "open-door policy" and placed its primary objectives on accelerating the speed of modernisation in agriculture, industry, technology, science and national defense. The ultimate goals of the modernisation are to catch up with the world's developed countries and eventually drive China forward in amongst the front ranking industrial countries of the world (Larson, 1988; Kemp, 1987).

The Chinese government well understands that transfers of foreign capital, new and advanced technology and management expertise, through FDI is the most effective and economic way to expedite economic reform which aims at decentralisation, greater efficiency and the provision of incentives (Kemp, 1987). Therefore, the government has started to build infrastructure, formulate, define and refine foreign investment policies, laws and regulations, strategies and otherwise improve the overall investment environment to attract, encourage and protect FDI.

From the administration aspect, a relatively more decentralised governance system of foreign trade has emerged to incorporate the open door policy. The central authority set up the China International Trust and Investment Corporation (CITIC), and re-structured the Ministry of Foreign Economic Relations and Trade (MOFET) to match and approve foreign funded projects (Campbell & Adlington, 1988; Shan 1989).

The most notable development, which marked the start of the reform and opening policy, was the establishment of the 1979 Sino-foreign Equity Joint Venture Law, the first piece of legislation to affect foreign investments in China. Since then, the vehicles for investment available to foreign investors have been proliferated, and ranged from equity joint venture, contractual joint venture, compensation trade joint development agreement, wholly owned foreign enterprise, compensation trade, processing and assembly agreements. Characteristics of different forms of investment will be further discussed in Section 3.4. The government also published the well known "22 Guidelines for the Encouragement of

Foreign Investment" to guide foreigners and foreign funded enterprises to reside and run businesses in the country (Abramson & Ai, 1999).

Other milestones since the inception of the open-door policy are the establishment of special economic zones (SEZs), opening up of coastal cities and allowing sub-development of economic and technological development zones (ETDZs) within the open cities, in which favourable investment policies, tax incentives, labour supply, financial services, and better developed infrastructure are available to foreign investors. The preferential measures are variously available to foreign investors with respect to site location, nature of businesses as well as the central government's development priority (see Section 3.5). Local authorities of some of the provinces are given power to approve construction and industrial projects(within the investment limits defined by the central authority to individual zones/provinces) involving foreign investment without reference to the central authorities (Kemp, 1987). Generally speaking, different provinces have gradually become 'islands of capitalist enterprise' within the socialist system (Kemp, 1987:31).

Since the open door policy was introduced, China has attracted a significant amount of foreign interest (Kemp, 1987; Samain, 1989; Simon, 1990; Blackman, 1997; Shaw & Woetzel, 1992; Luo, 1997; Shan, 1991; Abramson & Ai, 1999; The World Bank, 1997). Within the developing country group, China alone received one third of all FDI flows between 1970 and 2000 (Independent, 11/11/2001). Given that China started from a clean sheet with almost zero foreign investment in 1979, it is a remarkable transformation within two decades (The World Bank, 1997). According to official records, up until 1997 the accumulated contracted foreign investment in the country amounted to US$532,300 million (see Table 3.5). The growing investor interests and confidence in more recent years is demonstrated by the fact that China obtained over 90% of the accumulated contracted foreign capital over the period of 1979 to 1997 in the first seven years of the 1990s.

China maintained a steady growth in exports at an average annual rate of 12% between the period 1980 - 91. This performance made China the world's thirteenth largest exporter in 1991, up from 26th place in 1980. By the end of 1995, 39% of the nation's total exports came from foreign funded enterprises (Luo, 1997). In 1995, it was estimated that sixteen million local Chinese were employed by foreign funded operations. All these changes illustrate the importance of foreign investments to the country's economic and social reforms (Luo, 1997). Foreign trade has become a crucial element of the national economy, although historically it was regarded as supplementary to the basically self-sufficient China (Shan, 1989).

Initial success of the reforms encouraged the central government to press the open-door policy forward. China has gradually opened its door further to wider range of foreign investment and shifted to an unique socialist-market state. Significant progress has been shown in the rapid change of basic policies in the economy, and economic liberalisation in particular. Senior officials' reassurance gives out a clear signal of the government's continuous support to a deepened and quickened reform. Having reunited with Hong Kong in 1997 as well as Macau in 1999, China's position has been further strengthened. The recently granted membership of the World Trade Organisation, a rules-based multilateral system, will put further pressure on China for further liberalisation on trade and investment relationships. According to the present trend, China's open-door policy seems to be irreversible.

Along with the economic development, the mainland Chinese's standards of living have been significantly improved. The national annual average growth of personal income throughout the period between 1986 to 1990 was recorded as 16%. The increase was at a much higher rate in economic trade areas and southern parts of the country which are adjacent to the prosperous Hong Kong and Taiwan (see Figure 3.2). The surge in personal income has created a huge and unexplored domestic consumer market, which has attracted increasing attention from overseas MNEs who aim to penetrate the Chinese markets. Generally speaking, China has gradually changed from "being an economic backwater to a hot spot of investor interest" (Tretiak & Holzmann, 1993:vii). The country has become one of the leading host countries for foreign investment in terms of both its accumulated stock and annual flow of foreign capital (Wang & Swain, 1993; Luo, 1997). The World Bank's (1997:2) study on China in the world economy arrived at the following conclusion. "China's foreign trade has become an engine of economic growth and an engine of growth in world trade".

Although some criticisms suggested that China is an overstated opportunity (such as Kraar, 1987; Comte, 1987; Baird, 1989) and the economic miracle that will easily turn bad (The

Economist, 13-19th/9/1997), other observers agreed that China's importance will rapidly increase (Samain, 1989; Financial Times, 10/12/1992; Shaw & Woetzel, 1992; Simon, 1990; Kemp, 1987; Wang & Swain, 1993; The World Bank, 1997, 1997a; Buckley, 1995). Investors' confidence and inward FDI was adversely affected by the Tiananmen Square incident in 1989. Nonetheless, the "general business environment for foreign firm seemed to be on a path towards increased normalization" soon after the incidence (Simon, 1990:106). The Chinese government's immediate actions[8] to salvage investors' confidence worked. The phenomenon supports Brewer's (1981) argument, which suggested that political instability in developing countries is only one source of risk, but it is by no means the most important one for many investment decisions provided the opportunity is attractive enough to justify the risk involved. The reality shows that many investors have found the prospect of China promising enough to justify the risk involved.

[8] For example, the government reaffirmed its continuous support to the open-door policy and approved the related five- and ten-year plans at the high profiled 1991 National People's Congress (Luo, 1997)

Table 3.5

Annual foreign investment in China 1979 - 1997

(based on the signed agreements and contracts)

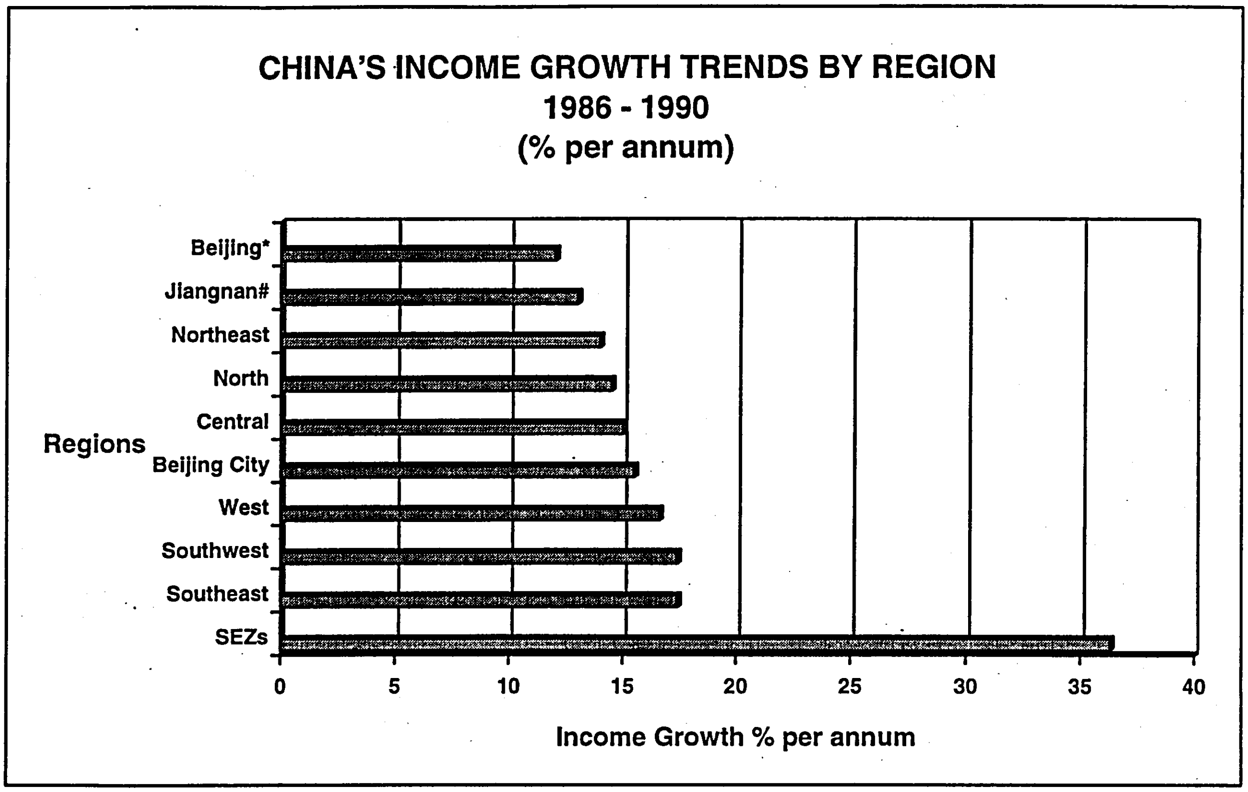
(US$ 100 million)

	FDI	*Others	The year's Total
1979 - 83	77.42	11.74	89.16
1984	27.51	2.24	29.75
1985	59.32	4.01	63.33
1986	28.34	4.96	33.3
1987	37.09	6.10	43.19
1988	52.97	8.94	61.91
1989	56.00	6.94	62.94
1990	65.96	3.91	69.87
1991	119.77	4.45	124.22
1992	581.24	6.12	587.36
1993	1,114.36	5.31	1,119.67
1994	826.80	4.08	830.88
1995	912.82	6.35	919.17
1996	732.76	3.71	736.47
1997	510.04	41.82	551.86
TOTAL	**5,202.4**	**120.68**	**5,323.08**

*Others include: International Lease, Compensation Trade and Processing and Assembly.

Source: China Statistical Year Book (1997:637).

Figure 3.2



Jiangnan Province.

*Beijing Area - includes Tianjin Municipality, Hubei Province, and Shangdong Province.

Source: Shaw & Woetzel (1992:41)

3.4 Forms of foreign direct investment (FDI) in China

According to their specific needs, foreign investors, to a great extent, are free to choose the modes of entry into the Chinese market. Basically, FDI in China is in six different forms - equity joint ventures, contractual joint ventures, wholly owned foreign enterprises, compensation trade, processing and assembly agreements, and joint development. Each form has associated with it some distinctive features, which in turn represent different benefits and drawbacks of operating in the country. These characteristics may affect foreign investors' initial choice of investment forms and the subsequent ways in which the investments are being run and controlled. Moreover, as was mentioned before, there is an increasing number of international operations employing a mixture of contractual modes simultaneously when entering a foreign market (Contractor, 1985; Beamish & Banks, 1987; Buckley & Casson, 1985). As a result, a review of individual forms of investments is considered as pertinent and a summary is recorded as follows.

3.4.1 <u>Equity joint ventures (EJVs)</u>

Joint ventures in China can be in two different forms - equity or contractual joint ventures. An equity joint venture (EJV) is a legal entity in the country and is governed by the Joint Venture Law, Joint Venture Tax Law, and the 1983 implementing regulations (Campbell & Adlington, 1988). The signing of an EJV contract automatically results in the creation of a legal identity[9].

An EJV is an incorporated company with limited liability formed between foreign and Chinese enterprises (it can be a dual- or multiple-ownership firm). Each side owns a proportion of shares and the equity ratio is calculated in monetary terms. The partners jointly share the risks, profits or loss, and management of the venture is in proportion to their equity contributions. The Chinese law requires foreign partner(s) of each EJV to take a minimum stake of 25% (in many cases there are exceptions) and the contribution from each partner can be in cash and/or other forms[10].

EJVs in most industrial sectors have a fixed duration of fifteen to thirty years. The ventures will be liquidated when their agreed life-span expires, and foreign partners are allowed to repatriate their shares. In almost all circumstances, foreign funded enterprises in China are required to export some proportion of their products in order to cover/balance their foreign exchange expenses[11].

Each EJV has a JV board. The number of directors of each board should be in proportion to the amount of capital each party injects into the JV, and its size and composition have to be clearly stipulated in the contract and articles of association. Both foreign and Chinese partners appoint their directors and they must agree on a chairman and vice-chairman. If a Chinese-appointed director serves as chairman, the vice chairman must be appointed by the foreign party (or vice versa).

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[9] Article 37 of the General Principles of the Civil Law states that a legal person has the following qualifications - (1) establishment in accordance with the law; (2) possession of the necessary property or funds; (3) possession of its own name, organisation and premises; (4) ability to independently bear civil liability (Campbell & Adlington, 1988).

[10] For instance, equipment, rights to the use of sites, factory buildings, raw materials, labour, local expertise, proprietary rights or technology.

[11] Such as remittance of royalty and dividends to foreign partner(s); import of equipment, machinery, or raw materials; and salaries of expatriates.

The Chinese JV law also stipulates that in each international JV, the board of directors is the highest decision-making authority whose main task is to make decisions on all important strategic issues for the joint organisation based on the principle of equality and mutual benefit (Li et al., 1994). Once the board has made decisions, full operational authority will be transferred to the general manager (GM), who normally stays with the IJVs on a permanent basis. The GM is granted the highest operational authority and he/she represents the IJV to deal with both internal and external matters. Indeed, the GM is a crucial position, which has possessed a lot of influence over the success of IJVs. Owing to these reasons, power to nominate the post is always one of the sensitive areas in JV negotiation process.

On the other hand, the Chinese Government does not have the right to nationalise EJVs. Only under some special circumstances based on social and public interest can EJVs be expropriated. In such situation the Chinese government must pay the corresponding compensation to the affected enterprises (British Embassy, 1993). Since EJVs involved both Chinese and foreign partners, it seems logical to assume that the risk of expropriation may be lower under this form of investment.

3.4.2 Contractual Joint Ventures (CJVs)

Contractual Joint Ventures[12] (CJVs) involve a different type of operation and set of responsibilities compared with EJVs. They are usually arranged to carry out some specific projects of limited duration (Kemp, 1987). CJVs are subject to and protected by the Cooperative Joint Ventures Law, which was adopted on 23 April 1988 (Tao, 1988). The law requires that CJV contracts must clearly stipulate each partner's contribution[13], responsibilities and rights, and the ways in which outputs of the ventures and profits or losses are going to be shared among partners. In addition, contracts must be approved by the Chinese government before the CJVs are formed.

Article 2 of the Law states that partners can choose between establishing a CJV with or without the status of a legal person (see Section 3.4.1 for definition). The related choice can raise different management issues. For instance, for a CJV with legal status, the venture does not have to be set up in China (while an EJV does) and the partners may

[12] Also known as co-operative or co-production ventures.

[13] CJVs are not required to have common registered capital and the equity ratio is not necessarily calculated in monetary terms.

operate as separate legal entities[14]. It will have a board of directors and a GM, which is fairly similar to the structure applied to EJVs. However, if no separate legal entity is set up, the CJV will establish a joint management committee consisting of representatives from each partner[15]. The two parties can either solely or jointly participate in everyday management, or appoint a third party to run the venture.

As compared to EJVs or wholly foreign-owned enterprises (see Section 3.4.3), CJV is considered as a more flexible form of investment. It usually requires less time to negotiate and establish. These advantages may be the key reasons to explain why CJV has become one of the most popular forms of investment in China.

3.4.3 Wholly foreign-owned enterprises (WFOEs)

Wholly foreign-owned enterprises[16] (WFOEs) are subject to and protected by the Foreign Enterprise Law and Implementing Rules, which were promulgated in 1986 and 1987 respectively. The law provides that, for a venture to qualify as a WFOE, it must benefit the development of the Chinese national economy and is required to fulfill at least one of the two conditions: being an (a) export-orientated[17] and/or (b) advanced-technology[18] operation.

Wholly owned FDI is excluded from certain industries, such as natural resource development, broadcasting and publication, post and telecommunications, national security-related industries and any other sectors prohibited by the Chinese authorities.

3.4.4 Compensation Trade (CT)

This form of FDI is also called counter trade or product buy-back. It is an agreement under which the foreign concern contracts a Chinese enterprise to manufacture goods that are then to be sold by the foreign party outside China. The foreign partner usually supplies technology, production equipment, and possibly raw materials and technical guidance.

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14 In this case partners have to file their own tax returns and the foreign party(s) is taxed under the Foreign Enterprise Income Tax Law (Kemp, 1987).

15 Chairman and directors of the joint management committee can be appointed by one of the partners, and these senior executives are not necessarily to be Chinese.

16 Branches (such as those established by foreign banks or insurance companies) or representative offices that engage in liaison services are not considered as WFOEs.

17 Export at least 50% or more of the annual output value of all productions and with a surplus in foreign exchange receipt and expenditure.

18 Which brings equipment, machinery, production techniques and management expertise to develop, improve or manufacture new and/or existing products, save energy and raw materials, or engage in import substitution.

While the Chinese concern commonly provides land, factory buildings, management and/or labour.

Investment by the foreign side is normally compensated by the revenue generated through the export of goods produced directly with the imported equipment and materials. However, in certain cases if it is impossible or impractical to repay the foreign investor in this way, it can be made up with other products or a combination of goods and cash agreed by both parties.

3.4.5 Processing and assembly agreements (PAAs)

This is a relatively simple form of business co-operation between foreign and Chinese enterprises. Under a PAA, the foreign concern usually supplies all required raw and auxiliary materials. In some cases, equipment and machinery, and technical and inspection guidance will also be provided. According to the foreign partner's requirements, the Chinese counterpart processes/assembles the materials provided. The finished products are then handed over to and sold by the foreign partner outside China. In return, the Chinese partner will receive processing fees for the work they done.

Since labour cost in China is cheaper than a lot of countries, PAA is booming in many labour-intensive industries[19]. It is a particular popular form of investment in Southern China, where hundreds of thousands of investors, mainly from the neighboring city of Hong Kong, are attracted. Undoubtedly, the preferential treatment[20] offered by the government has further boosted foreign interests in using PAA.

3.4.6 Joint development (JD)

This mode of investment is normally referred to joint exploration for offshore oil development. JD usually has two stages - geographical exploration, as well as exploitation and development. Under a JD agreement, the foreign party bears all risks and costs in the first stage. During the second stage, both foreign and Chinese partners make a contribution to the venture. Once commercial production has started, partners of both sides receive an agreed proportion of return from the development.

[19] Such as textiles, yarn, cloth-making, toys, electrical appliances, arts and crafts, and furniture industries.

[20] Inputted materials, parts or equipment that are used in producing finished products, which will then be exported, are exempted from duties and taxes in China.

3.4.7 Other forms of investment

Apart from the six main forms of FDI mentioned above, there are other semi-direct types of investment in China, such as licensing and leasing. In some cases, they are adopted in conjunction with other forms of FDI, such as a JV with licensing agreement of using the foreign partner's patented technology. Along with time, the forms of investment in China are getting more sophisticated.

In the following section, the analysis will move onto another part of the open-door policy in relation to investment incentives offered by the Chinese government to attract foreign investors. The incentive packages, to various extents, have influence over foreign firms' decisions on the forms and locations of their investment in China.

3.5 Investment incentives

Besides putting attention and state funds on improving national infrastructure and facilities to cope with the needs of rapid commercial trade and investment development, the Chinese government has also offered generous tax and other incentives to attract foreign investors.

The range of investment incentives includes: tax reduction and two-year tax holiday with further 50% reduction for further three years; exemption from payment of certain subsidies to staff and workers; full exemption or lower land-use fees; priority in obtaining supply of utilities, transportation or other services at the same rates as state enterprises, or loans through the Bank of China (Tretiak & Holzmann, 1993; Campbell & Adlington, 1988). Furthermore, according to the Unified Tax Law promulgated on July 1 1991, no withholding tax is levied on repatriated profits or dividends (Tretiak & Holzmann, 1993). What is more, there is the possibility of a full refund on at least five years of the enterprise's income tax on profits, if the profits are re-invested in either the same or other projects. In many cases, these tax concessions can be further extended.

However, it needs to be stressed that the offer of the above mentioned investment incentives varies from place to place. The ultimate incentive package offered to a particular foreign investment depends on a number of different factors, and the assessment of eligibility generally falls into two distinct but inter-related programmes - (a) site-specific[21] and (b) nature specific[22]. It is clear that the Chinese government has tried to use the incentive packages to attract the right types of investment to the right places. If the nature of an investment fits with the needs of the region where the investment is located, it will receive better tax treatment. This kind of incentive policy in turn may have impact on foreign investors' decisions, especially those which focus on cost minimisation, on the forms and locations of their investments in China.

3.5.1 Cheap labour cost

In addition to the investment incentives that are directly offered by the Chinese government, cheap and vast supply of labour is another important factor that attracts many foreign investors to China. According to a comparison of labour cost (including fringes and social charges paid by employers) of apparel industry among forty-one countries between 1991 and 1992 (O'Rourke, 1992), the labour cost per hour in China was more than fourteen times cheaper than Hong Kong, twenty-eight times cheaper than United States, thirty-three times cheaper than United Kingdom, and sixty-one times cheaper than Germany (see Table 3.6).

If we focus on the Asian block in which region a number of developing countries are competing for inward FDI, the average labour cost in China was the second lowest. Although the comparison focused on the apparel industry, it provides a general picture of the labour rate differentials among this group of selected countries. The study also shed light into the reasons why investors from the high labour cost nations topped the list of FDI sources in China between 1979 - 1991 (see Table 3.8).

China's labour policy has long been regarded as bureaucratic, inflexible and confusing by many western investors (Goldenberg, 1988; Tretiak & Holzmann, 1993). Under the old rules, which were applied at the early stage of the opening up, private enterprises did not

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21 The programme ties eligibility to location of projects in various types of special trade zones designated for foreign investment. Under the hierarchy of investment incentive scheme, greater autonomy and the best national tax treatment as well as other benefits are available to foreign investment which are located in the SEZs, the ETDZs, new and high-technology zones, free trade zones and other open areas. Generous tax reduction of 50%, which brings the corporation tax down to 15% (or less in certain cases), is available to all foreign projects in these trade areas. Enterprises are partly or fully exempt from customs duties; import taxes on machinery or equipment, raw materials and other production necessities; and consolidated industrial and commercial tax on equipment imported for production purposes. In addition, preferential land use fees is available in these areas.

22 The programme links the eligibility of incentives with natures/performance criteria of foreign investment. The Provisions of the State Council of the People's Republic of China regarding the Encouragement of Foreign Investment (also known as the Encouragement Provisions or the 22 Articles), which were promulgated in 1986, stipulated that foreign funded entities throughout the whole country which are designated as export (export at least half of their production and achieve a balance or surplus in annual foreign-exchange needs, or those which export 70% or more of production), technologically advanced or import substitution are entitled for the most generous tax reduction and other benefits (Tretiak & Holzmann, 1993).

have the right to directly hire or fire labour. Recruitment and transfer of workers had to go through local work units. The complication restricted the mobility of labour. Moreover, the average wages in foreign-owned enterprises were forced to be set significantly higher than state-owned enterprises.

The bureaucratic labour policy caused a lot of grievance from foreign investors. Along with the quickened pace of the reform, the Chinese government responded to the negative investor feedback with an important management concession introduced in October 1986 (Goldenberg, 1988) and in 1992 (Tretiak & Holzmann, 1993). Foreign enterprises are now granted the autonomy to hire, fire, train, and set wage for their workers. From the break-through of labour policy, it can be seen that the government has paid attention to those factors that are essential for foreign investors to stay and for China to attract more FDI.

Some economists (such as Vernon, 1966, 1979; Hood & Young, 1979) suggested that based on the profit maximising premise, when a firm's product or technology becomes standardised and when market competition is primarily on price, the company tends to transfer production of labour-intensive products to less developing countries with lower labour costs in order to minimise overall production costs. This argument, to a great extent, can nicely fit into the situation in China. Casson and Zheng's (1991) research in foreign JVs in China revealed that traditional labour-intensive industries, such as manufacturing industry - electrical, textile, food and drink; and servicing industry - hotels and tourism, accounted for 66.7% and 31.3% respectively of the total value of equity JV investment during the period of 1979 - 1986. These firms came to China in order to benefit from the country's cheap labour and remain competitive.

The background and essence of China's open-door policy has been outlined in the above sections. Under the overall investment environment created by the policy, the next stage of literature review will focus on analysing the characteristics of foreign investments that are attracted to the country.

Table 3.6

Comparison of labour costs of the apparel industry between China and other selected countries

(U.S.$ per hour including fringes/social charges)

Country	**1990**	**1991**
	$	$
People's Republic of China	***0.26***	***0.24***
Indonesia	0.16	0.18
Pakistan	0.24	0.24
India	0.33	0.25
Philippines	0.46	0.46
Malaysia	0.56	0.62
Thailand	0.63	0.69
Singapore	2.43	2.72
South Korea	2.46	2.75
Hong Kong	3.05	3.39
Taiwan	3.41	3.74
Canada	8.76	9.53
United States	6.56	6.77
Mexico	0.92	1.17
Brazil	0.98	0.76
United Kingdom	8.02	7.99
France	12.52	12.41
Italy	12.58	13.50
Germany	14.37	14.81
Poland	0.50	0.54
Hungary	0.92	1.19
CIS (former USSR)	1.69	0.36

Source: O'Rourke (1992)

3.6 Characteristics of inward FDI in China

The above analysis provided a summary of China's open-door policy and the related legal framework. This section analyses the nature and sources of the country's inward FDI.

The investigation of China's inward FDI revealed two distinctive features - the forms of investment and their sources. First, based on an investigation conducted by Tretiak & Holzmann (1993), which was based on contracted amount of foreign investment, equity and co-operative joint ventures (JVs) represented 38% and 30% respectively of the total contracted foreign investment in China over the period between 1979 to 1991 (as showed in the column marked * in Table 3.7). The results illustrated that investors preferred to adopt the JV mode to enter the country during the first decade of opening up.

In order to identify the FDI trend in 1990s, I researched more recent (1993-8) publications by the Chinese government. The data I found were based on utilised[23] foreign capital that was actually injected into the country by the end of each year. Although the basis of measurement is different from the one that Tretiak & Holzmann (1993) adopted, I used the percentage of the actual injected foreign capital to draw a comparison to their findings, as per Table 3.7. It can be seen that the JV boom continued in the 1990s, and the trend reached its peak between 1992 to 1996. Over this period, JV accounted for in excess of 70% of the total contracted foreign investment in China. The JV phenomenon in the country seemed to be consistent with the global surge of popularity of this new form of organisation to cope with the quickened pace of change in industrial structures and international competition.

Campbell and Adlington's (1988) study on patterns of equity JV in China added further detail onto the discussion above. It was found that between 1979 – 1986, JV investment in China tended to be fairly small (less than US$5 million in value). The study reflected that modest-sized investment accounted for 95.3% and 90.7% of the total equity JV investment from Hong Kong and Macau, and from the rest of the world respectively. The phenomenon might indicate foreign investors' sceptical attitude towards investing in China during the early stage of the open-door policy, and their preference of using small-sized investment to test the market.

[23] Utilised foreign capital tends to be different from the contracted amount, as some foreign investors inject the agreed capital commitment by installments.

Another characteristic of China's inward FDI is the source of investing countries or regions. An interesting discovery is that a majority of so-called "foreign" investors are actually overseas ethnic Chinese (OEC). According to Tretiak and Holzmann's (1993) investigation, which was based on contracted foreign investment data, an overwhelming majority of China's inward foreign investment actually came from Hong Kong and Macau (see Table 3.8). This single region represented 61.8% of the cumulative total for the period of 1979 to 1991. On the other hand, China also received substantial amount of investment from Taiwan and Singapore. Again, ethnic Chinese make up the majority in these two countries. It was estimated that investments from Chinese diaspora from South-east Asia accounted for another 10% to 15% of China's cumulative total (The Economist, 18/7/1992; CND, 1/8/94).

Following up Tretiak & Holzmann's (1993) work, I used the Chinese government's data, which are based on utilised[24] foreign capital, to draw up a breakdown of investment sources between 1992 - 1997, as shown in Table 3.9. My analysis shows that Hong Kong and Macau remained the dominant investment sources in the 1990s. These two regions jointly accounted for 70% and 64% of the total foreign funds injected into China in 1992 and 1993 respectively. Despite their significance decreasing in the second half of the 1990s, Hong Kong and Macau continued to be the major capital sources in China. On the other hand, it is noticed that the importance of funds from Singapore increased significantly over the time.

When the two characteristics of China's inward FDI are put together, a pair of notable results are highlighted - a majority of foreign investors were using JV to enter the country, and most of these parent companies are actually owned/run by overseas ethnic Chinese. According to these findings, a series of interesting questions arise: (a) why have the majority of foreign firms adopted JV as an entry mode to approach the Chinese market? Under what situations will JV become a more appropriate foreign entry mode than other alternatives, such as wholly owned subsidiary? (b) Do nationalities or cultural background of parent companies have social, economic or transaction cost influence on the choice of entry modes? (c) More importantly, under the influence of (a) and/or (b), what are the subsequent ways in which these Chinese JVs are being run and controlled?

[24] Utilised foreign capital tends to be different from the contracted amount, as some foreign investors inject the agreed capital commitment by installments.

The questions above indeed underline the heart of this research. In order to unlock the queries surrounding these important questions, related investigation will be undertaken in the next step of the research process.

3.7 Conclusion

The above analysis illustrates the ways in which the reduction and removal of national and international trade barriers have opened up previously protected industries to international competition (Julius, 1990, 1991). Rapid technological advancement has enabled many products to become tradeable or more tradeable internationally (United Nations, 1989). The trend shows that many firms have responded to the changing environment and widened opportunities by accelerating their FDI activities mainly in the form of JV.

Another feature, which characterised the economical and political structure of the later part of the 20th century, was the rise of China. Since the country opened up to the outside world in late 1970s, it has successfully attracted a significant number of ventures involved in FDI. Two characteristics highlighting the inward FDI in China are the forms of investment and their sources. A breakdown of FDI between 1979 – 1997 shows that JV was the most popular entry mode, and the majority of these foreign investments actually came from overseas ethnic Chinese. What are the explanations for these phenomena? Do these two features bear a direct relationship to the reasons why IJVs are formed and/or the ways in which they are controlled?

Before full explanations can be found for the above questions which constitute the heart of this research, it is pertinent to grasp an understanding of firms and their FDI behaviour. I strongly believe that we need to understand the underlying motives behind FDI decisions, before a deeper knowledge of the new JV form of organisations and IJV control can be established. In the next chapter, the literature review will focus on multinationals and their FDI activities.

Table 3.7

A breakdown of the forms of foreign investment in China: 1979 - 1997

(Utilised foreign capital, US$ 100, 000,000)

Forms of investment	*1979-91	1992	1992	1993	1993	1994	1994	1995	1995	1996	1996	1997	199
	%	$	%	$	%	$	%	$	%	$	%	$	%
Equity JVs	37.67	291.28	49.593	551.74	49.277	401.93	48.37	397.41	43.236	318.76	43.282	207.26	37.5
Contractual JVs	29.96	132.55	22.568	255.00	22.775	203.01	24.43	178.25	19.393	142.97	19.413	120.66	21.8
Wholly foreign owned enterprises	16.35	156.96	26.724	304.57	27.202	219.49	26.42	336.58	36.618	268.1	36.403	176.58	31.9
Share Enterprises	0	0		0		0		0		0		1.5	0.271
Joint Development	6.04	0.43	0.0732	3.05	0.2724	2.37	0.29	0.57	0.062	2.93	0.3978	4.02	0.72
# Others	9.98	6.12	1.042	5.31	0.4742	4.08	0.49	6.35	0.6908	3.71	0.5038	41.82	7.57
National Total		**587.34**		**1119.7**		**830.97**		**919.16**		**736.47**		**551.84**	

* Taken from Tretiak & Holzmann, "Operating joint ventures in China". (1993:x). Their survey was based on contracted amount of foreign investment. While the rest of the figures on the table reflect the amounts of utilised foreign capital.

#Others include value of equipment supplied by foreign businesses in transactions involving compensation trade, processing and assembly, and the value of equipment supplied in financial leasing transactions.

Sources: China Statistical Yearbook, 1994, 1995, 1997 and 1998.

Table 3.8

A breakdown of the sources of foreign investment* in China: 1979 - 1991

(Contracted foreign investment, US$ million)

Investing countries	**1979 - 1985**	**1986 - 1988**	**1989 - 1991**	**Cumulative Total**	**% share**
Hong Kong & Macau	***10,628.96***	***8,299.29***	***15,826.13***	***34,754.38***	***61.80***
US	2,177.01	1,287.26	1,566.86	5,031.13	9.0
Japan	1,628.63	1,039.71	1,879.89	4,548.23	8.1
Taiwan	N/A	N/A	1,392.34	1,392.34	2.5
Singapore	192.54	357.50	409.77	959.81	1.7
UK	378.30	136.65	286.46	801.41	1.4
Germany	162.06	264.42	772.23	1,198.71	2.1
France	262.47	118.62	44.65	425.74	0.8
Italy	137.43	133.91	95.64	366.98	0.7
Canada	74.31	164.81	101.76	340.88	0.6
Australia	105.23	96.41	145.53	347.17	0.6
Netherlands	4.70	153.70	61.97	220.37	0.4
Thailand	40.34	49.44	167.60	257.38	0.5
Switzerland	22.94	120.84	59.54	203.32	0.4
Philippines	46.94	49.81	32.87	129.62	0.2
Austria	N/A	94.40	23.98	118.39	0.2
Belgium	52.76	2.57	27.91	83.24	0.1
Denmark	6.53	43.69	0.06	50.28	0.1
Ex-USSR	N/A	N/A	33.46	33.36	0.1
Other	739.56	1,427.15	2,262.24	4,428.95	7.9
National total	**16,660.71**	**13,840.19**	**25,702.14**	**56,203.04**	**100**

*Including all kinds of foreign investment, such as: equity and co-operative joint ventures, wholly owned enterprises, joint oil exploration, leasing, compensation, and process and assembly.

Source: Tretiak & Holzmann (1993:viii)

Table 3.9

A breakdown of the sources of foreign investment* in China: 1992 - 1997

(Utilised foreign capital, US$ 100, 000,000)

	1992	1992	1993	1993	1994	1994	1995	1995	1996	1996	1997	1997
	$	%	$	%	$	%	$	%	$	%	$	%
HK & Macau	79.09	70.04	180.32	64.93	203.32	59.90	206.25	54.55	214.58	50.93	219.54	41.91
US	5.19	4.60	20.68	7.45	24.91	7.34	30.84	8.16	34.44	8.17	34.61	6.61
Japan	7.48	6.62	13.61	4.90	20.86	6.15	32.12	8.50	36.92	8.76	43.90	8.38
Taiwan	10.53	9.33	31.39	11.30	33.91	9.99	31.65	8.37	34.82	8.26	33.42	6.38
Singapore	1.26	1.12	4.92	1.77	11.80	3.48	18.61	4.92	22.47	5.33	26.07	4.98
UK	0.38	0.34	2.20	0.79	6.89	2.03	9.15	2.42	13.02	3.09	18.59	3.55
Germany	0.91	0.81	0.62	0.22	2.64	0.78	3.90	1.03	5.19	1.23	10.08	1.92
France	0.47	0.42	1.41	0.51	1.93	0.57	2.87	0.76	4.25	1.01	4.76	0.91
Italy	0.27	0.24	1.00	0.36	2.06	0.61	2.70	0.71	1.69	0.40	2.18	0.42
Canada	0.59	0.52	1.37	0.49	2.16	0.64	2.57	0.68	3.38	0.80	3.44	0.66
Australia	0.35	0.31	1.10	0.40	1.88	0.55	2.33	0.62	1.94	0.46	3.14	0.60
Netherlands	0.28	0.25	0.84	0.30	1.11	0.33	1.14	0.30	1.25	0.30	4.14	0.79
Thailand	0.84	0.74	2.34	0.84	2.35	0.69	2.88	0.76	3.28	0.78	1.94	0.37
Switzerland	0.29	0.26	0.47	0.17	0.72	0.21	0.79	0.21	2.14	0.51	2.16	0.41
Philippines	0.16	0.14	1.22	0.44	1.40	0.41	1.06	0.28	0.55	0.13	1.56	0.30
Austria	0.06	0.05	0.16	0.06	0.10	0.03	0.18	0.05	0.17	0.04	0.75	0.14
Belgium	0.04	0.04	0.26	0.09	0.32	0.09	0.54	0.14	0.45	0.11	0.33	0.06
Denmark	1.21	1.07	0.04	0.01	0.02	0.01	0.35	0.09	0.29	0.07	0.17	0.03
Ex-USSR	0.16	0.14	0.42	0.15	0.36	0.11	0.23	0.06	0.20	0.05	0.18	0.03
Other	3.36	2.98	13.34	4.80	20.72	6.10	27.90	7.38	40.32	9.57	112.91	21.55
National Total	112.92		277.71		339.46		378.06		421.35		523.87	

*Including all kinds of foreign investment, such as: equity and co-operative joint ventures, wholly owned enterprises, joint oil exploration, leasing, compensation, and process and assembly.

Sources: China Statistical Yearbook, 1993, 1994, 1995, 1997 and 1998.

Chapter 4

In search of explanations for the surge of worldwide FDI activities

4.0 Introduction

Chapter 3 highlighted the dramatic change in patterns of international competition and the rapid growth of the new forms of joint venture (JV) organisations in China. The analysis also revealed two noteworthy characteristics of China's inward FDI – (1) a majority of foreign investors use JV as a mode of entry into the Chinese market, and (2) most of these parent companies are actually owned/run by overseas ethnic Chinese. These findings have probed a series of interesting questions that are relevant to the central core of this research about control processes and systems in international JVs (IJV) located in China.

(a) Why have many foreign firms adopted JV as an entry mode to approach China? Under what circumstances does JV become more favourable than other alternatives, such as wholly owned subsidiary?

(b) Do nationalities or cultural background of parent companies have social, economic or transaction cost influence on the choice of entry modes.

(c) More importantly, under the influence of (a) and/or (b), what are the subsequent ways that these Chinese JVs are being run and controlled?

In order to unlock the above puzzles, the first step to be taken is a review of literature on JVs and the work will be illustrated in this and the next chapter. It is believed that answers for questions (a) and (b) underline the explanations for (c), which is related to the third and the fourth objectives of this research (see Chapter 1).

4.1 Existing joint venture theory - Theory of MNEs

Although JV has been widely used as a form of business organisation in recent decades, there is not one established or commonly accepted theory addressing the subject of JVs/IJVs (Parkhe, 1993). Despite the fact that there is a vast and growing literature in the field, various researchers have often employed a diversity of theoretical lenses to analyse JVs (Geringer & Hebert, 1989; Parkhe, 1993; Glaister, 1995). The major theoretical perspectives range from economics/transaction cost approach (Buckley & Casson, 1976, 1985; Kogut, 1989; Hennart, 1989a, 1991), organisational learning theory or strategic behaviour (Kogut, 1987; Casson, 1990; Harrigan, 1984, 1987, 1988; Kogut & Singh, 1988), structural approach (Killing, 1982, 1983; Schaan, 1983, 1988; Beamish, 1985, 1988; Anderson & Gatignon, 1986), resource dependency (Pfeffer & Nowak, 1976), bargaining power approach (Lecraw, 1984; Harrigan & Newman, 1990, Blodgett, 1991; Yan & Gray, 1994), and even game theory based on the prisoners' dilemma to analyse co-operative relationships (Axelrod, 1984; Parkhe, 1993).

The complexity of the topic is compounded by the variety of theoretical approaches that different scholars have adopted. It is a somewhat self-development process to identify and establish a middle-range research approach that best fits my ontological and epistemological commitments (see Chapter 2). I am glad that there does not appear to have been a well-established "norm" in place that is accepted as the "right" way of doing and seeing things. As I believe that a high theoretical and rational closure would only restrict flexible thinking and discourage discovery of new insights (Parkhe, 1993; Geringer & Hebert, 1989). Having seen my role as an explorer, rather than simply a follower to extend tradition, in an infant field of JV, it is more fruitful to find my own way and learn from experience and perhaps errors. I see this to be the essence of what research is all about.

Rightly or wrongly, based on the assumptions that FDI are economics business activities, the transaction cost approach, which has been used to advance our understanding of MNEs, seemed to be a logical choice at the beginning of the theoretical development process. I believe, at least at this stage, that JVs are MNEs' choice of FDI mode. Thus, an economic-based theory should be able to cast light on firms' JV decisions and their subsequent choice of processes and systems of control of this type of subsidiaries.

The first theory, which comes into place in the understanding process, is the economics-based internalisation theory. The ideas of Hymer (1976), which were extensively developed by Buckley and Casson (1976, 1985) and Rugman (1981, 1982) in their "internalisation theory", which aims to explain why and how MNEs exist, become my first choice. The theory synthesizes explanations of why firms may prefer FDI rather than organize their cross-border activities in a different way (Dunning, 1973, 1980, 1981, 1988). It brings analytical precision to the choice of entry modes into foreign markets.

Internalisation theory is widely accepted as a key theory of MNE (Buckley & Casson 1976, 1985; Rugman 1981; Dunning 1980, 1988).

4.2 Internalisation theory

The central thrust of the internalisation theory is the recognition of market imperfection, which prevents the efficient operation of international trade and equity investment (Rugman, 1980). Kindleberger (1969:13) claimed that "for FDI to thrive there must be some imperfections in markets". Buckley and Casson (1976) made the point further visible and stated that whenever there is imperfection in the market, particularly in intermediate products, domestic firms have an incentive to bypass the externality by creating internal markets. It involves bringing under common ownership and control the activities, which are linked to the market. Eventually the internalisation process, through FDI across national boundaries, generates MNEs.

Internalisation[1] is the process of creating a market within a firm (Rugman, 1981). The internal market empowers the firm to function as efficiently as in a regular market when it fails to operate or imposes excessive costs on users. The national and international market imperfections both permit an owner firm to acquire monopolistic advantages in its domestic environment and to exploit this through direct involvement abroad (Hood & Young, 1979). Kogut (1983) claimed that the primary advantage that differentiates MNEs from national corporations lies in their flexibility to transfer resources across borders through global cost-minimising networks. If a firm possesses monopolistic advantages, it is likely to maximize the overall return by creating internal markets for these advantages (Rugman, 1982).

In addition, the process of internalisation provides firms with a better control over their whole networks of assets and reduces their dependency on external supplies. Control over internal and external environments is considered as vital to firms' survival and ability to appropriate full return on skills and assets that they possessed (Hymer, 1976; Buckley & Casson, 1976; Cantwell & Dunning, 1991).

[1] Internalisation has different connotations in different branches of economics. For example, "internalisation of a market" means that an arm's length contractual relationship is replaced by an internal market (Casson, 1987). Whereas, "internalisation of an externality" refers to the creation of a market that does not exist (Buckley & Casson, 1985).

Essence of the internalisation theory is outlined above. In the following sections, the key assumptions that underlie the theory will be further explored.

4.2.1 Market Imperfection

Market imperfection is a key assumption underlies the internalisation theory. The concept of market imperfection was advocated by Coase (1937, recorded in Hymer, 1976) in a domestic context, and then by Hymer (1976) and other scholars (such as Buckley & Casson, 1976, 1985; Dunning 1973, 1980, 1981, 1988, Rugman 1980, 1981, 1982; Hood & Young 1979; Casson, 1986) in an international dimension. The basic idea of Coase's work is that the external market is costly and inefficient for undertaking certain types of business transactions.

Hymer's (1976) pioneering work on MNEs revealed that international firms do not operate and compete in a perfect environment. Agmon and Hirsh (1979) agreed with Hymer's ideas and argued that MNEs only exist in a world of imperfect factor and product markets. Under a perfect market, trade would exist as firms possess no advantage over domestic competitors in the host countries and MNE's would not come into being (Hood & Young 1979; Agmon & Hirsch 1979; Rugman 1980, 1981, 1982; Buckley & Casson 1976). The implicit neo-classical assumptions, such as a perfectly competitive environment with all firms possessing equal access to all production and information factors, zero transportation costs, identical tastes and so on are basically unrealistic (Hernart, 1986). There are numerous instances of market disequilibrium conditions that provide firms with incentives to invest abroad (Calvet, 1981).

Market imperfection may occur under different circumstances. For example, it happens in (1) goods markets[2], (2) factor markets[3], and (3) government policies and interference[4] (Kindleberger, 1969; Hood and Young, 1979; Calvet, 1981; Buckley & Casson, 1985). Various forms of market imperfections are considered as obstacles to trade, and they are usually assumed to be exogenous to transactions. Firms which develop their own hierarchies to resolve the problems caused by market imperfections inevitably incur costs.

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2 Such as product differentiation, price differentiation, brand names, and dedicated distribution network.

3 Such as differences in access to technology and information that are protected by patents, management know-how, firm-specific production assets, capital markets, raw materials, labour, consumer markets, and imperfect competition caused by internal and external economic of scale.

The costs that are involved in running internal systems can limit and/or severely reduce the power of MNEs in earning excessive profits in the long run (Rugman, 1982). Casson (1982, 1987, 1990) stated that a necessary, as well as sufficient condition for the existence of MNEs, is that there is a net benefit to internalise external markets linking activities located in different countries.

Central to the internalisation theory rests the analysis of costs and benefits of internalising markets and products (Buckley & Casson, 1985). For a firm to invest abroad directly, it must find FDI preferable to any other means of extracting the rent from a foreign market (Kindleberger, 1969; Caves, 1971; Hood & Young, 1979). The theory hints that firms economise on transaction costs and they consider explicitly the relative costs of servicing foreign markets which vary in an arm's-length or market relationship (market transaction costs) as compared to FDI (internal organization costs) (Rugman, 1982; Buckley, 1988). The total costs need to be weighed against the overall advantage in order to find a point at which the growth and profitability of the firm is limited.

Whenever transactions can be carried out at a lower cost within a firm's hierarchy than through the market, they can be internalised and undertaken by the firm itself (Williamson, 1985, 1990; Hennart, 1991). The efficiency of the company as a whole is thereby improved (Cantwell & Dunning, 1991). Dunning (1988) described these internalisation advantages as transactional benefits. Such benefits can only be achieved through co-ordination within the firm and it is said to be the result of what is referred to as transactional market failure.

Our economy is full of different types of imperfection. Consequently, there are always motives driving firms to internalise their external markets in order to satisfy various objectives. Market imperfection seems to be one of the sound reasons to explain the emergence of MNEs in the past few decades.

4.2.2 Firm-specific advantage

The above analysis of market imperfection has provided persuasive explanations of motives that drive firms to go abroad. Nonetheless, the existence of market imperfection is a necessary but insufficient condition for FDI to occur. This factor alone cannot fully

[4] On taxes, tariff, exchange rates, interest rates, international capital flows, technology transfer, and/or trade and FDI in general.

explain why firms prefer to use FDI rather than other entry modes to approach their overseas markets. Another question that arises is how can these foreign firms compete with innate rival firms and survive in alien host-countries?

Hymer (1976) was the first researcher who suggested that international firms do not operate under perfect competitive conditions and some firms possess specific advantages over others. Besides market imperfection, there is an intertwined factor to explain the growth of FDI. MNEs are believed to have acquired and developed some "firm specific advantages" (FSA) within the imperfect competitive environment, such as market failure and/or high transaction cost in moving and controlling goods or factors among different countries (Julius, 1990). The possession of a FSA provides its owner with temporary monopoly power and therefore enables the firm to yield a rent above the normal profit margin that is common in its line of business. Conventionally, FSA is regarded as an element of distinctiveness and it provides foreign firms with an edge over their indigenous or international competitors in similar locations.

Dunning (1980, 1981) stated that the possession of FSA is a necessary pre-requisite for foreign involvement. Caves (1971) also hinted that for the possession of some special advantages, which lead a firm to invest directly abroad, two conditions must be satisfied. First, the advantage must possess the characteristics of a public good[5] (Buckley & Casson, 1976). Secondly, return from the FSA must rely on local production to a certain extent. Buckley and Casson (1976) put forward the third condition and it is that a FSA must be readily transferable within the organizational structure in order for it to be exploitable in the foreign countries. FDI is considered as a superior device to licensing in the sense that FDI can secure complete control over the use of a firm's FSA, and to export when it is denied by tariffs, taxes, quotas or other government imposed barriers on free trade (Rugman, 1981, 1982).

Generally speaking, there are four types of advantages that influential to internalisation decisions: (a) industry-specific factors[6], (b) region-specific factors[7], (c) country-specific

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[5] Which can be sold many times over without reducing the supply available to others within a firm.

[6] Such as nature of the product, external market structure as well as real and pseudo economies of scale.

[7] Like geographical and psychic distances e.g. culture and language differences which raise transaction costs by impeding information flow between the two parties concerned.

factors[8], and (d) firm-specific factors[9]. Among these four groups, the industry-specific factors, within which the technology sub-group in particular, tend to suggest stronger incentives for internalisation (Buckley & Casson, 1976; Hood & Young, 1979). The characteristics of technological specificity will be elaborated in Section 4.2.3 below. Despite its importance, we need to recognise that individual firms have different motives to internalise external or missing markets, and technology superiority is only one of the driving forces.

In sum, various motives lead to different patterns of vertical, horizontal and/or conglomerate integration. The relationship strengthens the predictive power of internalisation theory, which in turn helps us to understand the recent surge of MNEs and their FDI activities.

4.2.3 Technology Specificity

The broad definition of "technological advantage" covers superior knowledge in products, production or servicing processes, managerial skills, marketing and organizational structure (Hood & Young, 1979). Among different kinds of FSA, technological superiority is often considered to be particularly influential in FDI decisions (Vernon, 1979; Hood & Young, 1979; Lall, 1979). There are several reasons to explain this.

4.2.3.1 Maximisation of return

Technology is a public good and its full exploitation logically occurs with international operation (Buckley & Casson, 1976, 1985). Once a firm has paid for the initial cost to achieve the know-how, its foreign subsidiaries can draw on it with zero, minimal or relative low marginal cost before it becomes obsolescent (Caves, 1971). The possession of technological advantages stimulates firms to operate a network of subsidiaries across national borders in order to maximize overall return on a global basis (Buckley & Casson, 1976, 1985; Hood & Young, 1979; Caves, 1982).

Furthermore, the nature of technology advantage can influence the choice of foreign entry modes. For example, certain types of technology advantages (e.g. superior knowledge in

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[8] Inlcudes political and fiscal factors between the nations concerned.

[9] For instance, management expertise in organizing an internal market.

marketing or organizational structure) cannot be transferred independently from the firm and its management. Under this situation, through establishing operations abroad the firms can export their intermediate goods that were previously not resaleable and/or exportable (Caves, 1971, 1982; Hirsh, 1976). Thus, internalisation can be used not only to maximise return, but also to open up new markets.

It is suggested that technological advantage is a source of quasi-monopoly power that increases profits of MNEs, who operate in imperfect markets, particularly in those countries whose factor as well as product markets are underdeveloped (Agmon & Hirsch 1979; Hymer 1976). This explanation seems to best describe the situation in China. The country's open-door policy has been in place only for two decades. Although there have been significant improvement over a relatively short period of time, the overall investment conditions in China remain below the international standards. The breakdown of FDI sources conducted in Chapter 3 (see Tables 3.8 and 3.9) reflected that firms from developed and newly developed industrial countries/regions are the key investment origins. These investors are likely to possess FSA that allow them to exploit the underdeveloped markets in China.

4.2.3.2 Maximisation of control

Williamson (1985, 1990) stated that due to bounded rationality, the limitation of human's cognitive competence to process and act on information, and complex contracts are unavoidably incomplete. As a consequence, higher costs of monitoring and enforcing contracts and arm's length contractual relationships are inevitably involved. Furthermore, owing to human being's self-interest seeking nature, economic agents tend to disclose information in a selective and distorted manner. Given high detection costs, incomplete contracts always allow agents to cheat. Subsequently, explicit planning, monitoring as well as bargaining efforts are required in order to screen against, socially recondition, and otherwise penalize opportunistic invaders (Williamson, 1985).

It is claimed that internal networks facilitate efficient information flow and hence minimize the total management costs. The advantage of reducing information asymmetry through common ownership explains why MNEs prefer to control overseas operations directly rather than through other alternatives (Casson, 1987). In addition, FSA considered to be best protected within a hierarchical structure as the flow of information and/or assets is managed under a single ownership (Williamson, 1990). The internal mechanism provides a safe and efficient channel for the transfer, and this mechanism is especially useful for knowledge which is difficult to patent (Casson, 1987). The consideration of control becomes even more prevalent in high technology industry where proprietary products or processes are vital to their survival (Hirsh, 1976; Gatignon & Anderson, 1988).

According to Rugman (1982), the key characteristic of FDI is the sense of control over FSA. The licensing modality can become a valid option only when the risk of dissipation is eliminated, and the higher cost involved because of policing a licensing contract is covered by the rent generated. In many circumstances, the uncertainty and high cost of using contracts encourage firms to invest directly abroad (Rugman, 1982).

4.2.3.3 Non-existence of external markets

In other situations, the non-existence of external markets to price certain technological assets motivates firms to create their own (Buckley & Casson, 1976). The process of internalisation empowers the owners to assign property rights in technology to their subsidiaries and apply discriminatory pricing in the pursuit of maximizing worldwide profits and/or growth (Rugman, 1981, 1982; Hymer, 1976; Kindleberger, 1969; Buckley & Casson, 1976, 1985).

There is often asymmetry of equality of knowledge between buyer and seller of the nature or value of products. If a firm is unable to inform or convince potential buyers about the prices of its products, the seller has the reason to use internal hierarchy to create an internal market to eliminate the uncertainty of demand and enhance return (Williamson, 1990). This alternative becomes especially important to knowledge products, which are developed through lengthy and costly R & D (Buckley & Casson 1976, 1985). Certainty is required for effective long- and medium-term planning.

On the other hand, for some intermediate goods there are only a small number of buyers in the market. The situation not only increases buyer uncertainty, but also bilateral dependency (Williamson, 1985, 1990). Bilateral monopoly can limit the sellers' ability to enforce price discrimination schemes and hence threaten their abilities to generate excessive profits from the possession of unique assets.

Moreover, there are certain types of technology that are of a flow rather than an isolated or one-shot basis. If an owner decides to exploit these advantages by licensing, s/he may later find it difficult to incorporate into the licensing agreements any additional and/or new development that might be generated from further R & D investment (Gray, 1976). Again, under this type of circumstance, FDI is often a preferable mode as it provides the owners with the flexibility and control over the FSA at different stages of the R & D.

4.3 Conclusion

The central thrust of internalisation theory is the recognition of market imperfection, which hinders alternative forms of international business transactions, such as export or contractual arrangements (Rugman, 1981, 1982). Internalisation is the process of creating a market, which is an approximation to the external one, within a firm. Whenever the transaction cost of using the regular market is excessive and/or when the external market for a firm's product does not exist, there is a motive for internalisation. Our economy is full of different types of imperfection, and so there are always motives driving firms to approach their overseas markets through FDI.

Nonetheless, we need to realise that firms which develop their own managerial hierarchies to resolve the problems caused by market imperfections inevitably incur extra costs. A firm can only achieve and/or enhance its competitiveness if it runs the internal network more efficiently and effectively than the competitors. Central to the internalisation theory rests an analysis of the costs and benefits of internalising markets and/or externalities.

It was mentioned in Chapter 3 that FDI outflows from fourteen industrial countries were increased two-fold over the 1980s and the trend is continuing. Firms operating in developed environments are likely to have acquired their FSA under various types of factor and/or market imperfections. In turn, they are encouraged to exploit these monopolistic assets in overseas markets, especially in those areas of which competitive environments are relatively less developed. The breakdown of China's inward FDI, as showed on Tables 3.8 and 3.9, has lent support to this argument. The analysis reflected that investors from developed and newly developed regions are keen to invest in China in order to tap the country's potential domestic market and other factor inputs[10].

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[10] Such as a vast supply of cheap labour and land, and generous investment incentives.

Internalisation theory has provided cohesive explanations for the rapid growth of FDI activities worldwide, and the possible reasons why MNEs from developed countries are keen to invest in China. In the next chapter, I will use the understanding gained from this part of the literature review to look into the two characteristics of China's inward FDI, which are the major form and sources of FDI.

Chapter 5

In search of explanations for the two characteristics highlighting China's inward foreign investment

5.0 Introduction

Internalisation theory adopted in Chapter 4 highlighted that under the considerations of maximisation of return and control of firm-specific assets (FSA), many firms prefer to approach their foreign markets through foreign direct investment (FDI) rather than other arm's length alternatives. The theory has also shed light on the underlying reasons why firms operating in developed environments may want to exploit their monopolistic assets in overseas markets, especially in those regions where competitive conditions are relatively less developed, such as China. Based on this understanding, the current chapter takes the investigation a step further to look into the two characteristics of China's inward FDI, in terms of their forms and sources, which underline control systems and processes adopted by foreign investors in China.

5.1 Internalisation theory cannot explain the two features of China's inward FDI

While internalisation theory provided satisfactory explanations to help me understand the changing patterns of international competition in Chapter 4, the economic model reveals its limitations when the investigation progresses further to explain the two characteristics of China's inward FDI. The two characteristics challenge the underlying assumptions of internalisation theory in two fundamental ways.

First, the central thrust of the internalisation theory posits that complete control is necessary in order to appropriate full rent from the ownership of a firm's specific assets (FSA). Because of the importance of controlling FSA without bearing the risk of dissipation, internalisation theory suggests various reasons that discourage sharing control with other party(ies) either through JVs or other non-equity alliances. Rugman (1982) argued that contractual arrangements are fraught with danger. These alternatives should only be considered when the risk of dissipation is low, and this usually occurs when an investing firm is producing standardised products or when resale is difficult. Because the prerequisite conditions are hard to satisfy, contractual arrangements therefore would not be widely used (Rugman, 1982).

According to this set of assumptions, internalisation theory explicitly rejects the ideas of co-operative or contractual arrangements that fall short of full ownership. Although joint venture (JV) is a major type of FDI which can be in various forms, such as majority or 50:50 equity holding, ownership and control is considered as partial as other owner(s) can take up an active role and interfere in decision making of the business. As a result, this type of incomplete investment inevitably creates problems in the establishment of a suitable governance structure (Contractor & Lorange, 1988, 1988b; Teece, 1980, 1981, 1982; Ingham & Thompson, 1994). The costs associated with protecting the FSA from exploitation by partner(s) may not be covered by the additional benefits gained (Beamish & Banks, 1987). Consequently, FDI in a form of wholly-owned structure is deemed to be the most appropriate channel for any rational profit-maximising MNEs, especially those industries where intangible assets are the main basis for FDI (Caves, 1982; Beamish & Bank, 1987).

Although internalisation theory has offered some persuasive explanations of why firms prefer FDI rather than arm's length alternatives, the simplistic 'black-and-white' assumptions are proved to be inadequate to explain the rapid growth of JV, one of the most popular new forms of organisations worldwide. In China, JV is the most widely used entry mode adopted by foreign investors (see Table 3.7). If we follow the assumptions highlighting the internalisation model, the JV boom would not have happened.

The second refutation of the internalisation theory is that the model is built purely on an economics grounding and relied heavily on the "hard" factors, such as FSA in terms of tangible assets and intangible knowledge, and cost and benefit analysis mainly in monetary terms. The theory has neglected the human side of organisational economics, and treated social, political or cultural factors as irrelevant to the forms and costs of operation or ways to control FDI (Griesinger, 1990). Again, following this set of logic to explain why China's FDI comes mainly from the source of overseas ethnic Chinese, the likely conclusion would be that "it is only a co-incidence". Be that as it may, internalisation theory has failed at least to acknowledge the existence of this type of "soft" factor that bears a close relationship to, and has various impacts on, any kinds of FDI.

When the internalisation model explained different queries so well in Chapter 4, the readers may be surprised by the way in which the theory turns from being very useful to inadequate in explaining the phenomena of investigation in this chapter. Nonetheless, the middle-range position on prior theorisation that I have adopted within the research approach (see Chapter 2) encourages me to look at the problems from another angle.

The medium stance reflects that it is possible to learn from others, however, it is not guaranteed to happen in all circumstances (Laughlin, 1995). This research is set to serve four broad objectives. What I have aimed to do is to gather bits and pieces from relevant previous studies, and blend the prior wisdom with my own subjective ideas to draw up a skeletal model of IJV control, which will be used to guide the empirical investigation. It is the empirical detail, which will complete and make the skeletal theory distinctive. Internalisation theory provides vital concepts to explain general motives behind FDI activities. However, economic reasoning is not yet rich enough to capture the diversity and enhancing complexity that arise in today's international business operation and competition (Casson, 1990). If internalisation theory has reached its limit in explaining other areas of investigation, I can either extend it by integrating other rationale or introduce another theory that is more useful. As Casson (1990) suggested, theories should not be purely judged by being right or wrong, but by being more or less useful in explaining different areas of inquiry. The middle-range research approach provides me with the freedom of choice.

The problems I encountered have enabled me to recognise that the adoption of an economic model is only a foundation, a starting point for theory development of the new form JV organisation, and its control systems and processes. I have indeed learnt from identifying and solving problems. The inadequacy of internalisation theory urges me to think harder and look further for explanations. The subsequent work is illustrated below.

5.1.1 China's inward FDI - Joint venture (JV) domination

Internalisation theory posits that MNEs are buying and creating complementary assets in different countries and integrating their operations within a single unit of control in order to reduce transaction costs and risks (Buckley & Casson, 1976, 1985; Rugman, 1982; Casson, 1982, 1987, 1990). Under the traditional economic reasoning, the most significant transactional contingency facing firms who are considering JV would apparently arise due to the problem of opportunism. This underlying assumption is built on two explicit grounds: (1) opportunistic behaviour is an inevitable aspect of any type of inter-firm co-operation, (2) transaction cost analysis focuses mainly on legal enforcement of contracts, while social as well as behavioural mechanisms are seen as having no significant impact on the costs or ways of running a JV. However, I would argue that these two suppositions are neither totally correct nor broad enough to capture the complexity of today's business relationships.

In contrast to what the conventional economic reasoning claims, the current trends, such as the permanent change of the global market, shorter product life cycles, and rapidly enhancing technological complexities, make 'doing it alone' not only risky, but extremely difficult for many enterprises with limited resources (Stafford, 1994; Moxon & Geringer, 1985; Porter & Fuller, 1986; Geringer & Hebert, 1989). FDI in the form of wholly owned subsidiary is not necessarily the most feasible nor the best option available to parent firms to explore their FSA and/or to overcome problems caused by market imperfection. On the other hand, JVs that conform to certain preconditions and structural arrangements can actually provide a better solution to problems due to opportunism, bounded rationality and buyer uncertainty than wholly owned subsidiaries (Beamish & Banks, 1987; Shan, 1991; Casson, 1990). The emergence of JV is in fact a response to the rapid global change in the forms and patterns of competition (Harrigan, 1988; Parkhe, 1991; Glaister et al., 1998; Van Der Meer-Kooistra & Vosselman, 2000).

Parkhe (1993:320) stated that "assumptions are a function of time and place". Traditional transaction cost economics was founded decades ago. The validity of these suppositions under the changing global environment may shift over time. In a given place like China, the transaction cost explanations, which were originally established to explain mainly western MNEs' investment activities, may not be equally valid in the East. Human behaviour is shaped by the particular cultures from which they grow up (Boyd & Richerson, 1990). The differences between Western and Eastern cultures influence the patterns of their firms' behaviour. The conventional way in which an economic rationale was used is too rigid and narrowly based. The convergent thinking would force researchers into certain conceptual boxes and eventually lead them to see what they expect to see (Parkhe, 1993; Daft & Lewin, 1990; Bettis, 1991, Laughlin, 1995). The first step of knowledge advancement in JVs/IJVs or other types of organisation phenomena is to loosen up the self-imposed theoretical straightjackets and set free our thinking (Parkhe, 1993; Daft & Lewin, 1990; Bettis, 1991).

FDI decisions and control practices are not natural phenomena but socially constructed (Parkhe, 1993; Laughlin, 1995; Scapens, 1990; Roberts & Scapens, 1985; Otley & Berry, 1994). There is a dynamic amalgamation of financial and non-financial issues surrounding JVs. These two types of apparent contrasting factors often co-exist and their interplay affects various aspects of JV formation and operation. It is the reason why economic rationale alone is unable to reveal the full picture. I strongly believe that any meaningful analysis of JV and its control requires a real understanding of the intertwined relationships between financial and behavioural types of reasoning. These are my theoretical and methodological standpoints based on which this research is developed (see Chapter 2).

5.2 Internalisation theory - Opportunism

Sharing and co-operation is the central theme of JV arrangement, and it is commonly seen as the origin of problems in JVs (as individual JV partners do not need to take full responsibility of unfavourable business results). Accordingly, it is widely believed that the most significant transactional contingency facing firms considering a JV would apparently arise due to the problem of opportunism (Williamson, 1985; Beamish & Banks, 1987).

The above assumptions undoubtedly are built on some logical grounds. Nonetheless, this type of rationale should not be interpreted in a rigid manner and applied indiscriminately to all cases. If the extreme views about the bad side of human behaviour have been widely accepted as valid assumptions in organisation economics, I would challenge that prepositions about the altruistic and trusting features of human nature should be just as valid as the opportunistic ones (Donaldson, 1990; Barney, 1990). There are always two sides to an argument.

My thinking on the topic of cooperation and JV is inspired by an interesting analogy put forward by Boyd and Richerson (1990). They mentioned that humans are not unique in terms of cooperation in large groups. There are other insect species, such as bees, ants and termites, which are also actively working and cooperating with other members in their societies. In both the human and insect world, cooperative behaviour could only have evolved over the past thousands or millions of years if members believed that they would receive more benefits from their cooperative acts (Axelrod, 1984; Boyd & Richerson, 1990). In other words, there are factors that can promote and sustain co-operation. In fact, the existence of complex urban societies is evidence, to some extent, of unselfish cooperation (Boyd & Richerson, 1990). In our societies, there are people who voluntarily make contributions to charities, give blood, vote and respect the law laid down. How could we use the traditional economic views of contracts to fully explain human emotions and relations, such as the love between parents and their children?

Conventional economics theories have assumed that the independent agents trading at arm's length cannot trust each other (Donaldson, 1990; Barney, 1990; Casson, 1990). However, I would argue that opportunism is not a way of life in all inter-firm co-operations. Pursuing self-interest is not a universal motive driving all human actions. To a contrast, a JV which is established in a spirit of trust and long-term relationship between partners serves to reduce the potential for opportunistic behaviour (Beamish & Banks, 1987; Casson, 1990; Barney, 1990; Mohr & Spekman, 1994). Different from the common view that many people hold, JV can actually work as an effective channel to establish a spirit of trust among participants in the first place (Casson, 1990). The accumulative experience of co-operation can lead to greater trust between partners over time.

With a foundation of trust and co-operation, partners will be willing to pool resources and commit themselves to the achievement of better efficiency and long-term success of the JVs. High level of commitment characterises JV success, as it provides the context in which partners will be more willing to balance short-term advantages with long-term benefits without raising the specter of opportunistic behaviour (Mohr & Spekman, 1994; Buckley & Casson, 1988, 1989). Indeed, the accelerating pace of globalisation requires trust as a prime enabler. JV, a complex form of organisation, requires a lot of trust input if it is to be successful (Casson, 1990).

JV is a type of long-term investment in which higher transaction costs will be incurred in the short run in order to achieve future savings in running existing and subsequent joint businesses that arise from the improved climate of trust between partners. Buckley and Casson (1988, 1989) stated that if JV partners consider only the immediate consequences of an action, they always have incentives to cheat. The prospect of future benefits casts a shadow upon the present, and this indivisible economic relationship can promote cooperation and significantly affect partners' current behaviour patterns (Parkhe, 1993; Buckley & Casson, 1988, 1989). Should one party act opportunistically, the long-term prospect will suffer. Once partners recognise the mutual benefits from interacting that could not be otherwise obtained individually, an inter-dependent relationship will be established. If this type of positive relationship can be properly managed through the internal control mechanisms, such as a fair profit distribution and joint decision-making systems, problems due to opportunism can be effectively dealt with (Killing, 1983).

In sum, traditional transaction cost theories have failed to recognise the economic role of co-operation and the invisible human forces, which may have significant transaction cost and behavioural impacts (Casson, 1990; Griesinger, 1990; Van Der Meer-Kooistra & Vosselman, 2000). Indeed, "there is plenty of room in organisation economics for trust", according to a comment Barney (1990:385) made a decade ago. This research examines IJV control from both financial and human economic perspectives, and it has addressed the major deficiency of transaction cost economics.

5.3 Bounded Rationality

Economics theories posit that due to the problem of bounded rationality, some complex contracts are unavoidably incomplete, and therefore higher monitoring and governance costs are inevitably incurred (Williamson, 1985, 1990). Based on these assumptions, using the internal hierarchy through forming wholly owned subsidiaries is considered as a better alternative to using contracts. However, I would submit that limitation of cognitive competence exists not only between market agents, but also between managers and customers. When serving a foreign market, bounded rationality will create more problems to a wholly-owned subsidiary which has to rely solely on internal capacity than to a JV that can draw on resources from different partners.

It is evident that no matter which investment mode is to be used, managers with limited cognitive competence will find it difficult to deal with problems arising from different business environment, social structure and language in a foreign market. However, through forming JV with indigenous firms, the foreign partner can internalise its partner's knowledge and contacts to speed up the local adaptation process. A key advantage of JV and different forms of alliances is that they allow participants to acquire expertise from their partners' rather than having to develop the capabilities in house, if it is possible at all (Blodgett, 1991; Glaister et al., 1998). Evidently, JV is widely adopted to facilitate inter-firm learning and transfer of organisationally embedded knowledge that cannot be easily blueprinted through arm's-length contracts (Kogut, 1987; Casson, 1990; Martinsons &

Tseng,. 1995). The complementary nature of resources between partners can actually reduce the problems of bounded rationality in serving new markets.

A valid point raised by Gomes-Casseres (1987) is that the importance of JV instability has always been misstated if one ignores the instability of other alternative structures. Certain types of instability of JV, such as the so-called high divorce, liquidation and sold out rates of JVs (Parkhe, 1993), are in common with those facing wholly owned operations. However, scant attention has been placed on wholly owned FDI. Hence, the validity of these studies, which are not built on a fair comparison of the extent of instability between various types of operations, is limited.

5.4 Asset specificity - buyer uncertainty

Williamson (1985, 1990) posited that firms who possess asset specificity, especially those in intermediate product markets, such as technology and information, have always encountered problems which are caused by buyer uncertainty. Bilateral dependency between buyers and sellers limits the sellers' ability to generate excessive profits from the possession of unique assets. Small number bargaining is likely to result when switching cost is high. Therefore, the internal hierarchy becomes a more sensible alternative to the market. The term hierarchy has been commonly interpreted as a wholly owned operation. From my point of view, this rigid interpretation is incorrect.

JV and wholly owned operations are similar arrangements in the sense that they both are administered within internal hierarchies. The main difference between the two is that there is more than one firm claiming ownership and power of control in a JV. Nonetheless, I believe that this difference does not necessarily create major problems to the parties concerned. They are indeed controllable. For example, as was mentioned in the last section, by establishing a trusting foundation, JV partners are more willing to forebear and pool resources in order to achieve a long-term success of the joint business (Casson, 1990). The possibility and frequency of changing partners can be significantly reduced.

Some JVs are terminated before or when the contracts expired. It is however incorrect to assume that in all cases premature termination reflects internal problems and failure. Relatively short-lived JV is not synonymous to failure (Casson, 1990). It needs to recognise that an organisational arrangement most suitable for establishing a business may not be the best structure for its continuing operation (Casson, 1990). Harrigan (1984) observed that JVs are always re-configured when partners have gained knowledge of market of which they previously did not understand. Instead of seeing a change of structure as a source of failure, the self-liquidating feature of JVs in certain circumstances is a sign of success (Casson, 1990).

Flexibility is one of the characteristics of JV that can directly or indirectly reduce the perceived risk and uncertainty. Changes of JV ownership structure after entry may represent adaptation to local environment or correction of mistakes made when the operations were formed (Casson, 1990; Gomes-Casseres, 1987). Anderson and Gatignon (1986) suggested that flexibility, the ability to change systems and methods quickly and at a low cost, is always an important consideration in foreign entry mode decisions. This factor is particularly crucial in lesser-known foreign markets that new entrants are likely to change systems and institutional arrangements once they adapt to the environment. It may be a key reason to explain why JV is widely used in less developed regions, such as China.

On the other hand, there is an increasing number of JVs which employ a combination of contractual modes, such as a mixture of equity JV with licensing agreement and/or buy-back contract of JV output by the foreign partner, simultaneously in serving a foreign market (Contractor, 1985; Beamish & Banks, 1987; Buckley & Casson, 1988, 1989). The licensing agreement creates a future market for the investing firm's technological assets. Whilst, the buy-back contract provides the JV with a stable future demand of its output. Through bringing together individual partners' existing sales and/or distribution channels, sales volume is likely to be achieved more quickly (Davidson, 1987). The total rent generated through the JV route is more likely to compensate the additional costs involved and it may exceed those available through the wholly owned subsidiary channel. Beamish's empirical study (1985) of JVs in LDCs reflects that none of the foreign partners of his LDC-based JV samples relied solely on dividends for compensation. The recent phenomenon has clearly showed that foreign firms have tried to negotiate hybrid JVs which serve to lower their risk as well as taxes and to diversify income channels (Contractor, 1985).

It can be seen that JV is not only a tool used by foreign firms to approach the host markets, but also a channel adopted by local firms to access the global arena through the collaboration with foreign MNEs. As Harrigan (1984) suggested, not all firms can afford to acquire the resources and competencies they need. Some projects would never be undertaken without using JV as a mean of spreading costs and risks. For these players, JV is the best solution to the small buyer dilemma. Accordingly, it is incorrect to presume that buyer uncertainty can only be resolved by using the wholly owned internal hierarchy.

5.5 Uncertainty and risk

Teece (1981) stated that the relationship between transacting parties usually couldn't be fully described by a court-enforceable formal document as there are many possible contingencies. These contingencies relate to some quantifiable matters or other behavioural issues. Therefore, it seems logical to assume that the transaction cost analysis of JVs should not purely focus on the costs of legal enforcement of contracts, but also on the behavioural and social mechanisms which have significant impact on behaviour. Mohr and Spekman's (1994) investigation into the characteristics of partnership success provides empirical support to the above argument. The study discovered that behavioural characteristics - mutual trust, the willingness to co-ordinate activities, and the ability to convey a sense of commitment to the relationship, are the key components of JV success.

FDI, with its characteristics of high risk and uncertainties due to different political, economic, social and cultural issues, may possibly be reduced by using international JVs (IJVs) that normally involve foreign and local firms. IJVs can work as a channel of cultural exchange and facilitate inter-firm learning. Based on a reciprocal relationship, partners will be more willing to share information as well as firm-specific knowledge through the JV mechanisms. Information is more accessible and is used more efficiently under a co-operative climate.

MNEs from developed countries may well be confronted with higher adaptation and information requirements than they are accustomed to, thus reinforcing the appropriateness of forming JVs with local firms who possess country-specific information that is costly, time-consuming, or otherwise impossible for the MNEs to gather (Beamish & Banks, 1987). JVs economise on information requirements of FDI via pooling of resources between partners (Beamish & Banks, 1987). In fact, this advantage enables MNEs to better deal with problems of information impactedness due to uncertainty and unfamiliarity. As Beamish's study (1985) of JVs in LDCs revealed, foreign partners of successful JVs tend to attach importance to their local-partners' contributions of management, and local knowledge, information and contacts.

The above analysis by no means aims to convey a message that control is unimportant in FDI decision, as it is vital. However, gaining complete ownership and control is not without cost or risk. As a contrast, it often involves a higher level of resource investment. A greater extent of commitment will reduce the degree of flexibility and increase the switching costs should an investment become sub-optimal.

For example, Maxon and Geringer (1985) found that high development and launching costs, together with significant market as well as technological uncertainty, led to the upsurge of international collaboration between aircraft manufacturers in order to share risks and costs. In addition, through bringing together the expertise from various partners, the 'eclectic atmosphere' is more likely to cultivate significant innovations which are not possible to be achieved under a 'monoculture' context (Contractor & Lorange, 1988). Better co-ordination can lead to greater stability in an uncertain environment. Other things being equal, relationships characterised by mutual trust are more likely to manage greater stress and facilitate better adaptability (Williamson, 1985). Rather than being a source which causes uncertainty, JV can become a unique mechanism to hedge against uncertainty (Franko, 1987, 1989).

Many LDCs have offered various forms of investment incentives to attract FDI. At the same time, due to the worry of foreign economic domination, some host countries have also imposed rigid policies to prohibit or restrict investment in a wholly foreign-owned format (Beamish, 1985, 1988; Beamish & Banks, 1987). Facing these ambivalent policies, many MNEs adopt JV to overcome government interference and the alien environment on one hand, and make themselves entitled to the generous incentive packages offered by the host countries on the other hand. Indeed, inter-firm co-operation can facilitate the expansion into new markets, which are either impossible or costly to approach through the full integration track (Dunning, 1981; Beamish & Banks, 1987, Casson, 1990).

To conclude this part, a firm's decision of ownership structure to a greater extent is based on the analysis of cost and benefit related to different choices. Under the dynamic global and regional political and business environments, FDI and investment mode decisions are often a compromise among four vital attributes - control, resource commitment, return and risk (Anderson & Gatignon, 1986). It is fair to say that the establishment of JVs involve lower resource commitment and hence risk, but often at the expense of return on investment and control, particularly control of a firm's specific assets. Nonetheless, under the influence of their own objectives, successful firms skillfully trade with different levels of control for reduction of resource commitment in the hope of reducing some forms of risk to the levels that they can afford while increasing the overall returns (Anderson & Gatignon, 1986). Preserving flexibility for future maneuvers is often an important consideration of the trade-off, especially when approaching unfamiliar markets. In some cases, like those examples mentioned above, lower costs associate with minimised opportunism and bounded rationality, lower uncertainty in buyer markets, and/or efficient internal mechanisms to transfer as well as to integrate partners' specific assets, can provide benefits that are greater than the extra costs incurred (Anderson & Gatignon, 1986).

The analysis on the choice of foreign entry modes has stimulated my thinking and made me realise that FDI decisions are far more complicated and widely linked to worldwide and/or regional economic, social and political environments than I once assumed. Having gained an understanding of the rationale behind the worldwide surge of JV, I will relate the knowledge to the specific environment in China and try to explain one of the two features of the country's inward FDI. The analysis will be illustrated in section 5.6 below.

5.6 Investment environment in China - JV domination

The above discussion has identified the key reasons why JV has become one of the most popular, and sometimes dominant form of investment mode in approaching different types of countries. Being one of the leading FDI host nations in the world (Wang & Swain, 1993; Luo, 1997; World Bank, 1997; Independent, 11/11/2001), China has further benefited from the rising popularity of JV. Indeed, JV domination is one of the two features highlighting the country's inward FDI (see Chapter 3).

Although China is classified as a less developed country (LDC), a combination of effects stemmed by the Chinese culture, stage of economic development, central planning, and the long-lasting influence of Mao's political policies and the cultural revolution, has distinguished the country from other LDCs or centrally commanded economies (Davidson, 1987; Newman, 1992; Shenkar, 1990; Martinsons & Tseng, 1995). In addition to the above-mentioned reasoning in favour of JV, the specific features of China's investment environment have added extra preference on using JV organisation.

China's economic reforms have introduced a market mechanism into a primarily centrally planned economy (Simyar & Argheyd, 1986). Although the Chinese government has assured, in word and deed, that the country will continue the policy of opening up, at the same time the party remains steadfast in using its version of socialist principles and ideology (Wang & Swain, 1993). The government argues that the reforms are consistent with socialism with 'Chinese characteristics'[1]. The distinctive set of socialist principles implemented in China has paved the road for creative thinking in economic reforms.

Between the period 1949 and 1979, there was no legal provision for foreign investors to reside, do business or invest in the country (Kemp, 1987). During that period, the ten-year long culture revolution further destroyed the basic, underdeveloped legal systems. Soon after the open-door policy was introduced, the Chinese government paid their immediate attention to the establishment of the legal structure, such as the Joint Venture Law 1979 and Joint Venture Tax Law, in order to attract and meet the needs of JV foreign investors. While, the legal framework, such as the Foreign Capital Enterprise Law, for wholly foreign-owned enterprises (WFOEs) was implemented at a later stage in 1986 and its regulations were enforced in 1988. Indeed, the concept of WFOE is still in its infant stage for both foreign investors and the government. After two decades of opening up, China remains a new territory, which presents a lot of unknowns, to many foreign investors.

In addition to the overall peculiar political and legal environment, inter-regional diversity has multiplied the extent of complexity of investing in China. Similar to many LDCs, China has suffered from unevenness in development between regions. The inter-regional diversity can be explained through two main groups of reasons. The first group is classified as 'natural distinctions' which are caused by geographic location, various level of natural endowment, dialects as well as social practices that characterise individual regions. The second group is considered as 'man-made' variances, which stem from the

[1] Their argument is based on the facts that all land, property, and production are still publicly owned, while collectives and individuals (local or overseas Chinese, and foreigners) are only allowed to have leasehold tenure on land and property (Kemp, 1987:17). Even in a socialist country due to differences in mental or physical ability and attitude towards work, some hardworking people and regions should be allowed to become rich first in order to serve as an example of rewarding the diligent and punishing the lazy.

government's emphasis on developing trade zones, and the gradual decentralisation of decision-making power during the first phrase of the reform (Shan, 1991).

Many special economic trade zones (such as SEZs, ETDZs, and OCCs. See Chapter 3 for details) are located along the coast or in Southern China that is adjacent to prosperous Taiwan, Hong Kong and Macau. These special trade regions have received the most attention and resource allocations from the Central government. Because of their convenient locations and better state of development, they have received the majority of FDI in China. Along with the FDI boom in SEZs and OCCs, some of these local governments have been empowered more authorities to approve JV agreements and to promulgate regulations and policies to cope with the needs of the industries in their territories (Shan, 1991). As a consequence, individual regions have gradually created their own 'region-specific' investment environment. China is not a simple, homogenous market.

China's unique investment environment, such as the part-capitalist and part-socialist structure[2], non-convertible local currency, tight foreign exchange control, differences in language/dialects, culture and social practices, together with the inter-regional divergence, have presented a real challenge to foreign investors. The peculiar conditions in China may lead one to conclude that the level of risk and cost of investment would be high, or too high to take on. Now to the interesting questions - (1) how is the high level of complexity and cost/risk tied into the rapid growth of China as one of the world biggest host country of FDI, and (2) why is JV the most commonly used entry mode to get into the country? I believe that the answers for these two questions will provide crucial hints of why and how the Chinese JVs are formed and controlled. The questions have prompted me to carry out further investigation on this aspect.

Root (1988) described that political risk normally arises from a foreign investor's uncertainty about: (a) general instability in the host country's political system in the future, and/or (b) future acts by the host government that would cause loss to the investor. Because political environment is so dynamic, political activities which do not significantly alter the business environment, and changes which are implemented gradually, do not represent political risks to international business (Robock, 1971).

[2] Generally speaking, the Chinese government fixes prices centrally and controls most of the public utilities, heavy industries and many strategic important industries. While many commercial, light and servicing industries are run collectively or privately by local Chinese and/or foreigners with production and prices determined by the market.

China has adopted a 'gradual' rather than 'shock therapy' strategy to open its door to the outside world. Since the open door policy was introduced in 1979, the country has implemented various types of reforms on a "step-by-step" fashion (see Chapter 3). Besides continuously improving infrastructure and facilities, the central government has also steadily liberalised the FDI policies[3] in order to attract foreign investors.

Moreover, China has undergone a major reform of its financial system since 1994 (The World Bank, 1996). The traditional inefficient dual mechanism of foreign exchange (official and market foreign exchange rates and mechanisms operated at the same time) was abandoned and replaced by a unified foreign exchange system (Cheng, 1995). Nowadays, the daily exchange rates between the local currency RMB and other major foreign currencies (US dollar is the leading currency) are decided by the market forces. The reform has stabilized foreign exchange rates and enabled foreign currencies to become more accessible. Although RMB remains unconvertible worldwide and the foreign exchange system still lags behind the normal standards in the developed countries, China has made considerable progress in setting the foundations for a modern financial system (The World Bank, 1996).

Various types of reforms implemented in China so far, to a great extent, are anticipated and they are no surprise to foreign investors. Moreover, these changes have substantially improved rather than adversely altered the business environment. According to Root (1988) and Robock's (1971) definitions, China's unique structure and systems do not present an unacceptable high level of political risks to many investors.

As Kobrin (1979) argued, the common conception of risks in investment decisions is often narrowly based. The author stated that political factors are not always a major determinant of FDI although a relationship exists. Brewer (1981) also suggested that government instability in LDCs is only one source of risk, and it is by no means the most important consideration for many investment decisions. It is because investors usually analyze potential foreign projects in the context of the overall investment conditions rather than just focus on the political aspect.

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[3] For instance, in 1990 the party announced two major revisions on the joint venture policy. The first revision is that foreign investors are now allowed to chair the JV management boards. The second change is that control over JV duration has been loosened up (Casson & Wang, 1991). Furthermore, from 1996 onward foreign firms are allowed to invest in the trading type of JVs which was prohibited in the past.

According to Root (1988), the environment facing FDI can be decomposed into two main parts, a transactional as well as a contextual environment. The transactional environment[4] is defined as a set of actual and potential transactions between MNEs and external parties. Whereas, the contextual environment[5] includes a multiplicity of external parties linked by political, economic, social-cultural and technological interactions that can constrain the MNEs' transactional interactions but do not enter into them.

Root (1988) argued that risks, which are embodied in the contextual environment, are usually beyond the control of individual firms. When the level of uncertainty is seen as unacceptable, the best choice is to avoid. However, if the extent of contextual risk is considered as affordable, the real challenge to those positive investors is to adopt appropriate strategies to enhance their control over various transactions and hopefully through which to reduce certain types of contextual risks.

Result of some prior studies, such as Bennet & Green (1972), Green & Smith (1972), Fatehi-Sedeh & Safizadeh (1989) and Brewer (1981), showed that firms may not stay out of potential or actual politically unstable countries if the opportunities which exist in these nations are sufficient to justify the risk involved. In addition, given an attractive or strategically important market, oligopolists may prefer to invest rather than being left out regardless of whether an individual investment can be justified on its own merit (Kobrin, 1979). Luo's (1997) investigation into foreign funded operations in China revealed that gaining access into the Chinese market and exploiting its potentialities are the primary strategic objectives driving many foreign investors to the country.

A point that needs to be emphasised is that the previous discussion is not intended to convey a message that political uncertainties do not have influence over FDI decisions as a relationship between the two clearly exists (Kobrin, 1979). Foreign investors are naturally concerned with the level of risk stemming from China's distinctive investment environment. Nonetheless, investors may have expressed their concerns through other channels, such as the required return on investment, payback time and forms of investment, other than just the allocation of resources (Kobrin, 1979).

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4 For example, the relationship between MNEs and the host government, the risk of dissipation of firm-specific assets to potential opportunistic transacting parties, such as business partners, sub-contractors and employees.

5 For instance, a change of political, legal or economic policies, the host governments' relationship with other governments, the occurrence of war and expropriations are classified under this category.

In sum, internal stability is not by itself an adequate indicator of a favourable investment climate, but neither does internal instability necessarily pose a serious risk which deters FDI (Fatehi-Sedeh & Safizadeh, 1989; Brewer, 1981). Political risk is only a restraining force in the investment decision making process, while return on investment and other net benefits are the driving forces (Fatehi-Sedeh & Safizadeh, 1989). China undoubtedly operates under a set of unique conditions, and offers a combination of business potentials and risks. For many MNEs, the net benefits presented by China are sufficiently attractive to induce them to invest rather than stay out, even on terms they do not normally prefer (Franko, 1989). The real challenge facing these investors is to maximise the risk-adjusted return through applying appropriate strategies to control the transactional and some extent of the contextual environments (Root, 1988).

For foreign investors, who are unfamiliar with the general environment in China, not to mention the divergence of dialectic and investment conditions between regions, may find it difficult, time-consuming and costly to obtain basic knowledge and information that is needed for day-to-day operation in the country. China presents a lot of unknowns to many new investors to explore it alone. The overall conditions have encouraged investors to form JVs with indigenous players or other firms who possess country-, regional- and/or firm-specific knowledge to aid them overcoming the disadvantages stemming from their alien status. As was explained in Section 5.5, JV is an effective mechanism to facilitate inter-firm learning and information flow that is crucial in speeding up the local adaptation process in the unfamiliar China. A better and faster local acceptance is undoubtedly more likely to lead to a higher return and shorter payback time. In addition, JVs require lesser initial outlay which in turn means lower switching cost if the mode of entry or the investment as a whole become sub-optimum at a later stage. Flexibility, the ability to change structures and systems quickly and at a low cost, is always an important consideration of foreign entry mode decisions (Anderson & Gatignon, 1986). This factor is particularly important to foreign investors in a new territory like China.

In China, government agencies and state-owned enterprises are usually the only or the most favourable candidates for JV partners. Often, these government related parties are actual the 'rulers of the games', the national monopolists of the related industries or in a position that can influence the local governments' decisions. Through forming JVs with these organisations, foreign investors may be able to hedge against both transactional and contextual risks. Having been involved with JVs, the Chinese partners are unlikely to impose changes, or let the higher government authorities introduce new policies that will adversely affect the JV operations.

To strengthen the hedging mechanism, foreign partners can strategically align their Chinese partners' incentives towards the success of the ventures either through inducing them to acquire a larger equity stake or introducing some specially designed profit sharing schemes that are closely tied to the achievement of the JV objectives. Through using this type of strategies, foreign partners can tactically shift more contextual risks to their local partners and exercise indirect control over the contextual conditions, which are normally out of investors' reach (Root, 1988). Again, this type of benefit has reinforced the suitability of using JV to approach China.

In summary, the above mentioned reasons may well explain why many investors prefer to use JV, minority or 50:50 in particular, in their initial investment in China in order to preserve flexibility and speed up the local adaptation process. Questions related to the first characteristic of China's FDI are now unlocked. The investigation will continue to search for explanations for the second feature highlighting China's inward FDI in relation to the major source of the investments.

5.7 China inward FDI - Country of origin

The analysis above disclosed the key reasons why JV has become one of the most popular forms of investment in approaching China. Now, the investigation turns to the other feature of China's inward FDI, which is concerned with the sources of investment countries.

Since China opened the door to the outside world two decades ago, Chinese diaspora, who are scattered around the world, are very keen to invest in their motherland. Hong Kong, Macau and Taiwan alone accounted for more than two-thirds of the total accumulated FDI inflow into China between 1979 to 1991 (see Table 3.8). Moreover, it was estimated that investment from businesses run by overseas ethnic Chinese (OEC) from Southeast Asia accounted for another 10 - 15% of China's cumulative total in the similar period of time (The Economist, 18/7/1992). China has benefited from the connections with and the wealth of its diaspora that the country once lost. By looking at China's current achievement, one can see that the collective power of OEC has been an important driving force that pulls the country forward (The Economist, 18/7/1992; CND, 1/8/1994).

Unlike other LDCs which depend chiefly on "foreign" investment to accelerate their speed of modernisation, China has enjoyed its native supply. The distinction between the terms "FDI" and "domestic investment" is blurred in China's case, especially those from Hong Kong, a previous British colony and now a special autonomous region which returned to the Chinese control in July 1997. The attraction, but also the difficulty to conduct this research, is that the circumstances underlying China's FDI are unique. The country has tried to build a capitalist mechanism within a communist political structure. There are no identical incidences occurred in other parts of the world that I could directly refer to.

Moreover, as Luo (1998) commented, there is a deficiency in existing literature in the strategic traits of FDI undertaken by different origin investors. There are so few relevant studies that can shed light on how investors of different origins may make FDI and control decisions in different ways. They are the challenges presented by this research. Now, if we refer back to the research itself, we can ask the question why the majority of FDI in China, most of which are in the JV form, comes from a homogenous type of sources. Is it a co-incidence?

The queries surrounding the investment sources is first illuminated by findings of Parkhe's (1993) study of strategic alliances. Parkhe's work revealed that partners' nationalities have important impact on structures, partner relationships and ultimate performance of the alliances. Parkhe's conclusions are founded on the ground that international alliances are often characterised by sharp national, cultural and organisational differences. MNEs tend to invest abroad based on the competitive edges that they have acquired from the home countries. In addition, the cultural and social characteristics of individual nations would further distinguish the tendencies in terms of the extent of their resource commitment, R & D, product diversity and market breadth in their FDI (Porter, 1986; Parkhe, 1993a; Luo, 1998). The diversity of background has often hindered the co-operation among partners and the performance of alliances. The problems have commonly led to high instability and/or divorce rates (Franko, 1971; Kogut, 1988, 1989; Geringer & Hebert, 1989; Parkhe, 1993). Because of that, potential investors should select JV partners who possess salient attributes and matching nationality in order to lay down a foundation so that a compatible relationship between partners can take root and flourish.

Parkhe and other researchers' suggestions have strengthened the key assumption underlying this research that control is not an independent phenomenon. Whom to choose and how to cooperate is all part of the plan. There are many steps and elements included in the build-up of achieving control. The idea of JV control as a "package" has gradually emerged in my thoughts (Otley, 1999). Parkhe's work (1993, 1993a) has had an important influence on the subsequent theory development of this research and the link will be further elaborated in Chapters 6 and 7. At this stage, it has indicated that the extent of compatibility in terms of partners' national, social and organisational characteristics is vital to the partners' relationship and JV performance. However, these findings still have not fully explained why the OEC investors are particularly keen on forming JVs in China. These queries have prompted further investigation into the area of partners' cultural background, JV decisions and control in China. The related analysis is illustrated in the following sections.

5.7.1 Confucius influences

The investigation into the origins of FDI in China reflects that in addition to the economic rationale, there are other invisible forces, which originated from the Chinese history and culture, driving OEC businesses to their motherland. There is a continuous interplay between transactional and cultural/behavioural factors that affects these firms' FDI decisions.

Confucianism - a set of pragmatic rules for daily life, has been deeply rooted in the Chinese culture for more than two thousand years (Hofstede & Bond, 1988; Kemp, 1987). Confucian ethics emphasise four key principles: these are individuals' tasks in life, human relationships, obligations to family linkage and maintenance of social harmony (Hofstede & Bond, 1988; Kemp, 1987; Luo, 1997). Traditionally, the Chinese society is built around family networks. Family is the basic social and economic unit (Weidenbaum, 1996). The interpretation of the term 'family' can be extended largely beyond the literal meaning. The network normally stretches from the close core blood-related family, to slightly distant family, more distant relatives, and finally distant friends or acquaintances who are connected to any of the above groups (Luo, 1998). According to these orders of association, organisation in a typical Chinese society is characterised by membership of exclusive groups, such as kinship, dialect, town or county groups (Blackman, 1997). While individualism is paramount in many western countries, the Chinese society is group and mass oriented (Triandis, 2000; Weidenbaum, 1996; Blackman, 1997).

Under the influence of Confucian thinking, the Chinese often consider that problems can and should be resolved in a spirit of conciliation and mutual trust (Kemp, 1987). Harmony is found in the maintenance of an individual's "face". The word "face" is derived from Chinese meaning a person's dignity, self-respect and/or reputation (Hofstede & Bond, 1988; Blackman, 1997; Luo, 1997). Having a sense of shame is interrelated to Confucius stress on one's tasks in life. In the Chinese world it is often human relationship or "guanxi" in Chinese, not law, that monitors the day-to-day social activities and provides the security necessary to do business.

Luo (1997:53) observed that people who share a guanxi are "committed to one another by an unspoken code of reciprocity and equity". The guanxi principals are often executed by receiving and returning favours or "renqing" in Chinese, the humanised obligation. Based on her experience in China, Blackman (1997) stated that Chinese friendship involves give and take, favours for favours. While this type of friendship can be burdensome, it works two ways. Similar to face, renqing is a type of relationship currency that can provide leverage in interpersonal exchange (Luo, 1997). On the other hand, disregarding the guanxi commitment can seriously damage one's reputation, leading to a humiliating loss of face. Losing face can jeopardise one's future. The cultural mechanism imposes a powerful enforcement of trust and acceptable conducts which binds every member of the network.

Conventionally, Chinese often see that there are two parts of the world, inside and outside, friends or strangers (Blackman, 1997). The race tends to show a strong preference for mutual benefits in social and business dealings, and this emphasis partly stems from their fear of being mistreated by outsiders. Triandis (2000) observed that collectivists can be extremely hospitable, supportive and helpful to in-group members. They can be indifferent, exploitative and/or even hostile to out-groups. As Luo (1997:53) described, "in the initial stages of any business undertaking Chinese people will look first to the network links as bases for guanxi". Following this type of social practice, whether you are an "in-group" or "out-group", becomes vital in doing business in China.

The cultural and social characteristics that underlie the Chinese society form a unique business environment for foreign investors. Now the investigation turns to seek for explanations of why so many OEC investors are attracted to China and how they cope with the specific investment conditions in the country.

5.7.2 Overseas ethnic Chinese - the greatest economic engine of China's reforms

There are an estimated 57 million OEC worldwide and a breakdown of their geographic spread is showed in Table 5.1. An interesting question is how this group of ethnic minority can form such an influential collective power to pull China forward, a backward and poverty-ridden country with the biggest population in the world? The answer to the question is that the majority (53 million) of these OEC are concentrated in Southeast-Asia, such as Taiwan, Hong Kong, Singapore, Thailand, Philippines and Indonesia (The Economist, 18/7/1992). They are accumulating wealth and power at a furious pace that is far in excess of their population (The Economist, 18/7/1992; CND 1/8/1994; Weidenbaum, 1996; Department of Foreign Affairs & Trade (DFAT) - Australia, 1998).

As was discussed in Chapter 3, over a twenty-year period the five Asian Tigers outperformed their western counterparts in terms of average annual GNP growth. In the early 1990s, the combined foreign reserves of the four leading Tigers (Singapore, Taiwan, South Korea and Hong Kong) amounted to US$180 billion, which was at the same level as the two super states - Japan and Germany's put together (The Economist, 18/71992). Among these four Tigers states, only in South Korea do the Chinese not make up the majority the population.

In addition, the Chinese minorities in other South-Asian countries have also achieved a lion's share of their economies' wealth. For example, although the ethnic Chinese only accounted for about 10% of the population in Thailand, they owned the majority of commercial and manufacturing assets, and fourteen leading banks in the nation (The Economist, 18/7/1992). The OEC in Philippines have written an even more fascinating story. They made up less than 1% of the population. But this 1% OEC not only dominated the small business side of the local economy, but also controlled about 40% of the biggest commercial outfits in the country (The Economist, 18/7/1992). The Chinese communities in Indonesia and Malaysia are no exceptions, and they have attained an equally outstanding achievement in their economies (The Economist, 18/7/1992; CND, 1/8/1994)

According to a rough and conservative estimate, OEC worldwide may probably hold liquid assets (securities are excluded) worth US$1.5 - 2 trillion, and they generate an annual economic output of more than US$500 billion, the same level as the GNP of China itself (The Economist, 18/7/1992; Weidenbaum, 1996). It is observed that almost nine out of every ten billionaires in Southeast Asia are ethnic Chinese (Weidenbaum, 1996; DFAT - Australia, 1998). Once their real financial power has been revealed, it is not difficult to explain how the OEC investors could have the ability to drive China towards the goals of modernisation (The Economist, 18/7/1992; CND, 1/8/1994).

Table 5.1

Geographic dispersion of the Chinese diaspora

Country	Population (million)
Hong Kong	6.0
Taiwan	21.0
Indonesia	7.2
Thailand	5.8
Malaysia	5.2
Singapore	2.0
Burma	1.5
Vietnam	0.8
Philippines	0.8
Rest of Asia and Australia	1.8
United States	1.8
Canada	0.6
Latin America	1.0
Europe	0.6
Africa	0.1

Source: The Economist, 18th July 1992

5.7.3 Inward FDI in China by peasant-turned-merchant overseas ethnic Chinese - restatement of the internalisation theory

Since the open door policy introduced twenty years ago, the peasant-turned-merchant Chinese and their descendants have been actively investing in China. For instance, Salim Group - the largest conglomerate in Indonesia, Charoen Pokphand Group from Thailand, Kuok's family's sugar empire from Malaysia, Li's plastic-flower-turned-property empire from Hong Kong, are pouring huge amounts of money into many vast industrial and development projects in China (The Economist,18/7/1992). 'China without boundary' is the belief held by the OEC, and it is also the spirit that the Chinese government has tried to promote (The Economist, 18/7/1992; CND, 1/8/1994).

We can analyze the Chinese diaspora phenomenon from the transaction cost and cultural perspectives. It was revealed in Sections 5.1 to 5.6 that under the quickened pace of globalisation and change and the specific environment in China, JV turns out to be a particularly suitable form of organisation to approach the country. From the cost point of view, similar to other foreign firms engaging in JVs in China, OEC businesses can benefit from lower labour and land usage cost, investment incentives, local market penetration, and internalisation of local partners' assets as well as guanxi with important external parties. In addition to these advantages, owing to geographic proximity, the OEC investors from nearby Asian countries can further benefit from lower transportation costs and shorter delivery time of materials, technical and management supplies to their China JVs. The ability to provide support at a low cost can resolve some of the problems of operating in an underdeveloped environment in China.

On the other hand, OEC share similar culture, business practices and language with the Mainland Chinese. The commonality presents a shorter "psychic distance" in their FDI in China (Buckley & Casson 1976:33-34; Hood & Young 1979:56; Kogut & Singh, 1988:413). With an understanding of the Chinese language and culture, their investment in China is likely to involve shorter negotiation and set-up time, lower communication and management costs. Indeed, there are a number of prior studies (such as Stopford, 1976; Caves, 1982; Thomsen, 1992; Kogut & Singh, 1988), which discovered that the shorter the psychic distance between the host and source countries, the greater FDI would be generated. The OEC phenomenon in China seems to fit into these descriptions. The transaction cost consideration seems to be one of the main motives, which induces OEC to invest in their motherland.

In addition to the transaction cost reasoning, there are other invisible cultural forces driving OEC to China. Under the influence of the Confucius ethnic about one's tasks in life and family linkages, conventionally Chinese strive to maximise achievement in order to glorify their ancestors and accumulate wealth for their descendants, and they consider that the obligation will never end (The Economist, 18/7/1992). The rise of peasant-turned-merchant Chinese, who built up their family empires under disadvantaged situations in foreign countries during the late 19th and early 20th century, displays strong self-reliance and the Confucian virtues of thrift, discipline, industriousness, and family cohesion (The Economist, 18/7/1992). As a comment Casson (1990:vii) made, "differences in the productivity of economic units - whether families, firms, or nation states - will reflect differences in the efficiency of internal coordination, which will in turn reflect the culture of the social group involved". The success has driven this group of OEC to re-establish their roots in China with the first port of call in their ancestral villages, towns, counties or provinces, which hold the family identities[6] (The Economist, 18/7/1992; Blackman, 1997).

One may recall from the discussion showed in Sections 5.1 to 5.6 that trust is a crucial factor which significantly affects FDI decisions and JV operation. It is suggested that trust is normally easier to establish and is stronger between members who come from the same culture, religious or social groups, and it tends to transcend national boundaries rather than between members of different groups within the same country (Casson, 1990; Boyd & Richerson, 1990). "Cultural differences affect the extent to which individuals can trust one another, and therefore the extent to which they can co-operate effectively" (Casson, 1990:vii). Findings discovered from the restatement of the internalisation theory, which was extended by the injection of social/cultural considerations, can explain the two characteristics of China's FDI.

Following the set of Confucian rules, the Chinese establish their own order by creating a range of informal networks, which support and develop their interests. "This ability has made ethnic Chinese business entrepreneurs especially competitive in environments where the legal and administrative infrastructure, the externally imposed 'order', is relatively underdeveloped" (DFAT - Australia, 1998:3). Since guanxi, face and renqing are as much a part of overseas Chinese businesses as it is of businesses in China, OEC know instinctively how to work around their customs and deal with the Mainland Chinese (Luo, 1998). The traditions encourage OEC businesses to rely on implicit contracts and snap up valuable business opportunities, which include undertaking apparently high-risk projects in China. Undoubtedly, using implicit contracts can economise costs and lead time of business negotiation (The Economist, 18/7/1992; Weidenbaum, 1996).

Moreover, the Confucius thinking emphasises loyalty and faithfulness. Commitment is an essential ingredient of successful negotiation and business strategy in China (Davidson,

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[6]This is very obvious in the Fujian province, the ancestral home of the majority of Taiwanese, and in Guangdong province from where most Hong Kong and Southeast Asian Chinese once set out. Overseas Chinese investment in these areas far exceeds that in other parts of China (The Economist, 18/7/1992; Blackman, 1997).

1987; Newman, 1992; Shenkar, 1990; Martinsons & Tseng, 1995; Blackman, 1997). OEC investors who often demonstrate a high level of commitment, even in some risky projects, have won a good reputation. A high social status in turn will form the foundation of their guanxi building and put them in an advantageously competitive position in China.

As was mentioned before, OEC businesses tend to invest in ancestral areas and engage in JVs with those parties and employ the people in China that they can trust. Evidence has shown that however widely separated are the diaspora, Hakka tend to deal with Hakka, Fujianese with Fujianese, Shanghaiese with Shanghaiese and Chiu Chownese with Chiu Chownese (The Economist, 18/7/1992). The phenomenon seems to have something to do with the Chinese's in- and out-group mentality. Working in the home town can further clarify the OEC's identity as an in-group. From the economics point of view, operating within their own "bamboo networks" enables the OEC entrepreneurs to minimise transaction costs and risks (DFAT - Australia, 1998; Weidenbaum, 1996).

In addition to the overall understanding, OEC entrepreneurs who invest in their ancestral areas possess region-specific advantages. The commonality of language/dialects, origin in a clan, a village or a county can provide the OEC with a sure foothold of trust for business dealings conducted even at a great distance (The Economist, 18/7/1992). Their close guanxi with local JV partners and other transaction parties (especially the governmental bodies) will facilitate cooperation and reduce a lot of complications of setting up and running businesses in China. Insightful information that is crucial to the JV operation will become more accessible through a well established local network. All these factors can substantially increase the chance of success in China. Ancestral tie appears to be a powerful influence in OEC businesses' location decisions (The Economist, 18/7/1992; Weidenbaum, 1996).

On the other hand, owing to their advantageous position, besides investing in China either on their own or forming JVs with indigenous firms, OEC businesses have become a popular medium used by non-Chinese firms to bridge the gap between Western and the Chinese business cultures (Beamish & Wang, 1989; Blackman, 1997; DFAT - Australia, 1998). A good example is a high profiled JV recently formed between the leading American retail chain Wal-Mart and Thailand's Charoen Pokphand Group to establish discount stores in China (recorded in DFAT - Australia, 1998:5). In fact, China's total inward FDI from the Hong Kong region has included money from other countries, who have used the previous British colony as a gateway to approach China (Tretiak & Holzmann, 1993). Furthermore, the appropriateness of using overseas Chinese to bridge the gap is demonstrated in the growing numbers of OEC personnel being chosen by foreign companies as members of their negotiating teams and/or managers of their Chinese operations (Blackman, 1997; Martinsons & Tseng, 1995; Paik & Tung, 1999).

Why have the non-Chinese investors taken the complication of using OEC as an agent, partner or middleman to exploit the China market? The answer is simple. The OEC possess some country-specific knowledge, guanxi and an in-group identity that are well sought by other foreign investors. This analysis has clearly demonstrated that the transaction cost of running a business is culture specific (Luo, 1998; Casson, 1990; Boyd & Richerson, 1990). There is a continuous interplay between the economic and cultural elements, and the interactions among these two groups of factors sharpen and determine MNE's behaviour (Casson, 1990).

New understanding generated from the analysis above has fine tuned Parkhe's (1993) findings that were adopted in Section 5.7. It is suggested that cultural traits tend to transcend national boundaries rather than between members of different groups within the same country (Casson, 1990; Boyd & Richerson, 1990). Therefore, it seems more accurate to state that partners' ethnic background and cultural links, rather than nationalities, have important impact on structures, partner relationships and ultimate performance of alliances. Where to invest and whom to choose as partners and employees are all parts of an investment strategy that will have substantial influence on the ways in which the JV is going to operate and be controlled.

The phenomena in China present a unique situation to illustrate the inextricable relationships between cultural and economic considerations in business decisions. Traditional economic based internalisation theory, which was adopted in Chapter 3 to understand MNEs' FDI activities, is inadequate when trying to explain modern investment strategies that are embedded with complex financial and human motives. The above findings are my contributions towards the understanding in the two characteristics, JV and OEC investment source, of China's inward FDI. The insights gained from this part of the research will form a knowledge base to support the next stage of investigation into control processes and systems applied to these investors' IJVs in China.

5.7.4 Conclusion

The re-statement/extension of the traditional internalisation theory highlighted some crucial findings, which reflected that transaction cost analysis should not only focus on the cost of legal enforcement of contracts, but also social, cultural and behavioural mechanisms on the costs of running businesses. Cultural elements do have material as well as emotional costs on many sectors of our economies (Casson, 1990). Indeed, the transaction costs of economic activities are often culture specific (Luo, 1998; Casson, 1990; Boyd & Richerson, 1990).

According to the rapid development of international business and greater integration of the world economy, firms have formulated different types of business co-operations or alliances in response to opportunities and challenges that have arisen in both the domestic and global markets. As their competitors, many OEC firms have followed the worldwide trend and are involved in IJVs. When designing the investment strategies, the OEC investors tend to be driven by cost and other apparent non-economic cultural considerations. It is fair to say that in many cases either economic or cultural motives alone are strong enough to support their investment decisions. On the other hand, the co-existence of these determinants have motivated many OEC businesses to snap up the best of the opportunities provided by China with their guanxi and knowledge of the Chinese culture and business practices (Shan, 1991). Also, owing to their knowledge of both the East and the West, some western investors prefer to partner OEC firms to explore the China markets. OEC's personal and cultural links have proved to be commercially valuable (The Economist, 18/7/1992).

Findings revealed in this chapter explain why the majority of China's inward FDI comes from a similar type of source, and the investors' preference towards the JV form of organisation. Having gained an understanding in these fundamental aspects, the next step of literature review is to explore the control perspective under an IJV context. The related work is illustrated in Chapters 6 and 7.

Chapter 6

Conceptualisation of control in an international joint venture (IJV) context

6.0 Introduction

As was revealed in the last three chapters, there are an increasing number of firms using IJV as a strategic weapon to strengthen enterprises' capabilities as well as global competitiveness. The analysis also illustrated the reasons why under the specific settings in China, the JV form of organisation becomes an even more suitable tool to approach the country. Nowadays the real competitive power of a business is demonstrated not only by its internal capabilities, but also by the network of relationships that it has established with other companies (Harrigan, 1987, 1988; Parkhe, 1993a; Glaister et al., 1998).

While recognising the potential benefits of using JV/IJV, we also need to realise that gaining a competitive edge through the JV channel is not trouble free. On the contrary, as Geringer and Hebert (1989:236) described, "a firm that agrees to participate in an IJV inevitably complicates its life". This comment is not difficult to explain. First, a JV will have at least two or more partners, who are possibly holding different business objectives, influencing a venture's strategic decisions and regulating its important activities (Killing, 1983; Glaister, 1995). In addition, firms often use JV as a tool to overcome high capitalisation, uncertain and/or risky business situations (Anderson, 1990). The difficult business environments and objectives inevitably compound the problems of managing JVs and partners relationships.

The complexity of control will take on an added perspective in the case of IJV when one recognises that their parents have often come from different countries. These parents have their main control bases established in various countries, which may be operating in a diverse environment that is differentiated by political, legal, tax, social, cultural and linguistic frameworks. The complicated business settings and objectives of IJV themselves, as well as of their parents, make it an even more difficult form of organisation to manage successfully. Also, significant geographical separation and time differences will add further pressure and costs to the communication and co-operation among partners (Groot & Merchant, 2000). Shenkar (1990:83) described IJV as "unique and problematic".

The difficulties are commonly blamed for the key reasons leading to poor JV performance and/or failure rate (Franko, 1971; Killing, 1982; Beamish, 1985; Gomes-Casseres, 1987; Kogut, 1988, 1989; Harrigan, 1986, 1988; Geringer & Hebert, 1989; Parkhe, 1993, 1993a; Yan & Gray, 1995; Groot & Merchant, 2000).

Despite China's increasing popularity as a hot spot for FDI, particularly those in JV form, many foreign investors have regarded China as a "bewildering", "exasperating", "frustrating" and "far different" world of management (Goldenberg, 1988:181). Undoubtedly, with their ethnic ties and instinctive understanding of the Chinese language and culture, OEC investors may find themselves in an advantageous position to deal with the problems arising in their IJV located in China. However, in a general sense the high extent of unfamiliarity and difficulty has led many foreign investors to conclude that China is one of the most difficult places in the world in which to work (Goldenberg, 1988). Many western firms are still searching for a successful formula to guide them in cross-cultural negotiations with their Chinese counterparts (Paik & Tung, 1999).

The high potential of incongruity, instability and JV failure repeatedly reported by various researchers is contradictory to the central thrust of control, which leads firms to invest abroad directly in the first place (see Chapter 3). In China, JV has been the dominant form of inward FDI. If IJVs are so difficult to manage successfully, why are some firms willing to get involved? The interesting question to me is that despite the alarmingly high failure rate, how do some IJVs manage to "buck the negative factors and succeed anyway" (Blumenthal, 1995:115)? Is it simply potluck?

Shenkar's (1990) view provides a simple, but striking answer to the questions above. The scholar suggested that foreign firms choose IJV as a vehicle to approach their target markets not because they believe that it is easy to successfully manage, but because they consider it as the best means to serve the wider array of their objectives. The complexity of JV operation and control is neither good nor bad, provided that this form of organisation is the most appropriate strategic choice among different alternatives (Lorange & Probst, 1987). Rather, the important question is how to develop and apply some appropriate control systems and processes to deal with the dynamism (Geringer & Hebert, 1989; Glaister, 1995; Groot & Merchant, 2000). Control is a key to JV/IJV success or failure .

In this chapter and the ones that follow, I will review the existing literature of control in order to gather ideas for the conceptualisation of control in an IJV context.

6.1 The current stage of theoretical development of control in a JV/IJV context

A control system is described as the techniques and processes used by organisations to increase the likelihood that their personnel will internalise the organisational goals, and thus behave in viable ways under a changing environment that lead to the attainment of these purposes (Flamholtz et al., 1985; Emmanuel et al., 1990; Berry et al., 1995). Control is a vital determinant of JV performance and whether individual partners' and/or IJVs' objectives are going to be met (Franko, 1971; Killing, 1983; Geringer & Hebert, 1989; Yan & Gray, 1994, 1995; Glaister, 1995; Groot & Merchant, 2000).

The recent surge in JV activities has attracted much attention from researchers in a variety of disciplines (Osland & Cavusgil, 1998). Interestingly, the majority of these studies are fairly general in nature and they tend to focus on some very separate issues (Geringer & Hebert, 1989; Glaister, 1995). The popular topics covered include: reasons for JV formation (for example Hannart, 1988; Buckley & Casson, 1988; Beamish, 1985; Beamish & Bank, 1987; Anderson & Gatignon, 1986; Contractor & Lorange, 1988, 1988a, 1988b), problems of running JVs and/or descriptive discussion of how JVs should be managed (Killing, 1982; Harrigan, 1987; Davidson, 1987; Schaan, 1988; Shenkar, 1990; Lorange & Probst, 1987), and JV performance and/or stability (Beamish, 1985; Kogut, 1988, 1989; Gomes-Casseres, 1987; Lyles, 1987; Luo, 1997).

In contrast, aspects of control have only received scant and unsystematic attention (Geringer & Hebert, 1989; Lyles & Reger, 1993; Parkhe, 1993; Glaister, 1995; Groot & Merchant, 2000). Parkhe (1993) observed that not all areas of research in IJVs are in a pre-paradigmatic stage. Greater progress has been made in developing theories of outcomes (like JV performance and stability) than of the invisible process (such as management control) that leads to the outcomes. Our understanding of the topic of JV/IJV is limited in scope and in depth (Yan & Gray, 1994).

Moreover, the limited prior research studies of the field have examined very different aspects of control. As a result, these studies can only provide us with fragmented, unsystematic, non-comparable and even distorted results (Geringer & Hebert, 1989; Yan &

Gray, 1994). The subject of IJV control is considered to be lacking a strong theoretical core or an encompassing framework that can effectively integrate finite past research and serve as a spring board for launching future research (Parkhe, 1993).

According to the rapid surge of JVs used by firms of different size to serve various purposes, managers have received inadequate guidance on how to choose an appropriate control system from a wide variety of options and in turn how to apply it to their JV operations (Geringer & Hebert, 1989). Consequently, many firms have either taken part in IJVs ill prepared or been forced to bypass the valuable JV opportunities to strengthen their competitiveness (Geringer & Hebert, 1989). In fact, Drucker (1974) hinted a long time ago that IJV is a demanding, yet poorly understood, channel of diversification chosen by many firms to approach their potential markets. Almost three decades have elapsed and little has been done to identify the root and possible solutions of the operational and performance problems. To date, our understanding of IJV control remains very primitive and lags behind the demand of practice (Geringer & Hebert, 1989; Parkhe, 1993).

As Daft and Lewin (1990:1) observed, many aspects of organisation studies "have been a source of recurrent disappointment for practitioners and academics alike". The rationale behind their criticisms is that many of the prior studies have not "typically focused on problems that are relevant to business and government organisations, and the real world of organisations have not drawn on the work undertaken by organisational scientists" (ibid).

It is suggested that research, social and business development have to grow hand-in-hand. The richness and breadth of our research need to keep pace with the changing world (Daft & Lewin, 1990). The lack of interactions between academics and practitioners is a key reason which accounts for the static theoretical development. Indeed, the deficiency of knowledge in IJV control presents some valuable research opportunities that need immediate attention. According to the importance of the topic and my area of interest, this research aims at filling the gaps of existing literature and drawing up an integrative theoretical framework to explain the holistic concept of IJV control.

6.2 Part I - The process of conceptualisation of IJV control

As was mentioned before, there are very few prior studies which have focused on the key issues of IJV control. Being one of the pioneers in the field of IJV control, I have felt not only the excitement but also fear as the exploratory process will be inevitably very difficult. However, this research aims to generate an integrative theory of IJV control, rather than a perfect model that can claim the last word of the field. In the future, if there is criticism challenging my initial thoughts, this research will have already achieved one of the its objectives which is to raise attention on the important topic of IJV control. Sharing the same view of Barney (1990), I believe that the ultimate winner of any healthy debates will be the related field as a whole. Bearing this motto in mind, the journey of idea searching and theory building begins here and the detail is recorded in the following sections.

Following a middle-range research approach (see Chapter 2), I believe that it is possible to borrow some ideas from existing research in organisation studies, control in MNEs and/or JV/IJVs, and integrate this prior wisdom into my own thoughts to build a skeletal model. In the exploratory journey, I have been lucky to come across Geringer and Hebert's (1989) review of prior research in the field of JV/IJV. Their insights have become the key inspiration of the subsequent theoretical development of this research. The scholars (1989:241) identified that parental control in the complex IJV context is multi-dimensional and comprises of three key parameters: (1) mechanisms, (2) extent, and (3) focus. In contrast to their incompatible appearances, these three perspectives are interdependent and complementary to one another in explaining the broad concept of IJV control.

In their review, Geringer and Hebert (1989) discovered an interesting phenomenon. They found that the majority of prior studies have followed a piece meal approach to examine a single aspect of IJV control. Very few attempts were made to address more than one of the three control parameters and even less adopted an integrative approach to study IJV control. Because of this, the existing literature can only provide the practitioners and the academics alike with fragmented, unsystematic, or even distorted findings (Geringer & Hebert, 1989; Lyles & Reger, 1993; Parkhe, 1993; Glaister, 1995). The multiple dimensional view of control in an IJV context is crucial in the refinement of the skeletal theoretical model for this research, of which I will further explain in Chapter 7. At this moment, there is another vital insight that has significant impact on the conceptualisation.

Geringer and Hebert's (1989) study pointed out the over-simplistic assumptions underlying many prior studies, which presumed that IJV performance is simply a direct outcome either of the mechanisms used or of the extent of control that individual parents applied. These prior studies failed to take into account other organisation variables, such as strategy and structure. In their recommendations for future research, Geringer and Hebert (1989:248) encouraged fellow researchers to adopt an integrative framework to study the complex concept of IJV control and they drew the following conclusion:

> "The critical issue for a parent firm is to exercise control, in terms of mechanisms, extent and focus, over an IJV in such a manner that will enable it to successfully implement its strategy without incurring a level of administrative or organisational inefficiencies which outweighs the gains from its co-operative endeavour. In other words, there is a strategy-structure "fit" when the benefits outweigh the costs of control, and this "fit" is best when the margin between benefits and costs is optimised".

The above recommendation spells out the ideas that I have got in my mind. It articulates and helps me to place the conceptual bits and pieces into a more cohesive framework. My ideas are similar to Otley's (1999:379) views, which consider organisational control systems more like "packages" with different elements added on by different people at different times. The view of IJV control as a package, which comprises of interdependent elements, has emerged in my thoughts ever since this stage of the research development.

Geringer and Hebert's findings support my initial thoughts and their suggestions confirm the possibility of employing a contingency approach to study IJV control. Indeed, my middle-range assumptions that IJV control and performance as dependants of other organisation and/or environmental factors are consistent with the set of assumptions underlying contingency theory. Contingency theory recognises that there is no one best control system for all organisations in all situations, and an appropriate design is contingent on various internal and contextual factors (Burns & Waterhouse, 1975; Mintzberg, 1983; Galbraith, 1973; Gordon & Miller, 1976; Belkaoui, 1986; Otley, 1980; Merchant & Simons, 1986; Kast & Rosenzweig, 1985; Govindarajan, 1984; Emmanuel et al., 1990; Berry et al., 1995). Control is not an abstract phenomenon but an element embedded in a wide web of connections (Berry et al., 1995).

As was mentioned before, there are an increasing number of firms using IJV as a strategic weapon to strengthen their global competitiveness. It means that many of the IJVs are actually subsidiaries or strategic business units of multinational firms. Strategy-structure fit has been widely adopted in organisation and strategic management literature to examine various types of parent-subsidiary relationships (Govindarajan & Gupta, 1985; Geringer & Hebert, 1989). It seems logical to assume that it is possible to extend the contingency framework to explain the concept of control in an IJV context (Geringer & Hebert, 1989; Groot & Merchant; 2000).

Indeed, Franko (1971), a true pioneer of the field of JV, pointed out three decades ago the usefulness of strategy-structure approach in examining control-performance issues in JV subsidiaries of multinational corporations. However, during the eighteen-year gap between Franko's research and Geringer and Hebert's review published, virtually no researcher picked up the significance of Franko's insights. Only until very recently, Geringer and Herbert's suggestions have finally stimulated a couple of notable studies from the field.

The two rare attempts, Glaister (1995) and Groot and Merchant (2000), adopted Geringer and Hebert's (1989) three-dimensional concept to examine mechanisms, extent and focus of parental control in IJVs. These latest studies represent a breakthrough of the static research development of the subject, and they have made an important contribution by putting the multi-dimensional concept of IJV control into practice. Nonetheless, a common problem highlighting both Glaister and Groot and Merchant's studies is that they tended to consider each of the three control parameters as if they were totally independent. The scholars made no explicit attempt to integrate the three dimensions with other variables, and ignored how these factors interact and shape the whole control package applied to an IJV.

For example, Groot and Merchant (2000) considered contingency variables, such as partner's objectives, IJV's fit with the partner's business, and the extent of trust between partners, as "causal factors", each of which potentially affects the choice on one or more of the three parameters of IJV control. Mechanisms, focus and tightness of control were treated as independent elements. These are the problems highlighted by many prior contingency studies, that the impact of specific combinations of control used in conjunction have not yet been investigated in detail (Hopper & Powell, 1985; Emmanuel et al., 1990).

Glaister used "chi-squared tests" to examine how the three dimensions of control differ according to characteristics of his samples. At this infant stage of theoretical development, can statistical tests fully explain the relationships between various complex elements comprising IJV control (Parkhe, 1993)? It is another weakness underlying many prior contingency studies, which relied heavily on quantitative methods to take snapshots of temporary structural manifestations, as Hopper and Powell (1985) criticised. Both Groot and Merchant and Glaister's studies failed to recognise that control is not an independent phenomenon that accidentally exists alongside with other variables. Rather, it is the result of interactions among various contingency factors over time.

Despite their conceptual appeal, the two studies have suffered from the same problem as other prior research and failed to explore the full potential of contingency approach for the use of research in IJV control. More importantly, they have failed to generate an integrative theoretical framework to advance our understanding and work as a springboard for launching future research (Parkhe, 1993). In their conclusion, Groot and Merchant did come up with a tentative model to show an overview of relationships between the six identified causal factors and the three control parameters. However, it is not a theory as the scholars claimed. A gap remains in the existing literature. The process of reviewing the developments in the field has gradually refined the initial conceptualisation of this research. The criticisms above have borne no intention to undermine the contributions from prior studies on various aspects of JV/IJV and its control. I have learnt from my predecessors' wisdom and mistakes. I believe that this study will play a similar role to support fellow researchers.

At this stage, I have established a fairly good idea of what I want to achieve and do next. Sharing the same views as Geringer and Hebert (1989), and Groot and Merchant (2000), contingency theory has a role to play in the early stage of IJV theory development. I intend to extend the contingency approach to examine the holistic concept of control in an IJV context. Despite its merits, I recognise the limitations of traditional contingency theory and endeavour to address as many problems as possible in the designs of the research approach and method. The provisions made to address the limitations will be summarised in Chapter 10.

As Checkland (1981) and Otley (1988) rightly pointed out, each stage in the development of organisation theory has the potential to teach us something about how organisations evolve and adapt to the changing environment over time. The next stage of my exploratory journey is to review existing contingency literature on organisation and strategic management with the hope that previous studies can shed some light of how parent firms may control their JV subsidiaries under a rapidly changing environment.

6.2.1 Contingency approach

As Ansari (1983) suggested, it is possible to conveniently categorise the existing organisation literature of control along with two main traditions: structural and behavioural perspectives. The former tradition has characterised many of the existing accounting literature, which focus on formal rules, information feedback, and system design for regulation. The behavioural school on the other hand has been exemplified by literature on the social and human behavioural process towards the achievement of organisation objectives (Flamholtz et al., 1985; Berry et al., 1995).

Different from much of the work carried out by researchers from either the main-stream accounting discipline who have taken an universalistic view and considered that there is one best way to approach organisations, or the behavioural school who have considered that each organisation and its environment is unique and thus needs to be studied separately; contingency approach has adopted a middle position between the two extremities (Kast & Rosenzweig, 1985). Fundamentally, the approach has adopted the key concept of the synergistic nature of multi-dimensional control in organisations introduced by Hopwood (1974). The scholar hinted that for any systems claimed to be under control, that control can exist along multiple dimensions[1]. Alternatively speaking, controls can only be studied, designed, adopted and eventually achieved if a wider scope of the subject has been considered.

The contingency perspective on one hand has recognised that there is no one best control system that is suitable to all organisations in all circumstances. The design of an appropriate organisational control system is contingent on various factors and the choice of a particular system should reflect the external environment where the organisation is set (Flamholtz et al., 1985; Emmanuel et al., 1990; Berry et al., 1995). The main managerial role is to maximise the congruence between an organisation's internal control sub-systems and its environment. It is believed that an appropriate fit between different variables will lead to greater efficiency and participant satisfaction (Kast & Rosenzweig, 1985).

[1] Hopwood suggested three types of control dimensions - administrative, social and self control.

On the other hand, contingency views have also suggested that under certain situations it is possible to generalise some appropriate patterns of relationships or configurations of variables. The emergence of the contingency approach for the use of organisational control research has filled the gap between the uni-rational and the multi-dimensional open system schools of thoughts, which have respectively underlined many prior accounting and human behaviour research.

6.2.2 Contingency theory: environment - structure - control system design

Among the vast amount of literature, structural contingency theory has dominated the field of control research (Otley, 1980; Merchant & Simon, 1986). The importance of organisation structure lies in the fact that it is the internal pattern of authority and responsibility relationships that determine the ways in which labour is divided into some defined tasks, the channels in which information circulate and also the locus of decision-making. Goal setting, planning, decision-making and control take place within the structures which organisations have adopted. Different forms of structure induce certain types of performance, and at the same time discourage undesired behaviour (Emmanuel et al., 1990). In other words, structure is one of the mechanisms for achieving control (Belkaoui, 1986; Emmanuel et al., 1990).

Also, the popularity of structural variables has contained some historical reasons. The contingency framework originated in research on organisation designs during the 1960s and the early 1970s before the ideas were extended by another group of researchers, management accountants in particular, from the mid-seventies to investigate the processes of control that take place within various organisation structures (Otley, 1980). Control theorists linked the initial ideas, which focus on structures, with the systems and processes of internal control in an attempt to develop a more complete picture of the ways in which organisations respond to their environment and/or technological change (Otley, 1980).

Many early contingency researchers (notably: Galbraith, 1973; Burns & Waterhouse, 1975; Gordon & Miller, 1976; Mintzberg, 1983; Gordon & Narayanan, 1984) drew heavily on three major classes of contingency variables - environment, technology and structure from the organisation literature. These studies were commonly built on a set of assumptions of the simple linear relationships among these three factors - uncertainty stemmed from environment and the change influences the choice of organisation structures, and it in turn affects the design and use of control systems. The intertwined relationships between structure and control systems as a function of the environment have been widely adopted. The situation led some scholars to conclude that the design of any planning and control system is inseparable and interdependent on the form of arrangement adopted by the organisation (Horngren, 1972; Dermer, 1977).

6.2.3 Contingency theory: strategy - structure - control fit at corporate level

While organisation structure played such an important role in much of the research on design of control systems at the initial stage, surprisingly, the relationship between strategy and control received relatively less attention (Emmanuel et al., 1990). Only in the early 1980s did researchers start to recognise that strategy is an important and perhaps the pre-eminent source of contingency variable for the design of organisational control systems (Dermer, 1977; Emmanuel et al., 1990; Govindarajan, 1986, 1988; Govindarajan & Gupta, 1985; Simons, 1987; Langfield-Smith, 1997; Otley, 1999).

Indeed, Chandler's (1962) classic study of historical development of American industries, which was conducted four decades ago, already demonstrated a strong link between corporate strategy and organisational structure. Nonetheless, very few fellow researchers picked up on the insights straight away. Chandler suggested that organisations grow through adopting various strategies, such as geographical expansion, vertical integration and production diversification, in response to the opportunities and needs created by the changing environment[2]. Accordingly, the enlarged organisations need to be structured in an appropriate manner in order to meet the increasing administrative needs. It is evident that some firms, large-sized enterprises in particular, achieve growth through pursuing a combination of strategies simultaneously. Therefore, the complex structures are the results of several strategies followed by the firms.

Chandler concluded that structure has to follow strategy. A new strategy requires a new or at least refashioned structure. If senior management fail to do so, it will only lead to economic inefficiency and eventually a loss of competitiveness. A basic triangular relationship between strategy, structure and control as a function of the environment confronting businesses started to emerge at an early stage of research development in the field of control.

[2] Such as change of population, national income or technological innovation.

Miles and Snow (1978) attempted to expand the early thoughts hinted by other researchers, notably Chandler (1962), to discover the structural and control characteristics associated with strategies followed by individual firms. Their study aims at drawing up a theoretical framework for portraying the patterns of an organisational adaptive process to the changing environment within four industries. According to firms' strategic orientation, the scholars identified four organisation typologies - defender[3], prospector[4], analyser[5] and reactor[6].

Basically, results of the study supported Chandler's suggestion about the importance of strategy-structure-control fit. It revealed that all of the identified strategies are likely to perform equally well in many industries, provided that the chosen strategy followed by each organisation is implemented through a properly designed structure and control process. In addition to that, another major contribution of Miles and Snow's work is its reconfirmation of the interchanging relationship between organisations and their environment.

Many early contingency studies prior to Miles and Snow's work were based on the same assumptions that organisations responded in a predicable manner to their environment. At that stage of theoretical development, it was commonly believed that firms carefully aligned their internal variables into some viable configurations in order to respond to the opportunities and threats stemming from the changing environment. Increasingly, this deterministic concept of organisation-environment relationship has been challenged by new research findings, which revealed a less rigid interaction between the two forces.

Researchers from the new school of thought argued that organisations do not respond passively to predetermined environmental conditions but instead proactively create their own destinies through a series of strategic choice of various functional aspects, such as market, size and geographic location of their operation (Miles & Snow, 1978). A

[3] Defenders tend to follow some lower-risk specialisation strategies in products, markets, or technology and compete through cost leadership and service. Thus, Defender firms rely on relatively high degree of normalisation and usually adopt a functional organisation structure. Accordingly, centralised and formal planning and control systems that emphasise cost-efficient control become more appropriate.

[4] Prospectors stress on innovation and constant monitoring of environmental change for new opportunities. Therefore, they tend to operate in a more dynamic environment. Prospectors prefer to adopt some higher-risk strategies and stress on new products and market development. Consequently, they require a more flexible organisational structure and decentralised planning and control systems in order to facilitate rapid adjustment. Correspondingly, performance measurement systems that are adopted by the prospectors tend to be result-oriented and are used more subjectively.

[5] Analysers are an intermediate hybrid who are positioned in the middle of the two opposite strategies - defender and prospector. Analyser firms have taken a balanced adaptive approach and followed a type of strategy that is a combination of both defender and prospector characteristics.

[6] Reactors are described as those firms who fail to align strategy, structure, and control in a consistent fashion within their chosen environment. In other words, reactors are firms who fail to adopt one of the other three successful strategies identified.

collection of strategic choice of various aspects will decide the kind of environment and hence the level of uncertainty that an organisation has to cope with (Miles & Snow, 1978; Govindarajan & Gupta, 1985). Miles and Snow's findings illustrated that organisations develop their own means - strategy, structure and control techniques and process to deal with the environment of which they create/enact. The discoveries challenged the simply pre-deterministic, simple linear presumptions on environment and organisation/control designs that many researchers held in the 1960s and 1970s (Otley, 1980; Hopper & Powell, 1985; Emmanuel et al., 1990)

From my point of view, I see the conflicting findings between the two schools are simply reflections of how organisations adapt to their environment. When globalisation surges and various new patterns of competition emerge, the traditional reactive approach is no longer enough to sustain growth and/or survival. Under this type of situation, firms need to adjust their approaches and become more proactive. Miles and Snow's study unfolded the ways in which organisations learn and evolve over time and the findings have taken our understanding in design of control systems a step forward.

6.2.4 <u>Contingency theory: strategy - control system design at the subsidiary level</u>

Chandler and Miles and Snow's initiations of strategy-structure-control fit have provided empirical evidence and inspiration to many fellow researchers. Simons' (1987) study, which aimed at examining the difference in accounting control system attributes associated with chosen strategies followed by firms, was built on Miles and Snow's two (1978) organisation typologies - defender[7], prospector[8]. However, different from many of the prior studies and even Miles and Snow's research, which focused on corporate level, Simons examined the relationships of strategy and control at strategic business unit (SBU) level, although the author did not explain the significance of looking at this particular level of operation[9].

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[7] Simons hypothesised that defenders, who always emphasise on cost control, will place heavier reliance on formal accounting control procedures.

[8] Whereas, prospectors, who stress on new products and market development, are assumed to emphasise less on the use of formal accounting control in general.

[9] Despite the author recognising that SBUs, same as the headquarters of a diversified firm, adopt various strategies and in turn require corresponding control systems, he failed to make public the focus of his study. There was only a footnote to define his sample firms as SBUs, which are either distinct legal entities or autonomous divisions of diversified, multidivisional companies. There was no explanation of why SBU level was chosen.

It was found that defender and prospector strategies are two commonly used strategies among the sample SBUs (171 in total) of the study. Moreover, the results supported many of Simons' hypotheses, which posited that firms who pursue different strategies do employ accounting control systems in different ways. For example, it was discovered that defenders tend to tie in their management reward systems with the control systems and place heavy reliance on bonus remuneration based on the achievement of budget targets. High performing prospectors are more likely to emphasise on the importance of forecast data and constant environmental scanning, especially scanning of competitor activities, in their control systems.

On the other hand, defender firms, large-sized defenders in particular, were found using their control systems less intensively. They tend to make little change in their control systems over time. Some possible reasons to explain this common practice are that defenders are usually operating in simple/stable environments. Because of that, a tight control may be seen as unnecessary and costly. Prospector firms often place emphasis on forecasting and budgeting rather than on cost control. These findings matched with the characteristics of prospectors, who stress on new products and market development. In sum, Simons identified that prospectors use their control systems to a higher degree than defenders, who are operating with different strategic orientation.

Another influential study by Govindarajan and Gupta (1985), which examined relationships between control system, strategy and effectiveness, made a significant contribution towards our understanding in system designs at subsidiary level. Different from Simons (1987), the two scholars put forward some sound rationale to explain their research focus. As they rightly pointed out, strategy formulation and implementation takes place not only at corporate level, but also with the business units comprising a firm. Often, various SBU within the same organisation pursue different strategies, and in turn require different structures and control systems.

Although there is a growing trend of diversification and globalisation worldwide, Govindarajan and Gupta observed that the majority of prior research in the field focused exclusively on corporate level. The role of control systems in implementing strategies at SBU level received sparse attention. Govindarajan and Gupta's study targeted to fill this gap and aimed to extend contingency research on strategy-control fit from interfirm/corporate to intrafirm/SBU context.

In the study, a business unit's strategy is operationalised in terms of strategic mission (purposes/objectives of the SBU) given to the unit by the head office. The authors viewed alternative strategic missions as spanning a continuous spectrum, with at one end missions to increase market share (pure build strategy) and at the other end missions to maximise short-term earning and cash flow (pure harvest strategy). On the control side, the researchers chose to focus on incentive bonus systems. The rationale behind this choice is that SBU managers tend to attach greater importance to those aspects of performance on which they are assessed and rewarded. Therefore, a SBU's strategy must be linked to its reward system in order to encourage desired behaviour that is vital to the achievement of the unit's objectives.

It was assumed that a SBU, which follows a build strategy, tends to place greater importance on tasks that have long-term implications[10]. Firms or business units in the growth stage of the life cycle, which are surrounded by competitive and uncertain environment, often adopt build strategies. As a consequence, the approaches of evaluating build unit managers' performance and determining their bonus payment have to be used in a subjective manner since a lot of long-term criteria, such as innovation, cannot be measured in a quantitative and objective way.

On the other hand, harvest strategies, which are usually adopted by business units in the mature or decline stage of the life cycle, attach greater importance to the tasks that have short-term implications[11]. It was suggested that harvest unit managers face more stable and predictable environments and therefore the approaches of bonus determination of their performance can be based on a more objective manner.

The empirical results generated from fifty-eight SBU managers supported most of the authors' initial hypothesis that greater reliance on long-term criteria and subjective approaches for bonus determination will have positive impact on the build units' performance but will have significant negative influences on the harvest units'

[10] Such as new product, production process and market development in order to establish market share.
[11] Such as profits, cash flow, and return on investment.

effectiveness. The only exception[12] discovered was that greater reliance on short-term criteria for unit managers' bonus determination would contribute to all SBUs irrespective of the strategies they follow.

In sum, Govindarajan and Gupta's research demonstrated the linkage of strategy as an important and possibly pre-eminent source of contingency for the design of control systems at the subsidiary level. The extension of contingency theory from interfirm to intrafirm context is a breakthrough, which has substantially advanced our understanding and widened the horizon of the field of control designs that looks into operation at various organisation contexts.

6.2.5 Contingency theory: strategy - structure fit at the subsidiary level

Following the last project with Gupta, Govindarajan (1986) made another attempt to examine linkages between strategy, structure and effectiveness of SBUs within multi-business organisations. Based on the proposition suggested by other scholars, notably Chandler (1962) who stressed on the importance of structure following strategy, Govindarajan targeted to extend contingency theory to subsidiary level by linking structures to business unit strategies.

In addition, the study also adopted Miles and Snow's (1978) ideas of the interchanging relationship between organisations and their environment. Govindarajan viewed MNEs establishing SBUs in order to fulfil some specific objectives. On the other hand, a SBU's chosen strategy becomes a key factor that determines the environment which the SBU faces. Consequently, the SBU has to structure itself in an appropriate format in order to deal with the enacted environment.

The term 'structure' was defined as the degree of decentralisation of decision-making authority delegated to the SBU managers. The author borrowed from Galbraith's (1973) ideas that the higher the uncertainty of a task environment, the greater the amount of information that needs to be processed among decision makers. According to the environments they face, SBUs need to structure in certain ways in order to process the required amount of information and remain effective. Whereas, the term 'strategy' consists

[12] A possible explanation for this exception is that build strategies which attach greater importance on long-run criteria may also imply an emphasis on some short-run objectives. For example, a long-term objective like innovation and new product development do require financial support from some short-term criteria such as operation profits and cash flow.

of two dimensions - (1) strategic mission which reflects the SBU's goals and (2) competitive strategy[13]. Definition of SBU missions are the same as those adopted in Govindarajan and Gupta's (1985) research, and are considered in the context of the build-harvest continuum.

Basically, Govindarajan's (1986) results are consistent with the findings revealed in his prior study with Gupta (1985). For example, it was found that a SBU, which follows build strategic missions, tends to face a more uncertain task environment than a harvest SBU. Therefore, greater decentralisation of decision-making authority to lower levels is required in order to avoid overloading of the top-level information network. Accordingly, decentralisation is considered to be more appropriate to build units, and the decentralised structure will have positive influences on the build units' effectiveness.

Regarding strategic direction, it was found that SBUs, who pursue differentiation or prospector strategies, are likely to face higher uncertainty than those who follow low-cost or defender strategies. The rationale behind the above statement is that prospector or differentiation SBUs tend to attach great importance to new product or market opportunities, Hence, they are the creators of change and uncertainty. Consequently, these operations are likely to face more dynamic environments than low-cost or defender SBUs, and their managers need to process a greater amount of information related to new products, markets, competitors and customers. Alternatively speaking, decentralised structures are more likely to facilitate efficient operation and will have positive impact on prospector SBUs.

According to the overall findings, Govindarajan concluded that the degree of decentralisation of decision-making authority delegated to the SBU managers should be contingent upon the SBUs' chosen strategies. The extent of 'fit' between strategy and structure will have significant impact on the effectiveness of the subsidiaries.

[13]The competitive strategies are discussed within two frameworks. One of the frameworks is based on Porter's (1980) low cost - differentiation generic strategy continuum, and the competitive strategy of a SBU is considered as its intended trade-offs between cost and uniqueness. The other framework adopted is Miles and Snow's (1978) defender-prospector continuum, the details have already been discussed in the previous sections.

6.3 Conclusion of the initial findings and the conceptualisation of control in an IJV context

Govindarajan, Gupta, Simons and some other researchers' efforts to extend the contingency theory from interfirm to intrafirm context have demonstrated a wide-ranging application of the approach. Their work has indeed provided a strong inspiration to this research, which aims at developing an integrative contingency theory of control in IJVs. Their ideas of strategy-structure-control (SSC) fit have helped me to take the first crucial step in the conceptualisation of IJV control by outlining a three-tiered framework for the skeletal model.

As was revealed in the literature review, firms choose JV because it is the best alternative to serve a broad spectrum of purposes (Shenkar, 1990). IJV has become an increasingly popular strategic weapon to strengthen a firm's capability (Harrigan, 1987; Geringer & Hebert, 1989). The surge of JV new form reflects the evolution of organisation learning and adaptation according to environmental change. Nowadays many IJVs are likely to be subsidiaries, which are established to fulfil some specific purposes given by their parents. As a result, a JV subsidiary should not be treated as a discrete unit, but as a part of the wider network of its parent firm's objectives. The strategic mission of why an IJV is formed shapes the environment that the subsidiary has to deal with (Miles & Snow, 1978; Govindarajan & Gupta, 1985; Govindarajan, 1986; Simons, 1987). Having shared similar views, I decided to adopt IJV mission as one of the contingency variables in the conceptualisation of IJV control.

Facing the enacted conditions that are created by the investment objectives, an IJV needs to structure itself in such a way that enables the strategy to be achieved, as the golden rule Chandler (1962) suggested. In the majority of previous research (such as Burns & Waterhouse, 1975; Dermer, 1977; Gordon & Miller, 1976; Galbraith, 1973; Miles & Snow, 1978), the nature of their samples, whether they are wholly or jointly owned, was not clearly distinguished. The structural variable these studies adopted is commonly interpreted as the degree of decentralisation of decision making or interdependence. Nonetheless, this definition cannot capture the structural characteristics of JV subsidiaries. It is because the multiple ownership of a JV inevitably affects the ways in which the operation is structured and decisions are made. The division of decision making authority is likely to be determined by who you choose as your JV partner(s) and the resulting ownership/bargaining structure, as the literature review recorded in Chapter 5 revealed.

There are empirical studies in strategic alliances, such as Lou (1998) and Parkhe (1993a), which discovered that specific elements of an alliance structure, such as partners' nationality and/or cultural traits, could effectively promote robust co-operation between partners and lead to higher stability and performance in JV businesses. Glaister & Buckley (1994) and Glaister et al's (1998) studies reflected that UK-based parent firms tend to prefer a simpler ownership structure in the sense that they are the only foreign partners in their IJVs. The tendency may be due to the fact that the complexity of co-ordination often increases as the number of partners grows.

Ouchi (1979, 1980) used a transaction cost approach to examine three different types of organisational control systems - market, bureaucracy and clan. The studies revealed that transaction costs are linked to a certain extent to the norm of reciprocity in any exchange. While the term "reciprocity" is interpreted as the notion of trust, a "clan" is defined as an institution which consists of a group of people who share some common values and beliefs.

In a clan-controlled organisation, individuals recognise the importance of mutuality and interdependencies and therefore they always show a high level of commitment to their own behaviour. They believe that co-operation is the best way to maximise the outputs, which will lead ultimately to long-term financial rewards. In clan-based companies, rewards are commonly attached to behaviour that are characterised with correct values and beliefs, and control is exercised through this sort of implicit but powerful channel (Langfield-Smith, 1997). In general, a clan-control system is different from the other two types of constructs identified in Ouchi's studies. Both market and bureaucracy mechanisms require some extent of reciprocity as a minimum social requirement to operate. However, the execution of the former type of control is through price mechanisms, while the latter is through formal rules. Because of these reasons, an additional social criterion of recognition of legitimate authority is required for the bureaucratic control systems.

Langfield-Smith (1997) discovered that pure clan organisations, which rely principally on shared values and reciprocity, are not commonly found. On the contrary, many firms prefer to use mixed control systems, which combine clan-based tools with other types of instruments to cope with the unique environment they face. Indeed, IJV is a typical type of hybrid organisation that Langfield-Smith described.

From individual partners' point of views, establishing a right structure, in terms of ownership, decision making and/or bargaining power composition among partners, is crucial in the implementation of strategies and hence the achievement of their goals (Yan & Gray, 1994). Because of that, a careful selection of right partners and JV personnel, who share similar values, beliefs and business objectives and possess complementary resources, to create the preconditions for robust co-operation will determine the degree of co-operation between different parties, and hence JV performance (Parkhe, 1993).

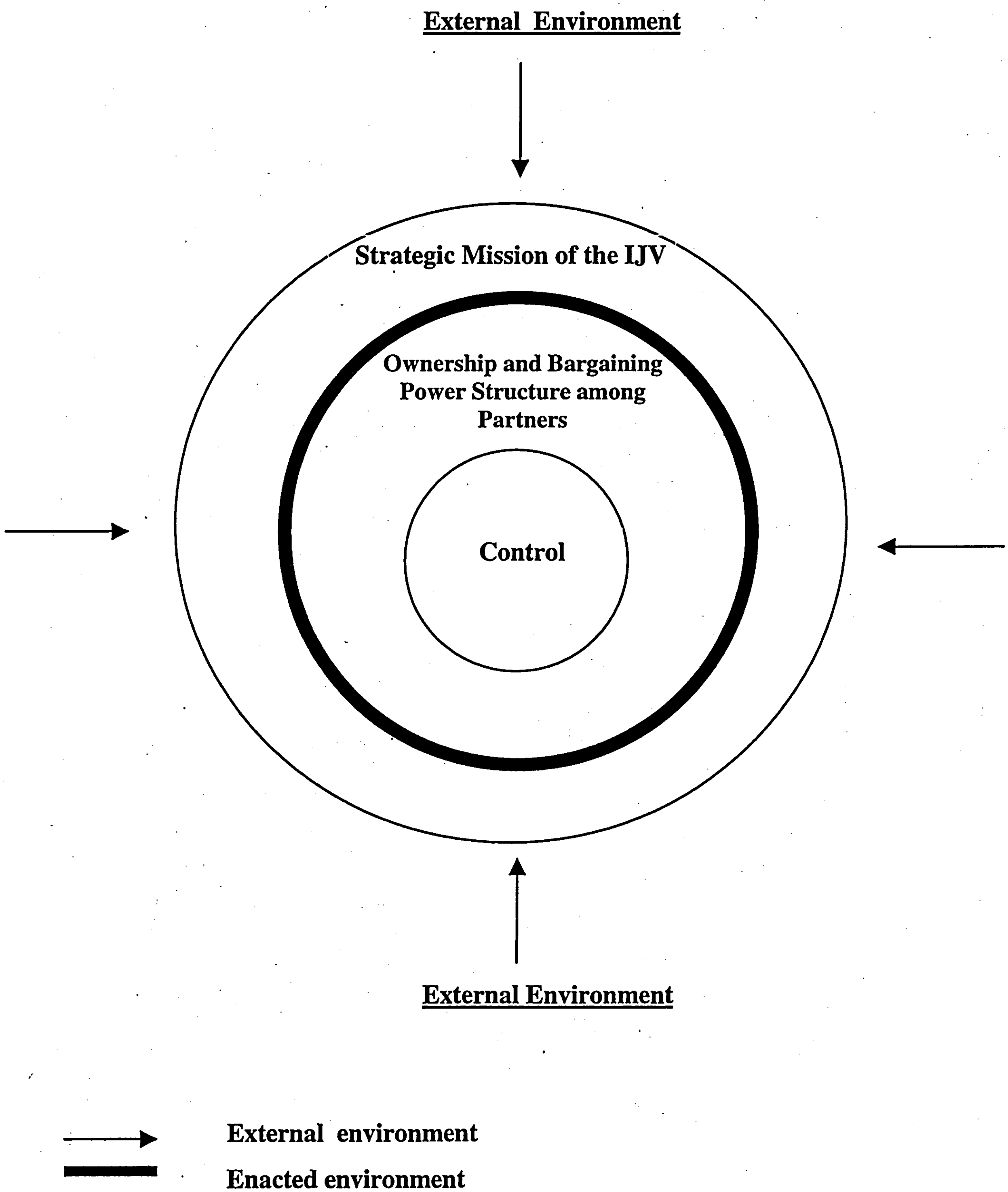
Similarly, the literature review recorded in Chapters 5 has demonstrated that how to choose and who to choose as partner(s) are all parts of a control package. According to the unique environment in China, the choice of suitable partners with salient characteristics has become even more important to parental control and success in IJVs (Parkhe, 1993a; Luo, 1997, 1998). Having taken all these points into consideration, I have chosen ownership and bargaining-power structure among partners as a structural contingency variable for the theoretical conceptualisation of IJV control.

Following the above investigation, the jigsaw pieces gradually fall into the right places and reveal a wider and wider picture of the holistic concept of IJV control. Step by step, a three-tiered, strategy-structure-control fit, skeletal model has been built. Now, I seem to be able to visualise the theoretical composition and I have captured these initial thoughts into a diagrammatic presentation as Figure 6.1.

Using these findings as a foundation, a starting point, the next stage of the theory building process is to complete the central core of the tentative framework. I aim to explore and identify the details of control systems and processes under the influence of strategic mission and ownership/bargaining power structure in an IJV context. The second part of the exploratory journey to complete the conceptualisation will be documented in Chapter 7.

Figure 6.1

Conceptualisation framework of IJV control - (1)



Chapter 7

Conceptualisation of an integrative theory of International Joint Venture (IJV) Control

7.0 Introduction

As was mentioned in the last chapter, Geringer and Hebert's (1989) review had a significant influence on the theory building process of this research. The two scholars pointed out that it is important for a parent to exercise effective control in such a manner that will enable it to successfully implement its strategy without incurring a high level of administrative or organisational inefficiencies which outweigh the benefits gained from engaging in an IJV. A "strategy-structure-control (SSC) fit" is achieved when the gain is higher than the cost of control. In Chapter 6, I amalgamated the SSC ideas with my own thoughts and drew up a tentative skeletal model of parental control in IJVs (see Figure 6.1). Using the three-tiered framework as a starting point, this chapter aims to complete the conceptualisation by detailing the elements which comprise the central core of the model.

According to Geringer and Hebert's (1989) observations, IJV control is complex and multi-dimensional. The control phenomenon can be studied through examining three parameters: (1) "mechanism" - the instruments used by partners to exercise control; (2) "extent" - the degree of control over various activities of the IJV achieved by individual parents; and (3) "focus" - the scope of activities over which parents exercise control. In contrast to their incompatible appearances, these three dimensions are in fact considered as interdependent and complementary to one another (Geringer & Hebert, 1989; Glaister, 1995).

In the following sections, I will look into the characteristics of each of the three control parameters, and examine the possibility to build them into the central core of the SSC tentative model. In addition, the investigation will examine the relationships between the three control dimensions and the other contingency variables, such as environment, strategic mission, and partnership structure of an IJV, that shape a holistic control package.

7.1 The "mechanism" dimension of IJV control

The mechanism dimension is described as the instruments used by partners to exercise control over various activities and/or the decision-making processes in an IJV. According to Geringer and Hebert's (1989) review, the majority of prior research, which examined this control parameter generated some apparently different results. The inconsistency is possibly due to the fact that they were built on diverse theoretical notions. Two leading approaches underlying this group of studies are the ownership-control-related approach and bargaining power approach.

7.1.1 Ownership-control related approach

Many of the initial studies in the field of IJVs discovered that foreign partners often rely on majority share-holding and thus voting right power to appoint the key posts in the IJVs as an effective mechanism to secure significant control over the JV operation (Geringer & Hebert, 1989; Glaister, 1995). For example, Stopford and Wells' (1972) study of MNEs' investments in developing countries revealed that foreign parents tend to acquire a majority of equity of their jointly owned subsidiaries in order to sustain an effective voice in management. The decisions could be driven by their alien status and the unfamiliar business environments in many of the less developed countries. Having held a significant share and hopefully the legal right of majority control of the IJVs, foreign investors might have felt more secure to pool resources.

Moreover, Tsang's (1994) research on technological alliances discovered that advanced technology always consists of some specific tactical knowledge and a successful transfer requires close interaction, supervision and exchange of personnel. From a supplying partner's point of view, the ability to appoint JVs' key personnel to co-ordinate and supervise the application of these specific assets is commonly seen as crucial towards the achievement of effective control. The ability to nominate the general manager, the head of a JV, is always one of the most delicate issue in the negotiation process of setting up JVs (Beamish, 1988; Geringer & Hebert, 1989; Glaister, 1995; Tsang, 1994).

Killing's (1983) research on thirty-seven IJVs[1] from developed countries provided empirical evidence to support the direct relationship between ownership and control. According to the management styles, Killing classified his samples as either dominant partner JVs or shared management JVs. A dominant parent venture is the one managed by one parent as if it is a wholly owned subsidiary. Whilst the other partner of the JV has

[1] Each of the IJV samples had two partners.

taken up a passive role. Whereas, a shared management JV, as the term itself indicates, is managed by both parents of a JV.

Being consistent with Killing's hypothesis, 70% of the dominant-control sample were actually majority owned by a single parent. On the other hand, 76% of the shared management sample were equally owned by both partners. These empirical findings have provided some persuading support to back up the central themes underlying the ownership-control-related school of thoughts.

Despite the overwhelming evidence which shows a strong correlation between ownership and dominant control in an IJV, Killing also discovered some "exceptional cases" that contradict other findings. Further discussion regarding the implications of the exceptions is recorded in section 7.2.3.

In addition to those early studies of the field, some recent attempts have generated similar findings or argument. For example, Agarwal and Ramaswami's (1992) research on the choice of foreign market entry mode reflected that higher operational control could be obtained through acquiring a greater ownership in a venture. Furthermore, Blodgett's (1991) research in partner contributions as a predictor of equity share in IJVs showed that if there is no host government pressure, JV partners gain power from their commitment of various resources, such as capital, technology and expertise. The level of control they obtain is in proportion to the assets that they command. Blodgett's research also revealed that technology type of contribution tends to strengthen the foreign partner's position over the local counterpart who provides the JV with local knowledge or marketing network. The study found that technological contributions are consistently associated with majority share holding position in the IJVs. Whilst, the provision of local knowledge is more likely to be associated with a minority equity holding which has a tendency to decrease over time.

Central to Blodgett's explanations is that in order to gain a foothold in an unfamiliar market, a technology-supplying foreign firm tends to form partnership with another party who can contribute local knowledge and/or marketing skills. However, sharing ownership with one or more local partners may drive the foreign firm to take some precautions in order to protect its firm-specific assets and minimise the disadvantages owing to their foreign status. Controlling a larger share of the equity normally allows foreign partners a greater measure of control over the use of technology and operation of the JVs. Once the market becomes more familiar though, the technology supplying partner would find the benefit of having a local partner diminished. Subsequently, they may opt to buy up more equity and reduce the shareholding of their local counterpart to an even less significant level, if the JV is not totally converted into a wholly owned subsidiary.

Tretiak and Holzmann's (1993) investigation into IJVs in China disclosed some similar findings. It is reflected that foreign partners increasingly favour asserting their major equity positions and getting things done faster without going through a cumbersome explanation or negotiation process with their Chinese counterparts. Indeed, Tretiak and Holzmann's findings may also be explained by the business and legal environment in China. The Chinese Joint Venture Law recommends that board of directors of all foreign-Sino JVs must discuss and decide business issues based on the principle of equality and mutual benefit. Specific strategic business decisions as well as determinant proposals[2] must be discussed in board meetings and decisions could only be made with consensus of all the directors or their representatives (Li et al., 1994). Nevertheless, the Chinese JV Law also suggests that the number of directors appointed by individual partners should be in proportion to the amount of capital each party injects into equity JV (see Chapter 3). This point directly links to the equity relevant or irrelevant argument.

In theory, the more shares a partner holds, the higher number of directors it can appoint to a JV board. With more directors representing a particular partner, the more likely it is that the parent firm would be able to appoint their ideal candidates as the general manager and/or other key functional managers of the JV through board decisions. In fact, the above phenomenon is not unique to China. There are other studies, such as Beamish (1985, 1988) and Schaan (1983, 1988) that will be discussed in the following sections, which also uncovered similar patterns in other less developed countries.

Another contribution of Tretiak and Holzmann's (1993) work is its confirmation of the interrelationship between strategy and equity structure of IJVs located in China. The findings reflected that the objectives behind the decision to set up IJVs in the country are the main determinants of ownership structure. For example, a partner firm, who is keen to

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[2] Such as amendment of JV contracts, termination of JVs, change of amounts of registered capital, change of registered trading addresses, and mergers with other organisations.

achieve or maintain a dominant position in its sector, tends to achieve effective control over the JV through majority share holding.

On the other hand, for a firm whose investment objective is to establish a foothold and gain experience of doing business in a new country, or to defend their existing market shares by following the market leaders' movements, it is likely to accept a minority position in an IJV without risking too much capital. In fact, Tretiak and Holzmann's findings have provided empirical support to the theoretical conceptualisation of this research. The tentative model illustrated in Figure 6.1 is built on the assumptions that strategic mission of an IJV will have significant influence over its ownership structure and control that individual partners may exercise over the IJV.

In sum, researchers from the ownership-control related school demonstrated that there is a correlation between equity holding and control. Their studies illustrated that many partners are in favour of using the majority equity position as the key mechanism to exercise effective control in their JVs/IJVs.

7.1.2 Bargaining power approach

Although researchers from an ownership-control related perspective have generated some persuasive evidence, scholars from another discipline have challenged their narrowly based theoretical standpoints (Geringer & Hebert, 1989). It is argued that there are situations in which foreign firms are prevented either explicitly or otherwise from acquiring full or dominant ownership in their international investments (Beamish, 1985; Schaan, 1983). As a result, the majority equity position is not a feasible instrument available to the foreign investors in this type of situation.

As was discussed in Chapter 4, a typical type of market imperfection, which encourages firms to directly invest abroad, is government intervention and restrictive trade policies. Some countries, especially less developed countries (LDCs), have deliberately used tariff, non-tariff, and investment incentives or import substitution strategies to induce foreign firms to set up local operations. At the same time, many of these host governments have simultaneously used other tools to promote local dominance or equality in shareholding in local-foreign JVs (Hood & Young, 1979; Beamish & Banks, 1987).

Local dominant policies range from "hard" rules, which restrict full foreign ownership of individual business operations, to "soft" strategies of offering more favourable incentives to FDI in forms of JV with local firms, licensing agreements and/or management contracts, to encourage minority or non-equity foreign investment. Under the influences of the hard or soft policies, majority ownership is not really an option open to foreign investors.

There are a number of prior research studies, which can provide empirical evidence to prove the influence of host governments' policies on foreign ownership. For example, Tomlinson's (1970) investigation of control-performance relationship for seventy-one IJVs in India and Pakistan indicated that the main reason why foreign firms choosing JV was because of government pressure. Janger's (1980) study of IJVs in LDCs also demonstrated that nearly half of his samples formed JVs with their local partners as a result of government requirements. In addition, Beamish's (1985) study of sixty-six JVs in LDCs discovered similar findings. The research showed that more than half of the sample JVs (57%) were created mainly due to the host government legislation. Moreover, in 70% of the samples, foreign partners were actually in a minority equity holding position.

Besides government intervention in some LDCs, there are other types of pressures prevailing in different markets that prevent investors from acquiring a majority stake in their JVs. For instance, along with the rapidly enhancing technological complexities, shortened product life cycles of many products, as well as increased size and risk of new projects, full or dominant ownership in many circumstances is only a quasi-option available to firms who need partners to share both cost and risk (Moxon & Geringer, 1985; Porter & Fuller, 1986; Geringer & Hebert, 1989).

In sum, under certain situations, firms are unable to rely on majority ownership as an effective mechanism to secure significant control over their JV investment. In some circumstances, although full or majority foreign ownership is legally allowed, owing to different reasons, such as insufficient resources, high risk or incentives offered to JV form of FDI by the host governments, some investors prefer to opt for a minority equity position and use other instruments to exercise the degree of control desired.

Based on the rationale mentioned above, scholars from the bargaining power perspective argued that control is not an automatic consequence of ownership. A parent may exercise effective control that is disproportionate to their share holding acquired in an IJV (Schaan, 1983, 1988; Geringer & Hebert, 1989; Yan & Gray, 1994; Glaister, 1995). Instead of seeing equity ownership as an absolute term, it may be more useful to consider it as an outcome of a particular negotiation process, which reflects the relative power between participating interests (Shan, 1991; Yan & Gray, 1994; Harrigan, 1986; Harrigan & Newman, 1990). Yan and Gray's (1994:1481) study of United States-China JVs illustrated that the relative bargaining power among various partners is frequently determined by the resources that they bring into the ventures.

Typically, capital, technology, management expertise, export capacity and/or brands are important contribution brought by foreign partners into JVs in developing countries (Beamish & Banks, 1987; Yan & Gray, 1994; Schaan, 1983, 1988). Under the resource dependent relationships, foreign partners with minority or 50% stake often obtain significant control over their JVs' activities simply because they have brought vital resources into the JVs (Harrigan, 1986; Tretiak & Holzmann, 1993; Harrigan & Newman, 1990; Yan & Gray, 1994). The superior status frequently works as a means of guaranteeing the supplying partners' participation in management (Glaister, 1995).

Schaan's (1983, 1988) research illustrated that the provision of management is another important control mechanism that can be achieved irrespective of equity position. A minority partner, who gets involved in the design and implementation of various operational and management practices, can make use of the situation to exert disproportionate control. The results indicated that effective control needs to be backed up by events and circumstances and such knowledge is more readily available to the parents if the key personnel who run the whole or some of the critical functions of the JVs are appointed and/or trained by them. As Schaan suggested, the provision of services, such as staff training and management contracts, can enhance the likelihood that the designs of systems as well as their implementation are in conformity with the parent firms' expectations.

In fact, Schaan's findings are consistent with administrative control hinted by Hopwood (1974) in his classic work on multi-dimensional control in organisations. Hopwood suggested that formal rules, standard procedures, and/or patterns of organisational relationships, are archetypal types of administrative mechanisms used to regulate staff behaviour. Accounting-based control, which stresses on formal organisational structure that links to responsibility, and budgeting process that focuses on plans, standards and reports, are typical examples of this category (Hopwood, 1974; Berry et al., 1995).

In addition, choosing the right person for the right job is another powerful means by which to increase the likelihood that the 'would be' employees' behaviour is consistent with the management needs. Training can be used as a channel not only to pass on technical rules and skills, but also a mechanism to inculcate social values and/or organisational culture with the aims to influence individuals' behaviour that is in favour to the organisation (Hopwood, 1974, Schaan, 1983, 1988; Groot & Merchant, 2000). Like the central thrust Hopwood held, for any systems claimed to be under control, that control can exist along multiple dimensions. Administrative control is a key type of control mechanism that exists side by side with other dimensions within a holistic package of control applied to IJVs.

On the other hand, Lecraw's (1984) study, which examined the relationship between bargaining power, equity ownership and control over ASEAN subsidiaries of one hundred and fifty-three American based MNEs, provided further support to the "equity irrelevant" argument. The research reflected that many of these American parents with low share-holding actually obtained significant control over some critical success variables in their jointly owned subsidiaries by means other than just equity holding. The results indicated that technological, marketing as well as export superiority always enhances foreign partners' bargaining power, and thereby control over the JVs. The extent of control the foreign partners achieved tends to be in direct proportion to the extent of importance, rather than simply the quantity or amount, of assets they have injected into the partnership.

Another interesting finding revealed in Lecraw's research is that foreign partners' participation in the management of crucial resources they contribute to the JVs is more likely to lead to successful results. Conversely, a low success rate is commonly found in JVs, where ownership and overall control is equally split between foreign and local partners mainly due to the pressure imposed by local governments.

In the equity relevant section, the main findings of Killing's (1983) study were discussed. Despite the overwhelming results, which supported a strong correlation between ownership and dominant control position in IJVs, the study also discovered some exceptional cases which contradict the main findings. For instance, there was a case where one partner who owned only 24% of the equity was its exclusive manager. In addition, there were four equally owned JVs, each of which was run by one dominant parent. The research also reflected that 25% of the shared management samples were not equally owned by the partners. An important message underlying these exceptions is that there are circumstances in which ownership makes little difference to the management structure of the JV.

In sum, the studies from the equity irrelevant school have demonstrated a wide range of mechanisms that are available to firms for exercising effective control in their JVs abroad and these options are not necessarily in direct correlation to the equity ownership.

7.1.3 <u>Equity relevant or irrelevant to the choice of control mechanisms in IJVs?</u>

Studies of the mechanisms of IJV control originated from "equity relevant" and "equity irrelevant - bargaining power" connotations seem to deny the explanatory power of each other and have become two competing schools of thinking. However, having examined their findings as well as implications, I would argue that they are actually complementary to each other and have made significant contributions towards our understanding in a broader range of control instruments adopted by IJV partners under various situations.

As was discussed above, the international investment environment is very complex. Firms are often facing different levels of legislation, red tape, and/or uncertainty when they expand their businesses abroad. Successful businesses tend to be those who demonstrate a high level of flexibility. Through adopting different strategies and structures, these firms can skilfully get round the restrictions imposed on them and maximise the benefits from their investment.

Generally speaking, where a business opportunity is best exploited via JV rather than other forms of business organisations, a particular set of control system and process is essential to success (Schaan, 1988). The mechanisms of control used by successful partners can be equity related or otherwise, and it depends on which types of instruments suit a given situation the best. Therefore, it seems impractical to assume that one theoretical connotation is broad enough to capture all control mechanisms chosen by individual partners under different circumstances. I believe that an integrative approach, which draws on the strengths of various schools, may sound more promising to reveal a fuller picture of parental control in a complex IJV context.

A finding revealed in Beamish's (1985) research in characteristics of IJVs in developing countries provided some important inspirations towards my understanding of equity structure and control. The study discovered an interesting strategy adopted by MNEs to accommodate some LDC governments' requirements for local dominance or equality. These MNEs apparently acquired less than 50% equity and were classified as "minority" shareholders. Nonetheless, they actually adopted the principles of 'relativity' and spread the ownership of their JVs over a wider number of participating parties. Although in theory they were minority shareholders, they possessed a greater equity than the other largest owners in the ventures. Through this clever manoeuvre, foreign partners could successfully exert significant control in proportion to their relatively more important equity status without offending the host governments or risking too much of their resources before vital local knowledge was gained in a new environment. With the JV status, these foreign investors would further enjoy the incentives offered by the host governments.

It can be seen from this example that in certain circumstances the distinction between majority and minority equity holding is blurred and somewhat misleading. The control mechanisms partners used contain both equity related and irrelevant characteristics. Under these circumstances, how can we draw a clear line between the two? If researchers had to stick with rigid ideas, their classifications and thus results would only provide us with misleading information. The implication of Beamish's findings has backed up my argument that a single theoretical notion is too narrow to fully capture the broad range of control strategies applied to different situations. An integrative approach is seen to be more fruitful to uncover a deeper understanding of various control mechanisms firms adopted to deal with the dynamic environment.

7.1.4 Integrative approach to study the "mechanism" dimension of IJV control

Integrating and extending the line of thought of his predecessors, Schaan's (1983, 1988) study, which was set up to examine parental control in terms of mechanisms, generated some rich empirical information to demonstrate the breadth of options available to IJV partners. The scholar chose to study IJVs in Mexico, a country which did not allow majority foreign ownership in JVs during the time of the research. Schaan's findings have made significant contributions towards our knowledge of the ways in which minority foreign partners overcome the restrictive investment policies in the host countries and successfully exercise effective control in their IJVs.

Through conducting in-depth interviews with senior executives of ten IJVs located in Mexico, Schaan identified a list of control instruments, some of which were not widely recognised by academics as control tools at that time. The list of mechanisms identified includes: board meetings, written reports, briefing sessions, the participation in the planning and budgeting processes, the provision of services, the appointments of key personnel, and the ability to design planning and reporting processes.

Schaan's study also reflected that a proper regimen of control should be balanced and complemented with appropriate informal instruments. Besides the mechanisms mentioned above, the study revealed a list of subtle instruments, which could be used to exercise meaningful control. The subtle tools range from: meetings, phone calls, social contact between partners and JV key personnel, inviting JV general managers to attend the parents' world-wide or regional meetings, tying JV general managers' salaries, bonuses or even future promotion prospect to the achievement of the parents' objectives.

It was disclosed that both direct and indirect control mechanisms enable partners who receive the reports and exchanges of contact to be in a position of sufficient knowledge of the JVs and of sufficient acquaintance with the JV personnel. The knowledge, familiarity and personal relationship empowers the partners to interpret, analyse and react to the information they receive in a more sensitive and accurate way.

As a rule Schaan (1988) suggested, for any JVs to succeed in the long-term, mutual trust between partners is vital. If one partner consistently overrules or refuses to compromise with the other partner(s), it will only lead to conflicts and the long-term survival of the JVs will be at risk. This viewpoint is very similar to the conclusion Killing (1983) made that a successful JV marriage is often built on mutual respect. No decisions should be forced by the shareholders' vote since the minority partners will lose faith in the relationship.

If we believe that the main reason of forming JVs is to gain something through the association with other partners, anti co-operative behaviour makes one wonder why firms bother to go through the trouble in the first place and how much benefit they will receive from their JVs (Blumenthal, 1995). Indeed, mutual trust and interdependency are the key elements of a solid foundation to encourage partners pooling resources and long-term commitment to the JVs (Buckley & Casson, 1988, 1989; Beamish & Banks, 1987; Casson, 1990). Thus, it seems logical to assume that instead of, or in addition to, merely relying on formal control tools to safeguard their interests, IJV partners should learn to exercise control in a subtle manner. Discussion, negotiation, persuasion, and inducement are examples of informal instruments to influence behaviours and decisions.

Furthermore, a JV should not be seen as a one-off business co-operation as there are many firms working with the same partners for multiple projects. Nowadays a firm's capacity is not merely a measure of its own assets, but also the whole network of resources of which the business is connected to (Harrigan, 1987, 1988; Parkhe, 1993; Glaister et al., 1998). Because of this, the need to establish a good reputation makes the success in the first JV even more important. The shadow of the future prospect of developing further business co-operations with the same partners can be a powerful control mechanism to regulate partner behaviour in the current JV (Parkhe, 1993a; Buckley & Casson, 1988, 1989).

All in all, the interests of one partner, no matter if it is a majority or minority stakeholder, are best served when those of everyone else's are also satisfied (Schaan, 1988). Along with applying formal control instruments, informal mechanisms allow JV partner firms to exercise control over their IJVs in a less intrusive or offensive manner. Having looked at the range of control tools that parents may adopt to control their IJVs, in the following section the literature review will turn to investigate the orientations of control mechanisms, which are the underlying reasons behind the application of certain control tools.

7.1.5 Positive and negative control mechanisms

In addition to illustrating a broad range of control instruments, another contribution Schaan (1983) made is his effort to classify the control mechanisms according to their nature and orientations. The scholar initiated two main classifications - positive and negative control mechanisms.

It is suggested that a JV partner tends to use positive control tools when it is in a position to influence or promote certain types of activities or decisions in a way, which is consistent to its own expectations and interests (Schaan, 1983; Beamish, 1988; Geringer & Hebert, 1989). The appointment of IJV key personnel, and participation in the planning or budgeting process are two typical examples of the positive category.

On the other hand, a partner may choose to apply negative control mechanisms when it is in a position to prevent the IJV from implementing certain decisions which are disagreeing with its interests. The right of veto over major decisions is an archetype of negative control instrument. Based on these definitions, Schaan categorised the control mechanisms his sample JV used and Table 7.1 illustrates these classifications.

Following Schaan's ideas, Geringer and Hebert (1989) raised some valid points that can further enrich our knowledge of control mechanisms. The authors suggested that some positive control tools are exercised through informal and less intrusive channels. This type of "user friendly" tools tends to cause no or less conflicts between partners or between partners and the JVs' personnel. As a result, trust and a co-operative relationship between different parties is likely to be built up or enhanced. If a norm of reciprocity has already existed between partners and the executives, the trusting relationship can provide synergistic elements to the control system and facilitate its effective operation.

Whilst negative control tools, which are used to prevent or stop some unfavourable activities and/or decisions, are frequently executed through some formal or bureaucratic means, such as veto rights, formal agreements and/or approvals by the board of directors representing each partner. In many cases, the negative control mechanisms are established as safety measures. Should anything "unexpected" happen, there are rules and facilities to refer to and sort things out. Killing (1983) found that inexperienced investors tend to concentrate on negative control instruments to protect their interests before they master the skills of using other more subtle techniques. Nevertheless, since the negative form of control relies principally on formal mechanisms and power, their application can significantly damage partner relationship and future prospects of the IJVs.

As a rule Schaan (1988) put forward, a proper regimen of control should be balanced by both formal and informal mechanisms. The exact weighting between the two forces in any IJV control system depends very much on individual partners' strategies, international experience as well as the specific environment facing the partner firms. Constructs of a control system may evolve over time following changes of key elements at different stages of the JV's life cycle (Lyles, 1987, 1988).

In sum, the analysis above has demonstrated the breadth of mechanisms that IJV partners may use to exert effective control. Various control tools are applied to serve positive or negative purposes, and the combination of choice in each case is subject to the influence of the mission and partners' bargaining power structure of the IJV. The new understanding of the mechanism dimension will be incorporated into the conceptualisation, and refines the central core of the skeletal model in Figure 6.1. The modified theoretical framework is illustrated in Figure 7.1.

Table 7.1

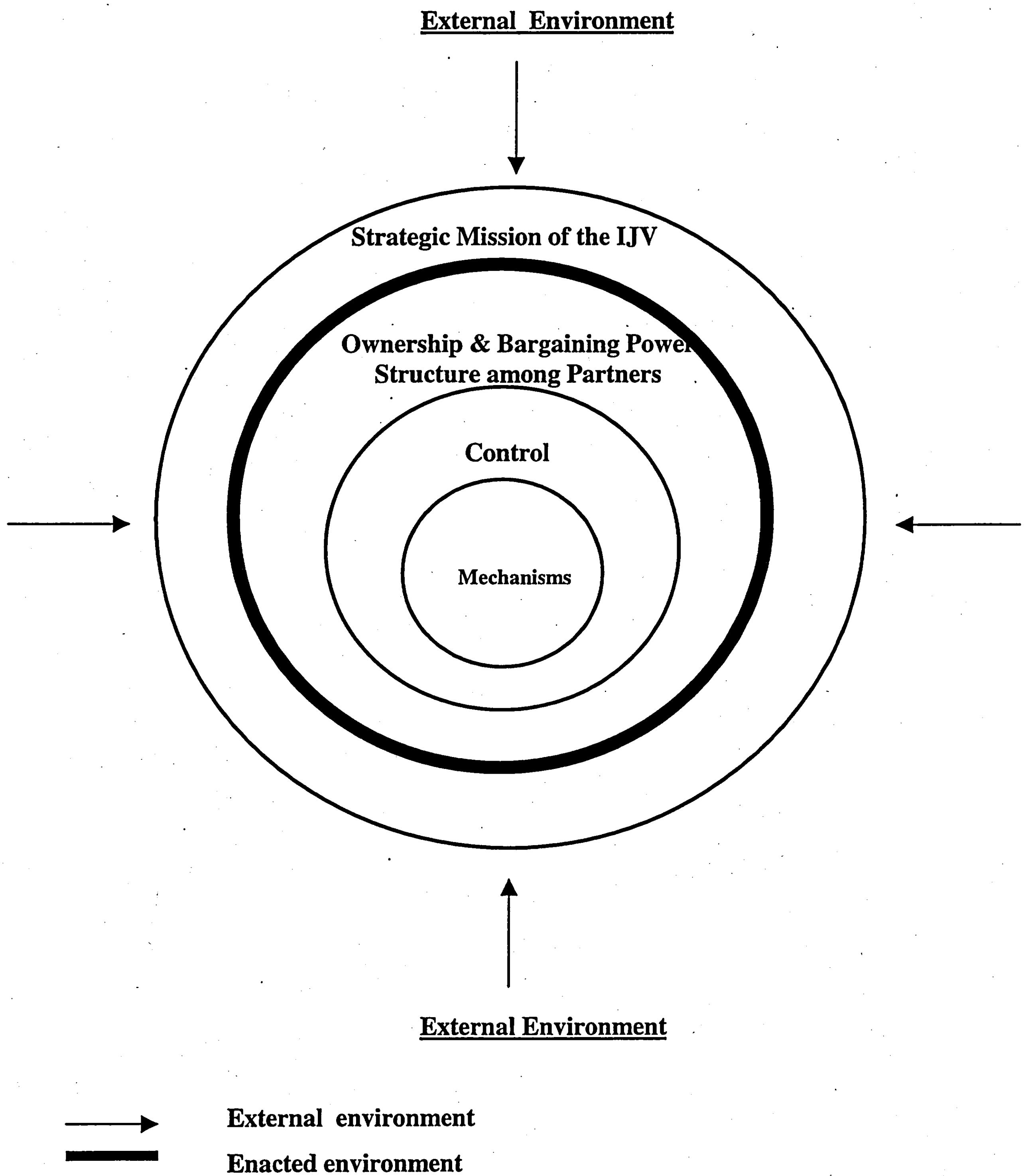
Positive and Negative Control Mechanisms

Positive Control Mechanisms	Negative Control Mechanisms
Ability to make specific decisions	Board
Ability to design: 1) Planning process 2) Appropriation requests	Executive committee
Policies and procedures	Approval required for: a) Specific decisions b) Plans, budgets c) Appropriation requests d) Nomination JVGM
Ability to set objectives for JVGM	
Contracts: Management Technology transfer Marketing Supplier	Screening/No objection of parent before ideas or projects are discussed with other partner
Participation in planning or budgeting process	
Parent organisation structure	
Reporting structure	
Staffing	
Training programs	
Staff services	
Bonus of JVGM tied to parent results	
Ability to decide on future promotion of JVGM (and other JV managers)	
Feedback: strategy/plan, budgets, appropriation requests	
JVGM participation in parent's world-wide meetings	
Relations with JVGM; phone calls, meetings, visits	
Staffing parent with someone with experience with JV	
MNC level in Mexico	
Informal meetings with other parent(s)	

Source: Schaan (1983:249)

Figure 7.1

Conceptualisation framework of IJV control - (2)



7.2 The "extent" dimension of IJV control

The second dimension examined by academics in the field is the "extent" of control over different business aspects of IJVs. Most of the previous research studying this control parameter focused on investigating how much influence each partner exerts into different types of decision making, in particular the ways in which decisions are being made. These studies often conceptualised the extent of control each party exercised is reflected on the locus or centralisation/decentralisation of decision making process at the JV level (Geringer & Hebert, 1989). Yan and Gray (1995) stated that the way in which a JV is structured and the way in which control is divided determines the degree of JV autonomy, the degree of conflict among partners, and the performance of the JV.

Indeed, the notion of locus or centralisation of decision making had been a well-established area in organisational design, organisational behaviour and control literature (see Section 6.2.2), before the concept was extended to research in IJV control more recently. Many of the early studies were built on the assumptions that different forms of organisational arrangements induce certain types of performance, and at the same time discourage other undesired behaviour (Emmanuel et al., 1990). In other words, structure is a means to achieve effective control (Belkaoui, 1986; Emmanuel et al, 1990). This central thrust has had significant influence on subsequent research studies in IJV control.

7.2.1 Research into the extent dimension of IJV control - developed country scenarios

Killing's (1982, 1983) study is an influential research in the extent dimension of IJV control. The scholar believed that multiple parenting is the key source for problems in managing JVs. Killing aimed to identify causes of the dynamism and intended to shed light on the appropriate management styles and policies which can facilitate JVs to achieve a higher chance of success.

Thirty-seven IJVs located in developed countries (mainly in America and Western European countries) were selected and each of the sample had a local partner. The author interviewed the parent firms' executives as well as the JV general managers, and intended to identify the partners' influence on decision making over nine[3] important business

[3] The nine areas were: pricing policy, product design, production scheduling, production process, quality control, nominating or replacing functional managers, budgeting of sales targets, budgeting of cost targets, and budgeting of capital expenditures.

aspects in their jointly owned operations. In addition to that, Killing wanted to find out precisely the extent of "jointness" in decision making between partners by investigating the exact ways in which decisions over the nine identified aspects are being made. Six distinctive ways of decision making in the IJV context were proposed[4]. Scoring the responses, the author intended to classify his samples into three main categories - (a) dominant partner JVs[5], (b) shared management JVs[6], and (c) independent JVs[7].

Results of the study reflected that 35%[8] of the samples were dominant, 54%[9] were shared management, and 11% were considered as independent ventures. Consistent with Killing's hypothesis, dominant partners were often found holding the absolute authority of the businesses[10]. Indeed, these ventures were run more or less by one parent like wholly owned subsidiaries. The overall operation of the JVs was integrated more into the dominant partners' strategies and management systems.

Killing also discovered that in shared management JVs both parents often shared the role of management via providing functional managers as well as board of directors to the JVs. The empirical data has demonstrated strong evidence that functional managers of 60%[11] of the shared management samples were drawn from both parents.

Interestingly, only four JVs' general managers were found having the freedom to make decisions in at least six or more of the nine identified areas, and were qualified as independent JVs. The small sample number in this typology might have reflected the importance of parents' inputs into the JV operation. The phenomenon seemed to indicate that independent management strategies in IJV subsidiaries were unpopular at the early stage of JV development in the early 1980s.

[4] Decisions are made (1) by the JV general manager alone, (2) by the local parent alone, (3) by the foreign parent alone, (4) by the JV general manager with input from the local parent, (5) by the JV general manager with input from the foreign parent, or (6) by both the local and the foreign partner.

[5] Only one partner has played a dominant role in decision making and the JV is managed like a wholly owned subsidiary.

[6] Both partners of a JV have played an active and meaningful management role in decision making.

[7] Neither partners have played a strong role and the JV managers are given extensive autonomy in decision-making.

[8] It was discovered that dominant parent JVs were usually engaged in high risk high capitalisation projects; such as land development and construction business, as well as oil and gas exploration.

[9] Shared management JVs were commonly found in manufacturing situations in which one parent was supplying technology and the other contributing local knowledge.

[10] Such as nominating all functional managers and making all operational and strategic decisions for the JVs.

[11] Other sample firms, who had not done so, was only due to their small size to justify employing full-time managers from both partners.

Another fascinating aspect revealed in Killing's study is that shared management ventures demonstrated a much higher failure[12] rate than dominant or independent JVs. Based on the fact that the majority of shared management JVs were indeed operating in relatively more stable manufacturing industries than many dominant parent samples, their high failure rates led Killing to conclude that it was a difficult form of control structure to achieve success.

Basically, Killing's argument is built on his central assumption of multiple parenting as a key source of JV problems. The dominant form of control can substantially reduce the required level of co-ordination between parents and cut short the complex decision making process. Based on his findings, which showed dominant[13] JVs consistently outperformed shared management JV samples, Killing concluded that partner firms should identify situations[14] which dominant control is feasible and use it whenever possible.

A recent discussion paper by Yan and Gray (1995), which looked at key determinants of JV performance arrived at some similar conclusions. The analysis revealed that independent and dominant control would tend to perform better than other forms, such as shared management. It is because the former two control structures give JVs the greatest sense of autonomy and require the least integration between partners. The lesser extent of integration will reduce conflicts among various JV parties and improve JV performance.

Killing's pioneer work has had a significant contribution to widen our knowledge in IJV control. It has raised attention and inspired a number of fellow researchers to explore the extent dimension of IJV control. However, some recent studies, which have adopted more or less the whole set of taxonomy and measures invented by Killings, revealed different results, some of which contradict Killing's findings.

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[12] Killing adopted a two-phased assessment scheme. The first fold is based on MNE parents and JV executives' self-assessment of their operations' performance. The second fold is according to liquidation and reorganisation of the sample JVs. Killing's idea of using the notion of long-term viability as a key predictor of stability and performance is widely criticised by other researchers as problematic. These scholars challenge that it is technically incorrect to classify ventures which cease operation as unstable as they might do so for reasons unrelated to performance. Evidently, some JVs are established to serve relatively short-term purposes. Therefore, the longevity of a JV may give out wrong signals of success or failure (Casson, 1990; Hamilton & Singh, 1990; Yan & Gray, 1995).

[13] Independent JVs are also found to exhibit superior performance. Killing believes that the high level of freedom given to the independent JVs is the "result" rather than the "cause" of their performance. The better the performance, the higher the chance that IJVs are given more autonomy. Owing to a small sample size (4%), very small coverage has been devoted to the independent typology as compared to the other two types of sample JVs.

[14] According to his observation, Killing has identified a few typical circumstances under which different forms of control are best suited. (1) If one parent's skills are not crucial to the success of a JV, then the other parent should dominate the operation. (2) When both parents' skills are crucial to the JV success, but those of one partner can be readily transferred to the JV without blueprint problems, then again the other partner should oversee the venture. (3) If both parents' skills are crucial to the JVs success and the transfer requires close supervision, a share management form of control should be adopted. Or when neither of the partners has all the skills required to run the JV alone, then a share management policy will become the best choice.

For example, building on parts of the work of Killing[15], Glaister (1995) examined the nature of management exercised by UK parent firms over their JVs formed with partners from developed countries[16], showed different results from those identified by Killing. Based on questionnaire replies from a total of ninety-four JVs (65 equity and 29 contractual JVs), dominant partner or truly independent JVs were found only in 5% of cases. Over half of the samples (56%) were shared management JVs in that all of the decisions are taken by either both partners together or by both partners acting with the JV management. In the majority of cases their planning and control systems were derived from both partners.

Another interesting finding is that 38% of Glaister's samples were identified as hybrid management JVs, in the sense that different decisions were made by different combinations of interested parties. The notion of hybrid control defined in Glaister's research indeed matches with a new form of IJV management - split control hinted by Cantwell and Dunning (1984), Geringer and Hebert (1989) and Yan and Gray (1995). It is suggested that under a split control arrangement, each partner plays a distinctive and complementary role in JV management. The distribution of authority or responsibility is likely to be based on competence and relevant interests of different parties. In some subtle ways, the hybrid category is different from shared control, under which form decisions are arrived at in an equally shared manner between JV partners. Glaister provided empirical evidence to show the emergence of a new form of split control which broadened our understanding of the dynamism of IJV control. In general, Glaister's findings do not support Killing's views of dominant control superiority.

7.2.2. <u>Research in the extent dimension of IJV control - developing country scenarios</u>

Beamish's (1985, 1988) work on the extent dimension of IJV control is an influential piece of research in the field. Extending Killing's ideas to less developed countries (LDCs), Beamish intended to draw a comparison of characteristics[17] of IJVs located in developed and less developed environments. The ultimate objective of the study was to put forward some suggestions of the ways in which LDC JVs should be managed and the ways in which their performance could be improved.

[15] Only one or two minor changes were made, such as the adding of one more category of decision making method - "by both partners and the JV executives" to Killing's original taxonomy.

[16] Such as Western Europe, USA and Japan.

[17] Beamish (1985, 1988) examined six distinctive characteristics of his JV samples: (1) reasons for creating the JVs; (2) autonomy, (3) stability, (4) performance, (5) frequency of government partners, and (6) ownership.

Beamish carried out an extensive survey with sixty-six JVs located in twenty-seven LDCs. The empirical information supported the author's hypotheses that certain JV characteristics differ between developed and developing countries. For example, 57% of Beamish's LDC samples were established due to host government legislation, while only 17% of the developed country samples were created for this type of reason. On the other hand, a significantly higher number (64%) of Killing's samples was formed because partners needed one another's skills, as compared to 38% of the LDC JVs in Beamish's study. Among the LDC samples, the key JV motive driving foreign partners was to get access to local knowledge through the local partners. In a sharp contrast to the 50% revealed in Killing's research, only a handful (10%) of LDC JVs were equally owned. In 70% of cases, the foreign partners of these LDC JVs were in a minority equity position. Based on the findings, Beamish concluded that there is not a direct correlation between ownership and control.

In examining JV performance, Beamish adopted Killing's control scale and performance measures[18]. The scholar observed that unsatisfactory performance is often correlated with dominating foreign control of the IJVs. While a positive association was found between performance and foreign partners using local management and/or partners for advice on the local economy, politics and customs. The mixing of personnel from different partners did not cause particular problems. The phenomena demonstrated a strategy-control fit as the key JV formation motive driving many foreign partners of Beamish's samples was to get access to local knowledge and contact.

According to the overwhelming results, Beamish arrived at a recommendation and stated that partners of developing country JVs should share or split the decision-making responsibilities with their local partners based on the strengths each party holds. A mutually trusting relationship can promote co-operation and encourage parents to commit themselves to the success of the JVs (Buckley & Casson, 1988, 1989; Beamish & Banks, 1987; Casson, 1990; Parkhe, 1993a). On the other hand, based on the high instability and unsatisfactory performance rates, Beamish concluded that developing countries present a more complex and difficult environment in which to manage JVs. It was believed that there are different factors that are more important to the success of LDC JVs than to

[18] The performance indicators Beamish used included the same type of problems as Killing's.

developed country ones. Accordingly, the approaches to control JVs located in these two separate types of regions should be different.

In fact, Beamish's results are consistent with those identified by Tomlinson's (1970) classic research in control-performance relationship of IJVs located in India and Pakistan. Tomlinson found that it would be more beneficial for foreign partners to share decision-making responsibilities with their local counterparts, who possessed important local knowledge and business contacts. An interdependent relationship would encourage greater contribution from the local partners, and in turn would more likely lead to a better JV performance. Because of that, foreign parent firms should not insist on dominant control and a more relaxed attitude would be more beneficial to all parties concerned.

7.2.3 Conflicting results - which one is correct?

Apparently, Glaister and Beamish's findings represent a big contrast to the positive correlation between dominant management and good JV performance revealed in Killing's work. The contradicting results among these studies, which used a similar set of measures, may lead one to wonder which side they should listen to or whether the findings are reliable at all. Having shared a similar viewpoint as Parkhe (1993:320) that "assumptions are a function of time and place", I believe the differences are likely to be caused by timing and environmental reasons.

First, the JV samples they used might be operating in different industries with diverse backgrounds. Moreover, the two broad categories - "developed" and "less developed", each covers a wide range of countries. Countries within the same category are likely to differ to various degrees in terms of culture and state of legal and economic development. The differentials on these aspects between developed and developing regions are likely to be even wider.

Although both projects took place in developed countries, we need to be aware of the time gap between Killing and Glaister's studies. Since Killing's work conducted in the early 1980s, the use of IJV as a strategic weapon to strengthen firms' competitiveness should have developed quite substantially until Glaister's research was carried out in the mid. 1990s. The accumulated knowledge and experience must have made the extent of control needed by partners today somewhat different from the level chosen by the pioneer firms.

To be fair to Killing, despite the overwhelming results supporting the superiority of a dominant control strategy, the author did recommend a couple of situations in which shared control policy might be appropriate in developed country environment. Killing observed that a shared control structure is most suitable when (a) both parents' skills are crucial to the JVs success but the transfer requires close supervision, or (b) neither of the partners have all the skills and knowledge required to run the venture alone.

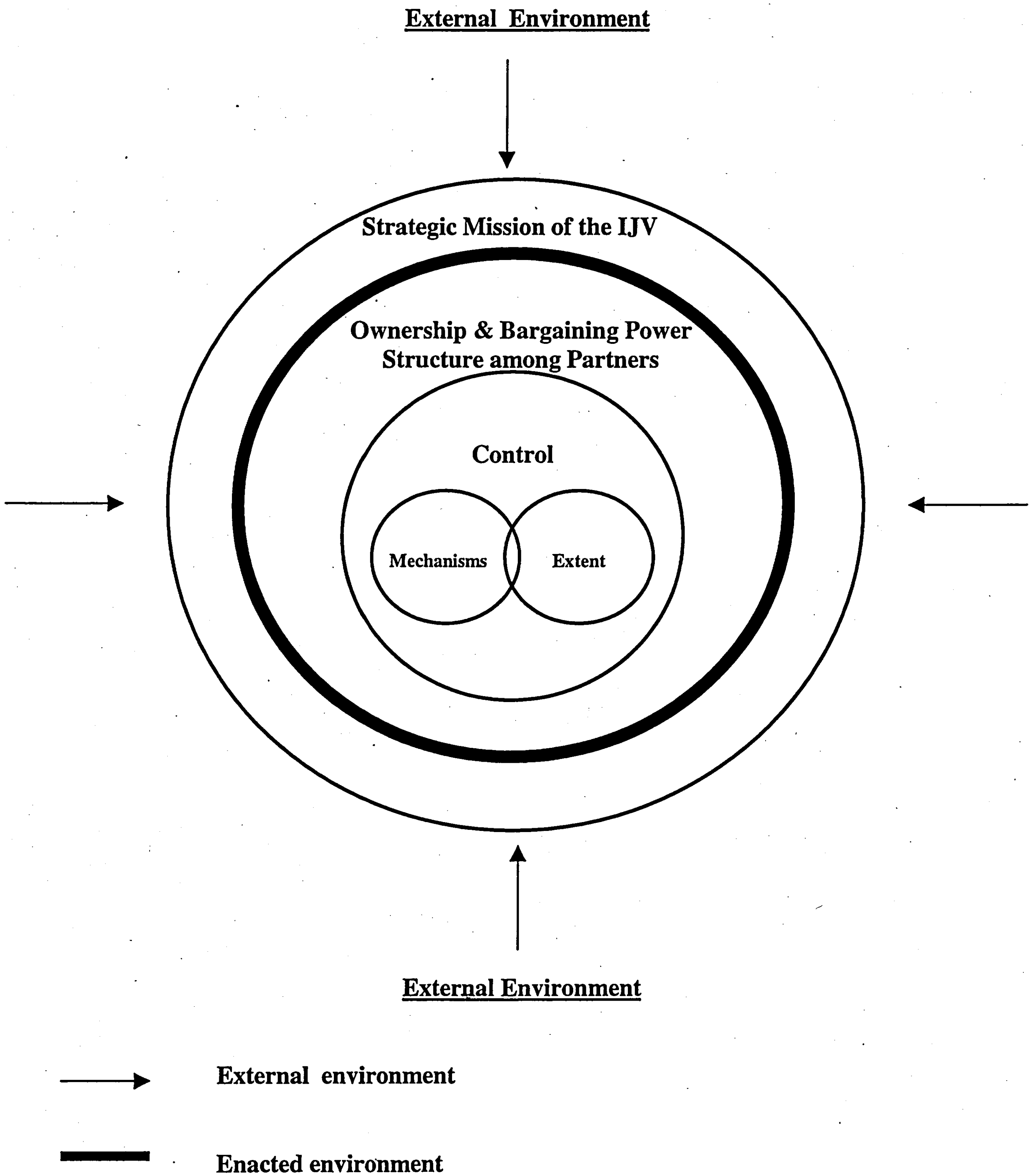
The above mentioned circumstances are typical situations underlying many LDC IJVs. Commonly, foreign partners have insufficient local knowledge to deal with the complexity presenting in many LDCs. Whereas, their local partners often lack capital, international business experience, and/or knowledge to manage the technology transferred to the ventures by their foreign counterparts (Beamish, 1985, 1988; Beamish & Banks, 1987; Harrigan & Newman, 1990; Tretiak & Holzmann,1993; Yan & Gray, 1994, 1995; Tsang, 1994; Martinsons & Tseng, 1995). Based on an interdependent relationship, a shared or split management policy will better serve the needs of all parties concerned.

Having adopted a middle-range research approach, I see there is no such thing as being right or wrong in theories and research studies (Casson, 1990). If a theory or a set of research findings reach their limitation of explaining observations, we may either extend the existing concepts, or look for other theories that can provide us with better answers. As a valid point Checkland (1981) and Otley (1988) made, each stage of development in the organisation theories has the potential to teach us something about how organisations adapt to the changing environment over time. The contradictions discovered in Killing, Glaister and Beamish's work are examples to illustrate how under the influence of investment strategies and bargaining power structures, partners choose the extent of control they need in order to cope with the changing environments presented in different time and space.

In summary, the analysis above has demonstrated that the extent dimension of IJV control bears a close relationship with the other contingency factors, IJV mission, partnership composition and the environment, comprising the skeletal model of this research. In addition, the analysis also illustrated the interdependency between the mechanism and the extent dimensions. The extent of control, in the forms of independent, dominant, shared or split, reflects the ways in which responsibility is distributed and the ways in which decisions are made in IJVs. The new insights fine tune the conceptualisation, which was last modified as Figure 7.1, and I have decided to incorporate the extent dimension into the central core of the skeletal model. The updated integrative framework of IJV control is exhibited as Figure 7.2.

Figure 7.2

Conceptualisation framework of IJV control - (3)



7.3 The "focus" dimension of IJV control

As was demonstrated in section 7.2, prior researches in the field of control extent have made a significant contribution towards our understanding in the scope of activities adopted by parent firms, and the jointness of decision-making between partners and JV managers. However, the locus of decision-making, in terms of centralisation and decentralisation, embedded in these prior studies has been criticised by some researchers as providing a misleading or incomplete view of control (Geringer & Hebert, 1989).

One of the key arguments is that decision making is not the only means available to the parent firms to widen their extent of control. Schaan's (1983) research demonstrated a broad range of positive and negative control mechanisms that parents might use to exercise effective control in their IJVs (see Table 7.1). Another criticism is that these previous studies seemed to imply that partners often seek control over all or the majority of activities of their IJVs. A linear relationship between the number of aspects a partner exerts decision-making power over and the actual amount of control the partner subsequently achieves is embedded in these studies. This set of linear assumptions however may prove to be inadequate in explaining some complicated control phenomena in IJVs.

As was discussed in section 7.1, parents could apply a range of subtle control mechanisms, such as provision of training and services, other than merely rely on exerting direct power over decision making to achieve effective control. From my personal viewpoint, the measure of effective control should be based on the degree of importance of the controlled areas towards the achievement of the IJVs and/or the parents' investment objectives. We need to realise that exercising control over all or the majority activities of an IJV usually involves higher resource commitment, which in turn means higher switching cost if the investment turns out to be sub-optimal (Geringer & Hebert, 1989; Anderson & Gatignon, 1986; Mascarenhas, 1982). It seems to be impractical for a parent firm to spend its valuable resources to acquire control over areas which bear little impact on the achievement of their objectives and/or the IJVs' success (Geringer & Hebert, 1989).

On the other hand, if a partner often insists on getting full control over those functions, which are either unimportant or unfamiliar to them, JV efficiency is bound to suffer. When one party constantly behaves uncooperatively, conflicts between partners are likely to result. A hostile and mistrusting relationship will only put further pressure on the JV performance. All in all, the benefit individual partners gained from their IJVs will be restricted.

It was previously discussed in Chapter 5 that FDI decisions are often a compromise between four attributes - control, resource commitment, return and risk (Anderson & Gatignon, 1986; Mascarenhas, 1982). Before a firm commits itself to a potentially problematic JV operation, it should have assessed the costs and benefits of adopting different investment modes, which comprise of the various combinations of these four factors. As Geringer and Hebert (1989) suggested, it is important for JV parents to exercise effective control in such a manner that will enable it to successfully implement its strategy without incurring a high level of administrative or organisational inefficiencies. A strategy-structure fit can be achieved only when the gain outbalances the cost of control. Therefore, it seems logical to assume that successful parents would target strategically important JV activities and processes (Schaan, 1983, 1988; Geringer & Hebert, 1989; Glaister, 1995). In other words, their choice of mechanisms and extent of control has a focus dimension. Indeed, the notion of selective control gives rise to the "focus" parameter of IJV control (Geringer & Hebert, 1989).

Results of Schaan's (1983) study provides empirical evidence to illustrate the notion of parent firms' parsimonious and contingent usage of resources for controlling IJVs. Parents may choose to have control over a relatively wider or narrower range of business functions that are crucial to their success in the JV investments. Newman's research (1992) into the characteristics of successful Sino-American JVs supported Schaan's findings. Newman discovered that the American parents of his samples had commonly adopted a so-called 'focus strategy' in order to improve quality of the JV outputs. It is considered that outputs can only be as good as inputs. Hence, tight control of inputs, such as local suppliers, employees and internal operations, are seen as the keys of this kind of strategies. Also, improvement on quality, wastage and lead-time will further contribute to cost minimisation in the JVs (Newman, 1992; Bromwich & Bhimani, 1994).

Poynter (1982) also suggested that MNE partners might find it advantageous to adopt a selective approach of control in their IJVs. Similarly, Lecraw's (1984) work in developing countries revealed a direct relationship between foreign partners' control of critical variables and success of their JV subsidiaries. Conversely, a low success rate is commonly associated with situations in which ownership and overall control of IJVs are equally divided between foreign and local partners due to government and/or other types of external pressures.

A more recent research by Glaister (1995) to examine the nature of control exercised by UK parent firms in their IJVs[19] arrived at some similar results as Schaan and Lecraw. Glaister found that in general UK parents do not adopt a single approach towards all types of decisions. Their choice of mechanisms and scope of control seems to reflect their pressing interests[20] in the IJVs and strengths of each partner. However, this pattern of control changes when the relative equity shareholding of the UK partners is taken into account. For example, in samples where the UK partners were minority stakeholders with less than 50% shares, they tended to accept a passive role in many management functions, apart from the R & D aspect where control was split according to the strengths of individual partners was more commonly used. This was different in situations where the UK partners were majority shareholders. These UK parents were taking on an active role in most of the management functions, again except in the R & D and marketing aspects where split control was frequently adopted.

Basically, Glaister's findings demonstrated that partners do not apply a unified approach. The partner may seek control over as wider or narrower range of activities as they need, and successful approaches to control are often embedded with a focus orientation (Schaan, 1983, 1988). The locus of control allows partners to concentrate on managing business aspects that are critical towards the achievement of their objectives and/or success of the IJVs. It can be seen that there is a relationship between the scope of control a parent adopts and the likelihood that its/IJV's objectives being fulfilled (Geringer & Hebert, 1989).

In sum, the new insights gained from the investigation into the focus dimension of IJV control provide me with the final clues to complete the skeletal theoretical model, which was last updated in section 7.2. Now I can see the whole conceptualisation, which posits that under the influence of IJV mission and partnership/bargaining power structure, the focus dimension is integrated into the other two control parameters, mechanisms and extent, to form the central core of a control package applied to an IJV.

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[19] Glaister's samples included both contractual and equity IJVs.

[20] For example, UK partners of equity IJV samples tended to be most active in controlling three types of functions - general management, personnel and finance, while their partners were more active in production, R & D and marketing.

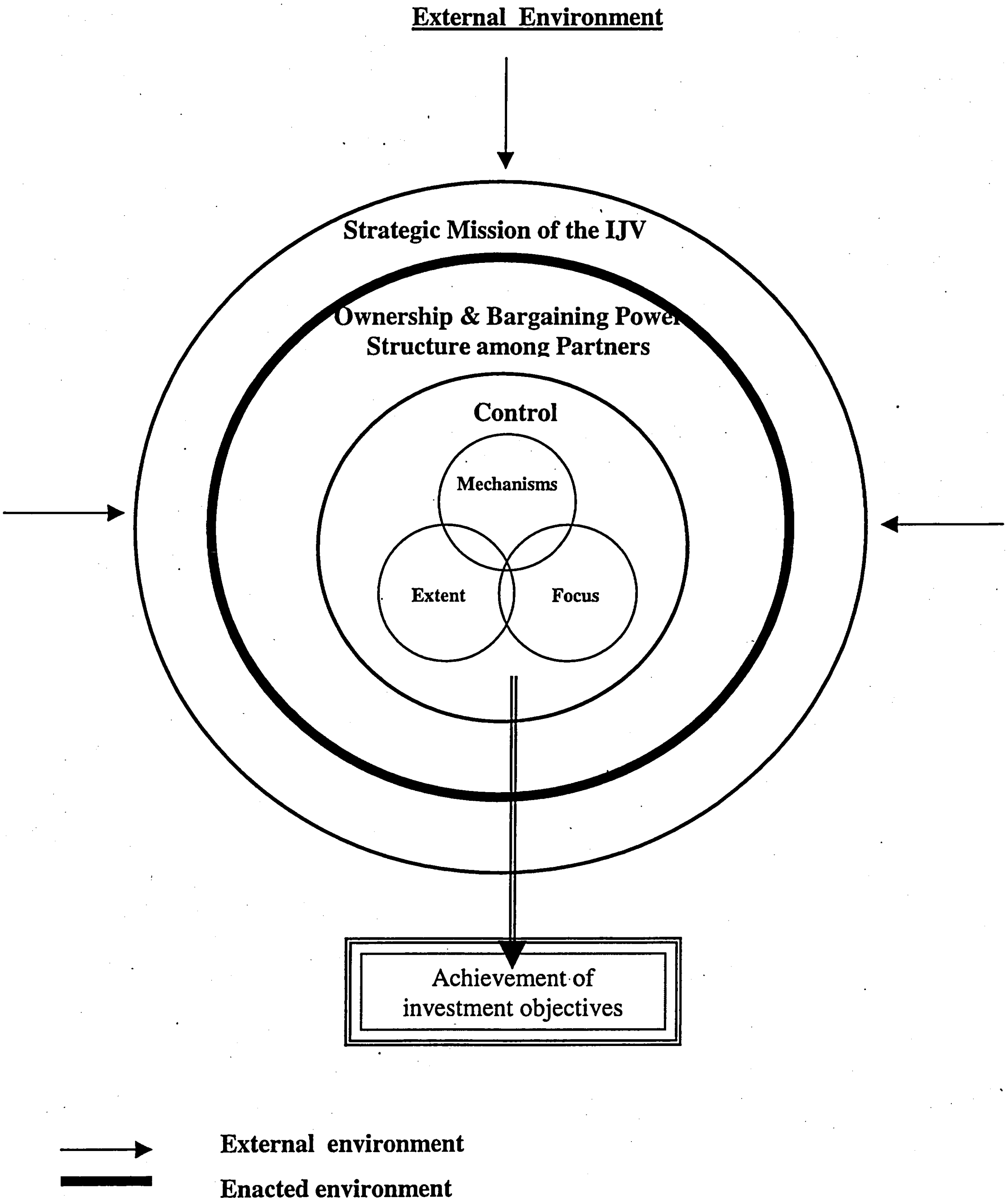
In addition to the above understanding, Franko (1971), Tomlinson (1970), Schaan (1983, 1988), Poynter (1982), Lecraw (1984), Glaister (1995) and some other researchers' findings strengthen my belief that control does not stand in isolation, and it should be seen as a means that can lead to the intended ends through careful design and implementation of control packages. As Otley pointed out (1980:423), "the use of a control framework also reinforces the central role of organisational effectiveness". Geringer and Hebert (1989) suggested that our researchers' attention to control in IJVs should not be limited to the study of the control concept itself. Rather, we need to understand the relationship of control to IJV performance. In IJVs, the same as in any other forms of organisations, the ultimate aim of applying control is to effectively deploy strategies and facilitate the achievement of objectives (Lorange et al., 1986; Lorange & Probst, 1987; Anderson & Gatignon, 1986; Geringer & Hebert, 1989; Yan & Gray, 1994; Glaister, 1995; Groot & Merchant, 2000). Therefore, it is important to examine the impact of control systems and processes in facilitating organisational effectiveness (Otley, 1980; Hopper & Powell, 1985).

Otley (1980) criticised that many previous contingency research studies failed to provide practical guidelines in relation to the implications of contingency variables on system designs. These studies only revealed vague links between specific contingencies adopted and appropriate accounting and/or control systems. It is one of the limitations of contingency theory that this research has tried to address. I agree with Otley (1980:423-4) on the view that "objectives are an essential part of a contingency framework not only because they are themselves one contingent variable... but also, and more importantly, because they form the criterion against which the effects of different configurations of controls must be evaluated". I see there is a close link, but not a direct, simple correlation (Otley, 1999; Norreklit, 2000), between control and organisational performance. In any meaningful study of control, the interdependency and relationships between the two forces need to be examined. I have decided to include the cause-and-effect link in the skeletal model to reflect a holistic view on, and examination of, control in an IJV context.

Upon this stage, the theoretical conceptualisation is completed, and the framework of a holistic package of parental control in IJVs has emerged in my mind. I have captured the whole set of thought and presented diagrammatically the final version of the skeletal theoretical model in Figure 7.3.

Figure 7.3

Conceptualisation framework of IJV control - (4)



7.4 Conclusion

The extensive literature review conducted in last two chapters has illustrated that different strategies will have various structural and/or control requirements (Dermer, 1977; Schaan, 1983, 1988; Emmanuel et al., 1990; Govindarajan & Gupta, 1985; Simons, 1987; Langfield-Smith, 1997; Otley, 1988, 1999). This set of assumptions can be extended to an IJV context.

Under a dynamic business environment, the reasons why a firm commits to an IJV determine the type of enacted conditions that the subsidiary has to deal with (Govindarajan & Gupta, 1985; Govindarajan, 1986). In turn, the IJV itself has to adopt the right form of organisational arrangement, such as the choice of partner and JV operational structure, in response to the self-enacted environment. A combination of strategic choices will determine the actual control that a parent firm can exercise in the IJV. The above points have lent support to an argument raised in Chapter 6 that an inextricable relationship of the three contingency components (strategy, structure and control) exists not only at corporate level, but also in subsidiaries, which include JV subsidiaries, comprising a firm.

As Geringer & Hebert (1989) suggested, a wider picture of control phenomena under a JV context is possible to achieve by examining all of the three dimensions, mechanisms, extent and focus, comprising control functions. In the literature review of the mechanism perspective, it was found that positive control is often used to promote favourable behaviour. Whereas, negative control tends to be used to stop some unfavourable decisions and/or activities from happening and is most often exercised through the formal mechanisms, such as veto rights. As Schaan (1983, 1988) hinted, a proper regimen of control should be balanced between the use of positive and negative instruments. The weighting between the two in any control system depends on a partner's strategy, international experience, as well as the specific external environment facing the IJV.

In the examination of the extent parameter of control, it was identified that parents may choose to focus their control effort over a relatively wider or narrower scope of activities or processes. The distribution of control among partners tends to be a function of the relative strengths and/or pressing interests. The scope of control individual partners acquired is always characterised with a focus dimension.

In sum, a clearer picture of the interdependent relationships between the four contingency components, environment, strategy, structure and control, has emerged. The whole process of ideas searching and theory building that I have just undergone fully reflects that IJV control is not a simple concept. It is indeed multi-layered and multi-dimensional (Parkhe, 1993; Geringer & Herbert, 1989), as the final version of the three-tiered skeletal model indicates (see Figure 7.3). For a parent firm to achieve effective control, the strategy needs to be started from the very beginning of the investment decision, carried on right through various stages of the formation process, and continued at the operational stage of the IJV. Control that a parent firm eventually exercises is in fact a gradual build-up of all the work that it has done throughout different stages of the investment process. Therefore, without looking at the whole of the control packages applied by the partner firms, I strongly believe that a wider picture of parental control in IJVs would never be revealed.

Blending together my predecessors' knowledge and my own subjective views on the topic, a complete conceptualisation of IJV control is established as per Figure 7.3. Due to the skeletal nature of the theoretical model, it is necessary to use the empirical details to define the skeletal framework and make it meaningful (Laughlin, 1995). According to the focus of this research, the model will be used to guide the empirical investigation in China. I intend to use the experience of those executives, who are running IJVs in the actual settings in China, as a means to enrich and complete the skeletal framework.

Four in-depth case studies, which are based on the information gathered from the empirical work and various secondary sources, are presented in Chapter 8. Chapter 9 includes a detailed analysis of the case materials. The continuous empirics-theory dialogistic exchange gradually develops the skeletal model into an integrative theory of IJV control that is definable under the unique environment from where it is derived.

Chapter 8

Empirical investigation - case studies

8.0 Introduction

Following my philosophical commitments, the concept of flexibility underlying middle-range thinking (MRT) has inspired me to become more creative. Through a long process of idea searching in the first stage of theory formation, which is recorded in chapters 3 - 7 of this thesis, a holistic model of IJV control was built, as Figure 7.3 shows. It is important to stress that the conceptual framework is only of skeletal nature, which is used to guide the empirical discovery and interpretation of empirical details. It is the empirics that complete the skeletal framework and make it definable under the unique environment from where the theory is derived (Laughlin, 1995). According to the focus of this research, target samples for the empirical investigation are firms, which already had IJVs established in China. I am using experience of the executives, who are managing IJVs under the actual settings in China, as a means of enriching the conceptual framework.

Through various channels and numerous attempts, contacts with some appropriate sample firms were established, which eventually led to personal interviews with executives from several MNEs (see Chapter 2 for the process of securing access and the criteria of selecting samples to write up the case studies). The information obtained from personal interviews and different secondary sources allowed four in-depth case studies, Superior, Marlee, Silky and Pearl, to be drawn up.

8.1 Formats of the case studies

As discussed in Chapter 2, part-constrained and part-free is the unique nature of methodology and method that this research adopted (Laughlin, 1995). Semi-structured interviews were used in the empirical process. In each interview, I brought with me a list of points/questions[1], which are reproduced as Table 8.1. These points were derived from the literature review, which underlined the formation of the skeletal theory, and they had the function of a prompt sheet to provide guidelines for the interviews. It needs to be stressed that the executives were free to express their opinions. A great extent of flexibility and diversity was preserved in the discovery process for new insights.

The exact scope and flow of discussion was different in each situation, and it depended on a number of factors, such as the executive's preference in different topic areas, the extent of interruptions during the interview, and the total time available for the meeting. For example, in some interviews, it was unnecessary to ask all the points listed on the prompt sheet, as the information was generally volunteered in the course of conversation (Spencer, 1980). However, on a few occasions I felt the executives were rather sensitive towards certain questions, and the experience taught me that I should respect their sensitivity.

On the other hand, when unexpected topics arose, the agenda of questions was put aside for the time being, and the interviewees were encouraged to discuss the new areas (Spencer, 1980). Often, much information additional to the original set of questions was obtained. Moreover, the executives' reactions and the activities around the interview scenes added further depth to the case studies.

In order to preserve the richness of the interviews, I decided to adopt an interview format to write up the four cases. The questions which were asked and prompted in the interviews are introduced as headings of different sections. In addition, quotes by the interviewees are used as key materials of the case studies. As was pointed out in Chapter 2, organisation research is in fact a study of 'lives' of the social actors involved. The rationale behind the case study design is to enable the readers to obtain an understanding of characters and experiences of the executives, who are involved in the design and implementation of control packages in their Chinese IJVs, and to share the richness of our conversation.

Moreover, the background information, that was gathered from the interviews and various secondary sources, about the partner firms and the IJVs is used to provide an introduction to each of the four case studies. This kind of introductory information aims to give readers an overall picture of the industries, business histories and strategies which influence the designs of the control packages that the sample partners adopt in China.

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[1] Wordings of the questions were slightly modified in some occasions due to the interviewees' positions in, and relationships with, the IJVs or the focal parent firms.

8.2 Outlines of the case studies - similarities and differences

The case studies are about four MNEs' experience, Superior, Marlee, Silky, and Pearl, of forming and controlling IJVs in China. Table 8.2 provides a summary of their backgrounds. It is useful to divide the four focal parents into two groups according to their nationality, size, business history and objectives to go into China. Superior and Marlee are European based multi-billion dollar operations, who went into China with an ultimate objective - to maintain their worldwide competitiveness. These MNEs have had a long history of doing business in China. Coincidentally, they started to invest in China in the 1920s, and they both left the country in the 1950s when the political situation became too unstable for foreign interests to stay. Their current investments in China are indeed the second round attempt in the country after their withdrawals in the 1950s.

Silky and Pearl are Hong Kong-based firms who have a much shorter business history and smaller operation than Superior and Marlee. The two businesses were formed in the late 1970s and early 1980s respectively, and both began their FDI in China in the 1980s. As with many businesses in the 1980s, Silky and Pearl were facing a rapid increase in operational costs in Hong Kong. The firms needed to move their production bases to China, which could provide them with a vast supply of cheap labour and land and was located at a convenient distance that could facilitate management and materials support from the HK headquarters. Indeed, China offered what Hong Kong firms desperately needed at that time in order to survive and/or improve their competitiveness.

Silky and Pearl can be regarded as pseudo foreign investors in China. This research started in 1994, and the project has overlapped the pre and post periods of the return of Hong Kong's sovereignty to China in July 1997. I realised that the transfer could influence the decisions of what should be classified as "foreign" investment in China. Therefore, a clear rule had been drawn before the research began that Hong Kong's investment in China would be classified as "foreign". This decision was based on the grounds that it was the way in which the majority of official surveys and research up until 1998 were conducted, and these materials have been the key sources of information underlying this research. Even up until this moment, four years after the return of sovereignty to China, funds from Hong Kong and Macau remain classified as "foreign" in many Chinese official statistical publications, such as those issued by the Ministry of Foreign Trade and Economic Co-operation (www.moftec.gov.cn, 26/11/2001).

The above summary has disclosed some basic characteristics of, and similarities and differences between, the two groups of case studies. A full version of the four cases will be shown in the following sections. The in-depth materials reveal complex investment strategies, criteria of partner selection, and designs of control systems and processes applied by the four focal partners to their Chinese JVs. The contrasting backgrounds between the two groups of case studies shed further insights into the webs of delicate relationships among hard economic and soft human elements embedded in the control packages. In addition, the differences of design and implementation of control packages between the two sample firms in each case study group disclose further details of parental control under the unique combinations of internal and external environments. Indeed, all four cases add value to one another.

There is a great deal of richness embedded in the case studies. I consider the case materials as a key part of this research, which is used to inform and enrich the skeletal model. As a result, I have taken the decision to include all four of the case studies in the main body, rather than in the appendices. The consequence of this decision is that the main body of the thesis is inevitably lengthened.

The four in-depth case studies are presented in sections 8A - 8D of this chapter. Whilst the sense-making process to understand and compare characteristics of the four cases using the skeletal model of IJV control is recorded in Chapter 9.

Table 8.1

Questions used in the semi-structured interviews

- How many partners are in the JV?
- Has the partnership structure been changed since the JV was formed?
- What is the share-holding composition among partners in the JV?
- Has the share-holding composition been changed since the JV was formed?
- Can you give me a brief outline of your parent firms and their businesses?
- What is the total consolidated annual turnover of your focal parent firm?
- How many investments does the focal parent have in China and where are they located?
- What were the motives, which drove your parents to invest in China?

- Focal parent
- Other parent(s)

- How did the focal parent assess the risk of investing in China?
- How do your parents and yourself see the legal system and overall investment environment in China?
- When was the China JV formed? (there might be more than 1 JV formed in China)
- What are the main business activities of the JV?
- What is the total amount of capital of the JV?
- What were the motives, which drove each of your parents to select JV rather than wholly owned form of operation in China?
- Is the Chinese JV an equity or contractual JV?
- How was the JV location selected?
- How did the focal parent identify the other JV partner(s) and what were the criteria behind the selection of partner(s)?
- Are there conflicts among partners in relation to their investment objectives and/or business interests?
- Is the China JV a cost, profit or investment centre?

- What is the composition of the management team of the Chinese JV?

- Mainly from the focal parent?
- Mainly from the other partner(s)?
- Equally from the focal and other partner firms?
- Mainly recruited externally?

- How do you see the quality of local managers and workers in general?
- What is the composition of the JV board of directors?
- Which party appointed the current general manager (GM) of the JV?
- Has the GM been given autonomy to run the JV?
- How are decisions being made on the following JV activities?

	Focal partner alone	Other partner(s) alone	JV GM alone	Focal & other partner(s)	JV GM & focal partner	JV GM & other partner(s)	JV GM & all partners
Marketing & sales							
Production							
R & D							
Product designs							
Pricing							
Finance & Accounting							
Budgets							
Purchasing							
Human resources							
Public relations							

- How does the focal parent view the importance of control over some or all of the above mentioned JV activities?
- How was decision making authority over the above mentioned JV activities being allocated among different parties?
- How has the JV performed in relation to the mission that it was set to achieve (from the focal parent's point of view)?
- Has the JV encountered any particular problems in China?

- Besides the current Chinese JV, have your parents planned further investment in China? If yes, are they doing it together or separately?
- How often does the JV report to the focal parent and what types of information are included in these reports?
- How often do the JV management and partners meet (through which channels?) to review JV operation and/or performance?
- Which types of measures and criteria have focal parent used to evaluate the JV performance?

Financial measure	Marketing & sales performance measure	Production performance measure	Other measure

- Which party is responsible for the design of performance evaluation system applied to the Chinese JV?
- If financial measurement is adopted for performance evaluation, which type of currency is used?
- If another type of currency besides, or in addition to, the Chinese currency RMB is used in performance evaluation, which party sets the exchange rate and which rate will be used?
- Which party will take responsibility for any currency translation gain or loss?
- To date, have the partners found that the benefit outweigh the cost and inconvenience of being involved in the JV?
- How do you see the future of investing in China?
- Have you encountered any particular problems of running business in China?
- What do you think the Chinese government should do to encourage more inward FDI?
- Additional points raised?
-

Table 8.2

Background information of the four focal parents of the case studies

	Superior	Marlee	Silky	Pearl
Country of origin:	United Kingdom	UK & Holland	Hong Kong	[2]Bermuda registered, Hong Kong-based operation
Consolidated turnover of the group:	£10,300 million	£31,500 million	HK$150 million (approximately £12.5 million based on an exchange rate of £1 = HK£12)	HK$1,358 million (approximately £113 million)
The time that the firm started trading/ investing in China	• Trading with Chinese merchants started from 1880. • FDI from 1926 and ended in 1956. • 2nd round FDI started from 1994	• FDI from early 1920s and ended in 1953. • 2nd round FDI started from 1986.	FDI from 1986/7	FDI from 1980s
Number of investments in China	2	12	4	9
Forms of investments in China	• 2 x JV	• 1 x holding • 2 x wholly owned • 9 x JVs	• 2 x PCTA[3] • 1 x wholly owned • 1 x JV	• 7 x wholly owned • 2 x JVs

[2] The company was founded in Hong Kong and its current registered address is in Bermuda. It is stated in Pearl's annual report (1994:3) that the Group's head office and principal place of business remains in Hong Kong.
[3] Process and compensation trade agreement.

Case Study "A"

Superior Group

Map 8A.1

The locations of Superior's Paints JVs in China and Hong Kong

Source: Magellan Geographix[SM] Santa Barbara, CA (800) 929-4627 (1993)

8A.0 Introduction

The first case study of the series is about Superior Group's paints JVs in Hong Kong and China. Up until the time of the interviews, it had already formed two paints JVs, SG Paints Hong Kong (thereafter called SGP HK) and SG Paints China (SGP China) in the areas. It was revealed in the interviews that a new Chinese JV, SG Paints Shanghai (SGP Shanghai), was under construction at that time. Superior included the same partner, Giant Conglomerate, in each of the three paints JVs.

SGP HK was incorporated in Hong Kong (HK) in 1990 between Superior and Giant. This JV is a paint trading company, which was formed to work as a vehicle to help the two partners to invest in China. Four years later, SGP China was established, and the venture included three partners, Superior, Giant and a local Chinese partner. This second JV is a paint production plant located in Southern China. The third JV, SGP Shanghai, is also a paint production investment, and the JV involved only two partners, Superior and Giant.

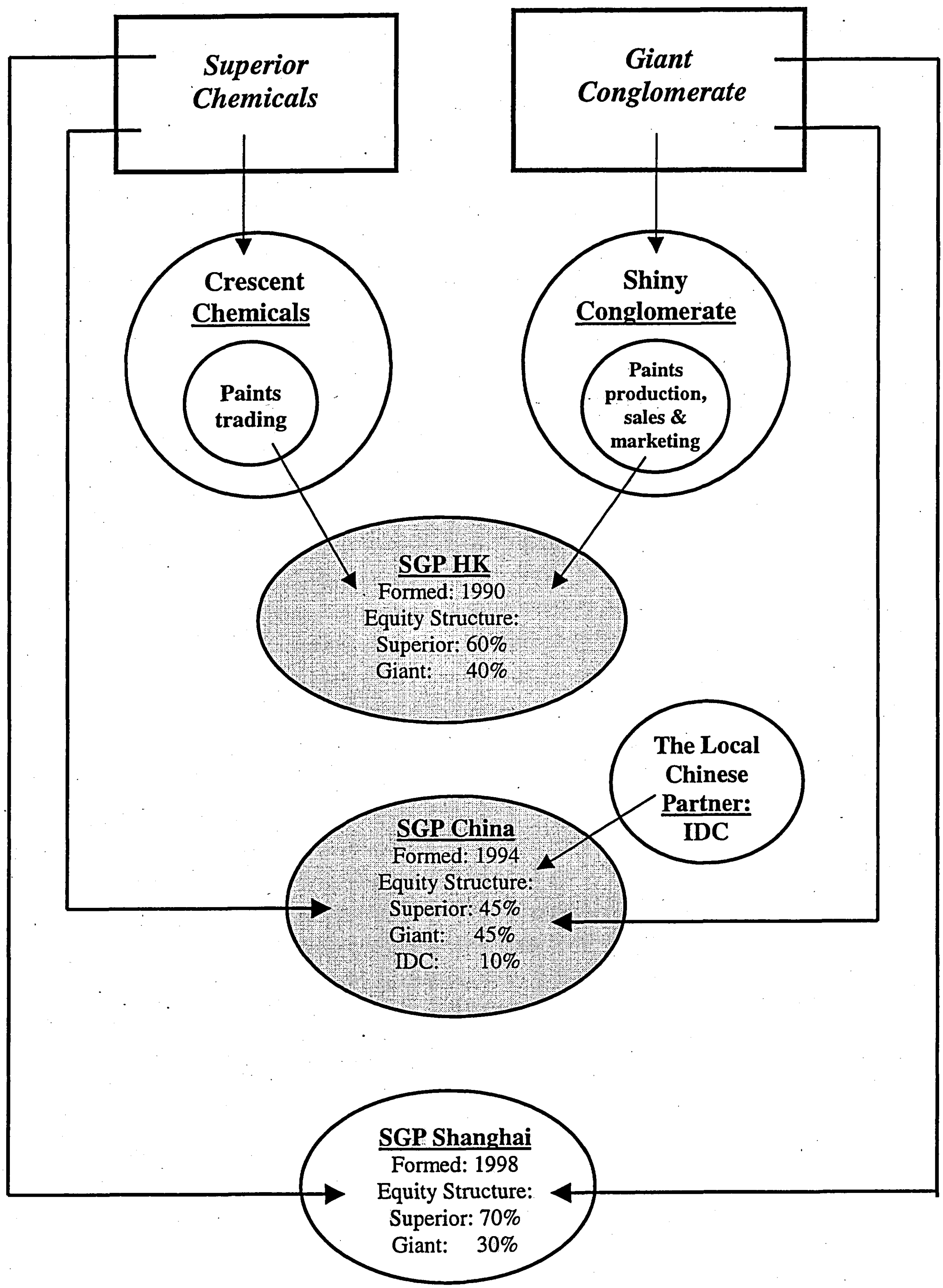
Superior and Giant, are both UK-based multinationals, who have been active in the Asian Pacific Rim for decades. Crescent Chemicals is one of Superior's subsidiaries in HK, which traded paints, heavy chemicals, pharmaceuticals, and other chemical products before SGP HK was formed. Shiny Conglomerate is Giant's subsidiary in HK, who dealt with production and sales of paints, together with other trading and manufacturing businesses during the pre-JV days.

In 1990, Superior and Giant took out paints production, trading, sales and marketing functions from their HK subsidiaries, Crescent Chemicals and Shiny Conglomerate respectively, and merged these resources together to form a JV - SGP HK. Since the paint division became independent from Crescent and Shiny, the new JV has been under direct influence of their powerful "grand-parents" - Superior and Giant.

This first case study is quite a complex story that involves players from different levels of their respective family hierarchies. Figure 8A.1 illustrates the chain of relationships between the various parties. SGP HK and SGP China, which are shaded in Figure 8A.1, are the focus of this case study.

Figure 8A.1

Relationships between various JV parties



8A.1 Some background information about the interviewees

There were four interviews conducted for this case study (see Chapter 2 for format of the interviews). The first interview was carried out in the UK with John Smith, manager of the Asia Pacific Liaison of Superior Chemicals. John[1] is one of the key members of the executive team in the headquarters, who controls/coordinates Superior's operations in the Asia Pacific Rim. John is an "old-Asian hand", who has a good knowledge of the region.

Another two interviews were held in SGP HK with Dennis Wong, the Financial Director and Company Secretary of SGP HK, and a board member of SGP China. Dennis is a successful professional, who had taken up an important position at a relative young age[2]. Dennis was extremely friendly and helpful throughout the time I conducted the empirical work in his company. Moreover, through his help, a meeting was successfully set up with the Managing Director of SGP HK - Richard Mather, who is also the Chairman of the China JV. Richard[3] is a very approachable executive. Indeed, his friendly manner made me feel relaxed in the interview and forgot the important position he was in the organisation. Richard has got lots of experience of running businesses in Asia. He had been in charge of another Asian subsidiary of Superior before he was transferred to Hong Kong.

Information obtained from the four interviews, together with other materials gathered from the secondary source, such as annual reports, the Group's autobiography and articles, was used to produce this case study.

8A.2 A bit more history about Superior's past experience in China

Before SGP HK was formed, Superior's subsidiary Crescent was trading chemicals and paints in China and HK. Crescent did not have its own production facility in the region. In fact, this description may not be totally correct because Superior Chemicals did once have its China headquarters established in Shanghai, several branch offices and a number of distribution warehouses/depots scattered around China to serve the local markets throughout the first half of the twentieth century. Indeed, Superior Chemicals was one of the pioneers, who sold its UK chemicals production to merchants in HK and China, and the earliest business records could be traced back to 1880.

---

[1] I guess John was in his mid 50s at the time of the interview.

[2] Whom I guess was in his early 40's at that time.

[3] I believe Richard was in his mid 50s.

Superior had been using its Shanghai office building as headquarters of the Greater China[4] region for a few decades. However, the situation changed in 1956 when the communist authorities evicted foreign businesses, and Superior was forced to close its operation and to hand over all its assets on the Mainland. It was the time from which the Group ceased to have any direct investment in China until SGP China formed in the 1990s.

Having left China with a bitter memory, Superior moved its focus to other nearby countries, such as Malaysia, Indonesia, Thailand, Taiwan, India, Pakistan and Australia. The Group has gradually built a network of chemicals and paints production plants in the Asia Pacific Rim. Superior was using its HK headquarters to co-ordinate the trading activities and technology licensing in Greater China since the 1950s. In 1984, Superior set its foot once again in China and opened an office in Beijing to symbolize its official return to the country.

8A.3 <u>Why was the first JV SGP HK formed and why was SGP China established at a later stage of your Group's FDI in China?</u>

In each of the interview, this question was asked. The three executives gave out some slightly different answers. Their replies were complementary to one another and provided me with a more complete picture. Basically, it was based on a combination of strategic, marketing, financial as well as technical motives.

As was mentioned in the introduction section, Superior has more than a century of history of doing business in China. The paints and chemicals businesses of Superior have a strong presence in Asia and Far East for many years. The Group has manufacturing facilities established in most of the key countries[5] in the region. The nature of their business really requires it to have production facilities on the ground to become a serious competitor. Crescent could have done business in HK and China based on having products imported from its sister companies. However, it can only trade profitably on high value-added products, not on normal paints.

The major component of paints is water and paints will be thickened during long transport or storage. Generally speaking, it is only viable to deliver paints within a short distance from the factories. Therefore, production must be near to final markets. If Superior wants to be a

[4] It includes China, Hong Kong and Macau.

[5] Such as Malaysia, Indonesia, Thailand, Taiwan, India and Pakistan.

serious player in a particular market, it really needs to have manufacturing facility there. According to the Group's strategies, to put manufacturing plants in China, Superior not only completes a network of production facilities around the Pacific Rim, it also represents a complete return to the country for the Group.

Besides the above reasons, marketing factors were strong driving forces leading Superior to invest in China. The feasibility study of establishing a plant in the country started from 1978. Superior was aware of the growing economy of the nation. The sheer size of the domestic market includes a rising population who require good quality paints for different purposes[6]. The Chinese government allows foreign investors to sell in the domestic market provided they can fulfill certain requirements, such as JV and local production. The aims to establish manufacturing plants in China were to establish a cheap production base, which was close to the consumers, and the most important was to penetrate the China market. SGP HK works as sub-regional headquarters to co-ordinate the Group's future investment in Greater China.

8A.4 How has Superior justified the risk of investing in China?

Superior experienced almost every type of calamity[7] in its first sixty-odd years of operation in China. Now, the Group has decided to have a full return to the country. I was fascinated to find out how Superior has justified the risk of investing in China, a place that brought them a lot of bitter memories.

From replies given by the executives, Superior has not relied on any specific scientific methods to assess investment risks. Decisions are mainly based on management judgment. Having said that, these judgments are not made in a vacuum. They are indeed built on the executive team's rich international experience and other information provided by their subsidiaries around the world. The senior management team also looks into the strategic importance of an investment, and political as well as economic development of the country to invest before making a decision.

The interviewees indicated that the Group would develop some scientific approaches to provide managers with more accurate information in evaluating risks of future FDI. However,

[6] Such as for domestic and industrial decoration, food and beverage packages' printings, and cars as well as marine refinishing coating.
[7] Like revolution, civil war, banditry, piracy, foreign invasion, famine, flood, drought and expropriation.

these scientific methods are only supportive tools to supplement, rather than completely replace, human judgement in assessing investment risks.

During the meeting with John Smith, he complained that the media had made a lot of unfair criticism, describing British investors as lagging behind their competitors in exploring the China markets. He stated that many British firms, especially the long-established ones, had had similar experiences in China as Superior's. Therefore, instead of saying the UK companies were slow starters, it was more appropriate to describe them as cautious investors. A comment Richard made summarises Superior's experience and decisions:

> "I think you know that Superior/Crescent Chemicals has a long involvement in China, we had a large operation in China from 1926 to 1956. But because like many foreign companies in China, we had our fingers burnt by the experience after the civil war. It was not until the early 1980s that really the opportunity presented itself to go back in a significant way. I guess for the first 5 - 6 years there were some cautions about whether or not it was appropriate to put assets back into China. But I think once the initial cautions have been set aside, then Superior Chemicals started to think seriously about the options and by the late 1980s has been taken in principle to go ahead".

In addition to the above, it was further revealed that since some of the key players in the paints industry have already moved into China, Superior had no choice but to catch up if it wanted to maintain its global position. Dennis explained the competitive pressure that they have been facing:

> "If we still hesitate whether we should put investment back into China, I think the loss of competitiveness will cost us more and the adverse consequences will hit us harder than the uncertainty we face due to the political situation in China and the return of sovereignty of Hong Kong to China".

According to the Group's second time round experience, it is felt that the Chinese government's open-door policy is well established and is not likely to be reversed. The investment environment of the country has been improved significantly over the past decade and everything is gradually in place. The continuous economic growth demonstrates the potential of the domestic markets. The experience from SGP China is very positive. The local authorities have been very supportive and they treated the project as a "celebrity" investment, which attracted a high profile of media attention. For instance, after the letter of intention to build SGP China was signed, a few other MNEs followed their move and set up their plants in China. The same happened after the letter of intention of SGP Shanghai JV was signed. Owing to Superior and Giant's influence, their two JVs are treated as blue-print Sino-foreign operations and are highly rated by the local authorities.

8A.4.1 <u>The undeveloped legal system in China - does it mean high risk?</u>

When the executives were asked whether the undeveloped legal system in China undermines foreign investors' confidence to invest in the country, Dennis stated that it might have been the case eight or ten years ago but not now. He felt that the legal system in China has been improved gradually, an example being the first company law was published in July 1994. Dennis commented that "as an international investor, we should be patient and allow more time for the system to develop and become matured".

In addition to the above, it was also pointed out that although a loosely constructed legal system can cause a lot of problems, it can at least provide investors one advantage - it means that there are always room for negotiation. A lot of money, which would have been spent on some unnecessary court cases or legal consultation, could be avoided.

8A.5 <u>SGP HK - Why was the JV form chosen and how were the JV partners being identified?</u>

In the meeting with John Smith, he revealed that there were three broad elements that influenced Superior's decision to choose JV rather than wholly owned subsidiary. These major motives included lower levels of capital and thus risk involved, together with the benefits gained from partners' experience as well as contacts. Given the experience they encountered in the past, it is not difficult to understand the importance of these factors.

During the pre-JV time, Crescent Chemicals and Shiny Conglomerate were running their separate businesses in HK and China. The two firms did some business before they got together to form a JV. It was due to the fact that the two firms were subsidiaries of major UK MNEs, they were reasonably well known to each other. Their parents at the UK and the international levels, were also well acquainted with each other. As Richard described, "there was a lot of knowledge on both sides before SGP HK and China were formed". Besides formal business dealings, informal discussions of possible business co-operation were carried out at both parent as well as subsidiary levels between the two parties. When Richard was asked why Giant was chosen as a JV partner to exploit the HK and China markets, the answer was two-fold.

> "Giant's greater experience in China
> Giant had wider investment in China than Superior at that time. Moreover, Giant is a similar company in term of business, size, and it is a British company. They seemed to be a compatible partner.
>
> Shiny's original paint operation that could be merged to form a more significant total business
> During the pre-JV time, Shiny was operating a small paint company here in HK which really was not going anywhere. It was a small plant and it did not have the access to technology or resources that Superior Chemicals had in the paints industry. Therefore, it was a logical fit - with Superior to merge Crescent Chemicals' trading businesses in paints with the small manufacturing and selling operation that Shiny had.
>
> From Superior's point of view, it was a quicker move to build a significant factory with Giant rather than rely on organic growth to expand the business in HK and China".

8A.5.1 Are there any conflicts between the two partners?

Crescent and Shiny were trading in the same field and might be competing with each other in the past. Their background could be a source of conflict in the current JVs. When Richard was asked this question, a very definite answer plus a big smile were given.

> "No. I think that it has been a good marriage! They are good partner and there has not been any conflicts. I think because there is a very good convergence between the two companies in terms of what their objectives have been and this really means a long-term profitable penetration of the PRC (People's Republic of China) market". So no, there has been no issues. We have similar aims between the two partners!"

8A.6 Details of SGP HK

The equity structure of SGP HK is Superior 60% and Giant 40%. This JV is a trading company, which sells only Superior's branded paint products[8]. In the first few years of its operation, SGP HK sourced mainly from other Superior's operations located in Asia[9]. This purchasing policy changed since SGP China started operation in 1994. Now the HK trading office sources the majority of its products from SGP China, with exceptions only on those

[8] Such as decorative paints for domestic and industrial decoration, refinish paints for cars and marines, and industrial paints for food and beverage packaging.

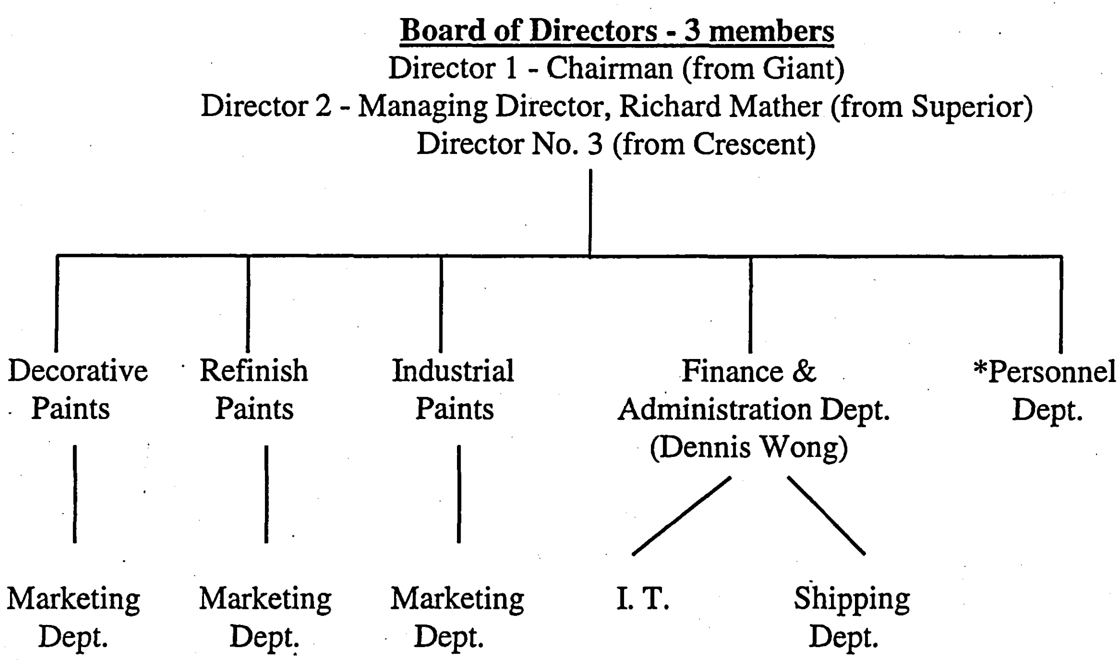
specialized items, which are still imported from other Superior's operations. This change is consistent with what the three executives described that targeted markets should be supplied by local production. Mirroring the nature of its operation, SGP HK is more or less totally integrated into Superior's global businesses.

8A.6.1 <u>Organisation and management structure</u>

The Board of Directors of SGP HK consists of three members. Two of the Directors are appointed by Superior, whereas the Chairman is from Giant. The basic organisational structure is based on product lines and functions. It may be due to the fact that the three product lines target quite different customers, each of them are having its own marketing department, while finance, administration, personnel functions are centralised. A simple organisational chart is shown as Figure 8A.2 below.

<u>Figure 8A.2</u>

<u>Organisational structure of SGP HK</u>



*SPG HK set up its own personnel department in 1996. Before that time, Crescent had been handling the personnel affairs for the JV in return of receiving a service fee.

[9] Such as Taiwan, Malaysia, Singapore and Australia.

8A.6.2 <u>What are the roles played by the Directors appointed by various parties?</u>

From the above chart, one may be surprised to see that the Chairman of SGP HK is actually appointed by Giant, although Superior is the majority partner with 60% of equity and the JV itself trades only Superior's products. The situation begs a series of questions, such as the roles played by the Chairman, Managing Director, and the Board of Director appointed by Crescent respectively. Dennis provided the answers:

> "The Chairman acts as a figure-head of the HK JV. He chairs all Board meetings. For all important decisions, based on courtesy, we will acknowledge him and ask for his approval.
>
> Mr. Mather is the one in charge of the HK and China JVs. He is the Managing Director of the former, and the Chairman of the latter.
>
> During the pre-JV days, Superior's paint business in HK was run by Crescent. Then the paint division demerged and Crescent has carried on the rest of the non-paint businesses. Because of this relationship, Crescent appointed a Director to sit on the Board of SGP HK. This Director is only a symbolic figure, who represents Crescent to ensure that SGP HK is on the right track at the initial stage. Unless there is any special issue arisen, he will not get involved in the JV operation".

8A.6.3 <u>Any role conflicts between the Chairman and the Managing Director?</u>

The roles played by the three parties were initially made clear by the above replies. Nonetheless, I queried that if there were any role conflicts between the Chairman and Mr. Mather, who is the real master controlling the JVs.

> Dennis replied, "in theory there could be a lot of potential conflicts. However, it works out quite well. It seems to be unusual that the majority share-holder of a JV not holding the Chairman post. I do not know the exact reason, it was the decision made between Superior and Giant. I guess the possible answer is that Giant and Superior have had a good business relationship and they trusted each other."

Richard added another comment on this aspect:

> "I think that Shiny/Giant has conceded to Superior that Superior knows most of the paints business. The key management was appointed by Superior and that is perfectly acceptable to Giant".

Indeed, the harmonious working relationship between the two founding partners is reflected in the comments made by the two executives. Moreover, their long-term business relationship can be seen from the fact that the two parties decided to build their third JV together in China.

It is a large paint production plant to be built in Shanghai. Further discussion about this second plant is recorded in section 8A.16.

8A.6.4 Staffing policy

Besides the senior management level which are agreed by both partners to be appointed by Superior, the lower level management and staff in the HK JV is a mixture of the original staff working for the paint divisions of Crescent and Shiny, together with some new staff recruited from external sources. According to information generated from the interviews, the mixing of staff transferred from the two partners did cause some conflicts at the early stage. Dennis provided the following example:

> "At the very beginning, the mixed management team did experience some internal problems. Although both partners are multinational businesses, they have different cultures and business practices. For instance, the practice in Crescent was that we issued invoices to collect payments straight after delivery. However, Shiny was used to give 30-day credit to customers and would not issue invoices immediately after delivery.
>
> Another example was that Crescent's management style was quite organized and could be regarded as formal. However, Shiny preferred to use the more traditional Chinese style of informal or less structured management.
>
> There were some conflicts and misunderstanding between staff appointed by different parents. The situation led to the formation of informal power groups and some of them were competing with one another. Nevertheless, the teething problems were gradually sorted out over the past five - six years.
>
> The mixed management team is working very well together now and they consider themselves as staff of the JV rather than representatives of their partners. In general, Giant and Shiny have been very co-operative".

8A.7 Details of SGP China

SGP China is a paint manufacturing plant, which is located in Guangdong, the southern part of China adjacent to the HK/China border (see Map 8A.1 for the location). As is showed in Figure 8A.1, SGP China was formed between the two founding members, Superior and Giant, together with a local Chinese partner - Industrial Development Corporation (thereafter called IDC).

8A.7.1 Why was a local partner needed and why was IDC chosen?

As Richard explained, SGP China was their first FDI in the country after their 1956 experience. There was a general feeling that they needed a local Chinese partner to help them through the bureaucratic procedures involved, and had some influence on that level. In addition, Dennis shed further insight into the strategic reasons behind their decision to invite a local partner:

> "The reasons why we chose to invite a 10% equity contribution from a local government agent is because of the benefits of having this local partner. IDC is the authority that is in charge of the development of ABC District where the JV is located. Locking the authority into an equity relationship is an effective way to guarantee their commitment to the JV.
>
> On the other hand, as the Chinese partner has only possessed 10% of the equity, it cannot really affect the strategies and business decisions of the JV. In general, it has far more advantages than disadvantages of including this Chinese partner."

8A.7.1.1 Are there conflicts of investment objectives and/or business interests between the foreign and the local partners?

In the interviews with managers from other companies which participated in this research, conflicting business objectives between the Chinese and foreign partners are commonly uncovered. It is interesting to know if the two founding partners' initial thoughts of including a Chinese partner have materialised, and if they have encountered any problems related to mis-match of objectives.

> "Yes, I agree with the comment made by managers whom you interviewed" replied Dennis. "For instance, our Chinese partner has always asked for dividends. From our company's point of view, we have taken a long-term view to invest in China. We are not desperate for an immediate return. There is a clear difference on this aspect. In general, I would say Chinese partners tend to be short-term profit orientated.
>
> However, I can understand their underlying motives. Nowadays, China uses various bonus systems to encourage state funded operations to generate higher profits and dividends for the government. Local managers will be awarded bonuses for dividends they made from Sino-foreign operations. For self interest sake, they naturally want to get the bonus now rather than to wait for another eight or ten years. Long-term investment does not mean too much to them. So they always push us to pay out dividends.
>
> When we prepared the expenditure proposal for the China JV at the very beginning, we clearly set out our objectives. Although agreement was achieved at that time, it is quite difficult to avoid some deep-rooted disagreement on some

subtle points due to different business background and managerial mentality. In our Guangdong JV, the composition of partnership structure is a matter of fact. What we can do is to generate more profits and hopefully this year we will be able to pay out some dividends to make our China partner happy. It is a way to motivate them".

8A.7.1.2 Overall experience of having a local partner

All of the three executives agreed that including a local partner has more pluses than minuses. The pluses are considered to be the opportunity to understand the local business environment and regulations, the most important of which is to understand the government and the bureaucratic procedures. All this information is particularly important to foreign investors who are unfamiliar with China.

Furthermore, the so-called "guanxi" (human relationship) is important in doing business in any Chinese community. Through the help of the Chinese partner IDC, a local authority in charge of the investment zone, it is easier to get inside the social circle and build up a relationship with influential parties. When problems arise, managers knows where and who to ask for help. Richard stated that "the involvement of local partners sometimes reflects the learning curve of most of the foreign investors". It was concluded that the overall benefits gained have outweighed the cost or inconvenience. SGP China's experience demonstrates that the inclusion of the Chinese partner is a strategic decision in order to ensure that the foreign partners and the JV's objectives are going to be achieved. Furthermore, the choice is indeed an effective mechanism to cope with the dynamism arising in foreign investment.

8A.7.2 Location of SGP China - Why Guangdong Province was chosen?

Besides the decision to include a Chinese partner, another key issue related to the establishment of SGP China is its location. It was revealed that management of SGP HK had set down a list of criteria when choosing the site for their first Chinese plant. The key considerations included:

- the development of infrastructure, transportation in particular
- supply of water and electricity
- distance from the target markets
- labour supply, quality and costs

Basically, Guangdong Province was the only place that could meet all the criteria stated by the management. Generally speaking, in a highly automated paint production process, labour represents an insignificant proportion of the total manufacturing costs. Thus, the relatively higher labour cost in the Guangdong Province was not a key factor for the decision. On the other hand, as the selected site is within an economic zone, the infrastructure there is better developed than many other parts of the country. The site is very close to a port, which is convenient for the import of raw materials and export of finished products.

At the early formation stage, it was Superior's plan to have SGP HK to provide management and technical support to SGP China. Guangdong is adjacent to the HK/China border and the proximity enabled this strategy to be operated in an efficient and effective way (see Map 8A.1). Finally, the aim of establishing the plant was to serve the HK and China markets. Again the geographical proximity was a crucial factor affecting the company's final decision. It can be seen that the choice of location does have costs and control implications on the Chinese JV.

> "It is no surprise that we decided to invest in southern China. We are talking about the late 1980s when we decided to form this JV (SGP China). Guangdong Province is more familiar with foreign trade, and the HK staff feel more comfortable to travel and work there, from a language point of view and everything. Therefore, Guangdong became a very obvious choice for investment". Richard summarised the overall decision on location.

8A.7.3 How is the objective to penetrate the Chinese market operationalised?

Richard explained the ways they dealt with the unique and difficult environment in China:

> "Well, you may be aware that distribution in China is the key element in a successful business. Distribution networks of many products in China are poorly developed and that combined with the poor infrastructure makes life very difficult. We are selling a premium product, which is not available in the domestic market. Because of that, we have found it necessary to establish our own distribution channels.
>
> We have created two networks. One is the Superior auto colour network for refinish paints and at the moment we have five hundred of those around China. We have also built up the so-called Decor Centers to distribute decorative paint products. We provide the products, arrange the premises, and provide technical assistance to the distributors. The Group tries to ensure that the level of service provided by our shops is better than what is available in the local market. The networks are important to the future".

In addition, as Dennis described, they had been using a semi-franchising model to run the two distribution networks. Superior has a corporate design for its showrooms[10] and the required standard is not easy for those local distributors, who have not got much experience in international marketing, to achieve. At the early stage, SGP HK and China have provided franchisees with technical support. The reason why it is called semi-franchising model is that the distributors receive the support free of charge. The rationale behind this policy is that the free support attracts more franchisees, and it in turn enables SGP China to establish a strong distribution network with wider coverage of the country.

Due to the importance to maintain an unified image of Superior brand products, the marketing strategies, such as pricing and promotion policies, used in HK and Guangdong JVs must be consistent. There are two basic reasons to explain this. First, due to the geographic proximity between Guangdong Province and HK, if there is any significant price difference of Superior's products between the two markets, black market dealings will be encouraged. On the other hand, citizens who live along the Pearl River areas in China can receive the television transmission from HK. Therefore, the JVs cannot confuse their customers of different images and price ranges.

8A.7.4 <u>Sourcing of raw materials - are there transfer prices set for intra-group dealings?</u>

Up until the time the interviews were conducted, all key materials used in the production in SGP China were imported, mainly from other Superiors' operations[11] in the Pacific Rim. The managers said that local supplies were not up to Superior's standards. Throughout the four interviews, it was noticed that there are quite a lot of intra-group dealings on the Superior side. According to Dennis' information, SGP China "tends to source raw materials from one of Superior's Malaysian plants and has only purchased a limited volume and range of chemicals from Crescent". Having been asked a sensitive transfer pricing question, surprisingly the executives were quite open about it:

> "Yes or no. There are some transfer prices set down by the headquarters (Superior). However, these 'transfer prices' are set according to the markets. Actually they are international market prices rather than internal transfer prices.

[10] Superior is concerned with the types of products to be showed on the shelves, the ways in which the shelves are decorated, the style of decoration and even the colour combinations of the showrooms.

[11] For instance, the JV has sourced the main ingredient of paints production - trioxide from Superior's Malaysian chemicals plant.

Trioxide, likes gold, has an international market price. You cannot really set your internal price for that.

Usually, intra-group buying and selling are handled on an arm's-length basis. Only in cases, let's say of a shortage of raw materials in the market, will sister companies get served first. Otherwise, no". Dennis replied.

Richard added, "...It is understood that sellers may want to have a satisfactory margin, while the buyers may want to make sure that they can trade profitably. Both parties (sister companies of the Superior Group) involved in a transaction are free to seek a normal commercial outcome."

8A.7.5 The management structure of SGP China

SGP China's JV Board consists of six Directors. Three Directors are appointed by Superior, two members are from Giant, and one Director represents the local partner IDC. The general manager (GM) of the JV is appointed by Superior. According to Chinese JV Law, the Board of Directors hold the highest strategic decision-making authority, whilst the GM is empowered with the highest operational authority. The current GM and most of the functional managers of SGP China were transferred from Superior's other Asia Pacific subsidiaries. Some mid-level supervisors and management trainees were respectively recruited from local paints companies and universities. A simplified management chart of SGP China is drawn up as Figure 8A.3.

Figure 8A.3

Structure of key management in SGP China

The Board of Directors - 6 members
Director 1 - Richard Mather - Chairman of the Board
Director 2 - Dennis Wong
Director 3 - (transferred from Superior Asia Pacific)
Director 4 - (from Giant)
Director 5 - (from Giant)
Director 6 - (from IDC)

↓

General Manager (transferred from Superior Malaysia)

↓

Functional Managers (mainly transferred from Superior's other Asia Pacific operations)

↓

Management Trainees and Supervisors

8A.7.5.1 The one-sided management structure - how have Superior and/or its top executives seen the importance of significant control?

It can be seen from Figure. 8A.3 that most of the key management posts are filled by Superior's executives. Richard explained the importance of being in control:

> "I think we regarded it as very important. Some companies are quite comfortable to take a minority position in JVs. We would not necessary rule it out, but we really want to start the position with management control. It is the general philosophy of the Group (Superior). There are generally three main reasons to explain this. Protection of technology advantages, easier management and as a vehicle to achieve the global strategies of the Superior Group.
>
> It is just a feeling that our objectives are likely to be best met and the Group is in the influential position to make decisions. Having management control or having the majority share-holding does not mean that you have to override everybody's opinions. However, when it comes to a difficult decision, we really feel more comfortable having control".

8A.7.5.2 How has Superior's management philosophy integrated into and/or accommodated other partners' policies?

Superior is very successful in putting its management philosophy into practice. However, has this philosophy integrated with and/or accommodated other partners' policies? "Has Giant had any significant influence on management of SGP China?" "Has the Chinese partner been involved in the day-to-day management of the operation?"

> "Yes! Through the share-holding they (Giant) are in a significant position and they have appointed two Directors out of the six members. They have a significant voice. Obviously no JV will succeed unless all the partners feel their voices are being heard, and their objectives are being met... Unless you have a group of people who have a feeling that the business is working to everybody's' best interests, then it is likely to fail". Richard defended their strategies and the partnership relationship in SGP China.

In a separate interview, Dennis added further details to Richard's above answer. It was revealed that IDC did want to get directly involved in running the JV. During the formation time, they suggested that they ought to provide a deputy GM for the JV. However, this offer was rejected by Superior.

It was explained that SGP China is highly integrated into Superior's global business. It only produces Superior's products. As a result, the management structure and quality need to mirror this investment and operational strategy. Senior managers need to possess skills of running the JV, and international business knowledge to deal with Superior's strategies. Since the JV GM has ultimate operational authority as well as access to confidential information of Superior Group, I can imagine this post cannot be filled casually by just "someone". It might be the reason why the top management of the JVs are dominated by expatriates from Superior, whom the Group feel they can trust.

8A.7.5.3 <u>How is control shared between managers appointed by various partners?</u>

Richard provided answers for my queries:

> "We have not done it (the allocation of responsibility and control) in a formal sense, but what tends to happen is that we draw on the relative strengths of various partners. For example, the China partner is obviously someone we turn to for advice and help when it comes to dealing with the PRC government, or try to understand which local rules and regulations may have impact on our business and so on. The local partner is in the best position to contribute on that sort of level.
>
> When it comes to say paint technology issues, then clearly Superior's people are in the best position to deal with this. Giant's people can be important in terms of their wider investment experience in China. For example, in areas like distribution they have similar issues to deal with in their JVs, so there are a wide range of issues where their experience is different from Superior's and is often very helpful.
>
> As I said before, there are no formal rules for the allocation of responsibility. It tends to be inputs coming from different sources on different subjects. It mainly depends on the competence of individual partners that can benefit the JV as a whole. ... Generally speaking, the decisions in important areas, such as corporate strategies, marketing and research and development, are controlled by Superior".

The above replies have reflected quite an interesting picture. Although Superior has emphasized on the importance of majority control, they have not insisted on taking over control of every single business function. Instead, the allocation of responsibility is based on the competency of individual partners. It can be seen that the degree of control Superior obtained covers those aspects that are of prime importance to the Group to achieve their global strategies and these are the areas of which Superior has plenty of expertise to deal with.

8A.7.6 <u>Human resource policy and localisation of management</u>

Continuing the topic of staffing, the executives further revealed that it is Superior's world-wide policy to localise managers and resources. However, this policy is contradictory to their emphasis on using expatriates in SGP HK and China, and their rejection to allow the Chinese partner to provide the deputy GM. This inconsistency between their policy and their actions caused me to seek explanations.

The interviewees replied that the Group understands that using expatriates is expensive and ineffective in long-term. They have to pay out generous packages to attract and motivate expatriates to work in China. Local managers often possess specific knowledge of the domestic market and the overall environment of the country. These are the reasons why the Group has always emphasized the importance of using local staff. Superior has put a lot of effort into training and developing local managers.

The situation in China is somewhat different. After the formation of the PRC, the communist government did not put education as the top priority and educational development was suppressed for some time. As a result, the country is now facing a shortage of management and professional intelligence in order to cope with the rapid economic growth. The current situation is that there are a group of older and experienced managers who have received minimal or no formal education, and another group of educated young managers who have little business experience and require substantial training.

Superior is a large MNE, its top managers need to have sound management skills as well as international business knowledge. Because of that, the localisation process in its Chinese subsidiaries is more difficult than in other countries. The executives expressed that it is difficult for them to forecast how long the whole process will take before the local managers can take up senior executive roles. Up to this stage, the Guangdong JV has employed a few local university graduates as management trainees and supervisors. Furthermore, as Superior is very concerned about their professional image, all their sales people in SGP China are locally recruited university graduates. It was claimed to be the starting point to build up a local management team.

On the other hand, Dennis stated that along with the rapid growth of FDI in China, the demand for well educated and/or experienced local managers is very high. The current situation allows quality staff to move around in order to boost their salaries. SGP China clearly stated to its employees that it would not compete with other head hunting companies and pay unrealistic salary just for the sake of keeping them. The Group's human resource policy is to provide its employees with appropriate training and internal promotion opportunities rather than focusing mainly on pay. At the moment all the senior positions in SGP China are filled by expatriates. The local staff know that in the future all expatriates will be replaced by local expertise. "The opportunities presented to them (local management) are so good and it depends on whether they work hard to get it!" Dennis stated.

8A.7.7 <u>The GM of SGP China - what is his role, responsibility and autonomy?</u>

A clear message reflected from all the interviews is that Superior has had a substantial influence on its subsidiaries' strategies and operations. It is understood from Figure 8A.3 that the GM of SGP China is appointed by Superior and was transferred from its Malaysian operations. Having a powerful parent, who draws up strategies and co-ordinates activities of the JV, the demarcation of responsibility and autonomy given to the GM can be a delicate issue.

It was explained that the GM has got responsibility to run a profitable operation. Organisationally, he is responsible for the Board of Directors of which Richard is the Chairman. Other responsibilities are reflected in the annual budgets that he submits to the Board and has that endorsed to become the business targets for the next year. In addition to the above, Richard emphasised that:

> "I do not sit back and hope that everything has got to happen. We obviously share some of the accountability and responsibility".

Corresponding to the profit responsibility, the GM is granted some degrees, but not the full extent, of autonomy to run the JV. This control structure is similar to the relationship between superior's UK headquarters and the rest of the world. There are certain types of decisions where the GM would be aware of the need to consult the Board of Directors or the regional office because the decisions may have wider implications to Superior Group, not just the PRC's operation. As a senior member of staff, the GM should know to which areas that this rule is referred. A reply from Richard captured the rationale behind the headquarters' control policy:

> "As a manager, we need to identify those areas which should come under the central control (by Superior) and those which are more appropriate to be handled at the local level. These things are usually fairly self-evident. For instance, we

would agree that it is the headquarters' responsibility to control the ways in which the Superior brand name is used. Individual countries and individual businesses would not use the brand in any other way, and it is dictated by the Group's policy.

Whereas setting prices in a particular country for example is clearly a local decision. It is something you cannot control from London because it involves an intimate knowledge of the market forces in that country. Hence pricing, within reason, can be handled satisfactorily at the local level.

Once you start to look at the various activities, it becomes more evident as to those which should be controlled centrally and those should be controlled locally. Generally, I do not find that too much conflict arises from this type of issue".

8A.8 <u>What are the business and/or operational relationships between SGP HK and SGP China?</u>

In Figures 8A.2 and 8A.3, it can be seen that top management of the two operations includes more or less the same key people. What are the strategic and operational relationships between HK and China JVs and what are the reasons behind the current management arrangement? The queries probed further investigation and discussion on this aspect.

In the early part of this case study, it was disclosed that the two founding partners aimed to use the SGP HK as a vehicle to invest in manufacturing in China. This key objective has had important impacts on the design of management structures in SGP HK and China. In legal terms, the JVs are two separate legal entities with their own JV Boards, and they are free standing to that extent. Giant provides SGP HK with the Chairman as a symbolic figure-head. Richard is on the Board and acts as the Managing Director, who is in charge of strategies as well as day-to-day operation of the HK JV.

On the SGP China side, Richard is the Chairman of the JV Board of which the Managing Director reports directly to him. Moreover, Dennis is the Financial Director of SGP HK, who works as the right hand man of Richard, is also a Director of the Chinese JV. It is through this kind of arrangements that Superior and its managers can control the strategies of the two JVs and ensure that they are compatible. Obviously, the HK management has put in a lot of effort to ensure that the two businesses talk to each other.

As a point Richard repeatedly emphasised, the HK office is really concerned with the development of business strategies across HK and China. SGP HK is driving the development of strategies in China, which included the initial formation of the Guangdong JV and the establishment of the distribution networks (see section 8A.7.3 for details), and the plan to build a second factory in Shanghai. Generally speaking, there is a common strategic direction developed out from the HK office to be implemented in both regions.

Despite the close strategic and management link, the executives stressed that SGP China is responsible for its own profitability and operational effectiveness on a day-to-day basis. When the Shanghai JV comes into being, it would operate in a similar basis. The strategies of all businesses will be made compatible because they will be directed from HK. That is the operational, day-to-day effectiveness resting in the hands of its managers.

8A.9 <u>The reporting systems in SGP HK and China</u>

8A.9.1 <u>The reporting systems to Giant</u>

As was revealed in the above discussion, Giant is acting more or less as a sleeping partner in the HK and China JVs. The Chairman appointed by them is only a symbolic figure-head of the HK operation. Based on mutual respect the general practices are that before each Board meeting, Richard as the Managing Director of SGP HK will discuss with the Chairman any special issues. On the other hand, Directors of the Guangdong JV meet at least once every four months to discuss and review performance of the operation. Giant has got two members on the Board and these representatives surely will pass on relevant information to their parent.

In addition to the above channels, SGP HK and China provide Giant with a set of reports on a monthly basis. This is the only formal reporting mechanism used. The monthly reports contain financial and operational information, such as production and sales volumes, sales values, profit margins, fixed costs, and working capital. It is a summary of the two JVs' overall performance and financial positions. Dennis stated that as an investor Giant did not ask for too in-depth information related to day-to-day operation of the JVs. The monthly reports provided them with the information they needed.

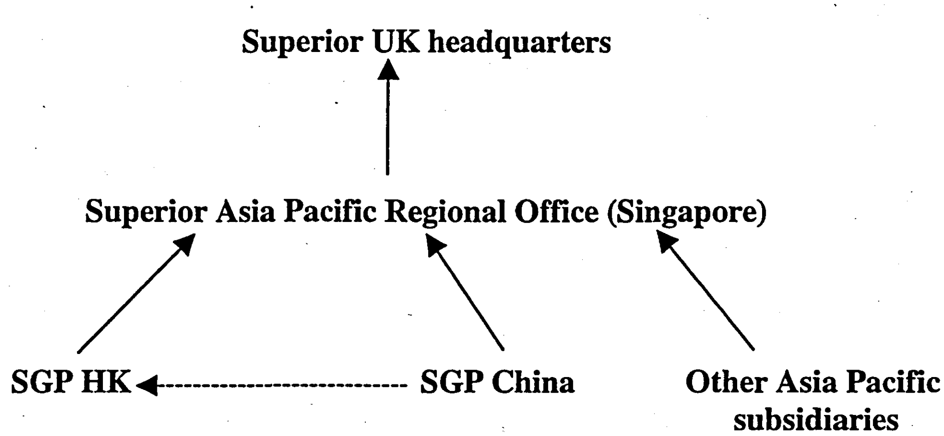
8A.9.2 <u>Reporting systems to Superior</u>

It is a different picture on the reporting relationship with Superior. Since SGP HK and China are highly integrated into Superior's global businesses, the two JVs basically have adopted more or less the whole set of reporting systems of the Group. For financial accounting and external reporting purposes, Superior has a world-wide standardised reporting system for consolidation of financial results. On the other hand, they also have a corporate reporting system for internal planning and control purposes.

According to the organisation structure of Superior, SGP HK and China belong to the Asia Pacific grouping, and they report to the regional headquarters located in Singapore. Figure 8A.4 shows the reporting relationships. As with the other wholly or partly owned subsidiaries in the region, SGP HK and China need to prepare various types of reports for the regional head office on monthly, quarterly, and/or annually bases, and the frequency depends on the nature of the information reported. Details of various types of reporting materials will be discussed in sections 8A.9.2.1 - 2. The Singapore head office in turn consolidates all its sister companies' financial results and other management information, then provides feedback to the UK headquarters.

Figure 8A.4

The reporting systems of SGP HK and SGP China



◄-------------- Indirect reporting system according to the management arrangements of SGP HK and China.

8A.9.2.1 Financial information

The financial information reported to the Singapore head office includes annual financial reports for external reporting purpose. In addition to that, all subsidiaries need to prepare a set of standardised management accounting reports on a monthly basis. This type of monthly report covers detailed ratio analysis on various business aspects, described by Dennis "as many ratios as you can name".

All Asia Pacific subsidiaries prepare their budgets in June each year. In August, the Financial Director of each operation presents their proposals to the regional head office. Dennis outlined how the system operates:

> "Although managers are allowed to set their own targets based on the situation facing their businesses, sometimes the regional office rejects our budgets and requires us to change our original forecasts, such as sales and production figures. If the requirement is not too far away from the original targets, we will normally review our budgets accordingly. It is somewhat a negotiation process.
>
> At the moment our two operations out-perform many other Superior paints subsidiaries, which include most of the growing Asian subsidiaries. The China JV has started to balance its costs against revenue this year. The good performance can strengthen our bargaining power...
>
> All revised budgets have to be re-submitted at the beginning of September. We prepare budgets once a year, but we review and update them monthly".

8A.9.2.2 Non-financial information

In addition to financial information, there is an area of reporting which covers operational effectiveness, safety, health and environment performance. All Superior's subsidiaries need to report some specific information related to their operational performance, such as % right first time, % of on-time in full delivery; number of dangerous incidents of classified injury and lost working hours due to the accidents.

Superior has established a system to deal with safety related issues and precise ways to classify and record injuries. Industrial accidents need to be reported to the regional head office. The Group has put health and safety performance as a criterion to evaluate subsidiaries' performance.

In conjunction with safety and operation efficiency, a comparative method has been employed in examining subsidiary performance. The headquarters often draw performance comparisons of their paints subsidiaries around the world. They also compare their subsidiaries' performance with the main competitors. The comparative information is commonly used by the regional management as benchmarks to assess subsidiaries' budgets every August.

8A.10 The two-way communication systems

The reporting systems mentioned above show an upward information flow starting from subsidiaries to the regional head office, then to the UK headquarters. Superior has had substantial influence on the strategies and operations of its subsidiaries. According to the interviewees, there are channels which enable the UK and/or regional headquarters to disseminate strategic information down the hierarchy to the subsidiaries.

For example, each year there are two regional conferences held in the Singapore head office, which allows the Financial Directors of individual subsidiaries to meet up and discuss important issues with the regional management. Besides, every three months, the GMs of all Asia Pacific subsidiaries are invited to attend a GM meeting at the Singapore head office. Through these regular gatherings, senior executives can get to know and communicate with other colleagues representing different sister companies, especially those they have direct dealing with via intra-group buying and selling. Through the same mechanisms, the regional office can disseminate updated information regarding Superior Group's global and regional strategies to the participants.

In addition to gatherings, the Singapore headquarters send out circulars to operations within the region to keep them informed about any new projects, strategies, and/or changes. According to Superior's policy, subsidiaries will be given at least six month prior notice to prepare for any significant change that will have direct impact on their operations. As is shown in Figure 8A.5, Superior has been using formal and informal means to build up a two-way communication mechanism between subsidiaries and headquarters.

Figure 8A.5

The two-way communication mechanism

Singapore Regional Headquarters

↑	↓
-Annual financial reports	-Annual budget presentation
-Management accounting reports	-Half-yearly executive conference
-Half-yearly executive conference	-Quarterly GM meeting
-Quarterly GM meeting	- Circulars of any new/change of strategies, projects, products, etc.

Subsidiaries within the Asia Pacific region

8A.11 The management style of Superior

It was repeatedly mentioned in the interviews that Superior has exerted significant influence in their subsidiaries. However, the headquarters have always tried to strike a balance between granting a degree of autonomy to the local managers with the need to maintain compatibility of strategies. As we can imagine, it is not easy to achieve the right balance. A lot of communication, negotiation, and commitment between various parties is required. Discussion recorded in the last few sections have demonstrated the channels used to facilitate three-way communications between management of the regional head office and subsidiaries, as well as between executives representing different sister operations. To sum up this section, a comment Richard made reflects his opinions on the management style of the Group:

> "Global strategies are not something somebody writes to me from London to tell me what they are and how to implement them. Rather, I, along with my colleagues around the region, participate in deciding how things should be taken forward in certain circumstances. As a combination of individual business inputs and top-down inputs, I would describe the management style as participative".

8A.12 Performance evaluation of SGP HK and SGP China, and their managers

It was revealed that Superior headquarters has been using the same standards and techniques to evaluate performance of JVs and their managers. The rationale to explain the homogeneous treatment is that subsidiary management are given a certain level of autonomy in day-to-day running of their operations, and naturally the JVs' performance reflects the managers' performance. The overall performance will have direct impact on the managers' career prospects as well as financial rewards in terms of year-end bonus.

Despite the apparent rigid rules applied to performance evaluation, the executives claimed that the headquarters would take into account factors that affect JV performance but are clearly beyond their control. For instance, the Guangdong JV is a new plant. It inevitably has to go through a steep learning curve, which in turn means high costs of operation at the beginning stage. It takes time and money to build up a smooth operation. Furthermore, the total depreciation charge in a new plant is likely to be more significant than other long-established plants, such as the one located in Malaysia which has over twenty years history. The net book value of some of their assets is almost zero. The headquarters understand all this. They would not use those reasons to blame the managers for spending too much or earning too little profit. The specific circumstances underlying each subsidiary provides some leeway within the boundary of a standardised performance evaluation system. A comment made by Richard captures characteristics of the corporate system:

> "obviously any investment in any country, not just in China, is not going to become instantly profitable from day one, although our experience (in China) has been quite good. This kind of expectation is reflected in any new investment proposals. Besides that we would not be given other allowance just because we are operating in China".

8A.13 <u>The currencies used in the reporting and budgetary systems</u>

SGP HK and SGP China adopted HK dollar (HK$) in their reporting and budgetary systems. Market spot rates are used in the currency translations.

SGP HK is a trading company and its target market is HK. Therefore, the use of HK$ in budgets and reports causes no major concern to the operation. However, SGP China relies on imported materials and it sells the majority of outputs domestically in China. They seem to be more exposed to any exchange fluctuations between RMB and other foreign currencies.

Dennis stated that between 1991 - 1993, the exchange rates between RMB and other currencies were very unstable. Meanwhile, the Chinese government imposed tough control on buying and selling of foreign currencies. The problems caused by foreign exchange shortage and control were considered as a big hindrance of running businesses in China. Due to the increasing needs of the industries, the government established several "swap centers" where firms were allowed to swap their foreign exchange balances according to the official swap rates. Nonetheless, both of the official exchange rates and the swap rates were artificially set at a high level, and it significantly increased the cost of operation of those firms who needed large amounts of foreign currencies.

In 1994, the Chinese government introduced an unified foreign exchange system to stabilize RMB. Since then the access to foreign currencies has substantially widened, and the exchange rate between RMB and US$ has became more stable. Although RMB is not an internationally convertible currency, it is now accepted as a business currency in some Asia Pacific countries, such as Singapore and Malaysia. In some circumstances, SGP China pays for their imports by RMB or a combination of RMB and other foreign currencies, such as US$.

8A.14 <u>Were there any major foreign exchange gains or losses before the unified foreign exchange system introduced in 1994?</u>

Before the unified system was introduced in 1994, SGP China was only at the construction stage. Therefore, foreign exchange fluctuation mainly had effects on the JV's construction/formation cost. Dennis was in charge of the project. He went to China himself to negotiate with some large firms to swap HK$ for their RMB.

SGP China's construction budget was drawn up by using the official rate, which was about HK$100 to RMB 70 at that time. However, at the times they actually changed money, the rates became more favourable due to the devaluation of RMB. As a result, they actually gained from the foreign exchange fluctuation. Nonetheless, inflation was exceptionally high in the first half of the 1990s when China's economy took off. The overall construction cost of SGP China was increased substantially. The profits they gained from foreign exchange were just enough to cover the additional costs which were caused by high inflation. Basically, right hand's gain covers left hand's loss. Dennis added the following remark:

> "During the construction stage, we kept a close eye on the foreign exchange markets and reviewed the budget monthly. Luckily, the actually spending of the whole project was very much in line with our estimates.

However, if we had overspent due to inflation or other reasons, Mr. Mather and I would have to take the responsibility, as there were only two of us in charge of the whole project".

8A.15 <u>Performance of SGP HK and SGP China - have they fulfilled the investment objectives?</u>

Some consistent answers were received for this question. "Yes, we are satisfied with the progress to date" according to Richard. The executives expressed that the two operations have either met or exceeded the aspirations set down when the investment decisions were made. For instance, the HK trading office has been a profitable operation since it was formed, and the Guangdong JV started to balance its books after the first year of operation. It has to be remembered that SGP China was their first FDI in China second time round and it was a greenfield plant built from scratch.

In addition to the outstanding financial results, another big success is that against all odds a solid foundation for the two distribution networks is laid down in China. Within a relatively short period of time, hundreds of showrooms were established in the main cities, and a team of distributors and sales representatives gradually put in place. It can be seen that their key motives to form the first JV, such as penetration of the domestic market, establishment of a local production base, are initially fulfilled.

According to the executives, the combined result of Greater China in 1995 closely followed the two leading Asia Pacific subsidiaries located in Thailand and Malaysia respectively. According to the current trend of performance, Greater China is set to overtake these two regional leaders in the first decade of the 21st century. The satisfactory results and the harmonious business relationship between partners are reflected in the founding partners' further plan to form a new JV in Shanghai, one of the most important industrial and commercial cities in China. Undoubtedly, the good initial experience was a vital driving force leading to the establishment of the second plant. Besides that, the steady economic development of China and its continuous opening up are other key factors . One of Richard's comments shed further insight into their decision:

> "...obviously we have a good initial experience. If we want to develop the opportunities, we need extra capability and we need to be situated in other parts of China as well. It is because of the huge size of the country and the poor infrastructure hinders efficient transportation, and so on".

These reasons correspond to the key motives which drove the partners to China initially - penetrate the PRC markets and to establish local production which is close to the final customers. China is a huge country (forty times bigger than the UK), the geographic distance between places together with the poor infrastructure makes the needs to set up factories in other big cities even more important. On the other hand, key world-class players in the paints field have already moved into China and gradually built up their territories. The competitive pressure influences Superior's decisions to move quickly into other major cities in order to secure a dominant position in the country. Besides the Shanghai JV, discussion of other paint production investments in China between Superior and Giant has been underway.

8A.16 Details of SGP Shanghai - why was a wholly foreign owned structure chosen?

The second plant, SGP Shanghai, involves only the two founding partners Superior and Giant. It is a wholly foreign owned JV of which Superior is the majority shareholder with 70% of the equity, while Giant has acquired a 30% stake. The executives put forward a few reasons to explain why they decided to set up a wholly foreign funded enterprise (WFOE).

It was revealed that the management had actually contacted a few government authorities to see if they were interested in forming a JV together. However, some of these potential candidates were unable to raise the required capital. A local authority, who was at that time in charge of the trade zone where the identified JV site is located, was running a servicing company to provide management and consultancy services to private organisations. Management of SGP HK considered that hiring the local agent would be a better alternative than including a local Chinese partner, as it would simplify the ownership structure of the Shanghai JV.

Another reason to explain the WFOE decision was that having acquired a good experience from the Guangdong JV, Superior and Giant felt confident to establish a WFOE themselves. The wholly foreign owned structure is considered as an easier way to align investment objectives and management practices between the two British partners who have compatible background. It was seen as an ultimate solution to eliminate any potential diversity of investment aims between foreign and local partners.

8A.16.1 Location - why was Shanghai chosen?

The criteria to select location for the second plant were basically the same as those used for the Guangdong JV. Stage of economic and infrastructure development, geographic location, and distance from target markets are all important considerations. Shanghai was and has been a cosmopolitan city before 1949 and since the opening up of China in 1979. The city has natural harbours which are perfect for sea transportation

In addition, the Chinese government has also injected a lot of resources to re-generate this historical city. Several large-scale investment zones were commissioned to build or have already been underway. The most well-known PuDong Economic Zone occupies an area which is nearly half of the size of Hong Kong and is considered to be possibly the biggest construction site in the world at the moment. Hundreds of sky scrapers and residential blocks are included in the plan. Shanghai has become a popular spot, which has attracted a lot of foreign investment from different industries. These newly developed industries need paints for various purposes and the recent developments in the city have created a vast market for local paint production. SGP Shanghai is built with a key objective to capture the opportunities arising in the important city of Shanghai, the heart of China.

8A.16.2 Are there any potential conflicts between SGP China and SGP Shanghai?

Ownership structures of the two Chinese plants are different (see Figure 8A.1). Guangdong JV includes three partners, while only foreign partners are involved in SGP Shanghai. However, the two JVs are involved in the same type of business, and aim at serving the Chinese domestic market. Hence, there is a real possibility of direct competition, which may lead to a conflict of interests.

"Of course, there is a potential for that. Therefore, it has to be managed". Richard said.

It was explained that some of the potential conflicts had already been addressed by forming a WFOE with the same foreign partner Giant. Consequently, the only potential for conflict is between the two foreign partners and the Chinese counterpart IDC. Penetrating the Chinese market has been a long-term objective of the two foreign partners. When they formed the Guangdong JV, they made it clear in the JV proposal that further investment by individual partners in the country could occur. Therefore, the Shanghai JV should not be a sudden shock to IDC as they knew it all along. The management team were very careful in handling this delicate issue. They communicated their plans thoroughly to the Chinese partner along with the proposal and construction stages of the Shanghai JV. The executives felt very confident that if there are any chance for conflict, it will be properly managed.

Moreover, the geographic location of the two JVs is fairly far apart (see Map 8A.1). The Guangdong JV aims to serve HK and Southern China, whereas the new plant plans to capture Shanghai and near-by cities. They operate in different regions and thus there should not have any direct conflict of interests between the two operations. In fact, the current demand for quality paints is very high in China. Dennis drew an example that even if Superior and Giant had decided to build ten factories in different parts of China now, it still could not be able to meet all the existing demand. According to Richard:

> "The overall conclusion is 'no', there is no conflict between the existing and new investments, or between the foreign and Chinese partners. Everything is under control!"

8A.17 Any particular difficulties of doing business in China?

"Yes, many problems!" An immediate answer was given by Richard. Throughout the discussion, Richard described China as a difficult environment to find your way around. The centrally controlled economy has characteristics that many foreign businessmen are not used to deal with. The problems are often associated with the bureaucratic procedures.

> "It has been very complicated, and it has been very unfamiliar. Just to understand who you need to talk to in order to obtain advice or approvals to do things can often be a drawn-out procedure". Richard claimed.

Nonetheless, the executives admitted that the situation in China is getting better all the time and so are they. The foreign investors are becoming more familiar with the procedures, and the PRC people are getting used to foreign investors and their expectations. It is a learning process for both sides.

8A.17.1 Are language and social/cultural differences key problems of running business in China?

I was aware that language and social culture were not included in the executives' lists of "difficult experience in China". Out of the three interviewees, only Dennis is a HK ethnic

Chinese. Although John Smith and Richard have had lots of experience of working in the Far East, they are European and both of them cannot speak Chinese. Because of this reason, the two foreign executives were asked to explain why.

"Language of course is a barrier". Richard replied. If it is a barrier, why do the executives not see it as a key problem of running business in China? My curiosity probed further discussion on this aspect. Richard described language as a "technical barrier", as it is difficult for western expatriates to be sure of the real intention of what was said is being translated. However, this area is less a problem for Superior Group as a whole because they have a group of staff who are very good at languages. For example, besides two English speaking managers, the rest of the expatriates in SGP China come from Singapore, Malaysia, Taiwan and HK. These managers possess knowledge of the Chinese language, dialects and culture. English has been an important business language, in addition to Cantonese, in HK. Therefore, the place where problems may occur is really in SGP China. Superior appointed a Malaysian Chinese expatriate, who is fluent in Mandarin, Cantonese and English, as the GM of SGP China. The potential issues caused by language and culture differences is further minimised by this arrangement.

Indeed, the flexibility to transfer personnel through internal networks provides multinationals with an edge which deals with country- or culture-specific issues. Superior and Giant's experience is a good example to illustrate the market imperfection assumption behind internalisation theory adopted by this research (see Chapter 4 & 5). In addition to the points above, Richard added the following comment.

> "Generally we manage to form a very warm and good relationship with people we have been dealing with. It is quite a few years now and hopefully trust and respect have been built up. On the culture side, by giving reasonable sensitivity by both parties and particularly by the foreign investors, I think that it is not a problem".

8A.18 <u>How do the management see the future of investing in China?</u>

"Very positive". A quick and confident answer was given by Richard. Superior Group feels very positive about the prospects of many Asian Pacific countries, such as Malaysia, Indonesia, Taiwan and China. It is considered as a region of growth, and Superior Group as a whole has tried to establish a strong foothold there. The investments in China have their strategic importance towards the Group's world-wide position. Up until this moment, all the signs have shown that it will be full-steam ahead for further investments. I will use a comment of Dennis to conclude this section and the case study:

> "Regarding the China market, I think it will be volatile in the short-term. However, according to the rapid rise of GDP and the steady development of the whole country, from a long-term point of view I believe that the opportunity is there and the future of China should be very positive and prosperous!"

The case study of Superior Group is now completed. The second case, which is about Marlee Group's investments in China, is recorded in the following section 8B.

Case Study - "B"

Marlee Group

Map 8B.1 **The locations of Marlee's JVs and the Headquarters in China**

• ShangJiakou (Marlee) • Marlee (Beijing)

•Guangdong Marlee

* Two wholly owned subsidiaries, Marlee Chemicals and Guest International, are located in the Guangdong Province and Shanghai respectively.

- Marlee China
  (Headquarters for Greater China)
- Marlee (Shanghai)
- Marlee (Shanghai) toothpaste
- Shanghai Marlee personal Care products
- Shanghai Lee Bros
- Shanghai Van
- Shanghai soap

Source: Magellan Geographix^{SM} Santa Barbara, CA (800) 929-4627 (1993)

8B.0 Introduction

The second case study is about Marlee Group's FDI in China. Marlee was created in 1929 through a merger between a Netherlands-based MNE Mars and an UK firm Lee. The Group manufactures and sells foods, toiletries, cosmetics, special chemicals, as well as cleanliness products around the world. Up until 1996, Marlee had a total of twelve investments in China. Before the story of its IJVs begins, a brief introduction of Marlee and its parents' history is seen as important. Their background covers some fascinating stories of how the first generation of MNEs seized the opportunities created by the particular economic and political settings in the 19th and the early 20th century.

8B.0.1 The birth of Mars Union

The Dutch partner Mars was originally a partnership between two big margarine producers Jan and Van in 1927. Both Jan and Van in fact played a key role in bringing production of butterine (how margarine was called in the early days) from its home of invention (laboratories in France) into Netherlands between the 1870s to 1880s, and the subsequent development of the margarine industry in the world.

Along with their main butter and margarine product lines, the two Dutch companies also started their soap[1] production and trading business at home and abroad. In 1927, Jan and Van eventually decided to fully amalgamate[2] their businesses and formed Mars Union[3].

8B.0.2 The history of Lee

Lee's soap business started in UK in the 1870s to explore the newly formed cleanliness market, which was created by the growth of industrial population from the mid 19th century. Lee rapidly extended its existing soap markets, and at the same time explored new ones[4].

In the early 20th century, British soap export to China was considerable[5]. Lee handled approximate 30% of soap trade in China, while another UK-based soap maker Crossage,

1 Soap production uses the same type of key ingredients and similar ancillary production process as edible fats.

2 Prior to the formation of Mars, Jan and Van were engaged in some forms of business collaboration to protect their market share.

3 Both Jan and Van had significant interests in other European countries, the UK in particular. In order to avoid double taxation, Mars Group was designed to have a dual structure: a Dutch and a British parent linked together by an equalisation agreement. When Mars Union was born in 1927, it adopted the same structure and consisted of two holding companies - Mars Holland and Mars UK. In 1928, Mars bought out a number of smaller margarine firms and was renamed as Mars Union Holland and UK.

4 For example, the firm went into edible fats business when there was a shortage of margarine supply in the UK during the First World War.

5 For instance, well over 10,000 tons were imported into the country in 1912.

which was acquired by Superior Chemicals[6] in 1912, captured the rest of the market. From the early 1910s, negotiations were underway between Lee, Crossage and Superior on the possibility to set up a JV together to produce soaps in China. Unfortunately, the discussions, from the beginning to the end, were unfruitful. The hindrance of arriving at an agreement was simply due to conflicts of business interests[7] among various parties, and the problems were only deepened[8] over time. Superior regarded that the negotiations would go nowhere, and decided to announce a new plan[9] on its own. Lee rejected the proposal and took legal actions against Superior.

In order to settle the legal battle, Superior offered to sell half of Crossage's ordinary shares to Lee and also agreed to let Lee appoint Directors for the new Chinese factory. However, the differences were never resolved. But Superior's offer led to a later development, which allowed Lee to acquire the whole business of Crossage and become the world leading soap producer. In the 1920s, Lee went into China and set up a soap factory in Shanghai. While Superior also went into China and established their distribution networks to explore the chemicals market, its main line of business (see Case Study A for Superior's story).

8B.0.3 The birth of Marlee Group

As was mentioned before there are similarities associated with soap and margarine production. The existence of a number of key players in both fields inevitably led to severe bilateral competition. Mars approached Lee in 1928 with a proposal to acquire their margarine business. It was Lee's speedy growth in the margarine market that created a threat to Mars' position. Lee immediately counter offered to buy out Mars' expanding soap

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[6] The focal partner of SGP HK and SGP China in Case study A of this thesis.

[7] Superior and Lee had a long business conflict over the access to raw materials first and control of the UK soap export at a later stage. Caustic soda is an important material of soap and its production requires soda ash. Superior was a key soda ash producer at that time and the firm held a monopolistic control over access to alkali. In its alkali supply contracts with soap makers, Lee included, Superior set down a clause to prevent them from producing caustic for general sales. In 1911 when Lee grew into substantial size, it requested Superior to change this restrictive clause on the soda ash contract. Lee took an initial step in the year and bought an estate in Cheshire under which contained valuable salt deposits suitable for alkali production. Superior reacted strongly towards Lee's potential move into alkali production, its major business. In autumn of 1911, Superior acquired Crossage's ordinary capital and gained control of the company. Crossage was in fact a collaboration between two leading soap makers Cros and Sage, whose combined output was only next to Lee in the UK. However, Crossage was in a commanding position in the UK soap export trade in China. In 1913, Cros (nearly 50%) and Sage (16%) together shared nearly two thirds of the UK export trade, and Lee family obtained some 30%. Lee's desire to produce alkali for its own use and possibly for general sales, and Superior's response to enter into the soap business to defend its share in the alkali market led to a hostile relationship between the two firms.

[8] In the early 1910s, the three leading UK soap exporters Cros, Sage (through their collaboration Crossage) and Lee were involved in a negotiation. It aimed to set up a policy to divide up the UK soap export market, and draw up an agreement to set up a JV together to explore the Chinese trade. After taking over Crossage, Superior wanted to use the advantageous new position to force Lee to renew its alkali contract with them and withdraw from caustic production. In return, Superior offered to sell its shares of Crossage to Lee. However, the other owners of Crossage, the Cros family in particular, strongly refused to be used as a pawn between Superior and Lee. In fact, Cros and Lee were long-time rivals in the soap industry. Also, due to the conflicts over the fats hardening patent that Cros was reluctant to co-operate with Lee.

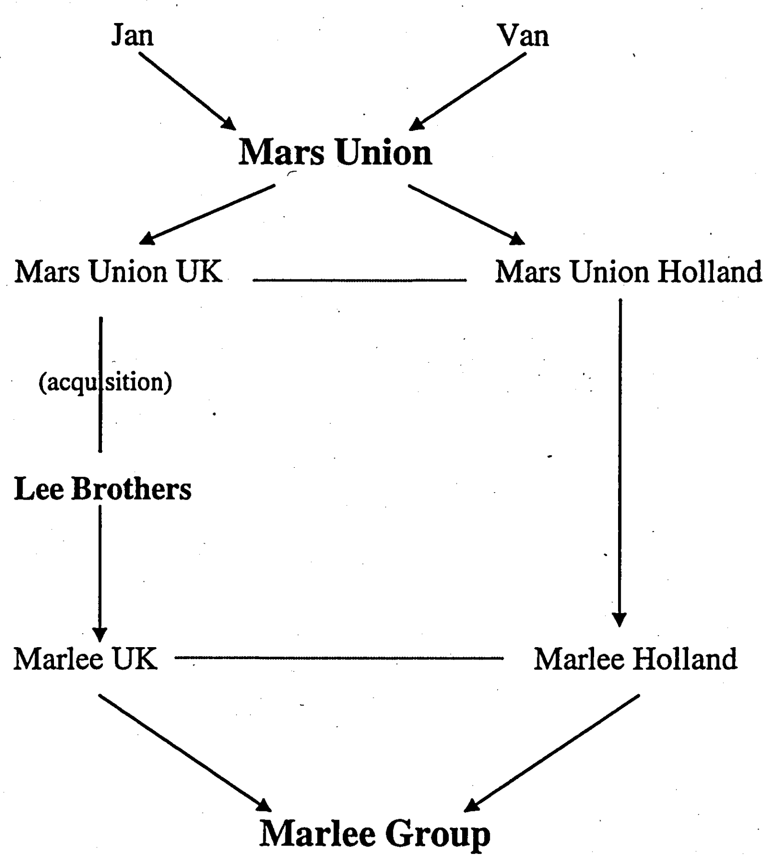
[9] They stated that Lee would become only a financial investor who had no right to run the future JV in China.

division. However, neither of the two firms saw the full benefits of selling out a part of the business. A proposal of full merger[10] between the two firms finally resolved the problems of indivisibility, and the new company Marlee[11] was born in 1929. Figure 8B.1 outlines the relationships and the formation journey of the Marlee Group.

Since the formation of Marlee, the soap and margarine production networks expanded rapidly. In addition to these original lines, Marlee diversified into frozen foods in the 1950s, special chemicals in the 1960s, and toiletries, tea and household cleaners in more recent decades. The Group now possesses over a thousand well-known brands worldwide.

Figure 8B.1

The formation journey of Marlee Group



———— The equalisation agreement

[10] The amalgamation combined the two firms' hundreds of factories all over the world and with tens of thousands of employees, was one of the largest in the European history.
[11] Marlee also adopted a dual structure as Mars' with a Dutch and a British parents.

8B.1 Marlee's past experience in China

Marlee followed the footsteps of its parents, and was very active in Asia Pacific. The Group established new factories in many places within the region[12]. China and India were two specific Eastern markets, where the Group targeted to have very considerable expansion. As with other pioneers who operated in China during the first half of the 20th century, Marlee experienced various types of calamity[13]. Nonetheless, the Group not only survived, but also managed to grow its business over the turbulent years.

However, the situation changed rapidly in the 1950s, and Marlee's destiny was reflected in a simple sentence, "following an absence of 33 years, Marlee returned to China in 1986", included in the Group's website (Marlee China, 18/6/97). The message says it all, Marlee left China in 1953. Why did they leave? It was likely to be due to the same reason which drove Superior (see Case Study A) out of China. The communist party evicted foreign interests in the 1950s, and Marlee was one of the victims in that chaotic era.

Against all odds, Marlee has now returned to China again. The Group's commitment to China can be seen from its substantial investment in the country over the past ten years, and the recent establishment of a holding company, Marlee China, as a headquarters to handle the Group's future long-term investment in Greater China.

8B.2 Personal interviews and secondary source of information

Two personal interviews were conducted in Marlee China, Shanghai. One interview was carried out with Harry Evans, the Financial Controller and Treasurer of Marlee China. The other interview was carried out with Ken Ng, the Controller of Sales and Distribution. Both of the interviewees are young professionals in their late 30s or early 40s at the time of the interviews.

Harry is a British expatriate. Throughout the interview, the impression of personality he gave me was "down to earth". Harry did not like to waste time, and his discussions were always straight to the point. He seems to be a strong character, which is quite an opposite to Ken. Ken is softly spoken and he is a Hong Kong expatriate, who was transferred from

[12] For example, China, Japan, Burma, Siam, Philippines, Malaysia, India and Ceylon.
[13] Such as flood, famine, drought, banditry, communistic battles and internal strife.

Marlee HK. Both of the executives were very helpful towards my research, as they said that they would not normally accept any requests for interview.

This case study is based on the interview materials together with information gathered from various secondary sources, such as Marlee Group's annual reports, Internet website, the Group's autobiography and journal/newspaper articles.

8B.3 <u>Marlee's return - what are the key motives?</u>

From an early stage of its business history to the present time, Marlee has been a worldwide business. Indeed, Marlee is perhaps one of the most international businesses in the world today. The Group has established operations in more than ninety countries, together with export agreements with local companies in a further seventy countries. Although it was a Dutch and British based business originally, nearly a third of the Group's operating profits come from countries outside Europe and North America.

"Overseas expansion" and "providing the right products at the right time and right place" are the objectives of the Group. A key business priority for Marlee now is to generate growth in places that are important to the Group. According to the World Bank's forecasts, the emerging markets will overtake the advanced industrial countries in their share of world output in twenty-year time. Among this fast growing group, China is predicted to become the world's largest economy, while several other Asian countries, such as India, Indonesia, Thailand, Taiwan and South Korea, will also be in the top ten. This emerging region consists of a very large proportion of the world's population, and its increasing spending power presents excellent opportunities for consumer products and services. According to the Group's strategies, Marlee has to move into China to seize the opportunities. Harry explains their rationale:

> "Marlee is a world-wide business... When you have a market of a billion people opening up in China, we cannot ignore that. We have to be here. When we formed the first JV, it was a trial. We thought that we would see whether or not we could do business in China. By 1990, we found out that we could. So we formed two new JVs. By 1992, it became quite clear that our competitors were all moving into the country. This is another impetus to grow the business here. We have to be in China".

Marlee started its first FDI in China in 1986 and up until the beginning of 1996, twelve operations were set up. Nine out of the twelve are JVs, and the other three are wholly foreign owned enterprises (WFOEs). Except the holding company Marlee China, the rest are manufacturing businesses. The ownership structures, main business activities, and locations of these twelve operations are listed in Table 8B.1. Map 8B.1 shows the locations of Marlee's JVs and headquarters in China. Some of Marlee's Chinese subsidiaries are large investments. For example the ice-cream JV in Beijing is the largest with a total capitalisation of US$90 million, and the second biggest is a detergents JV in Shanghai with the total investment of US$64 million. The combined turnover of all the China subsidiaries amounted to US$300 million in 1995, and they expected to become a billion-dollar turnover business around 2000/2001.

Table 8B.1

Marlee Group's FDI in China up until the end of 1995

Names	Equity owned	Locations	Main Business Activities
Marlee China	100%	Shanghai	Holding company, Head office for the China operations.
Shanghai Lee Bros Company	54%	Shanghai	Detergents and personal products
Marlee (Shanghai) company	87%	Shanghai	Detergents & personal products
Marlee (Shanghai) Toothpaste Company	60%	Shanghai	Toothpaste
Shanghai Marlee Personal Care Products Company	50%	Shanghai	Personal products
Shanghai Van Company	50%	Shanghai	Foods - margarine & ice-cream
Marlee (Beijing) Company	95%	Beijing	Foods - ice-cream
ShangJiakou Marlee Company	70%	Hebei	Detergents
Guangdong Marlee Company	60%	Guangdong	Foods - tea bags
Marlee Chemicals	100%	Guangdong	Chemicals
Guest International	100%	Shanghai	Flavours & fragrance
Shanghai Soap	25%	Shanghai	Soaps

8B.4 How has Marlee justified the risk of investing in China?

Marlee's recent investment in China is indeed their second attempt to explore the country. Having experienced a lot of extraordinary moments in China, how has Marlee justified the risk of investing in China this time? Harry's straight-to-the-point character started to show from this second question:

> "As I say, the biggest risk is not being here. All our competitors are here. Marlee has targets, one of which is to be the biggest ice-cream manufacturer in the world. To remain the biggest ice-cream manufacturer in the world among other things, we cannot achieve that objective without being in China, when all your competitors are making ice-cream in the country.
>
> According to my understanding, we have so far put in a certain amount of money, US$300 million or whatever it is, and that might all be lost tomorrow. We trust that it will not be. All the statements by the Chinese government and by all the official authorities here are that there is no risk and they would be insulted if you suggested there was. But of course there are risks.
>
> Banks use credit rating to assess each country for risk. We read and use all those figures. But in our judgement, it is full steam ahead in China at the moment. We have to be here, and we will grow the business. However, we will not take on undue risks".

The above answer is a good example to illustrate methods and criteria firms use to assess investment risks. From our point of view, expropriation may seem to be the worst that could happen to any foreign investment, and Marlee has experienced that before. However, the top management are fairly confident that this time the decisions are right, and they believe the chance of losing the initial investment is very unlikely. On the other hand, if the Group did not move into China, the chance of losing their world-wide competitive position is almost certain. It is a simple cost and benefit analysis. Their current moves show the type of risk that they prefer to take.

8B.5 Why was JV form of organisation chosen for a majority of the FDI?

It can be seen from Table 8B.1, JV was a popular mode of entry for Marlee's FDI in China. The executives explained the decision was based on a combination of factors, such as the stage of FDI and economic development in China, the government economic policies, benefits that could generate from having local partners and the Group's strategies.

It was revealed that in 1986 when the first JV was formed, it was not easy to establish WFOE in China. As was recorded in Chapter 3, the Foreign Capital Enterprise Law was enforced only in 1986/7. WFOE was a new concept to both foreign investors and the Chinese government in the 1980s. As a result, at the start JV was the only possibility opened to Marlee. Their three FDI, Shanghai Lee Bros.[14], Shanghai Van, Shanghai Marlee Personal Care Products, were established through forming 50:50 JVs with local partners.

The motives, which led Marlee to adopt JV at the beginning stage, are understandable. Nonetheless, why do the Group's recent FDI in China remain mainly in a JV form, despite the fact that the business environment in China has been improved over the past ten years? The main reason behind their later decisions was because Marlee felt that having a Chinese partner could bring them substantial benefits.

First, according to the Chinese investment policy, foreign enterprises are required to export the majority, if not all, of their outputs. However, if the FDI are in a JV form, especially with local partners, then the treatment is different. Sino-foreign JVs do not necessarily have to have an export quota. Generally speaking, this type of enterprises is entitled to sell half of their outputs in China. It is clear that Marlee has aimed to exploit the Chinese markets and sell the majority of their outputs there. Thus, JV naturally became a favourable choice under this condition.

Another type of benefit of having local partners is that these Chinese counterparts usually have all the contacts with local government and other parties that are important to running business in China. In addition, local partners normally have existing distribution channels and expertise to market products, which the new JVs can continue to use. A comment made by Ken Ng revealed the difficulty of product distribution and explained why quite a few of Marlee's recent JVs in China are with existing businesses, who already have the networks established that the new JVs could use immediately:

> "The national distribution channel in China is fragmented and chaotic. The infrastructure is badly developed that it is unable to cope with the rapid development of the country... There are so many business players using the facilities to distribute their products, and it makes the under developed infrastructure further handicapped".

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[14] The share holding of Shanghai Lee Bros. was increased to 54% recently.

Another point Harry made has shed further insight into Marlee's investment mode decisions:

> "The new JVs are between Marlee and existing businesses... Then when you introduce new, what we call world-wide brands like Marlee Soap (into China), the distribution channels are already in place. It means that you will have a good start. If you have a wholly owned business, you will have to start from scratch. Employing salesmen, starting to build contacts with wholesalers in different cities. That is generally more difficult than using an existing business".

In addition to the benefits mentioned above, another key factor which motivated Marlee to form JVs with established local businesses was the Group's interest in internalising some leading local brands. This strategy corresponds to one of the Group's objectives, "success depends on providing the right mix of international and local brands for the local consumers" (Marlee Annual Report, 1995:11). If Marlee chose to establish a 100% owned business, they would not have a local brand, which had already held a significant market position in the country.

A good example to illustrate how they operationalise this type of strategies is the Group's recent toothpaste JV with a leading Chinese manufacturer, who at that time was already one of the largest single toothpaste business in the world. By forming a JV with that local company, Marlee got instant access to the biggest brand in China. Combining this immediate result with its share in other toothpaste markets, Marlee greatly shortened the journey to achieve one of its targets, to become the world leading toothpaste producer. This dream almost instantly came true when the JV was formed.

8B.6 JV preference - has Marlee worried about the risk of dissipation?

Among many economic-based research in FDI, it is widely believed that the most significant transactional contingency facing MNEs considering a JV would apparently arise from the problem of opportunism (Rugman, 1980, 1982; Williamson, 1985). A related question to Marlee's preference towards using JV was whether the Group worried about the risk of dissipation of technology to their JV partners, given that Marlee had owned a number of world-wide leading brands. According to the executives, the risk of dissipation was not a critical issue hindering Marlee's FDI in China, and the Group had taken necessary steps to prevent possible adverse consequences caused by getting involved in JVs.

> "I suppose that there is always a risk. But what is the alternative? You cannot import products and sell them legally in China. That is not allowed. Then you have to manufacture here, and given that we do not want to set up a green field factory for every JV: (a) it would be difficult, (b) requires an export quota, and (c) we may want some of the local brands to be part of the JV.
>
> Yes, there is a risk that our partner will find out the technology. But having said that, you know technology is there and it is not particularly difficult. We are making soaps, not building space rockets. Soap technology is well-known around the world. There may be some specific technological advantages that we might bring. But it is easy to copy if our partners want to.
>
> If your Chinese partner is copying what you are doing, it is not only a partner, it can be a competitor. That is the reason why we prefer to form JV with an entire existing business rather than with a division or subsidiary of an existing business". Harry stated.

8B.7 If JV is a favourable form, why WFOE is also used in a few other FDI in China?

As shown in Table 8B.1, three of the FDI in China are of wholly owned format. One is the holding company, which works as the headquarters for Greater China[15], and its wholly owned structure is understandable. What are the reasons to explain the decisions on the other two cases?

It was disclosed that the two WFOEs are related to the special chemical side of Marlee's business. Both of the investments are relatively small, and they are producing specialist chemicals, of which process covers a lot of confidential information. Dissipation is a real issue that Marlee is concerned. On the other hand, the two plants have relied on local supply of raw materials and much of their outputs are used for export. Because of all these reasons, Marlee has seen no big advantage to have JV status for these two FDI. Again, the Group's entry mode decisions follow the basic rule of cost and benefit analysis.

8B.8 How were the JV partners identified?

It was revealed that the initial point of contact is normally via the Shanghai government agents, who provide information on local businesses, which are available to form JVs.

[15] It includes Mainland China, Hong Kong and Macau.

That is a common channel through which foreign investors get their contacts. An alternative way is that foreign investors employ private consultants to conduct surveys in the related industries in China to identify potential candidates. For the existing JVs, Marlee used both channels to identify suitable local partners.

8B.9 <u>How has Marlee assessed the suitability of JV partners and what are the criteria they based on?</u>

"It depends". Harry said. It was explained that whenever the Group decides to manufacture a particular product in China, it is likely for them to start by looking at existing businesses in the same field. Harry drew an example to explain the normal procedures and common criteria they follow to select their partners:

> "If you want to create a JV to manufacture toothpaste for example, you are likely to look at existing toothpaste businesses first. Not necessarily true all the time but you are likely to do that. First of all, they have good and strong local brands. Other considerations include: do they have good management? Do they have good distribution systems? Do they have good connections with the local government? Are they recommended by the local government? If those are the case, then of course we will be interested to look at them.
>
> Nevertheless, we also use these criteria to reject companies. We do not necessarily want to take over or form JVs with lots of small cosmetics manufacturers because there are hundreds in China. We cannot possibly form a hundred of JVs. So the potential partners have to be of reasonable size as well. That is the reason why our partners tend to be leaders or certainly the top three or four businesses in that particular field in China".

8B.10 <u>Had Marlee known these partners before the JVs were formed?</u>

This question brought out some interesting stories. The partner of Marlee's first JV in China is in fact its own factory. What does it mean? According to Marlee's history, this so-called local partner was one of the establishments that they left behind in 1953. Reunion with their 'lost child' had sentimental value to the Group, and the move also symbolised Marlee's determination to return to the country. To some extent, the local partner was not seen as an outsider. It was originally Marlee's factory.

Besides this first incidence, in other JVs Marlee did not normally have business dealings with the partners before the JVs were formed.

8B.11 Is it riskier to form JVs with partners whom you do not know?

Harry gave a quick answer to the question:

> "It is one of the risks. But we try to minimise the risk by doing a very thorough survey of all the possibilities on all potential partners before we finally make a decision. We have rejected partners. We have gone a long way to approach partners to form JVs. But after 2 - 3 months of discussion, both parties could not agree on the way forward.
>
> For example, we would want a minimum of 60 or 70% of the equity. We are not interested in anything lower than that. If our partners are not prepared to do that, we are simply not prepared to discuss it any further."

8B.12 Why has Marlee stressed on gaining a majority equity holding in its JVs?

A notable point embedded in Harry's answer above is that Marlee preferred to secure the majority shareholding in its JVs and it was a key criterion in the JV negotiation process. The answer probed further investigation to find out the reason behind that policy.

> Harry answered, "majority control is the preferred model. Because we can then run the businesses in China as one business. If we are going to be a billion-dollar turnover business by the end of this decade, certainly with the existing sales target it would not be a problem, then it requires a huge infrastructure, training, recruitment and central treasury management to raise cash. To implement these plans, a lot of co-ordination is needed between different subsidiaries in China. That level of co-ordination is easier to achieve if you have the majority share holding of the existing JVs.
>
> For instance, if you want to move personnel from one JV to another, it is easier to do so if you have the control of personnel and operation of each JV. Not everything is easy, and in some JVs we do have problems. There the Chinese partners are still effectively in charge of the personnel functions. As a result, they can veto your appointments. They can prevent existing people from leaving to support other JVs, of which we think is a good opportunity. A part of Marlee's culture is to allow individuals to get experience in several businesses as they progress up the management ladder. If you are prevented from doing that, the China partners are not very helpful towards (a) the individuals and (b) our businesses in China.
>
> ... Secondly, in order to consolidate the businesses in China into our global results, we have to have more than 50% stake in each of the Chinese operations. Otherwise, they are classified as associates rather than subsidiaries. We need 50% or more equity in order to consolidate 100% of the results".

The above answer indicates that equity and control is having a direct relationship in Marlee's JVs in China. The higher the equity holding, the greater the degree of control the

Group can exert into the operations. The importance of control lies in the sense that Marlee could run all its FDI in China, wholly owned and partly owned, in a cohesive and effective way.

Among the twelve FDI in China, only in three instances is Marlee's ownership below 51%. The Group owns 50% of Shanghai Personal Care Products and Shanghai Van. As was discussed in 8B.5, these JVs were two of Marlee's earliest FDI in China. At that time, based on the Chinese government's encouragement of mutual benefits, 50:50 JV was the most popular investment form available to foreign investors. In the third case, Marlee could only acquire 25% of equity of Shanghai Soap. That JV was a strategic investment which was used as a vehicle to approach the Chinese partner's expertise and leading local brands. It was not a major outlet for Marlee's own products, and thus the "no-less-than 50%" criterion did not apply to the negotiation process.

8B.13 <u>Were there any particular problems in the JV negotiation?</u>

The biggest problem experienced in JV negotiation tended to be the differences in investment objectives between partners. Marlee wanted to have the majority of equity and hence control of the JVs. If it were not available from day one, in many cases the executive team would stop the discussion. However, once agreement on this fundamental point was achieved, it would then proceed to detailed negotiations on individual clauses on the JV contract.

One particular contentious area on the contract was the licensing agreement between the JVs and Marlee headquarters for the use of their trade-mark and technology, which normally costs 1 or 2% of a JV's sales as licensing fee. This issue could take a lot of time to negotiate[16]. Another problematic area was whether or not it needed to have redundancies if the existing plants are used as part of the JV co-operation. State owned businesses in China often employ too many people. Marlee makes it clear to all their potential partners that they are not prepared to take on more workers than necessary. The executive team is concerned about the mechanism of making redundancy payments, and any liabilities that the JVs might have taken on in the future. It is because state enterprises have employed their workers for many years, and are responsible for providing housing and

[16] Licensing fees are normally paid in foreign currencies and the payments could affect the JVs' foreign exchange balances.

pensions for their retired employees, naturally Marlee does not want to take on this type of liability.

Another critical issue in the negotiation process was the number of expatriates that Marlee is allowed to bring into the JVs. Using experienced expatriates to run new ventures is the common policy of Marlee (see sections 8B.19 & 8B.25 for further details). Expatriates are much more expensive than local employees as the JVs have to provide them and their families with some generous packages. Another related issue is that they need to be paid in foreign currency and it in turn will put pressure on foreign exchange balances of the JVs. These are the main issues, which have to be discussed in the negotiation stage.

Evaluation of assets provided by the Chinese counterparts could be a problematic issue. Marlee has preferred to form JVs with existing business. If the Group is taking over assets from a partner as a part of the JV deal, the mechanism is actually buying the partner's business or being bought into the partner's business. Normally, it will take one or two months as well to get the Chinese authority to approve it. Generally speaking, the whole negotiation process takes at least a year.

8B.14 <u>Have there been any particular problems between JV partners beyond the negotiation stage?</u>

Examples recorded in the above section demonstrate that the difference of self-interests can lead to potential disagreement over the negotiation process. However, I am interested to discover if the incongruity goes beyond the initial formation stage

According to the executives, in some of their Chinese JVs the business objectives between partners are clearly different and this diversity goes beyond the negotiation stage. An example Harry drew can explain the situation. Marlee has an objective to become the world's leading soap manufacturer. However, the Chinese partners do not have a goal to be world leaders. They want to be successful, but in China only. One may wonder the reason why.

It is because to become a world leader requires a lot of capital investment and a very substantial growth target, of which some of Marlee's Chinese partners regarded as "ludicrous", as Harry described. Moreover, in order to grow the business fast, a lot of working capital is needed. It is not such a problem for Marlee to raise funds via its worldwide networks. They have fully committed to explore China. However, for some of their Chinese partners it is a problem, as they do not have further cash to put into the JVs.

Furthermore, the executives described some of their local partners as being relatively short-term profit orientated. They often tried to minimise further investment on one hand, and make sure their initial investment would be paid back as soon as possible on the other hand. They always want dividends, but Marlee wants to reinvest.

Ken gave an example to explain the above point. Marlee treats building a strong local distribution network as one of the requisite assets to explore China. Thus, investing in human resources, IT, and customer services, and setting up a right distribution structure is crucial from Marlee's point of view. However, the Chinese partners do not necessarily want to put a huge amount of capital into this type of long-term investment, provided the existing facilities are making profits. The main task of managers appointed by the local partners is to achieve payback as soon as they can. Making profits and getting dividends are very important to them. In sum, conflicts of investment objectives between foreign and local partners exist in some of Marlee's JVs.

8B.15 <u>Has the incongruity of investment objectives affected partner relationship and/or JV performance?</u>

Some strong feelings were expressed on this question:

> "We need to sit down and sort things out. Sometimes they (the Chinese partners) compromise, sometimes they don't. We have spent a lot of time in the meeting rooms to sort out things like why, why not, who, and how... It is very time consuming and is not constructive to the business. We have wasted a lot of time on these kinds of negotiations rather than serving our customers." Ken complained.
>
> Harry added, "we have tried not to let it affect performance of the businesses... There is a clear mis-match of objectives quite often, and those have to be resolved. You have to sort them out. If you cannot, then Marlee will take another way forward, and it might mean forming a new JV."

Ken and Harry's replies reflect that the Group has been using both soft and harsh approaches to deal with the complicated partner relationship. In fact, there are a number of

Chinese state-owned enterprises very keen on forming JVs with MNEs. It is prestigious to have a well-known partner like Marlee. As a result, the advantageous status has provided Marlee with a strong bargaining power to achieve co-operation from their partners.

8B.15.1 Incongruity of investment objectives - have any JVs got divorced yet?

> "No, there have been no divorces. But there are clearly differences in objectives with some of our partners. Some work very smoothly and there is no real issue. Other subsidiaries, particularly the older ones and the one where we do not have majority shareholding, it can be very difficult and frustrating. You have to have a lot of discussion to put our view forward, such as why you want to do something and how we move our business forward. Those discussions are on going. It can be very difficult." Harry said.

Again, Harry's reply indicates the importance of the degree of control in some of their older JVs is equity related.

8B.16 What are the criteria for location selection?

It was stated that the choice normally follows where the markets and expertise are. Marlee has chosen, "rightly or wrongly" as Harry described, to set up its headquarters in Shanghai in their first- and second-time round to invest in China.

Shanghai was and has been a cosmopolitan city before 1949 and since the open-door policy introduced in 1979. The overall culture, living standard, infrastructure, tax regime and many other aspects of business are better developed in Shanghai than many other parts of China (see Case Study A for further details about Shanghai). It has a better environment to produce and sell consumer products.

Apart from the better state of development, choosing Shanghai the second time round was based on sentimental grounds. Shanghai was once where Marlee's headquarters were based before 1950s. When Marlee returned to the country in the 1980s, they chose to form the first JV with its own factory that the Group left behind in the 1950s (see section 8B.10). This long-lost factory experienced a lot of extraordinary moments and it is special to the Group. It was a historical reason why Marlee decided to start again in Shanghai this time.

The following two FDI were also established in Shanghai. Some similar motives underlined the decisions. It was because the Group built its foundation and contacts in

Shanghai since the 1920s. It would be easier for them to follow the past tracks and set up FDI there. Based on a combination of sentimental and economic rationale, Shanghai was seen as the best location for Marlee's first few JVs and its headquarters for Greater China.

In a later stage, Beijing was chosen for one of Marlee's biggest FDI in China to date, an ice-cream production plant with a total investment of US$90 million, plus other valuable firm specific assets like brand names and technology. The capital city was selected simply because none of the Group's major competitors were there at that time. Ice-cream is not an easy product to produce and sell. They need to be properly refrigerated all the time and therefore efficient distribution is a key factor to determine success or failure. Because of these constraints, the Group felt that it would be easier to try out the new project in Beijing, where there was effectively no competition. It would be more difficult to do it in Shanghai, a city in which main worldwide players have already got their distribution networks in place.

According to the current performance of Marlee Beijing, the Group's decision proved to be correct. Within three years of the initial idea being put on paper, two state-of-art ice-cream factories were erected and tens of thousands of ice-cream cabinets were set up in every corner of Beijing and other major cities in China selling the Group's products. Marlee's ice-cream has become one of the most prestigious foreign brand names in Beijing[17]. It is an extraordinary result to be achieved within such a short period of time.

On the other hand, Guangzhou was chosen for a tea production investment. The main factor to explain this fairly different location decision was because the required expertise was there. At the time when the investment was proposed, one of the biggest tea producers in China was in Guangzhou and there was no big tea factory in Shanghai. According to Marlee's policy, they prefer to form JVs with leading players in the related field (see sections 8B.8 & 8B.9 for criteria of partner selection). The availability of a suitable JV partner was the key force driving Marlee down south.

The executives stressed that Marlee's future projects are not necessarily or likely to be in Shanghai. It is because they will not set up two or three similar JVs in the same city, but

[17] In my recent trips to Beijing and a few other major cities in 1997 and 1998, I could see selling points of Marlee ice-creams in every corner of the streets.

prefer to spread their investments around the country to get a reasonable geographic coverage. As was previously discussed in section 8B.5, distribution infrastructure in China is far from satisfactory. Transportation from one city to the others is difficult and costly. Just imagine the extent of difficulty to distribute ice-cream products from one city to another. Therefore, besides setting up your own distribution network, another effective way to solve the problems is to spread the production bases around in order to capture the opportunities arising in various parts of China (see Map 8B.1 for the JVs and headquarters' locations).

8B.17 <u>The target markets for outputs from the China factories</u>

Except for the holding company Marlee China, the rest of the eleven FDI are manufacturing operations. Among the eleven FDI, two are small-sized wholly owned subsidiaries making special chemicals for exports. The outputs of the other nine JV subsidiaries are used mainly for the domestic sales. The percentage of domestic sales of the Chinese production depends very much on the products. For example, 100% of ice-cream outputs are sold in China. In other businesses, such as personal care products, about 60 - 70% of the outputs are sold locally. The rest are exported to Hong Kong, where Marlee has a wholly owned subsidiary to sell the Group's products. In addition to Hong Kong, Marlee China is now planning to export some of their production to other Marlee's trading companies in the Asian Pacific region.

8B.18 <u>Sourcing of raw materials</u>

It was stated that the Chinese production relies on local supply of raw materials. When the executives were asked whether the quality of local raw materials were up to their requirement, Harry provided the following answer:

> "They have to be (of high quality), otherwise we will not use them. We might have to be slightly more flexible on certain things than you would be in other parts of the world. But that is not a problem. Often, businesses start from import, and then localise their sourcing of raw materials. At the moment, detergents is using 99% of local materials, ice-cream is not. For example, Belgium chocolate is not available in China to be used in the production of Icy (one of their well-known brands). But we are moving rapidly down the route of sourcing locally, provided they meet our requirements. In food, it is clear that the requirements are more stringent than in detergents."

Often, outputs are as good as inputs. Proper control of the quality of raw material supplies is a crucial step to ensure high quality production. It can be seen from Harry's reply that their position has strengthened Marlee's bargaining power with their local suppliers. If suppliers did not meet their requirements, the Group would not use them. The size of Marlee's operations and their speed of growth in the country motivate their suppliers to keep improving their quality in order to secure future orders. Moreover, the local suppliers realise that including Marlee in their lists of clientele can boost their businesses with other foreign operations which also look for high quality local supplies.

8B.19 The management structure of the Chinese JVs

There is no one unified management structure that is applied to all Marlee's JVs in China, although in all the operations the general managers (GMs) were appointed by Marlee and the deputy GMs are from the Chinese partners. The way in which the control strategy was designed and works in each case depends on when the JV was formed and the share-holding structure of the business.

For the older JVs, they were established according to a particular type of partner relationship, which characterised the investment environment in China in the early 1980s. The primary objectives underlying the open-door policy are absorbing foreign capital and advanced technology. The 'mutual benefit' policy and ideology created a typical system for JV investment and partner relationship during the first decade of opening up of the country. Foreign partners tended to bring expertise on technical matters, marketing, and probably other things like accounting systems to the JV. The Chinese partner would bring to the JV personnel, local understanding and sales (Woodward & Liu, 1993).

In Marlee's older JVs, this type of demarcation is still largely applied nowadays. The two key roles - GM and deputy GM, have been understood by both partners to be effectively the same. The deputy managers assigned by the Chinese partners are effectively managers of sales and personnel. Whereas, the GMs Marlee appointed are in charge of technology and marketing. The executives stated that it is one model of management and partnership, which tends to be more difficult to manage. Marlee feels that it does not have the control that the Group needs in order to run the Chinese operations as one business. The Chinese partners are in a strong bargaining position, and they can veto Marlee's decisions that are not considered as beneficial to the JV as a whole (see sections 8B.13 & 8B.14 for details).

In other businesses, particular the green-field plants that Marlee has obtained a larger equity, there is no demarcation. In these operations, all employees are new and they do not report directly to the Chinese partner, but the JV GMs who control the whole business. In these investments, Marlee clearly has achieved overall control, as the GMs and some key functional managers are appointed by them. These managers are experienced expatriates who have a good knowledge of Marlee's worldwide operation. From Marlee's point of view, this second model of management works well in their younger JVs. The decision-making system is smoother and the JV works much more as one. As a result, these operations perform particularly well.

In sum, the real demarcation of management policy is between those businesses, which started from no employees, and those began with an existing business. It was stressed that in either of the two models of control, the Board of Directors and the GMs have to ensure that the JV operations fit into Marlee's strategies. Harry put forward an interesting example to illustrate their roles:

> "For instance, if a business says that it is going to make yoghurt, Marlee would not agree to that because we do not make yoghurt. We are not interested to make yoghurt. The Board of Directors has to agree on the scope of business of a JV, and in this respect each partner has a veto right. For any major change in JV operation, it requires unanimous Board approval."

8B.20 <u>The extent of autonomy granted to GMs to run the JVs</u>

The extent of autonomy held by the GMs to run their businesses very much depends on the management structure employed in each operation (see section 8B.19 for the two types of structures they adopted).

In the older JVs, the deputy GMs, who are appointed by the China partners, see themselves not as a deputy, but equivalent to the GMs. Because of this reason, the GMs are not totally free to run the JVs. The restrictions are not coming from Marlee headquarters, but from the local partners. The GMs need to share the authority of control with the Chinese deputies, who represent the Chinese partners to speak and act in the JVs. The two executives emphasised that this model was done at the time and is historical. The same would not happen in the younger JVs, and all employees report to the GMs, who are in charge of the whole operation. Following the Chinese JV Law, the JV GM reports to the

Board of Directors. Whenever Marlee has the majority share holding, in almost all new JVs, they have the majority members on the JV Board. Through this type of arrangement, Marlee's GMs are in charge of the JV operation, and they work closely with the Board of Directors, whom Marlee headquarters have got huge influence over. The two-tiered control strategy ensures that Marlee's strategies and decisions are successfully implemented in the Chinese JVs.

8B.21 Is the allocation of control between JV partners clearly stated on the JV contracts?

It was disclosed that the JV contracts have stipulated the overall allocation of authority, obligation and rights of each partner. Nonetheless, the clauses are not in the level of detail covering the way in which control of the daily activities is divided.

It may be due to the fact that it is very costly and sometimes impossible to put everything down on a single agreement. As a result, the JV contracts are bound to be incomplete and their implementation is largely based on some unwritten agreement between partners. As Harry described, "that is understood".

8B.22 Organisational structure of Marlee Group

Before explaining what and how frequent the Chinese operations report to Marlee, it is necessary to explain the organisational structure of the Group first. Marlee is a big global operation and its top management structure includes two broad levels: Executive Committee of the Board (ExCo) and Executive Council (EC). The top decision making body is the ExCo[18], which is responsible for corporate strategic leadership. Below this top level, Marlee world-wide business is organised into fourteen business groups, each of which is headed by a president. Besides three specialist lines that are organised globally, the rest of the product groupings are further divided into eight geographical divisions[19].

The business group presidents are responsible for the development and execution of regional strategies. They are required to report formally to the ExCo on their groups' performance every quarter. The fourteen presidents, combined with the ExCo, form the

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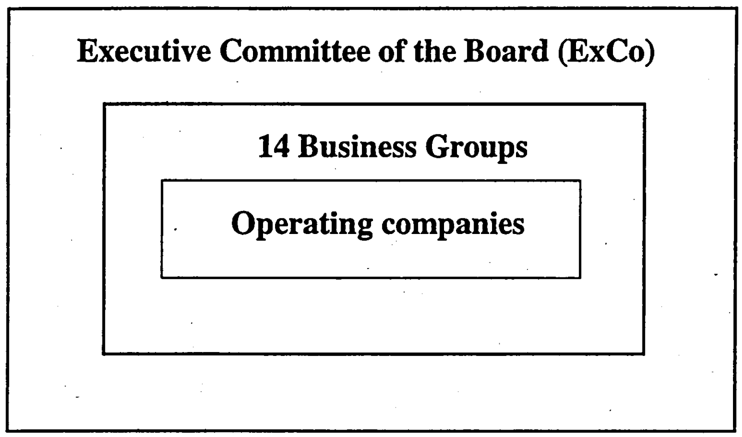
[18] The committee consists of seven members - two Joint Chairmen from Marlee UK and Marlee Holland, one director for foods, one for home and personal care products, one for strategy and technology, one for finance and the last one for personnel.

[19] The eleven consumer products groups include: Food & Beverages - Europe, Ice Cream & Frozen Foods - Europe, Home & Personal Care - Europe, and Home & Personal Care - North America, Foods - North America, Africa, Central Asia & Middle East, Central & Eastern Europe, Latin America, North East Asia, South East Asia & Australia.

EC, a team that is responsible for corporate strategic leadership and operational management of Marlee. Figure 8B.2 shows the management structure of Marlee Group.

Figure 8B.2

The senior management structure of Marlee Group



8B.23 The frequency and materials of reporting

Marlee's operations in China are categorised under the North East Asia grouping. Individual businesses within the group report monthly and quarterly for various types and levels of detail of information to the business president of the region. The president consolidates the information from the sister companies and reports the overall performance of the region to the ExCo every quarter.

Under the Chinese Law, Sino-Chinese JVs have to provide a monthly profit and loss, and balance sheet to the government. Similarly, under Marlee's rules, all subsidiaries report monthly to their business group headquarters. For monthly reports, they include mainly sales, marketing and financial information. There are also requirements to report a few types of operational information.

For the quarterly reports, they cover basically the same scope of information as the monthly reports, but in a more detailed and formal format.

8B.24 Two-way communication mechanism

As what was mentioned in section 8B.22, ExCo is responsible for corporate strategic leadership. The committee draws up annual plans for each business group. Each contract basically lays down strategic, operational and financial targets, and resources that are available to each group. This annual plan provides a framework of strategic direction to guide the business president to design his/her regional strategies.

On the other hand, based on the information collected from the sister companies, business presidents are responsible for feeding back their understanding of local needs and market characteristics to the ExCo as inputs of future corporate strategies and allocation of resources. As Figure 8B.3 illustrates, the organisational and management structures, together with the reporting system, make up a two-way communication mechanism, which facilitates the flow of information and control of the Group.

Figure 8B.3

Two-way communication mechanism between ExCo, Business Groups and Operating Companies

ExCo

-Annual contracts ↓ ↑

- Annual budgets
- Feedback of local needs and market characteristics
- Quarterly reports

14 Business Groups - Presidents

-Regional strategies ↓ ↑

- Annual budgets
- Feedback of local needs and market characteristics
- Monthly and quarterly reports

Operating Companies - GMs

8B.25 Human resource management

One of Marlee's major targets is to localise the staffing of management. Also, in one of the Group's Internet publications, it mentioned that "a core strategy in the developing markets is to ensure the business is run as soon as possible under local management" (Marlee Ice-cream, 18/6/97). However, this strategy seems to contradict with the human resource policy adopted in their Chinese operations. The GMs of all the Chinese subsidiaries are expatriates. In addition, many functional managers, such as Harry and Ken, are also expatriates transferred to China from other Marlee operations. Up until the interviews were conducted, it was more than a decade since the Group returned to China. Strictly speaking, some of the early FDI are no longer in their infant stage that might have more reasons to use expatriates. The contradiction prompted further discussion on this aspect. Harry put forward an explanation for their policy:

> "It was only in the last 3 years that we expanded the numbers of JVs and started to go into proper growth. In the first 5 - 6 years, the older JVs grew more hands off with less interference from Marlee. Now it is much more important to achieve the growth targets. So it was only in the last 2 - 3 years that we started to employ the level of staff that is needed to sustain a billion-dollar turnover business. We have recruited a lot of graduates around the world to become managers of the businesses. The new members of staff have been with us for just 2 - 3 years now, they cannot be the GMs yet. It is just not practical. It has got to be a few more years.
>
> Many people in this office have been in the business for 2 - 3 years now, and they are promoted to managers. They have been pushed hard. Provided they perform, they will replace the expatriates in 2 - 4 years."

8B.26 Quality of the local supply of labour

From the above explanation, it can be seen that a lot of opportunities are opened up to the local candidates. In the interviews, both executives expressed their views on the quality of local employees. They both felt that if the candidates are given the right guidance and training, they can do the job. Nevertheless, a common characteristic highlighting these local employees is their lack of international business knowledge and a high level of resistance to change. It is Marlee's policies to provide employees at all levels with suitable training to help them develop their full potentials. However, it takes time to build up knowledge. Another hindrance that slows down the speed of localisation in China was discussed by Harry:

> "Younger people are much more receptive to 'normal', I hate to use the word 'western' because it is not just western, if you like 'normal international business practices'. The intelligent level and understanding is very high. It is absolutely no problem for people to learn new things.
>
> The difficulty sometimes is in taking the initiatives to move the businesses forward, constantly question decisions and basically just to be more inquisitive to how to make the businesses work. These qualities were driven out of the Chinese culture during the Culture Revolutions. The younger people are much more receptive to that and will pick it up. The very best of the younger people have already started to question and criticise decisions, and they will easily become managers in the future. People in their 40s and 50s are more difficult to train."

8B.27 <u>Is it appropriate to apply the whole set of Marlee style operational and management tool-kits into the Chinese operations?</u>

It was repeatedly mentioned in the interviews that Marlee is a significant driving force of all its subsidiaries, JVs and WFOEs. The Group brought in expertise in many key business aspects, such as technology, production, management, marketing, and/or accounting, into their China FDI. Many of the key posts are filled by Marlee's expatriates. This background begged a question of whether it is appropriate to apply the whole set of Marlee/western operational and management tool-kits into the Chinese operations. It might be due to the fact that he does not agree with people misusing the word "western" to describe all kinds of systematic management practices, a rather strong response was given by Harry:

> "Just because the GMs are expatriates, it does not mean that they are western. Most of the GMs are Taiwanese, HK Chinese or Singaporeans. So they are not western managers, and we have to operate those businesses in a Chinese way. Yes, we will bring in western practices where we feel they are appropriate. One thing Marlee knows from its operations in other parts of the world, in South America and India where we have a huge business for more than fifty years, is that you cannot simply impose western values and practices on the businesses in China. That is why we have Taiwanese or HK GMs, and many expatriates in China are from that part of the world."

Marlee's experience is another example to illustrate the ways in which MNEs overcome barriers caused by diverse business environment. These points lend empirical support to internalisation theory, which was adopted in Chapter 4 to understand worldwide FDI surge. Having utilised internal personnel capacities, cultural and language, national boundaries and geographical distance are no longer key factors that can hinder MNEs from expanding their operations into some different markets, such as China. Marlee's world-wide network enables them to transfer resources and expertise economically around the world. This type of advantage has put them in a favourable position to compete with local firms as well as the other MNEs operating in China.

8B.28 Budgeting system of Marlee

Budgeting is an important annual exercise in the Marlee Group. Based on the guidelines given by their business group headquarters, subsidiaries are required to produce their own business plans, which show targets and progress milestones that the operations expect to reach periodically, e.g. every quarter. At the time the interviews were carried out in October 1995, the two executives had just finished the 1996 budgets, which consisted of a combination of sales, profit, cash flow, new products and marketing targets for the following year. Their 1996 budgets would be discussed and hopefully would be agreed in the London headquarters by the end of October. Once the budgets are accepted, they will be formally updated in February and again in August of each financial year.

8B.29 Performance evaluation

Same as other Marlee's subsidiaries, performance of the Chinese operations is judged against the targets set down in their annual budgets. The two executives disclosed that at the moment growth is considered as the most important goal for the Chinese subsidiaries. Building a strong foothold in China and thus improving Marlee's world-wide position is seen as their first priority. Accordingly, market share, turnover and introduction of new products, are chosen as performance indicators to measure the extent of growth that the Chinese operations achieve.

In addition, operational performance such as operation efficiency, number of employees (local versa expatriates), staff development will also be looked at. On the financial side, return-on-investment, internal rate of return, cash flow potentials are some important criteria that performance evaluation are based on.

Basically, subsidiaries' performance will be monitored throughout the year according to the progress milestones set down in their annual plans. All businesses are expected to reach the stated levels by the agreed time. If these have not been achieved on the scheduled time, the business group headquarters will question the reasons why. Subsidiary management is required to provide explanations as well as suggestions for immediate actions.

8B.30 Is quality an important criterion for performance measurement?

In the discussion of performance evaluation, quality of products was not included as one of the criteria. Marlee's Chinese subsidiaries are producing food and personal care products, naturally quality should be an important indicator of performance. Why it is not included as a management target? Achieving ISO 9000 international standards is a status symbol that is pursued by many firms in order to demonstrate their quality of products. Again, why has not the achievement of ISO9000 included as a performance indicator? Being asked these questions, Harry explained his company's policy:

> "If it is important, then that will be taken into account and will become a management target. Achieving ISO 9000 standards would not be necessarily the highest priority of the detergents business. It might be more important for ice-creams and that will be measured and monitored. However, whether it will be made a specific management objective for one year, I would not necessarily say it will. It has almost been given that you must have good quality and you must be consistent. Based on that then incentives will be set, and that not necessarily be written directly on quality."

The rationale behind the above reply is not difficult to understand. For Marlee, good quality is almost a pre-requisite requirement that is embraced in most of the other performance criteria, such as turnover, profit, growth and customer satisfaction. In today's competitive world, firms find it difficult to survive in the long-run without firstly obtaining the required level of quality in their products or services. The quality needs to be recognised by consumers. Their recognition will be reflected in a firm's turnover, reputation and growth. Therefore, through measuring the sales and profit levels of the Chinese subsidiaries, their performance on product quality is indirectly assessed.

8B.31 Are the JV GMs being assessed by the same set of methods and criteria as those used for the operations?

"Yes". A quick response was given by Harry. As was mentioned in section 8B.28, each business in China has an annual plan. Accordingly, the GM of each operation is responsible for the budgets. The annual targets are normally a mixture of financial and non-financial goals, and the weighting between the two depends on the business group's strategies at that time. Harry illustrated how this system works:

> "The GMs are given performance targets each year... There is an incentive system based on achieving those targets. So you might have four targets for the year. For example, one of which is profit, one is turnover, one is to launch new products and the last one is to improve operation efficiency.
>
> There might be a 3% bonus for (achieving) each one, for example. There is a world-wide incentive system in Marlee, which is the same for all countries, or similar in all countries. That is imposed on managers here, just like anywhere else."

8B.32 <u>The currencies used for budgeting, reporting and performance measurement</u>

The local currency RMB is used for budgeting, reporting and performance measurement purposes. Budgets and reports submitted by all Chinese operations will be translated into Sterling and Guilders at the business group headquarters. At that level, there are potential foreign exchange translation risks. Nonetheless, the senior executives at the headquarters would have taken this type of risk into account when they prepared the annual plans. Subsidiary managers are not held responsible for the foreign exchange differences arising from the translation of budget results at the business group level.

However, when subsidiaries make transactions with other parties using foreign currencies, it is the GMs' responsibility to control transaction and translation exposure. Foreign exchange gains or losses arising from day-to-day business operation form part of the result of a subsidiary.

8B. 33 <u>Any problems arisen due to the tight government control on foreign exchange?</u>

The Chinese government has been imposing a tight foreign exchange control on all types of operations in the country. Sino-foreign JVs are required to balance their foreign exchange needs. Harry is the financial controller of Marlee China, and he has the first hand information to tell us more about this particular aspect:

> "It becomes tougher. In this year (1995) the Chinese government has introduced an annual foreign exchange audit policy that all JVs have to go through in order to make sure that the businesses balance their foreign exchange. If the companies cannot balance their requirements, they need to access the Swap Markets to swap foreign currencies. This type of pressure will

force the businesses to either gain foreign exchange through export or to source raw materials locally in order to reduce their needs of foreign exchange inputs.

I think eight out of nine of the JVs got through the audit okay this year. One of them did not and we are trying to sort it out at the moment with the holding company. The authorities are quite helpful on it."

8B.34 Have your China operations encountered any difficulties to repatriate royalties or dividends to the headquarters?

Another question related to the Chinese government's control of foreign exchange is whether Marlee can get their profits out of the country. It is the ultimate question that all foreign investors are concerned with. Based on his experience as the financial controller of Marlee China, Harry put forward the following comment:

"No problem. Provided you have an agreement, which clearly stipulates and is signed by all partners as to the payments may be made, together with the supporting documentation. Our experience shows that if you have all these, then there is no problem to make payment to your parent company".

8B.35 How do you see the development of legal system in China?

In addition to tight foreign exchange control, the legal structure in China is another area which draws the concerns of foreign investors. The two executives expressed some different views on this topic.

"The legal structure in China is not well developed at the moment. It provides investors with both advantages and disadvantages. The disadvantages are that it is difficult to get opinions on whether it is legal or not to do certain things in China. It depends on which law you use. One would say that it is legal, one would say it is not. It is very difficult and frustrating.

But that also provides you with a lot of flexibility because it means that in China the Chinese are not particularly keen to take you to court. If you have a problem, you sit down and sort it out. That is also an advantage as it means that there is a big scope for negotiation. Generally speaking, there are advantages and disadvantages". Harry said.

However, Ken seemed to hold a different view on the legal system in China:

"The legal system in China is far from satisfactory. You always hear people talking about the importance of guanxi. In China, you can hardly talk about the legal systems when 'guanxi' rules the place. It depends on who you know, and your network in China.

> ...No, I do not agree that the handicapped legal system will provide any advantages to foreign investors in the long-term. It will only benefit big enterprises or those with good relationships with some powerful parties at the expense of small firms, or those foreign investors who do not have much local knowledge. These poor investors are working in the dark. So I do not think the handicapped legal system will encourage FDI".

8B.36 <u>How has Marlee assessed the risk caused by the underdeveloped legal system and the risk of investing in China in general?</u>

Although there are differences of opinions, the two executives generally felt that the legal system in China is underdeveloped. The ways in which Marlee assesses the opportunities arising in the unique environment in China will shed light on how multinationals justify the risks and returns of FDI.

> "Yes. It is part of the risks that we measure. But for Marlee, the biggest risk the Group faces is the adverse consequences resulted from missing out the opportunities in China. What one should not do is constantly to be afraid of all the risks in China. If you do that, you will never do anything. Yes, there is a risk. Yes, we take a view when we make a decision whether or not it is a legal decision. We would never knowingly do something that is against the Chinese law.
>
> If something is vague and open to different interpretations, or if there is not a law, then we might take a decision to move forward and see what will happen while guessing there may be a risk that we might get taxed on. We argue that we should not be, but we might be. So risk analysis is part of the discussion. But it must not be used as an excuse of not doing anything." Harry said.

In addition to the above points, in our conversation on some publications criticising the over-stated potentials and the under-stated level of risks of investing in China, Harry put forward another comment on the topic of assessing risk of investing in the country:

> "I am not sure what these people have said in their publications. I understand that a lot of articles tend to be anonymous. You are not going to write an article in the newspaper to say that everything is nice in China full stop. You may tend to start stating the risks, the difficulties of being in China. Yes, we know that, of course there are risks and difficulties. There are risks and difficulties to work in anywhere in the world and China is no exception.
>
> Recently, there has been no major political change in China that discourages foreign firms to operate in the country. You can never state categorically that

the reforms will continue regardless. It may change, particularly when Deng dies[20]. But it does not seem likely that China will reverse to a hard line communist country and no foreigners are allowed to stay. I personally would say it is highly unlikely. But it is possible, everything is possible."

Indeed, Harry's above reply gives empirical support to an argument I raised in Chapter 5 that some firms may not stay out of risky markets, provided the potential returns of their investment are attractive enough to justify the risk involved. Nonetheless, according to Ken, Marlee has taken precautions to balance the risks of investing in China:

> "Our parent has kept a close eye on the businesses here and they have their ways to minimise risks. For instance, we have spread the risk by diversifying our product range. We don't just focus on one product line. Moreover, we have also diversified the investment locations. For example, our investment used to be concentrated in Shanghai. In order to reduce risk, we are looking for other locations in the interior China, like Chengdu, up to Beijing, Hebei province, and even down south. China is a very big country and different provinces can be treated as individual countries. Tastes and living standards are different between various cities."

8B.37 <u>What types of difficulties have you encountered in running business in China?</u>

Despite Harry suggesting "there are risks and difficulties to work in anywhere in the world", further questions were asked as to whether the executives had experienced any country-specific difficulties of doing business in China. The questions aimed to uncover how the Group runs and controls their operations in the unique Chinese environment.

Throughout the discussion, the two executives expressed some similar opinions to those made by the interviewees in the first case study of Superior. The communist market economy is complicated. Underdeveloped systems and infrastructure have created fairly difficult conditions that many investors have found it hard to deal with at first. In our conversation, Ken revealed his opinions and some frustrating experience:

> "Sometimes we do not understand the policies, even some established policies. In many circumstances, it depends on how you interpret the law and which government agencies translate these policies to you. You can employ lawyers to solve the problems. However, some lawyers may not be fully aware of the impacts of the change of policies on our business.

[20] The interview was conducted at the end of 1995 and Deng died in February 1997.

Policies can change very rapidly and suddenly. The government has not provided much help to aid investors to overcome the change either. The implementation of VAT is a good example. The authority suddenly announced that from 1st January they would introduce VAT. They announced a day or two before the enforcement of the policy and there was no prior warning. People needed to know how to do that, how to deduct tax, whether they should increase invoice prices, or whether they could get a credit from the Government. The whole thing was so disorganised. It was very destructive to businesses."

8B.38 <u>What the Chinese government can do to improve the current investment environment?</u>

When Ken was asked what he thought the Chinese government could do to improve the current investment environment and help the investors to run their businesses, several suggestions were put forward. For example, following up his above complaint, Ken provided the following ideas:

> "I think they have to involve more private sector executives, like us, in the decision-making processes before they implement any significant change, such as VAT. In the past, many policies were implemented through bureaucracy. The policy makers might not have experience in working in private organisations, ...servicing customers, or being competitive in a free market. They may not realise the impact of their decisions on foreign investments. The executives in the private sector know how to structure their businesses and management. I think the government makes better decisions with their help."

Besides the above points, Ken also suggested that the Chinese government should not impose artificial tax or duty as it would discourage foreign investors. Moreover, there are concerns among investors that an upper limit of return on investment has been set in some servicing industries. To restore confidence, the government should develop a more transparent legal system. Ken considered it as a better way to attract foreign investment. However, if the Chinese government tries to control the market by using bureaucracy, it will only jeopardise the current development that they have achieved.

On the other hand, Harry put forward a slightly different comment towards the current FDI policy in the country:

> "I am not so sure whether they (the Chinese government) necessarily want to encourage a lot more FDI at the moment. They are becoming more selective in those industries in which tax preferences and preferential treatments are given. That is quite clear that they want a lot more investment in certain areas, like

infrastructure, construction and housing, as they are important to the country. The government may not be too bothered about other industries, such as making ice-creams. It may become more difficult in the future and our businesses may not enjoy the tax preferences that they had in the past."

Regarding what the Chinese government should do to help investors to run businesses in the country, Harry mentioned the following suggestions:

> "Continue to improve the laws and improve the clarity of the laws and make them less vague so we know where we stand in operating in China. To retain the tax advantage. We quite like the tax advantage. However, we would like the tax law more transparent.
>
> Balancing foreign exchange is tough, but I understand why it is there. We would like the control gradually relaxed to make RMB convertible. Again, the authority has already declared its intention to do so. To rule out corruption and to rule out counterfeits, which can be a problem for our businesses. Generally, continue to promote growth of a market economy. If they do that, then we would be happy!"

8B.39 **How do Marlee and the executives see the future of investing in China?**

The ultimate goal of applying any control strategy is to achieve the investment objectives that brought the partners to a IJV relationship. Throughout the interviews, the executives repeatedly mentioned that the current rapid growth rate would allow Marlee's Chinese subsidiaries to become a big billion-dollar operation in a few years time. One of the key investment objective driving Marlee to the country is to penetrate the Chinese domestic market. Having achieved a significant growth in the last three to five years, together with the further expansion in the near future, the performance seems to reflect the fact that Marlee has fulfilled parts, if not all, the investment objectives in China.

In the final part of the interviews, the two executives stated that despite the problems, the conditions in China are getting better over time. Generally speaking, they are optimistic about the future of investing in the country. The following comment has demonstrated Harry's optimism:

> "It (the business environment) has improved a lot over the last few years. The laws are moving in the right direction. Also the new tax law, company law and new labour law are moving in the direction of standard international interpretations. Far more so, let's say for example than in Russia, where the tax law is still in chaos and subject to a lot of corruption. In here, there is

undoubtedly corruption, but no way near the evidence in our businesses as it would be in other countries.

So we would assess the investment potential in China. At the moment, it is very good. It has become slightly more difficult recently because cash is not available in China and the credit squeeze is used to reduce inflation. But that has not stopped any of our businesses. Providing the political environment is stable and the government continues to move towards what they called a market economy, all the evidences have proved that they want to do that and will continue to do that, then the prospects are very good!"

8B.40 Conclusion

In several of Marlee Group's publications, such as annual reports (1996) and Internet homepage (18/6/97), the senior executives announced that the Group's strategies are to build up strength in faster-growing markets. Based on The World Bank forecasts, Marlee has identified several regions[21] as their focal points of future investments. Among the selected group of emerging economies, China is their top priority as the country is set to become one of the world's biggest economies within the next two decades. I have noticed from the Group's 1996 annual report that two new JVs were established in the year, it was within fourteen months of visiting Marlee China in October 1995. The strategic importance of China is demonstrated by the Group's swift expansion in the country. To conclude this second case study, from what the executives stated and the Group's rapid growth in the country, Marlee's ambitions and commitment to China are clearly seen.

The Marlee case study is now completed. The third case study, which is about a HK-based firm Silky's investment in China, is recorded in the following section 8C.

[21] China, India, South Latin America, South East Asia and Central and Eastern Europe (Marlee homepage, Strengths where it matters, 18/6/97).

Case Study - "C"

Silky Garment

Map 8C.1 **The locations of Silky's JV in China and the Headquarters in Hong Kong**

*Silky's other investments in China are all located in the Guangdong Province.

Source: Magellan Geographix^{SM} Santa Barbara, CA (800) 929-4627 (1993)

8C.0 Introduction

In contrast to the prior two case studies which relate to large MNEs' experiences in China, the third case study is about a small-sized Hong Kong (HK) textile company - Silky Garment. Silky is a family business, which manufactures silk pyjamas and female underwear for the United States and Canadian markets. As compared to Superior and Marlee, Silky has much smaller operation, simpler business structure and a shorter history. The company was established by Peter Li in 1980 and its FDI in China began from 1986/7.

This case study is written based on information gathered from an interview with Peter in September 1995. Peter, who was in his early 50s at the time, is a very entrepreneurial individual. Although he modestly claimed that he had founded the company with no prior management training, his business has developed steadily over time. Throughout the interview, Peter provided much insight into the ways in which he assesses opportunities and risks of FDI, and the ways in which he controls the business. It was a fascinating story.

To date Silky has four production subsidiaries in China, a head office in HK, and selling companies in Canada and USA. With the assistance from his son, all the operations have been centrally controlled by Peter. Although he is a softly spoken person, Peter is a strong character. Basically, he knows exactly what is going on in all the operations and he is the one who makes decisions.

The interview was conducted on a Sunday afternoon in Peter's home. Throughout the afternoon, there was constant telephone contact from one of his China factories to inform him the progress of production of an important order which had to be delivered to HK immediately for trans-shipment to the States. It could be felt that the work ethic of Peter and his team is very strong.

8C.1 Some background information of Silky

As was mentioned in the introduction, Silky's main products are pyjamas and female underwear. Originally, all production was located in HK. In addition to the HK base, from 1981 onwards, Peter started to place trial orders with a few Chinese sub-contractors to produce his products via "process and assembly agreements" (see section 3.4.5 for detail of this form of trade).

Silky provided the sub-contractors with materials and technology support, and the sub-contractors processed the materials into finished products according to the specifications laid down by Silky. In return, the Chinese factories would be paid the processing fee. Basically, hiring sub-contractors in the first half of 1980s was a way to test the water. In 1986/7, Peter decided to establish his own factories in China.

8C.2 What are the motives driving you to invest in China?

It was stated that the availability of raw materials and lower production costs were the motives driving Silky to China. When the business was first established, the operation was based in Hong Kong. It was not easy for them to source locally for silk fabrics, which were originated from China. In addition, imported materials would add up to be more expensive. Because of this, it seemed practical to move the production base near to the material supply source.

Another vital factor was the surge of production costs in HK that made local production impossible. Since the early 1980s, the economic growth in HK was very fast. There was a serious shortage of labour supply to cope with the rapid development. Along with the intensified market demand for blue- and white-collar labour, staff turnover was correspondingly increasing. The job market encouraged people to change jobs on a regular basis in order to boost their salaries. Under this situation, firms had no choice but to pay more and more in order to keep their staff.

Besides high labour cost, the scarcity of land boosted property prices and rent, and consequently the prices of everything else were other crucial factors, which squeezed out local production. This tiny size of HK was unable to accommodate the growing industrial and residential needs for land. The situation forced HK businesses to consider other alternatives. Gradually, a trend was established which showed that many HK firms moved their production to the Guangdong province of China that is just adjacent to the HK/China border, where a vast and cheap supply of land and labour was available. Apparently, this strategy worked, at least at that period of time, otherwise there would not have been that many firms following suit. Map 8C.1 shows the locations of Silky's JV and headquarters.

8C.3 <u>Lower production costs in China = higher profit to the HK businessmen?</u>

When Peter explained the reasons why he started production in China, he mentioned that there has been a misunderstanding among many people that increasing profitability was their main motive. He claimed that many people saw the situation too literally without a real understanding of the market. It is true that production costs in China were lower and it was why they went there. However, it did not mean that their profitability would be increased proportionately. Peter used the following examples to explain his points:

> "According to my past experience, we had two options of country of origin for our products. One was "made in China" and the other one was "made in HK". My clients were used to accepting our products produced in either of these two places and this gave me the flexibility to choose my production bases. However, in turn, they required two different prices.
>
> For instance, for "made in HK" products, they would pay $10 per unit, but for "made in China" items, they would only be willing to pay $9. The customers knew that "made in China' labels usually meant lower quality and so lower price. The quality of goods produced in HK was usually higher and so they could set higher prices in the US market.
>
> At that time HK was a key garment supplying source and our customers had to accept the two options of origins. From this example you can see that our profitability had not been improved due to moving our production base to China. It was not the main issue leading us to invest in China at that time. There has been a common misunderstanding on this point."

It was also mentioned that along with the rise of other industrial countries as garment supplying sources, competition in the field was intensified. The trend of moving production bases to China created a one-way street for the HK businesses. After the first few years of transition period, customers no longer accepted two different prices for the two countries of origins. They offered the lowest price and left the manufacturers to choose their production bases. The situation actually left no alternative to HK firms and they had to produce in China. Therefore, reducing production cost and maintaining in business became the reasons why so many HK firms invested in China.

Peter stressed that "our profit margin has not been significantly improved just because we have moved our production to China". The above discussion has reflected Peter's character. He is fairly sensitive to moral issues of running business, and he is keen to clarify things that he believes are misleading. Peter's experience and views lend empirical support to an argument raised in Chapters 2 and 5 that there are financial and human factors embedded in business operation and decisions.

8C.4 Is penetration of the China markets also a key motives?

China is considered as one of the biggest markets in the world and many firms, such as Superior and Marlee in Case Studies A and B, are competing to get a solid share in the country. However, it was not a key driving force that led Silky to move into China. Up until this moment, Silky's main markets remain to be America and Canada. Up to the time of the interview, all outputs from the Chinese factories were used for export purposes. Therefore, penetrating the local market was not a motive to invest in China in the past.

Nevertheless, owing to the increasing problems to trade in America, which will be discussed in sections 8C.16, 17 and 18, and the continuous economic development in China, Peter stated that he had already decided to explore the Chinese domestic market. He claimed that, rather than put all his eggs in one basket, Silky should diversify its markets and China is going to be their next target.

8C.5 Number of operations and the forms of investment in China

At the time the interview, Silky had four production operations and all of them were located in southern China. The four plants were formed by different forms of entry modes:

1 x Wholly owned - Capitalisation HK$4 millions

Silky's first and latest investments are both of wholly owned form. However, the first factory, which was established in 1986/7, was sold off in 1991.

1 x JV - capitalisation HK$6 million

Silky has got a JV, which was formed with a local Chinese partner. Silky owned 44% and the Chinese partner acquired 56% of the equity. The company originally had two JVs, and one was sold off in 1991.

2 x Process and compensation trade agreements (PCTA) - capitalisation HK$11.2 million

Two other production bases are of a new form of investment, which embraces a mixture of characteristics of process and assembly agreement (PAA) and compensation trade (see

Chapter 3 for details). This new form is known as (三來一補) in Chinese. I translate the term as "process and compensation trade agreement (PCTA) in English.

PCTA is in fact a form of investment developed from PAA, which has been widely used by many HK firms in the coastal areas of China. As PAA is a flexible entry mode, it is commonly adopted by investors as a channel to test the water in China. Gradually, investors modify the original form by adding additional clauses or combining the characteristics of other investment forms to suit their special needs. Control is one of the key issues leading to the change.

Basically, under a PCTA the Chinese partner usually provides building and labour, whilst the foreign partner would bring in machinery, materials, and technology to start-up the business. The total investment of the foreign investor will then be compensated by a fixed periodical payment from the Chinese side regardless of the business results. Profit responsibility rests solely on the Chinese partner's shoulders. Before the full amount is paid up, the foreign partner remains the legal owner of the assets and has the right to repossess them if the Chinese counterpart fails to pay up the instalments.

In addition to bringing in assets, the foreign partner will normally provide all or part of the orders to the factory. Before a PCTA contract is signed, there are often written or verbal agreements between the two parties that capacity of the PCTA factory is always reserved for the foreign counterpart's orders first. Only when the foreign investor's orders are completed, then the spare capacity can be used for other customers. The foreign partner pays process fees[1] for the work that the PCTA factory does for their orders.

To describe this new form in a simpler way, the foreign partner basically acts as a lender of capital and in return they will have a reliable production base which will always put their orders first. Not until Silky's orders are finished can the factory produce other customers' products. The foreign investor has a great extent of control over production scheduling, quality, labour costs, and return of investment. This new form is quite similar to

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[1] It can be seen that the compensation of the original investment to the foreign investor can be paid in various forms: (a) cash, (b) a combination of cash and processing fee, (c) pure processing fee, (d) if the processing fee is more than the periodical payment, the foreign partner has to pay the Chinese partner the balance or agree to have the balance reduced from the next payment.

contractual joint venture in the sense that there is no requirement to establish a legal entity and a PCTA will dissolve after the predetermined payback time.

8C.6 PCTAs - foreign partners seem to have all the advantages. Why should the Chinese partners get involved?

The discussion above seems to suggest that foreign partner is often in a favourable position in a PCTA. Their initial investment will be fully paid back, and they can have the production capacity whenever they need without bearing the investment risk. Then why would have the Chinese partners got involved in this type of unequal agreement? Being asked the questions, Peter explained PCTA form of investment in further detail:

> "Actually, the Chinese partner is not disadvantaged. It mirrors to the situation in which they borrow money from a bank to buy machines, they have to pay interest no matter they make a profit or not. On the contrary, the Chinese partner enjoys a great advantage, as the loan is interest free or with very low interest rate. Moreover, my business will place constant orders to the factory.
>
> For me, I just invest some money on machinery. Through this way, I can secure an extra production capacity for my business if I need their help. In the case that my business is not doing that well, I will have one less to worry about..... If the factory can generate a profit at the end of the year, the Chinese partner will use it to pay me. If the venture makes a loss, the Chinese partner has to cover it and they still need to pay me. If they cannot, I can take the machines away at any time.
>
> But on the other hand, if the venture is doing very well and making a good profit, I will not receive extra share. For instance, I had a garment factory, which both partners agreed that the payback time would take about 5 years. However, the factory was doing very well and earned a lot of money. It repaid me in 1.5 years. For me, I was losing out a very profitable opportunity as I could not share any profit from this investment."

The above explanation illustrates the potentials and flexibility of PCTA for both foreign and Chinese partners. The foreign investors will get the level of security they need, in term of assets they bring into the factories and control of production scheduling, by taking a fairly low risk in term of level of capital commitment and responsibility of profit and loss of the operations. Meanwhile, the Chinese partners obtain low-cost capital and steady supply of orders from the foreign partners. Once the foreign investors' capital is fully repaid, then the factories will turn to the Chinese partners.

8C.7 What are the criteria behind decisions relating to the forms of investment?

Peter has adopted a diverse range of entry modes to invest in China. The decision for each case depended on the situation at the time, such as Silky's business performance and plans. Peter illustrated how the process works:

> "For example, if I want to get the initial investment paid back as soon as possible, I will then be likely to choose PCTA as this form guarantees a fixed periodical payment and the pay-back time of the whole investment is also predetermined."

In addition, it was stated that the decision was also driven by the investment environment.

> "I have just established a wholly owned factory in China. In the area where I wanted to invest, there is only one state-owned enterprise operating in the same field. I want to use their facilities, but I do not want to form a JV with them. It is because that enterprise and the region are under the control of provincial government, which are indirectly under the control of the central Government. The structure of control is very complicated and I knew that there would be a lot of problems of forming a JV with that state-owned factory.
>
> Because of this, I decided to set up a wholly owned factory and use the state factory's land and relationship with the authorities. I have used them as an external agent. They are now helping me to handle some administration and hectic problems. I pay them a monthly fee for the facility and service they provide to my business there."

The above example explained why under that particular situation the wholly owned form of operation was the best alternative among others. Peter further revealed that in few other occasions, JV became his favourite choice. According to the Chinese JV law, there are some industries that formally or informally require foreign firms to form JVs with local partners. Silky's dyeing factory is an example to illustrate the influence of this type of governmental requirements. If they did not use the JV mode, they would not have been given the license to start the dyeing business.

However, there were other circumstances, although Peter was free to choose the form of organisations, JV turned out to be the preferred mode. It was because forming JV with a state-owned enterprise or government agent, who had good local knowledge and some influence over the local authorities, usually brought a lot of advantages to the JV.

Silky's experience illustrates that investment mode choice is a complex issue and the decisions are often driven by considerations of control, resource commitment, risk and return, as the analysis and literature review recorded in Chapter 5 revealed.

8C.8 <u>How were the JV partners identified, and what were the criteria for partner selection?</u>

If the JV mode was considered to be the best alternative, the selection of JV partners would normally focus on those who have had prior business dealings with Silky. Peter stressed that he would only form JVs or PCTAs with compatible partners. The best way to ascertain the extent of compatibility is to choose from those candidates whom Peter knows. Silky has been using Chinese garment sub-contractors from time to time. Through this channel, Peter has established business contacts with some potential JV or PCTA partners.

Once a mutual recognised business relationship and understanding has been built up, if both parties are compatible and want to work together, they will start discussion on the possibility of forming a JV. These criteria are the pre-requisite conditions for further negotiation. Besides these, there are other aspects that also need to be fulfilled before a right partner is finally identified. For example:

> "It is necessary to consider the potential partner's background, their relationships with the local government authorities, and whether or not they have the ability to run the factory. There are many things that I need to take into consideration before I agree to form a JV. Whether the final result will come up to your prior expectations is another matter, it is my way to assess partners for joint businesses."

It can be seen that Peter was using different sources of information and personal judgement to support the investment decisions he made. It was emphasised that the profitability of a JV depends not only on your ability to run the operation, but also the partner relationship. When two parties agree to form a JV, there must be some extent of trust. Otherwise, they would not have done business together in the first place. Running JVs in China, same as in other places of the world, is based on incomplete contracts. Even with a complete contract, it does not mean everything in China, a country which emphasises human relationships, private negotiation and settlement. Due to the unique investment environment, it makes the selection of JV partners even more important.

8C.8.1 Other criteria for choosing JV partners

Continuing the above discussion, Peter further revealed his preferred partners and the reasons behind the decisions. He stated that he had had experience of forming JVs or PCTAs with three types of Chinese partners: (a) township enterprise, (b) local government agent, and (c) provincial government agent. The past experience demonstrates that it is easier to work with township enterprises. This is because this type of firm has been empowered with more autonomy to run their businesses than state-owned enterprises.

Township enterprises are local or regional businesses and they are not directly under the provincial government's control. Thus, the partners are able to discuss business issues, solve problems, and/or plan for the future without the direct interference from government authorities. There is always room for negotiation and space for discussion. Peter emphasised that Silky's investment in China is only small and his small factories do not have any influence on the provincial or municipal government levels. Therefore, it is easier to form JVs with the township type of partners. Again, the extent of control that Silky can exert into the operation and environment is a key factor, which determines FDI and investment mode decisions.

8C.9 Do you worry about dissipation and being mistreated in a JV relationship?

A rather unexpected reply was obtained on this question:

> "You should have prepared for that if you invest in China. It happened to me before. If it happens to me in the future, I will sell the JV and form a new one."

It was explained that mutual trust is a basic pre-requisite requirement underlying any JV co-operation. Throughout the partner selection process, precaution has been taken to ensure that both parties are compatible to working together. However, it is wise to prepare for the worse and plan for the worse in case it really happens to you.

8C.10 How important is the majority control in your Chinese operations?

The above discussion has demonstrated the complex process and criteria of choosing the forms of investments and partners. It is not a straightforward formula and as Peter said, it very much depends on the situation. Going back to the main theme of the interview, Peter was asked how important is majority control of his Chinese operations to him.

> "The right to control is the most important issue to me. Once I feel that I cannot control the operation, I will sell it and buy another one. That was why I was buying and selling my investment in the past."

8C.11 <u>Why do you see the majority control so important?</u>

The above answer gave me an immediate impression that the majority control is a very important factor, which significantly influences the investment decisions. Nonetheless, why is it so important? As Peter explained the reasons why:

> "I am afraid the way my JV partner runs the operation does not match fully with my requirements. It is the most important consideration behind my decisions. For instance, if I need an order to be finished in ten days and if the factory is controlled by my partner, I cannot guarantee that. My partner may say the order takes twelve days to complete or he may have his own priority to schedule the production.
>
> Another example is that my calculation shows the cost to produce a shirt is $10, and my partner says that it will cost $15 to produce in our factory, then the majority control matters under this situation.
>
> My objective to invest in China is to establish a low cost production base. If I cannot control production scheduling and production costs, why should I invest in the first place? It is my principle, if I cannot have the majority control, I will quit and sell off my share in the JV."

8C.12 <u>What is the equity structure of the China JV?</u>

It was disclosed that Silky has acquired 44% of stake in the JV, and the Chinese partner owns 56%. The number of Board of Directors that each partner appointed was described as 'even'. This ownership structure seems to have either one of the following two implications: (a) equity bears no direct relationship to the distribution of control in the JV, or (b) Peter contradicted himself by what he had just said about the important of majority control in the JV. Owing to the confusion, clarification was sought. The reply given was that "I have used a different approach to run my JV from many other investors."

8C.13 <u>Equity relevant or irrelevant to IJV control - how different is your approach?</u>

Peter has been using a method called "internal exclusivity" to run the JV. Under an internal exclusive agreement, both partners have estimated and agreed on a reasonable annual return of the JV, then Silky pays the Chinese partner his share of the forecasted profit in return for full control of the operation. Basically, the Chinese counterpart acts somewhat like a *cumulative preference shareholder of a limited company.* They own equity of the JV and have the right to share a fixed return of dividend. The cost for the security is that they are not entitled to any further profit sharing if the JV is doing well, and they cannot interfere with the ways in which policies and strategies are made and how the JV is run. The Chinese partner could remain working in the operation to help out the administrative work[2]. However, Peter is the boss. It can be seen that the difference of this special form is that Silky pays for the right of outright control.

Peter mentioned that internal exclusivity has become more and more commonly used in China nowadays. Often, the Chinese partners will suggest an amount of so-called reasonable return of the JVs to their foreign counterparts, who want to secure an exclusive right of control. Past experience will help you to judge the cost of the opportunity. However, if you are not sure whether the suggested amount is reasonable, the best way is to seek information from the market. Peter used his recent experience to illustrate how this approach works in his case:

> "My dyeing factory is three-year old now, and it operated as a typical JV in the first year. Unfortunately, we made a loss in the first year. My Chinese partner soon started to lose confidence and suggested that the dyeing factory could be converted into an exclusive sub-contracting production base in order to guarantee a stable annual income. I agreed with his suggestion. My partner started to look for suitable candidates and check the market price of our production capacity. Indeed, I was not prepared to give up at that early stage.
>
> After my partner found out the market information, I suggested to him that I would take up the exclusive right myself. It meant that I had to pay the dyeing factory a fixed amount out of my pocket every month for the exclusive right no matter if it was making a profit or not. There are pros and cons of doing it.
>
> For example in the first year of the agreement, I achieved a break-even of getting extra business to pay out the extra fee to my partner. This year up until June, the business was not very good. Nevertheless, from July onwards the business has grown rapidly and I have earned quite a bit of money in these few months. Up until this moment, we break-even. As we predict, the business in the next few months will get even better. So I have decided to establish a new (dyeing) plant in the near future and this time it will be a wholly owned subsidiary."

[2] Such as customs and tax declaration, applications for tax relief, various types of licenses, insurance and labour affairs.

8C.14 Has the fixed life span increased the level of risk of using JVs?

According to the Chinese JV law, each JV has a fixed life span. Although the predetermined life span is possible to be extended, this limitation may increase the perceived and/or actual level of risk of using this form of investment. In Silky's case, its JV has an agreed operational life of ten years, which is a common length for JVs.

Peter stated that the time limit has not really influenced the level of risk of using JV. It is because when he made FDI decisions in the past, no matter which entry mode was chosen, he would not accept a project, which was predicted to pay back longer than two to three years. Because of this, ten years operational life is indeed more than he asks for. The reasons behind the desire for a quick return is illustrated in the following reply:

> "The political situation in China is not that clear and stable. When I calculate payback of each investment there, I have to make allowance for this factor. For me, I usually set down a payback time of about two years... It is impossible for me to set five or ten years. My investment is only small as compared to other companies, I do expect a quick return."

8C.15 If political risk is high, will it influence the extent of investment that Silky puts in China?

The above discussion has reflected Peter's concern over the political stability in China. It will be interesting to find out if this worry has hindered the level of investment that Silky has and will commit in the country. "No, it does not work that way". Peter stated.

It was pointed out that there is risk wherever you invest. The difference is the level of risk and the openness of these risks in different countries. Investors have to balance the level of these two types of risks that they are prepared to take.

8C.16 Open and or hidden risks - which one do you prefer?

In many less developed countries, such as China, there are various types of risks and they are quite well known to many investors. Because investors are aware of the risks, if they still want to invest, they will prepare themselves for the possible problems. They would adopt different strategies to cope with the difficult environment.

In Silky's situation, Peter prefers to choose investments which can provide him with a quick return and the level of control he needs. Through this way, Peter is in a reasonable position to ensure that he is well informed of any major change in the environment and thus immediate action could be taken. Moreover, the payback time is normally around two to three years in each case, there is unlikely to have major change in China within such a short period of time without any prior indication. When worse comes to worse, Peter could only blame himself for the misjudgement. As he said, he had prepared for it.

On the other hand, Peter argued that some well developed countries, which are apparently safe to invest, in fact have got a lot of hidden risks and costs. Interesting enough, it was claimed that these hidden risks and costs are created by the well-developed social and legal systems. It is understandable that people are complaining that less-developed legal systems, like those in China, impose threats on their investment. Now, what is the logic behind his comments? "It is a long story". Peter said.

Firstly, he explained that due to their good public image, many investors are unaware of the hidden risks in many developed countries until they get their fingers burnt. He has put forward his experience to illustrate the points:

> "I have investments in USA, Canada and China. The political situation in USA and Canada are known by many of us as stable. However, there are many regulations imposed on foreign investors to restrict their activities. These restrictions and boundaries are much tougher than China's. If you talk about investment climate, as a HK businessman, I would rather invest in China. I do not mean that I have never lost money in China as I have. But at least most of my investments are profitable. I have invested in USA twice, and I lost in both attempts.
>
> ... I had established a (trading) company in America six years ago and I closed it down this year. The business was in fact making small profits at the very beginning and showed a lot of potential. However, once you started to make a profit in America, there would be a number of regulations that would be relevant to your business. I feel very frustrated and confused. Then my company started to make losses and finally I decided to close it down. It was impossible for us to survive in America.
>
> ... My Canadian (trading) company established ten years ago and we have been struggling throughout these years. I have not recovered my investment yet. But on the other side of the world, I can achieve payback of most of my investments in China to date within two to three years. I really want to close down my Canadian company soon!"

8C.17 Developed countries - is it easier and safer to invest there?

It was an unexpected development of conversation in the interview. In order to find out more about the contrasting experience Peter encountered in China and in the two developed countries, USA and Canada, in where foreign investors normally believe that they are protected and fairly treated, further questions were probed. Why have these fancy images turned sour in Silky case? Peter provided the following answer:

> "At the beginning, I thought that we should have offices in our main markets in USA and Canada. Unfortunately, it worked out more expensive to set up offices there. According to my own experience and experience of some of my friends who also have garment investment in the United States, we are all making losses there.
>
> Many foreign investors say that China is a risky country to invest. However, for me and for many of my friends in the same field, we feel that America is a higher risk country to invest in and it bears a lot of hidden costs."

Why America, the biggest economy in the world, was regarded as an investor nightmare? What exactly are these problems that lead to the unsatisfactory results? It did not take Peter a few seconds to find out a series of examples:

> "As I said before, the laws are really too restrictive to foreign investors. For instance, my American offices import products from my HK/Chinese factories. In the United States, the customs and excise department requires businesses to declare their imported goods at 'reasonable prices'. But what is a reasonable price? It depends on the markets, customers and the products themselves. It is so difficult for us to find out what is reasonable from their point of view.
>
> In fact, the situation is so simple. If I sell my products to some low-end department stores, such as Target Store or Walmart, we need to provide them with low-end products like US$5 or $6 for a shirt. On the other hand, if we sell our products to up-market department stores, an apparent similar product may cost US$50 or $60, as the materials, quality, design, brand and packaging are different. All these things make up the price differential. Then how can the IRS judge our prices too expensive or too cheap? The IRS does not understand and will not try to understand that.
>
> Another example is that if there is a potential order from Sears, who offers us US$5 per unit and our cost is US$4, although the profit margin is small, I may still accept it as their orders are usually quite substantial. At the end of the day, I can make a small profit and also keep the customer. If our US sales office imports the products from the HK office at US$4, the US customs office may challenge the reason why we declared the goods at US$5 in the past and now you say it only costs US$4. They may immediate charge us for dumping.

Who are willing to dump their products? We are trading in a free market and the capital is our own money! Who will want to dump their money? .... But you cannot argue with the IRS as they believe that they are right all the time."

In addition to the worries of being accused of setting unreasonable transfer prices, the control of repatriation of dividends outside America can create further problems to foreign investors. Peter stated that as soon as his American office started to make some profits, his business immediately faced a new problem - denial of repatriation tax. The charge was due to the fact that Silky's US office transferred Silky HK's share of profit to the headquarters without realising the need of paying tax on the repatriated dividends. Silky ended up paying a fine, which off set the dividends they earned. Peter claimed that the difficulty to survive in the United States could be seen from the range of taxes and the possible fines that you may have to face. To invest in America, one needs to face not only business and financial, but also regulatory risk.

Indeed, Peter and his friends are not fighting this no-win war alone. In a newspaper article titled "gunned down - by the law" (Independent, 16/02/1997), it revealed that there are many people and corporations, who live and work within the eccentric American legal system, joining the battle. Technically, it is incorrect to say that the restrictions are imposed only on foreign firms, as most of the laws are applied to everyone in the country. The main difference between local and foreign firms perhaps is that litigation is deep-rooted in the American culture. Local firms would regard the run-of-the-mill allegations as part of the business life. The American system has bred a vast number of lawyers, whose livelihood relies on winning cases for their clients. However, some foreign firms may suddenly find themselves become soft targets in the 'jackpot'[3] mentality of the US litigation. Foreign firms cannot rely on the local government to help them out from the battle as very often the system is weighted towards home town win.

[3] For example, Barclays Bank fought against California's unitary tax law under which the state tried to tax the group's world-wide earnings; a UK engineering group was brought to court by its American franchisees for a US$31 million compensation over a dispute of which they might end up to pay either one of the two rolling jackpots - US$740 million if they lost the case or a US$340 million fine if they could get out of it (Independent, 16/02/1997).

8C.18 <u>Have the under developed and loosely structured legal systems in China provided a better and safer environment to run business?</u>

The above examples demonstrate the difficulties that many firms face in America are due to the country's deep-rooted litigation culture. Nevertheless, the problems in the developed countries do not necessarily imply that a less litigation culture, such as the relationship-based culture in China, will provide a better or safer environment for FDI. For any valid argument to be made, a balanced discussion and comparison has to be drawn. Accordingly, a related question was asked.

Peter stated that there are pros and cons to run and manage businesses under a loosely structured legal system. It is a personal choice, and it depends on which type of environment you prefer to work with. Peter's preference clearly reflects his Chinese ethnic background. The justification he put forward is showed as below:

> "Well, as we know that the legal system is so well developed in America. But if I compare it to the under-developed legal system in China, I would prefer China's. I am a Christian and I am not talking about illegal or back-hand deals. In China, if your business is having trouble, you can discuss your situation openly with the local authorities and tell them if the regulations remain as they are, you will be forced out of business. Often, they will consider your case individually and they may ease up some aspects of the regulations with the hope to help you out. They do treasure foreign investments.
>
> For our products, the formal and full export declaration procedure normally takes two days. In some urgent cases our production runs late and customers do not accept late delivery, we can negotiate with the customs department. We may request them to let our goods leave China before the full declaration procedure finishes, and the whole set of document will be followed up later on. Most of the time, the customs and excise officers will accept that, provided your past records are good enough to build up their trust."

The above is a persuasive example to prove the benefit of operating in a less developed legal system. Nonetheless, if we look at the other side of the coin, flexibility implies that some government officers do have the power to change the existing regulations according to individual situation, personal preference and/or self interests. From this angle, flexibility could lead to the problems of legitimacy, as many things are open to different interpretations. It is a potential risk to many investors. How could Peter justify this danger?

"Many people have misunderstood the situation. The officers have not changed the regulations, as we are doing what the government requires us to do. Often, documentation takes a long time to proceed in China, since most of the departments are not computerised. Thus, these procedures should be more flexible and negotiable. In America, it is very difficult to do so.

Two days ago I had a batch of goods that were required to leave China by nine o'clock in the morning. If you do business in the American way, you would be in trouble as the customs office only starts work from 9:00 in the morning.

For us to handle the case in the Chinese way, we had phoned up one of the customs officers at home the night before and requested him to come into work a bit earlier. On that morning, the officer turned up to handle our declaration before 8:30 and let us leave the customs before 9:00. I have to clarify that it was not something illegal as I did clearly declare my export items and pay the tax. In China, the authorities can be that helpful to our investors. It is impossible to do that in America."

8C. 19 <u>Control of investment environment in China</u>

Peter's argument was not totally one sided and he admitted that it is not easy to work in China. There is a lot of bureaucracy, and restrictions on operation, capital movement and foreign exchange. Moreover, some basic infrastructures, such as power and water supply, are far from satisfactory. The frequent power cut is the worse part of running manufacturing business in China, and the shortage of water supply and drainage system for waste is considered the second biggest problem to Silky's dyeing business.

However, foreign investors know about these before they get involved in FDI in China. Also many of these problems can be resolved by means within their control. To a great extent, the situation is controllable, although is not preferable. For instance, in Silky's case, they have invested in generators to overcome power cut interruptions to their production. The dyeing factory has installed its own water tanks and purification system to treat the residuals.

The investment environment is difficult, but it is not impossible to operate within. Having invested in the additional assets to cope with the backward investment conditions in China, Silky's factories are still profitable. Peter concluded his argument on the topic of risk:

"If you ask me which country in the world bears the highest risk of investment, I would say America".

8C.20 <u>What are the criteria behind decisions of FDI location in China?</u>

Up until the time of the interview, all Silky's investments were located in southern China, which is adjacent to the HK/China border. The main reason to explain why the southern region becomes the preferred location is its proximity to HK.

Refer back to the key motive driving Silky to China was to set up a low cost production base. Up until now all outputs from the Chinese factories have to be delivered to HK for re-export to the final markets in the States and Canada. The HK headquarters are in charge of sales and the administration side of the re-exports. Therefore, the distance between the factories and HK would affect the total cost and lead time of production. Besides cargoes, Peter and his staff also need to travel regularly to the factories (see 8C.22 for details of the management structure). The location decisions in turn have had significant cost and control implication. Because of these reasons, geographical proximity and the relatively better state of development in southern China are clearly the main attractions.

8C.21 <u>Are the investment incentives offered by the Chinese government key determinants of FDI location?</u>

As was discussed in Chapter 3, FDI located in special economic zones (SEZs) will enjoy preferential tax treatment offered by the Chinese government. However, the incentives were not the key motives driving Silky to southern China. Nowadays foreign firms can enjoy the basic investment incentives in most places in China. Although SEZs and coastal areas offer extra preferential treatments, the higher living standards in these regions offset the benefits that foreign investors gained from the incentives. Moreover, two of Silky's four investments are in the form of PCTA, a mode with an ambiguous status which lies between sub-contracting and contractual JVs, may not be entitled to some special incentives offered to JVs.

In fact, due to the sharp increase of production cost in southern China, Peter begins to look for alternative regions to invest. Silky has placed a few trial orders to sub-contractors located in other parts of southern China (towards midland) in order to test the water of investing there in the near future. China is an enormous country and moving production base from one city or from one province to another may mean anything from a small to dramatically large change of investment environment. Because of this, Peter wants to get a feel of the new environment before he commits FDI in any new regions.

8C.22 Human resource policy and management structure adopted in the Chinese factories

Up until the time of the interview, Silky's four Chinese operations employed the following number of local workers:

- Wholly own subsidiary - 200-odd workers
- JV - 80 workers
- 2 x PCTA - about 1,000 workers in total

As was discussed in the above section, PCTA is a form of investment, which lies somewhere between sub-contacting and contractual JVs. Silky has been using the two PCTAs as a means to secure extra production capacity. Although Silky does have a lot of say in production scheduling, process and quality control, they could not impose the whole set of management toolkits into these operations. Because of that, the following discussion focuses on the other two investments.

Peter stated that he had been using more or less the same management structure in the JV and wholly owned factory in China. The main reason behind the unified policy is because the JV has been run like a wholly owned subsidiary through the use of an internal exclusive agreement (see section 8C.13). The normal practice is that the headquarters send two HK managers to each Chinese factory to act as the GM and plant manager. They are in charge of the operation and technology transfer to the subsidiaries. These two managers are staying in China on a permanent basis. In addition, Peter, his son and other technicians from HK pay regular visits to the Chinese operations to provide further support on different aspects. Below the top level, supervisors and shop-floor workers are all recruited locally[4].

Peter considered that it is inappropriate to use only expatriates to run business in a foreign country. No matter how good these senior managers are, they grew up and were educated in a different environment. It may not be fully effective to have them to control local workers directly. For example, a majority of workers in southern China actually come from rural villages in the midland or northern parts of the country. These workers are

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[4] Silky has been using three main channels to recruit local employees from supervisor to shop-floor levels (a) candidates recommended by friends or other known parties, (b) advertising in the local newspaper, and (c) government recruitment agents (this channel is used mainly to recruit shop-floor workers). Furthermore, Silky has also taken on a few local university graduates as trainee technicians.

speaking a wide range of local dialects. Most of them have received minimal education and some are illiterate. It is difficult for the HK managers to train and monitor these workers directly. The strategy Silky adopted is whenever the company recruits a group of workers from a rural area, it will at the same time find the group a leader from the same place. The workers then all share the same local dialect and custom. Various group leaders report to the local supervisors, who then report to the plant manager.

Basically, Silky has been using a three-tiered management structure in the Chinese subsidiaries. The two HK managers in each operation work as the senior management, while the middle level is filled by local supervisors who are in charge of the team leaders. Peter stated that this kind of three-tiered structure is commonly adopted by HK businesses. The popularity reflects its appropriateness to cope with the present environments in China, particularly from the ethnic Chinese investors' point of view.

8C.22.1 <u>How do you see the quality of local managers and workers?</u>

It was replied that the answers would depend on which stage of the economics reforms in China my question was referred to. In the early 1980s when Silky first went into China, the country's open door policy was only in its infant stage. At that time, the average quality of local managers was low. They knew little about international business and quality control. After fifteen years of opening up, local staff and foreign investors have both accumulated knowledge of running businesses in China. The overall standard of the local managers has been improving. They know a lot about the technical side of running production in China.

8C.22.2 <u>Localisation of management in the near future</u>

Peter pointed out that the extent of localisation is possible only up to middle level management at present and top managers could not be appointed locally. It is because the majority of local managers had been working in state-owned enterprises or government departments before they joined the private businesses. They were used to implement plans set down by their superiors, who often built their budgets on an incremental basis without taking into account many external factors. Being competitive in a free market was not used to be a part of the management culture in many state-owned enterprises.

Over the last fifteen years or so, the middle-level managers have acquired a lot of experience of monitoring shop-floor workers and day-to-day operation in foreign-funded businesses. However, they are still inexperienced in dealing with international business affairs. Local managers have got limited knowledge of how societies and businesses operate in other countries, such as HK, America, and Canada, the three main places in which Silky trades. They are not yet ready to take up the GM or plant manager posts, which act as the middlemen between the HK headquarters and the factories. However, Silky has provided regular on-job training to the Chinese supervisors to help them develop various skills that are required when they take on more senior posts in the future.

8C.23 The roles of Silky HK and the subsidiaries

The HK office works as the headquarters where Peter, his son, and other senior managers are based. It is a trading office, which is responsible for administration, accounting, sales and marketing functions of Silky as a whole. It is the nerve centre of the Group that co-ordinates activities in America, Canada, HK and China. Once the HK office receives orders from customers or the Canadian sales office, it will then place orders to the China factories. The Chinese plants are basically production departments of the Group. They are profit centres and have to take responsibility of their own profit and loss.

8C.24 How are orders being allocated to the Chinese factories?

Silky's FDI in China are formed via different entry modes. Various organisational forms represent different profit sharing methods. This characteristic may have influenced the way in which the HK headquarters allocate orders among the four factories. Being asked this sensitive question, Peter was fairly open about it. He stated that the proportion of profit sharing is not a key factor to determine where an order should go, but the delivery date of the order and the strengths of each factory are the deciding elements.

Silky only had one dyeing factory at that time and therefore all dyeing orders must go there. On the other hand, the company had three production plants to choose from when placing the garment orders. Although all factories are able to produce Silky's products, each of them is indeed specialised in manufacturing a particular line of items. The allocation of orders is according to their strengths. Peter explained how this method works:

> "For example, I have a factory which is specialised in producing pyjamas. The factory is very efficient, quality is good and the production cost is relatively low. This factory is a PCTA and it is an ideal production base for pyjamas. I have another factory, let's call it B, which is specialised in producing vests.

Every time when we placed pyjama orders to them, they made a loss. The workers in B just cannot produce as good and cheap pyjamas as the other factory and they hate to do pyjama orders.

According to these characteristics, the HK office knows where to place the orders. However, if the pyjama and vest orders do not arrive evenly, we will still place pyjama orders to B, although the factory is not strong at producing pyjamas. Basically, we will allocate orders to our factories according to their strengths."

8C.25 <u>How are prices of the orders set?</u>

Initially, it seems logical and fair that the allocation of orders is according to strengths of individual subsidiaries. However, I queried that profitability of these Chinese factories is not determined only by the number of orders they receive, but also the prices set down on each order. The subsidiaries are acting as exclusive production bases for Silky HK and they are not free to choose their customers, although the two PCTAs are allowed to accept orders from other firms once Silky's work is completed. The queries prompted further investigation into how prices were set.

Silky's current business is more than enough to keep its Chinese factories busy. Help from sub-contractors is needed from time to time to cope with any overflowing orders. Based on the sub-contractors' prices as a basis, the HK headquarters will set the same prices on similar orders placed to its own factories. Peter believes that if external parties can make a profit out of the quoted prices, his factories should be able to do the same or even better. It is fair to make a direct comparison of external and internal production costs to evaluate performance of the Chinese factories.

Peter stressed that the headquarters would not set artificially low transfer prices in order to keep the profits in HK. The profits generated in HK or in China are all his money and there is no point to understate the prices as tax rates are very similar in these two places. Peter wants to find out how well his factories are doing production wise when they stand on their own feet. It is the reason why he uses market prices as a guide to set internal prices.

8C.26 <u>The extent of autonomy granted to the GMs of JV and wholly owned subsidiaries</u>

Throughout the interview, a picture of a highly centralised control policy applied to Silky's Chinese operations was revealed. The allocation of orders and prices are all decided by the HK headquarters. The situation made me wonder the extent of autonomy granted to the GMs and plant managers, who were sent to China to run the so-called profit centres.

Peter argued that it is simply a division of labour. The way he runs the whole business is that the HK office is responsible for finance, accounting, sales and marketing, whilst the Chinese plants take care of production. Instead of looking for orders themselves, the factories automatically receive business from the HK office with no sales and marketing costs being incurred. Owing to the steady supply of business, no matter how low the market prices set in the orders, the factories should be in a better position than the external sub-contractors, who quoted Silky the same prices, to generate a profit.

Once the orders are allocated, the headquarters would not interfere with the ways in which the factories are run. The two HK managers assigned to each factory are the bosses. They have full authority at that level to control the operation. They have the authority as well as responsibility to make sure that local supervisors and workers are properly trained and managed, orders are completed on time, and the quality of outputs is up to Silky's requirements. These are the key criteria to measure performance of the senior managers.

8C.27 <u>Do these senior managers set their own budgets or being involved in the process?</u>

When Peter was asked whether the senior managers in the Chinese subsidiaries are required to prepare their budgets, his reply was "no, they don't need to do that". It was explained that the Chinese factories are basically production bases. Their managers would not have the relevant information, such as fashion trends and market demands, to build up various budgets. All business strategies are developed in the HK office. To be more precise, all budgets are prepared by Peter, as he mentioned in the interview that he had not required the Finance Manager or the Accountant to assist him to prepare budgets or strategies.

Once the budgets are established, the HK office will consult the GMs of the Chinese factories with the production targets assigned to their operations. During the consultation process, if the subsidiary managers find their existing facilities are insufficient to meet the targets, they can apply for more funds to expand the factories. Peter provided an example to illustrate this:

> "As I mentioned before our dyeing factory's business has developed very fast. The manager suggested to me that they needed to expand the capacity in order to cope with the increasing production target. He applied for funds of HK$1 million. After a thorough assessment, I felt that it was feasible to further invest in the factory and I accepted his proposal.
>
> On the other hand, if the managers of our factories feel that they need more workers to meet the increasing production demand, it is their duties to recruit and train their employees. Generally speaking, they are responsible for day-to-day operational decisions and for the higher level decisions, they need to consult me or refer to the HK office".

The above replies seemed to indicate that Peter meant that the managers are not required to set strategies, sales or marketing plans/budgets. However, they are required to 'assess' whether the existing capacity of the plants could meet the projected production targets. The managers need to 'estimate' further capital investment. They also need to 'forecast' the direct costs and production overheads of their operations. These managers are involved in the budgetary process at the production level, and they have also produced forecasts or inputs to the budgets in an informal way.

Furthermore, according to the information revealed, the Chinese operations seem to be "pseudo profit centres" in the sense that they are not free to choose customers and control their sales or profits. Their main objectives are to produce products efficiently within a cost set down by the HK office. Their characters in fact bear more resemblance to a cost rather than a profit centre.

8C.28 <u>How do you measure the performance of the subsidiary managers?</u>

The way in which performance of the subsidiary managers is measured was indeed embraced in discussion illustrated in the above sections. Fundamentally, the assessment is based on the management's ability to hit the production targets which they have agreed, and their ability to manage the factories to manufacture products that are up to the HK office's (their customers') requirements within the required delivery dates and costs. It was revealed that the reward system for the managers is closely tied to these measures.

8C.29 <u>Performance evaluation of the Chinese operations (wholly owned and JV)</u>

It was disclosed that the performance of the operations is evaluated more or less the same way as the managers. Peter used a fairly broad term to describe that the factories are evaluated according to their economics returns. As he explained, economic return is not an absolute term, which only refers to profitability. For Silky, the most important is on-time delivery, and then quality. The third is the factories' efficiency to complete the orders, and finally it is their profitability. Although profitability is measured, it is not an important performance indicator. This evidence seems to support my queries on the nature of the Chinese factories. They seem to be pseudo profit centres. Peter provided the following reasoning to explain the policy:

> "To be honest with you when we place an order with our China factories, the HK office has already kept a profit margin here. It means that we have already generated the first profit from the order. If the China factory can at least break-even, strictly speaking it is acceptable to the headquarters. Of course, I do want both sides to make a profit from the same order as the total return of investment of the Group will be increased. It is my target to make operations in both regions profitable.
>
> However, I would not place my first priority on profitability in the China factories, because the objective to establish them is to provide the HK headquarters with a low-cost production base. Therefore, on-time delivery, quality and productivity are always the first three criteria with which I am concerned. But you should realise that if the China factories can fulfil these three criteria, they will naturally be profitable".

In addition to production measure, Peter also revealed that he uses comparative measures to compare results of his Chinese subsidiaries with other similar factories in China in order to check out how well his investments are doing under the same environment. The way Peter sets order prices for his factories, according to the external sub-contractors' prices, is an example to illustrate the use of the comparative measure. Moreover, during social gatherings with friends who are working in the same field, they always compare notes and exchange experiences of their businesses. Information related to average return in similar factories in China can be obtained through this informal way.

It can be seen from the above answers that performance evaluation of the managers as well as operations is built on the key investment objective - to establish a low-cost production bases in China. Through diversification into dyeing fabric, garment production and sales, Silky can cut out the middlemen margin at each stage of the activity and maximise return from each order. Since the HK office has already generated the first profit, the Group as a whole can afford to put on-time delivery and quality as a priority at the subsidiary level, despite generating a second profit from the same orders being preferred.

Accordingly, the managers' performance is evaluated based on their achievement on the production targets. Through providing high quality products and meeting delivery deadlines, it will have a favourable knock-on effect on sales. Peter mentioned that Silky's products have earned a good reputation in the field for their high quality. Some customers have specifically required the use of Silky's own dyed fabrics in the garments. This good response has encouraged Peter to establish a second dyeing plant in China in the very near future. Customers' satisfaction is a clear sign of performance.

From Peter's answers above, some possible explanations for his unhappy American experience have emerged. From an individual business point of view, it does not matter which part of the business as a whole keeps the profit as eventually the money will all be Peter's. From a state government's viewpoint however, it does matter as investors' private allocation of profits will have significant impact on their tax incomes. American tax systems are better developed and/or more aggressive than those in China and HK to detect any lost taxes due to MNEs' allocation of resources and profits. Undoubtedly, their interference with private business decisions contradicts the principles of the free markets. However, we need to follow the rules of the big countries if we want to play the game. The conflicts of immediate interests between governments and investors seem to be the main cause of the unpleasant business experiences in America for Peter and some of his friends in the garment field.

8C.30 <u>How often do the Chinese subsidiaries report to the HK headquarters?</u>

All Chinese subsidiaries are required to report weekly and monthly to the HK headquarters. The weekly written reports cover mainly production information, such as production quantity, progress of various orders, and number of workers. This type of regular reporting enables the HK office to keep a close eye on the progress of various orders they place to the

Chinese subsidiaries. Immediate action can be taken if actual performance is different from the stated targets. While the monthly reports are in greater detail, which include both production and financial information, like costs, profit and loss of the period.

In addition to the written reports, Peter and other staff visit the factories on a regular basis. They can see the operation themselves and collect any information they need. Furthermore, the day-to-day contacts via telephone and fax between the HK office and factories provide the headquarters with even more updated information. Just like the Sunday when this interview was conducted, Peter was working from home and there were a number of phone calls coming in from one of the Chinese factories to keep him informed of the progress of an important order. Basically, he wants to know everything about his business on a regular basis.

The above mentioned reporting channels are not absolutely one-sided with information only passing up the hierarchy. In each type of contact, no matter through written reports, telephone, fax or face-to-face conversation, the factory managers can seek advice or information that they need from the headquarters. Although the expatriates stay in China on a permanent basis, the geographical proximity allows them to travel to HK on a regular basis. Again, their regular visits to the HK office enhance communications between headquarters and the subsidiaries. Moreover, in the consultation process of the budget preparation, the headquarters will provide the subsidiary managers with information that is related to the production targets and resources available. A combination of these forms a two-way communication mechanism between the HK office and the Chinese factories, as shown in Figure 8C.1.

Figure 8C.1

Two-way communication mechanism between the HK headquarters and Chinese subsidiaries

Pearl HK Headquarters

- Weekly & monthly written reports
- Subsidiary managers' personal visits to the HK office
- HK staff's personal visits to the factories
- Daily contacts via telephone & fax

- Budgetary process
- Annual production budget
- HK staff's personal visits to the factories
- Subsidiary managers personal visit to the HK office
- Daily contacts via telephone & fax

Chinese subsidiaries

8C.31 Reporting currencies

Often, HK dollars (HK$) and the Chinese currency RMB are used for orders and invoices in internal dealings between the headquarters and the factories. In some situations when another currency, usually US dollar (US$), is involved, a future rate will be set in advance when the order is placed. The settlement will then be made in RMB according to the agreed rate.

Basically, the income as well as expenditure of the Chinese factories are in either HK$ or RMB. Because of this, a standard format, which has two separate currency columns showing the currency used in each activity, has been adopted in the written reports to the HK office.

8C.32 Which party is responsible for any foreign exchange gain or loss?

Since the Chinese factories are said to work as 'profit centres', it would be interesting to find out which party is held responsible for any foreign exchange gain or loss. The answers given by Peter disclosed similar information as those revealed in case studies of Superior and Marlee. The Chinese government introduced a unified foreign exchange system in 1994. Since then the foreign exchange rates between RMB and other main currencies, such as HK$ and US$, have become quite stable, although small fluctuations are still expected.

Since income and expenses of the Chinese factories are mainly in HK$ or RMB, small foreign exchange gains or losses should not have significant impacts on the subsidiaries' performance. Peter stated that when he evaluated the managers' performance, he would take into account the impact of foreign exchange. Any loss or gain on this aspect is neither the managers' fault nor achievement and they would not be held responsible for it.

8C.33 Have the Chinese subsidiaries encountered any difficulty in repatriating dividends to the headquarters?

The Chinese government is well-known of its tight control on foreign exchange and the movement of funds. At the beginning of the interview, Peter was complaining about the treatment that he received in America when he transferred dividends to the HK headquarters. I was keen to find out if he had encountered the same type of problems in China.

Peter replied that since all Chinese outputs are for export purpose, balancing foreign exchange has not been an issue to the Chinese plants. Regarding the question about repatriation of dividends, it was stated that:

> "For foreign and Sino-foreign JVs, once you have paid the corporation tax, you can transfer your profits freely. The Chinese government accepts and allows it".

8C.34 How would you describe your own management style?

Throughout the interview, a picture of parental management style and a centralised management system had gradually emerged. In order to reveal more information of why and how these style and methods are chosen, I asked Peter to describe his own management style.

> "As I mentioned earlier on, I have not received any formal management education. If you ask me about my management style, I think I do it according to my own judgement and experience or common sense. I use the method which I think is sensible. If it turns out to be inappropriate later on, I will try to correct and improve it. So far I am happy with the methods I use.
>
> My wife has received management training and got a MBA. However, at the moment I feel that there are difficulties to introduce a whole set of western management toolkits into China, as human relationship has such a significant influence on many things. Moreover, the educational level of local workers is generally low. Systematic, western management styles and tools are unsuitable to this environment. China is a different world. It is my opinion."

In addition to the above justification, Peter suggested that for a small-medium sized business, centralised parental control have its own merits. The key advantage is that the power is held within an intimate family circle between Peter and his son. Basically, they know everything about the business. Problems are resolved and decisions are made centrally by the father and son. The communication and decision-making channel is short and direct.

This system is considered as efficient and effective, at least up to the present stage. It will be used until one day Silky grows into a size that the centralised control is no longer feasible. Peter claimed that he knew about the limitations of using centralised control and running Silky like a small family business, but at the moment it is the best choice.

8C.35 <u>What types of difficulties have you encountered in running businesses in China?</u>

At the last part of the interview, Peter was requested to sum up any particular difficulties that he has encountered in running businesses in China. Interestingly, the given examples of problems are quite different from those mentioned in the case studies of Superior and Marlee, such as difficult to understand the policies and systems. According to Peter, the biggest problem is that in China many things are resolved by human relationships.

It was stated that when problems arise in the Chinese factories, often Peter has to go there physically in order to show his authority and respect for other parties. At the same time, his presence will earn the respect, understanding, forgiveness, and/or help from others. It is a process of exchanging respect, trust, favours, and faces. Often, one cannot use other impersonal means, such as faxes, phone calls, lawyers or representatives to replace personal presence in the exchange process.

It is considered that this type of human-based ruling system has got its merits and drawbacks. The good points are that there is always room for discussion/mediation and problems are less likely to turn into a deadlock immediately. Moreover, all Silky's Chinese factories are located near to the HK/China border. The short distance enables Peter to get to the scene quickly and normally the problems will then be resolved.

The main drawback however is that there are so many issues, most of which can easily be sorted out by letters, fax, phone calls, or by managers from the headquarters, require Peter's presence on the spot. He could have saved the time of travelling to work on other more important aspects of his business. Also, one's ability is limited. How could Peter travel all the time just for the sake of showing respect, having a chat or dinner with the parties concerned in order to resolve problems?

In order to illustrate his above points, once again, Peter drew a comparison of the two different types of systems exist in China and in America/Canada. It was stated that the situation in the two developed countries is completely opposite to China. If there are serious problems in your American subsidiaries, it does not matter whether you are physically there or not. The most important thing is that your representing lawyers and/or accountants are there to act on your behalf. Peter used a recent incidence to demonstrate his points:

> "Some time ago, I had a large shipment exported from HK to Chicago for our US company. When the Chicago Customs and Excise checked our US office's import declarations, they said that we declared the goods by using a wrong category. They refused to discharge the cargoes. The order was quite big and our customer stated clearly that they would not accept late delivery. I went to see the customs officers and explained to them that the category had been used previously and this order must be delivered to our customer on time. What they said was 'no' unless I could get a rule binding from Washington to prove that we were right. I had to hire a lawyer to do this.
>
> Eventually my lawyer got the rule binding from Washington and proved that we were right. Nevertheless, we had already missed the delivery date, and the

customer refused to accept the delay unless we offered them a big discount to cover their loss. The US Customs and Excise would not compensate our loss and you could not sue them either. We had to absorb the compensation offered to the customer and the fee of hiring the lawyer. Then how do you judge the pros and cons of this so-called perfect legal system?

If the same case happened in China, I could go there personally and showed the customs department some old documentation that could prove the product category used in the past for the imported goods. If we could provide that, the customs would normally discharge our cargoes without a long delay. We are not cheating or doing something illegal in China. The Chinese authorities build up their understanding based on the normal human judgement and relationships. It is efficient and effective in the present circumstances. It is different from the Americans who prefer to use a set of written law to judge all types of human behaviour and solve all types of problems".

8C.36 <u>Have your investments fulfilled their objectives and how do you see the future of investing in China?</u>

In concluding the interview, Peter gave an overall summary of his experience of and opinions on the future prospect of investing in China. The ultimate goal of adopting any investment and control strategies is to fulfil what you want to achieve. In term of experience, Silky has been very lucky and none of its Chinese factories have come across any serious or unresolved issues in the country so far, although many day-to-day problems do arise from time to time. Each of Silky's operations has achieved its objectives and has been profitable. Regarding the future of investing in China, Peter expressed that:

"I always feel that China is the biggest market in the world.... It provides so many investment opportunities... Actually, I have already planned to explore the domestic market and sell our products in China next year. America is undoubtedly a big market too. But if we compare it with China now, you will see that China has got much more potential. Not only my business but also many other HK businessmen I know in the garment field are doing very well in China.

From my point of view, there is investment risk in any country. I am a HK businessman, an ethnic Chinese. For me I feel the investment risk in China is lower than other countries. When we go to China, at least we have some knowledge of the culture, the people and the place. It is easier for us. On the contrary, for our HK businessmen to invest in America, fifteen to twenty of my friends in the same field including myself are all having bad experiences and our companies are all making losses there."

8C.37 <u>Are the advantages for the ethnic Chinese to invest in China due to the bias of the policies?</u>

Peter's reply above seems to imply that the ethnic Chinese have had advantages of investing in China over other non-Chinese investors. Are these advantages due to the bias of the policies which favour the ethnic Chinese? Or are they due to other reasons? If the ethnic overseas Chinese (OEC) have possessed advantages over other investors, these advantages may affect their and other investors' choice of investment modes and/or JV partners in China. These points were discussed in Chapter 5 that cultural/behavioural factors can have emotional costs of running businesses. Silky's experience will lend empirical evidence to support or challenge the argument.

Peter stated that the Chinese government had set down various investment policies, which offer different types/extents of incentives to foreign investments according to their forms, locations and/or industries. The policies aim at attracting the preferred types of industries to the designated areas, and are not discriminating against investors' nationalities. The reason why OEC enjoy additional advantages over other non-Chinese investors is because of their knowledge of the Chinese language/dialects, customs, culture, people, and/or places, and also their personal contacts in the country. Any combinations of these factors will have positive impact on the costs of running business in China.

From the OEC's point of view, the psychic distance (see Chapters 4 & 5 for definition) that they are facing in China is shorter than the one they will have to face in other countries, such as America. For Peter and other HK businessmen, most of them have the actual and instinctive ability to speak the language/dialects, and to adapt to the business and legal systems much quicker than non-Chinese. Moreover, OEC may already have their family/business links built up in China. Their sources of information and help can be seen as more secured, wider and cheaper. These are valuable assets to support OEC to run businesses in China.

In addition, for Silky and other HK investors, they benefit further from the geographic proximity between China and HK. The short distance may mean lower transport costs of raw materials, finished products and personnel. It may also allow better control and support from the parent companies. The regular exchange of visits between the staff from

Silky's HK office and the Chinese factories facilitate a two-way communication and better co-operation between the two parts.

8C.38 Conclusion

The case materials have reflected that there is no universal system and method of control that suits every business in every country. It very much depends on the investors' own background, or in general what they are used to and know best. Silky's contrasting experience in America, Canada and China is a good example to illustrate these points.

Peter's confidence in the future of China was shown throughout the conversation. To end the interview, he put forward the following conclusion:

> "I think China's open-door policy is irreversible. The death of Deng in the future (at that time Deng was still alive) is likely to cause some changes to the political policies, but it will not significantly affect the economic reforms. The reforms will not go backward. I strongly believe that.
>
> So far I have not regretted the decisions of investing in China and getting involved in JV. I only have a few factories and so far each factory is doing well and making profit...
>
> Yes, I am always optimistic about the prospect of China... If there are future opportunities for FDI, I will invest in China rather than in America or Canada."

The Silky case study is ended here. The case is an interesting account of a HK-based firm's investment experience in China, Hong Kong, America and Canada. In the following section 8D, it records the last case study - Pearl of the series.

Case Study - "D"

Pearl Electronics Group

Map 8D.1 **The locations of Pearl's JVs in China and the Headquarters in Hong Kong**

*Pearl's wholly owned subsidiaries are all located in the Guangdong Province.

Source: Magellan Geographix[SM] Santa Barbara, CA (800) 929-4627 (1993)

8D.0 Introduction

The fourth and the last case study of the series is about a medium-sized[1] Hong Kong (HK) based electronics group - Pearl Electronics Group. Pearl manufactures personal and car audio systems, video players and satellite receivers. The company was founded by two partners in 1984 in HK, and it initially worked as subcontractor to produce "original equipment manufacturing" audio products. Along with the rapid growth of the business, Pearl began to invest in product designs and tooling, and started to manufacture its own branded products. Gradually, its scope of business extended to other electronics items, such as car audio and home video systems. Their main markets have been America and Europe.

Having grown into a substantial size, Pearl went public in 1991 and changed its registered address to Bermuda. However, it was stated in Pearl's annual report (1994:3) that the Group's head office and principal place of business remains in HK. The two founders have remained in control of the business and acted as Chairman and Vice Chairman of the Group. Up until the end of 1995, Pearl was structured in five divisions, and had eleven subsidiaries[2], as Table 8D.1 shows. The Group's production function was concentrated in China, and up until then nine production plants were established. Pearl's head office, the nerve of control, remains in HK.

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[1] The Group's consolidated turnover in 1994 amounted to HK$1,357,885,147 (1994 annual report, p.19). The official exchange rate has been set at HK$1 to US$7.8.

[2] There were in fact more than eleven subsidiaries recorded in Pearl's 1994 annual report. However, some of them were dormant investments with minimal capital, such as 2 shares of $1 each, and a few others were trading, investment, and/or parts/component supplying operations which worked under the main subsidiaries.

Table 8D.1

Corporate structure of Pearl Group

Pearl Holdings Limited

Video	**Car Audio**	**Audio**	**China**	**Others**
• #Pearl Video Mfg Ltd (Development, manufacture & sale of televisions and satellite receivers and investment holding)	• Pearl Car Stereos Ltd (Manufacture and sale of car stereo products & investment holding)	• Pearl Electronics Ltd (Development, manufacture & sale of consumer audio products & investment holding)	• Pearl (China) Investment Ltd. (Trading of consumer audio & car stereo products)	• Pearl Technologies Ltd (Development & sale of electronic components)
	• Pearl Car Security Appliance Ltd (Development of automotive security products)	• Pearl International Ltd (Trading of consumer audio & video products)	• *Pearl Northern Star (TianJin) Ltd (Manufacturing & sale of consumer audio & car stereo products and investment holding)	• Pearl Industrial Ltd (Manufacture & sale of plastic products & investment holding)
	• Dion Pearl Ltd (Manufacture car audio and related products)	• Pearl Hi-Fi Mfg Ltd (Development & sale sound systems)		

Source: Pearl 1994 Annual Report, p.7, 10 and 32 - 34.

#At that time, video production rented three floors of space and 540 workers of production capacity from an audio plant located in southern China.

*The JV employed approximately 300 shop-floor workers and 20 supervisors/managers.

8D.1 Background information about the interviewees and the case study

This case study is based on information gathered from three meetings (two interviews and one factory visit) with Pearl's senior managers, Sam Margarina, David Wong and Ming Chau, in October 1995, and the Group's 1994 annual report. Parts of the interviews were tape-recorded, and the richness of the discussion largely captured. A factory visit was included in the investigation, and the opportunity allowed me to obtain a deeper understanding of the company and its key personnel. During the factory visit, I met a consultant Paul Chan, whose company was appointed to help the video division to implement the ISO9000 international quality system in the plant. In our conversations, Paul provided me with further information related to Pearl's operations and other HK firms' experiences in China. This additional information was used to help the understanding and interpretation of the empirics.

Sam, the Managing Director of the video division, and David, the Production Manager and the right-hand man of Sam, are both young professionals[3]. Video division was formed in 1991. Up until the interviews, all video production relied on borrowing/renting three floors of factory capacity/space (there were four buildings on the site) from one of the audio plants. The rapid growth of the video division threatened the dominant position of the audio division. Moreover, the chairman's support, which authorised the video production to move into the audio's territory, caused resentment from the old guard of the audio division. Even as an outsider, I could sense the internal politics from the conversations with Sam, David and Paul. The experience gained from the factory visit helped me to understand the situation. For example, upon our arrival on the factory, David gave me a guided tour of the video production lines. While we walked passed a floor on the same building which was used for the audio production, David reminded me that I must not go into that floor as the Audio Manager would not be pleased to see video division's staff set foot on their territory.

Sam is Maltese and initially came to HK as a trade commissioner for the Maltese Government Development Agency. Through business contacts, he got to know the senior executives of Pearl, which led him to join the Group in 1993. In Pearl, Sam was one of the only two foreigners employed at the director level[4]. Sam is a marketing expert and he has

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[3] Who were in their mid and late 30s respectively at the time of the interview.

[4] The other foreigner was a technical director, who was in charge of video designs.

got a good sense of humour. David[5] is HK Chinese who is experienced in managing production in Hong Kong and China.

Also through this contact, I secured an interview with Ming Chau, the general manager (GM) of Pearl's TianJin JV. Since Ming resided in TianJin on a permanent basis, I was very lucky to get hold of him during his visit to HK. In terms of personality, Ming is a complete opposite to Sam and is a serious person. It was also a contrasting experience of meeting the three managers. The meeting with Sam and David was fairly informal and we chatted over lunch, while the meeting with Ming was held in Pearl's HK headquarters, and the interview was conducted in a very formal way. Ming did not have an office or a work base in the headquarters. We borrowed an office of another manager for the interview, as it would otherwise be impossible to hold any private conversation in such a busy office with an intense atmosphere - staff members were running around the central open planned office, and phones were ringing constantly. The HK headquarters were located in a factory building, "down to earth" is the most appropriate description to illustrate the style of the office and the attitude of the staff working there.

This case study combines the experience that I gained from the meetings with three fairly different characters, who were in charge of various parts of Pearl's operation.

8D.2 <u>What are the motives driving Pearl to invest in China?</u>

The motives, which drove Pearl to China, are indeed very similar to those discovered in the Silky case study. It was stated that the sharp rising labour cost, rent and shortage of blue- and white-collar labour in the 1980s were the main reasons that squeezed out production from HK. Manufacturing businesses, especially those in labour intensive industries, had no choice but to move their production to other lower cost bases, which were located at a convenient distance to enable management and materials support from the HK headquarters and delivery of the finished products to HK for re-export. Southern China turned out to be the place that many HK companies, such as Silky, SGP HK and Pearl, sought after. It is adjacent to the HK/China border and had a vast supply of cheap labour

[5]David is a friend of mine from university. The old link brought me an opportunity to meet Sam, who was described by David as a workaholic who would not have time to do anything outside work. After many attempts, one morning I got hold of David on the phone in HK (he travelled very often to the Chinese factory) to request an interview. Sam suddenly suggested to meet up in a restaurant for lunch that afternoon.

and land. Similar culture and common language/dialect in Cantonese added more attractions to the place.

Besides the above benefits, the incentives offered by the Chinese government were other attractions. For example, imported materials used in the production of export products were free from the import tax. It was an important consideration of FDI decisions in the 1980s, at which time quality of local supply of raw materials was largely below the required standards. Again, this example has illustrated that the choice of investment location has cost and control implications for FDI decisions. It is indeed part of the whole control package, one of the ideas underlies the skeletal theoretical model developed in Stage 1 of this research (see Chapters 6 and 7).

Sam further explained that the relocation of production base to China was corresponding to the company's low-cost strategy at that time:

> "You need to consider the pros and cons of investing in the country. Nowadays, there are very few places that you can compete in the market that we are in. China is one of the few places. Although we would not like to admit it, it is what we are. We are a company, which does everything to lower the production cost per unit and basically we sell on price. I think the company wants to change it, but I would say that in the past we sold on price. We tried to do the best price. The only place that you can achieve this objective is China."

Sam stressed that FDI decisions should be based on the reasons why you want to invest abroad. Whether it is because of penetration of the domestic market or cost saving, or a combination of both, will lead you to a final decision. David, the Production Manager of the video division, used an example to illustrate Sam's point of FDI decisions should follow strategies. At the time, Pearl was considering to make its first FDI in Europe, more precisely Malta, the home country of Sam[6]. The main reason behind this rather different idea was to avoid trade barriers imposed by some European countries on Chinese products.

> David stated, "the reason why we want to invest in Malta is because of the anti-dumping regulations in Europe. The European market has become more protective to local businesses, and they make it more and more difficult for Chinese companies to export certain products into the community. There are a

[6] The Group wanted to make use of Sam's knowledge of, and connections in, the country.

> lot of trade barriers. So we need to set up a factory somewhere else. We have had some reasons to go into China. On the other hand, we also have other reasons to go into Malta or other European countries. Because if we manufacture our products in Europe, there will be less trade barriers applied to us".

The importance of China was fully reflected from the Group's decisions to put all its production capacity in the country. At that time, Pearl had nine factories and all of them were set up in China. Eight plants were located in the Guangdong province, and only one subsidiary, the TianJin JV, was formed outside the familiar southern region (see Map 8D.1).

8D.3 <u>How has your company justified the risk of putting all FDI and the whole production base in China?</u>

> Ming replied that "I do not think that the political situation in China has caused too much uncertainty. From 1983 onwards, the party has shown our foreign investors a clear direction. You can say that the direction was not so obvious in the very beginning, it has however become clearer over time. China has been opened to the outside world for a period of time now. Although it is still called a 'communist country', a clear capitalist structure has been gradually built up within the communist boundary. As many people believe, China will not go back along its old route. Moreover, the intensified competition in the electronics industry, and the present economic development in HK, will not allow HK investors to withdraw our investments in China and go somewhere else".

Despite Ming sounding confident, in our further conversation he revealed that his company, and indeed many HK investors, have actually taken precautionary measures when approaching China. For example, he mentioned that:

> "The open door policy was introduced nearly twenty years ago. At the very beginning, the foreign investments tended to be small, and the investors were using small amount of capital to test the market. The investors then found out that the first year was okay, second year was fine, third year was also okay, and so on. Investor A looked at investor B, B looked at C, and they could see that most of the investors were actually doing well. The steady development is very encouraging and it has gradually built up our confidence."

In addition to employing a step-by-step, incremental approach, I found out from Sam that Pearl's senior management is generally risk averse. A way they adopted to deal with potential risks of investing in China is to minimise capital investment. Sam stated:

> "We actually have not owned any factory. It is quite easy to rent factory buildings in China. We never invest in property, because if anything unexpected happens in China, you cannot move the properties to HK. Basically, we invest in machinery and equipment, but not in properties. We rent all the buildings. The main reason is that should any problems arise, it will be easier for us to get out".

Pearl's pace of growth from a small factory into one of the largest car audio systems manufacturers in HK and China in just over ten years reflects the suitability of the low capital investment strategy. Reducing the need of raising big amounts of capital every time they formed a new plant enhanced the flexibility and speed of responding to the opportunities arising from the fast moving electronics market. It was a key reason to explain Pearl's rapid growth in the past.

8D.4 <u>HK firms are pseudo foreign investors in China</u>

Coincidentally, all three of the interviewees commented on the point that we could not see HK firms as real "foreign" investors, the same as American or European companies, in China. For HK firms, investing in China is very different from investing in other foreign countries in terms of geographic and psychic distance. Sam emphasised that there may not be a great deal of difference between China and other Southeast Asian countries in the eyes of the real foreigners. All these countries are foreign to them. However, from a HK investor's viewpoint, it is a different story in FDI decisions. Sam continued to state that:

> "For the directors and shareholders of Pearl, setting up a factory in China is something natural. They have done it so many times and they know how to do it. You can see that when we consider setting up a factory outside China, we are full of uncertainty.. Just because we will go into an alien environment and you are unsure of a lot of things. You are afraid of the distance, culture and management, all of these things. For our Group, to set up a factory in China is different from setting up a factory outside China, as China is part of us. We do not face the same types of problems that other real foreign investors do. I think that you have to make a distinction between HK and other foreign investors."

I also mentioned in the interviews that other countries in the Pacific Rim, such as Thailand and Indonesia, also offered incentives to foreign investors, Ming's immediate reply was that from the HK investors' point of view, they would encounter language and cultural differences in these countries. Also, productivity in these countries is not any higher than China. On the other hand, the increased geographical and psychic distance would mean extra costs on management and resource supplies from the HK parents. These are reasons why China is seen as more attractive than other Asian countries in Pearl and many other HK firms' FDI decisions.

8D.5 <u>How do you see the development of the legal system in China? Has it increased the risk of FDI?</u>

Although significant improvement has been made recently, the executives considered that the current legal system remains underdeveloped. Ming described that the Chinese government is heading in the right direction and they are very humble to learn from other countries. However, the whole process to develop a proper legal environment for both local people and foreign firms to work and stay in in China will take a long time. In this transitional period, investors have to deal with the particular environment highlighting the current state of development of the country.

Ming stated, "the incomplete legal system is definitely a bad thing". The executive expressed a strong feeling against those people, who try to take advantage of the loopholes presented by the underdeveloped legal and social systems in China. Sam agreed with Ming on the point that the lack of proper policies certainly increases the risk of investing in the country. It is the reason why Pearl has tried to avoid investing in properties in China. However, one of Sam's comments contradicted Ming's point above, and revealed that Pearl is indeed one of the companies, which are taking advantage of the country's low living standard and inadequate legal system to protect local workers.

> "It sounds really bad, but fundamentally we are exploiting the cheap labour in China. For example, if we need our workers to work fifteen hours per day, we do not have to go through the union or any local authority, at least up until now. If we require our workers to work on Sundays, we just ask them to do it. Although it becomes more difficult, as the government is trying to stop local people working seven days a week, but you can still do it. Just imagine if you do the same thing in Europe, no way".

A new labour law was just introduced in China at that time. The government gave foreign funded firms a grace period of two to three years to change their operation into five-day week. When the policy is fully implemented, it will bring a significant change to the local industries, as the majority of them are in labour intensive manufacturing businesses. Until the time of the interview, the new labour law did not cause too big a controversy. It was because many investors, such as Sam, believed that the Chinese government would buy into the power of the foreign investors, and they would not enforce the policy regardless of the consequences on the local economy.

> "The government has no alternative but will keep extending it (the grace period), if they want FDI. But I would say as the Chinese economy develops, it naturally becomes more difficult to ask people to work for such long hours. They will not accept it. When you achieve certain income, you will start to talk about the quality of life. For example, fifteen years ago the HK people just closed their eyes and worked. Now you have unions, you have strikes and you have complaints from workers. Most of our competitors have offered five-day week working conditions (in their HK offices) to keep their staff. If you want to see how China will develop in the future, you can look at other places in the world. They are going through exactly the same process".

8D.6 Criteria and decisions of forms of FDI

8D.6.1 Criteria of and decisions behind forming seven wholly owned subsidiaries

Out of Pearl's nine production plants in China, seven of them are in the wholly owned form and two are JVs. Sam stated that normally a firm would invest in JV, if it believed its partner would bring something to the venture that was useful to them. However, in most part of the last decade, there was no firm which could offer any particular advantages to Pearl. As was mentioned in section 8D.3, a way Pearl used to deal with the potential risks of investing in China was to reduce heavy capital commitment in its FDI. They rent buildings and land to perform mass production of low-cost items. The majority of outputs have been used for export to the American and European markets. According to the Chinese Law, imported materials used in the production of exported items are exempted from import duty in China. Based on the investment objectives and strategies held at that period of time, Pearl had no real needs to acquire JV status and get other partners involved in its FDI in China.

8D.6.2 Forming a JV with Dion, a leading Japanese electronics group

It was a very different story in two recent JV investments. One of the JVs was formed with a leading Japanese electronics group, Dion, in 1994. It was a 51% and 49% equity co-operation between Dion and Pearl respectively. The motives which encouraged Pearl to choose this rather unfamiliar channel were that the JV with Dion would enable Pearl to get access to Dion's advanced manufacturing technology and a new market in automotive security. Started from the early 1990s, Dion was facing problems of high production costs in Japan. Competitive pressure drove them to consider investing in China. Nonetheless, the alien environment in China, which meant a high risk to bring into the country new product designs and production technology, encouraged Dion to find a companion to guide them through the first FDI. Pearl's rapid growth in the electronics field drew Dion's attention and all these factors brought the two partners together to form a JV in southern China.

In our discussion, Sam and David repeatedly stressed that many foreign investors feel uncomfortable to go into China on their own. They do not have clear ideas of what to expect and how to prepare. Because of that, many of them prefer to partner with the HK entrepreneurs, who have the knowledge of dealing with both the East and the West. It was what Dion did. These factors seem to be able to explain why JV has been the dominant form, and why HK is the main source of FDI in China (see Chapter 3). Throughout the interview, Sam fully demonstrated his sense of humour and used a funny example to explain why foreign firms prefer to use JV:

> "It is because there is no system in China. Foreign investors do not feel comfortable to go into China on their own because they come from a more structured environment. For example, at home if your customers do not pay you, you can take them to the court. It is simple and clear. If your customers in China do not pay you, what can you do? If you go there to chase after the payment, they may kill you. If people suspend my money in China, I would not know what to do. Where should I go and how can I handle it? Should I approach the police? No way, the police station is perhaps the last place that you want to go".

8D.6.3 Forming JV with Northern Star, a local producer and distributor in TianJin

Interestingly, Pearl's second JV was a very different investment from the one with Dion. This JV is formed with Northern Star (hereafter called NS), a local Chinese producer and distributor, and the plant is located in TianJin, Pearl's first FDI outside southern China. According to Pearl's long-term plan to penetrate the Chinese domestic market and gradually change their strategic direction from being a follower to become one of the leaders of the field, the senior management decided to diversify their focus of location. In fact, it was mentioned in the Chairman's Statement of Pearl's 1994 annual report (p.10) that using JV was the Group's strategy in response to their long-term plan:

> "...continues to pursue joint venture opportunities with right strategic business partners to expand production capacity in China, and to improve the Group's overall profitability by further reducing reliance on the HK operations."

To date, FDI, especially those in the electronics industry, are highly concentrated in southern China. Popularity of the area as a FDI spot has inevitably led to high inflation. The rising living standards in the south will soon force foreign investments to move up midland or the north of China. The senior management of Pearl believed that TianJin would become the future industrial centre of northern China. The assumption is based on the fact that TianJin was a major industrial city and it has the expertise and industrial foundation. Pearl's senior management wanted to make inroads for the Group's future investment in other parts of China, and take positions themselves before their main competitors get there. They were the main reasons why TianJin was chosen.

However, China is a big country. Going into a new province creates uncertainty and thus risk. Pearl's foothold was established in southern China. For the first investment in the north, the Group decided to do it through the JV route. It was seen as a mechanism to share cost, expertise and risk. Pearl acquired 55%, while the Chinese partner obtained 45% of equity stake of the JV.

8D.6.4 Video division

At the time of the interview, Sam's video division planned to set up a production JV in China, as soon as a suitable partner was found. Initial contact and negotiation with potential candidates was underway. This plan was a response to the Group's overall strategy. Indeed, from the personnel's point of view, Sam and David were very much hoping to get their own JV plant set up as soon as possible. They both saw it as the best tool to expand the division and gain a sense of independence, since they were under the roof of the audio division at that time.

8D.7 How was the Chinese partner of the TianJin JV identified?

Once TianJin was selected, the next step was to look for a suitable local candidate. While Guangdong province is flourishing with thousands of FDI due to its proximity to HK and Taiwan, many industries in northern China have been facing recession in the past ten years or so. Many state-funded enterprises are losing money and some are forced to shut down. Only a small number survive and continue to struggle, as losing money means no more funds are available for modernisation, and old facilities will not produce good quality products to attract business. For the survivors, they are very keen to form JVs with foreign firms, as it is perhaps the only way to turn around their businesses.

Up until then, Pearl's FDI were all located in southern China, and they did not have immediate contacts in TianJin. However, the partner NS is a reputable firm, which has a long history in the electronics industry. They have the expertise to run production and have established networks for local distribution. Their resources were considered as complementary and would be valuable to Pearl's future development in the region. When Pearl made the initial contact, NS was very keen on the idea and the whole negotiation process only took half a year to complete.

8D.8 Did Pearl encounter any particular problems in the negotiation and formation process?

Ming was the GM of the TianJin JV and naturally he had the first hand information about this venture. As I mentioned earlier on, Ming is a serious person. He stated a couple of times that he would only talk about the TianJin JV, not the Dion one, as he was not involved in any aspects of the Dion's operation. From Ming's reaction and the rivalry relationship between the management of the video and audio divisions, I could sense that a strong territorial culture existed in the company.

Ming stated that the duration of negotiation varies according to the size of the JVs. The TianJin JV is only a small investment[7], the whole negotiation was fairly smooth and short. The major problems they encountered were related to NS's inability to raise capital. Both

[7] With an initial capitalisation of US$2.5 million.

parties agreed on a 55% foreign ownership structure. However, NS had difficulties to raise enough funds for the proportion of equity they wanted to acquire. NS had gone through a lot of troubles before the required amount of capital was obtained. Ming mentioned that it is a typical scenario facing many Sino-foreign JVs. The Chinese partners often cannot afford to pay for their share in the JVs, and the situation usually forces them to accept a smaller equity holding.

8D.9 <u>How was the decision of 55% and 45% equity structure arrived?</u>

> Ming stated, "our Group aimed to gain the majority control of the JV, therefore we decided to acquire at least 50% of the equity".

Ming's reply above seems to indicate that the control they gained in the JV is equity related.

8D.10 <u>Why is the majority control so important?</u>

> Ming continued, "the main reason why the state owned enterprises are so keen on forming Sino-Foreign JVs is that they can learn and utilise foreign investors' management techniques, technology, information sources and capital. If our foreign investors need to inject these resources into the JVs, how can we do it without holding the majority control of the operations? If we need to invest our resources into the JVs, we want to have the majority control. Indeed, our Chinese partner is more than happy to let us acquire the majority shareholding".

Owing to lack of capital and experience in the international business, the Chinese counterpart willingly took up a minority position and supporting role. Their key objectives to get involved in a JV relationship were to turn around their business and learn as much as they could from the foreign investor. Despite taking on a supporting role, NS's views would not be ignored. They would have their say in the partnership:

> "If NS has any queries about our decisions, they can raise it as they have the right to speak on the JV Board meetings. They can disagree with our proposals. But so far they seem to be happy with our decisions. The JV GM is also accountable to the Chinese partner, they are one of the owners". Ming explained.

In the interview with Sam and David, I asked them about the 49% minority equity position that Pearl has taken up in the Dion JV. The supporting role they played is very different from the dominant control policy, which has been commonly applied to Pearl's other FDI, which included the TianJin JV. Sam stated:

> "Obviously, if you are a minority shareholder, there is always a concern on the issue of control. But at the same time, we are confident that we can manage the relationship. There should be no problem. Our ultimate aims are to assist Dion to (a) penetrate the China market, (b) manage and run a factory in China. The Chinese JV is a very different operation from their factories in Japan".

The above reply shows that the decisions of investment mode and control are very much determined by individual partners' investment objectives. As Yan and Gray (1994) suggested, the bargaining relationship between partners depends on who brings what to the JVs. In the Dion JV, the Japanese partner is a bigger contributor of resources, and thus it seems logical to let them take the leading role. The benefits Pearl received compensate the dominant position that they have conceded. The same explanation can apply to Pearl's TianJin JV. As Ming said, if they needed to inject various types of resources into the operation, they would not have done it without a bigger say in the JV.

8D.11 Have your company worried about the risk of dissipation?

Relatively speaking, JV was not a popular entry mode in Pearl's past FDI decisions. Given that they are operating in the electronics industry, I am interested to find out if dissipation is an issue which affects Pearl's confidence in using JV.

> "No, I do not think so. It is because real high technology does not normally exist in the HK industries. New technology always comes from Japan, Germany and America. HK firms often pick up the new ideas developed by these leading countries. It is uncommon for the HK electronics industry to have real technological secrets, and therefore we do not need to worry too much about it". Ming replied.

8D.12 Target market of the TianJin JV

As with other subsidiaries of the Group, most of the outputs from TianJin were used for export to the European and American markets. Domestic sales in China only accounted for a very small proportion of the Group's consolidated turnover[8]. Although one of the JV objectives was to establish a distribution network in the north, domestic sales was not top of the agenda at the initial setting up stage. The JV was due to set up its own marketing and sales department in the near future. Up until then, its sales were handled by the HK

[8] China domestic sales only accounted for 4% of the Group's turnover in 1994.

head office. Ming provided an explanation for the Group's slow progression in the domestic sales:

> "China is a very potential big market. However, it is short of cash. If you want to sell your products in China, your investment has to be large. It is because there is a fair chance that you won't get paid. Bad debts can be a huge single expenditure that ties up most of your capital. It is easy to sell, but difficult to collect payment. Our Group understands this point very well. Therefore, we do not want to expand the domestic sales too fast before the time is right... Our focus is still on expanding the export businesses".

The Chairman's Statement in Pearl's 1994 annual report (p.10) indicated that the Group adopted a cautious approach towards the Chinese domestic market:

> "During the year under review, China sales had a satisfactory growth but still accounted for only 4% of the Group's consolidated turnover. Notwithstanding the Group adopts a cautious approach towards the economic development in China, it is generally accepted that China represents a market of significant potential. Inroads have already been made to establish an extensive sales network in the country... Although the business in China only represents a small portion of the Group's sales at present, the Directors are confident that the Group is well positioned to take advantage of an improving China market in the future".

8D.13 <u>Management structure of the TianJin JV</u>

Pearl appointed the Chairman, and the Chinese partner assigned the vice-chairman to the JV Board. Operational control rests with the GM, Ming was the current JV GM appointed by Pearl. There were approximately three hundred workers and twenty supervisors employed by the JV at that time. Pearl appointed both the GM and the deputy GM, and the two managers were transferred from the HK headquarters. Supervisors were recruited locally by the GM. A few of these local supervisors had worked for the Chinese partner, and they stayed on after the JV was formed. This group of staff had good knowledge of the plant and the business, they have been a big help to assist new staff to run the JV.

8D.13.1 <u>Have the existing and new staff/supervisors integrated into one team now?</u>

It was a follow-up question of the discussion above related to human resource policy and management structure. Ming gave an unexpectedly strong reply:

> "I cannot say whether they are getting on harmoniously or not as everyone has their own thinking, previous working experience, and educational background. But basically they are under the control of our HK headquarters, and we have the authority to replace them at any time. Therefore, if they do not listen to us, the likely result is that they will be forced to leave the Group".

Whether it is a natural development or buying into the power that the supervisors and managers in the TianJin JV work together as a team, I better let the audience make up the conclusion. Basically, throughout the three meetings with the executives, I detected that a highly centralised control has been adopted in Pearl. An authoritarian management style has been commonly used from the Chairman to functional head levels. There is plenty of evidence embedded in the case study. Ming's strong reaction is a valid example to illustrate the authoritarian culture of the Group.

8D.13.2 Quality of the local workers and managers

Interviewees' reactions, as with discoveries from the conversation, can be unpredictable. It is a merit but also difficulty of using case study, which enables/requires researchers to feel and deal with the empirical dilemma first hand. In order to ease Ming's tension, I quickly moved on to another topic about the quality of local workers and managers.

Based on his ten years[9] of experience working in China, Ming criticised the overall standard of workers in southern China as being poor. Most of the workers there were originally peasants. They have received little or no education. What they know about production and business is built on a couple of years of working experience on the production lines. To train and manage this group of workers requires a particular set of control processes and systems. When I visited the video plant, I saw the set of control systems and processes that David adopted, and the difficulties that he encountered in the process of implementing the ISO9000 international quality standards.

For example, as some of the workers are illiterate, most of the instructions of work and safety procedures are put in diagrams and pictures. In the past, some foreign visitors complained that there were few written instructions given to the workers. Sam was used to answering back - "Hey, the workers cannot read, what do you expect?" Using this example, Sam further illustrated why JV is a suitable entry mode for foreign investors.

"Including myself, many of us (foreigners) have never thought about that before. We usually come to China with an expectation that everyone can read and write. We assume that it is the basics, the minimum. However, the fact is that many people in China cannot read or write. It is another reason why it is important to get the local expertise".

Since David joined the video division six months prior to the interviews, he worked with the new quality assurance manager to redesign training, work procedures, production flow and layout of the factory. For example, to overcome the problems caused by illiteracy, David put most of the instructions in diagrams and pictures. To overcome the lack of initiative, which characterised many peasant-turned-industrial workers who were not used to pressure, an hourly output count was introduced. Line supervisors went round to check and sign production sheets of their workers hourly. Pass and reject rates of each production line were advertised on a big performance chart of each floor. Workers and supervisors of the bad performing lines were put under spotlight. Losing face and the possibility of losing their jobs exerted pressure to urge them to improve performance. It was an effective way to increase self-awareness, accountability and productivity. David said that to manage this unique environment, you need a particular set of control tool-kits.

Now the discussion goes back to Ming's last point on the differences in production control in northern China. The overall standard of workers, in terms of education and living standards, is higher in TianJin. Generally, those who are currently at work should have already received some career training. Therefore, in terms of technical knowledge of performing daily tasks on the production lines, the majority of these workers have no real problems. However, the main problems with training and managing workers in the north tend to be related to the people's attitudes and mentality. The culture in northern China is generally more conservative and underlined by a stronger communist mentality. Many people still feel strongly about serving the party, and the life-long job security provided by the government. Foreign investors have to deal with the legacy left behind from the old days. According to the culture and the overall environment in TianJin, Ming has chosen to use a hard-line management style and system, like he said:

"It will take a long time to change their mentality, if it is possible at all. Our foreign investors need to brainwash give them in order to get rid of their old

[9] Ming joined Pearl in 1992 and before that he had been working for another similar company in China for 7 odd years.

communist thinking. We need to inject some basic business concepts into their thoughts".

Ming stated that the potential of the local managers is good. The long industrial history in the north has cultivated a group of capable managers, who are knowledgeable in the technical side of the business. However, these local managers share the common problems with the shop-floor workers. To work in foreign operations, the local managers need to be perceptive to change, and become more business and customer orientated.

Throughout the three meetings with the executives, they all repeatedly stressed that foreign investors should not directly transfer the whole set of management methods and strategies from home to China. They are inappropriate to deal with the local partners, workers or customers. The business environment in China is unique at each stage of the country's economic development, thus tailor-made control processes and systems are required.

8D.14 <u>How would you describe your management style?</u>

To follow up the above discussion, I asked Ming to further explain his management style and strategy. He stated that:

> "We are using a pyramid hierarchical management approach. I only need to control one or two senior managers in the JV, and they are responsible for training and monitoring performance of their subordinates. I will not directly control the shop-floor workers. It is the managers' job...
>
> I can see their performance from the daily output. If the quantity and quality of outputs is stable and good, and the turnover of workers is low, it means that everything is under control. If there is anything special, the managers will report to me immediately...
>
> We have to use this type of approach to control our investments in China".

From what I saw in the factory visit, the video production is also using this so-called pyramid approach to control the local managers and workers. For example, the plant manager, Hong Chen, is in charge of the whole video production, and he reports to David. Under Hong, there is a local quality assurance manager, Ling, helping David to implement the ISO9000 systems in the plant. Hong and Ling are the two key staff members in the factory that David directly controls and communicate with. He would not interfere with how Hong runs the factory, provided the performance is steady. Both Ming and David considered that it would be more appropriate to use local managers to control local workers.

8D.15 <u>The extent of autonomy granted to the GM of the TianJin JV</u>

The JV GM is given a large extent of autonomy at the subsidiary level. Through the annual budgeting exercise, the headquarters provide the JV GM with general guidelines, in terms of the Group's long- and short-term strategies, and availability of resources. According to this framework and the specific environment in China, Ming would then develop strategies and policies for the JV. In general, the HK headquarters will not interfere in the day-to-day running of the JV, unless they feel that the progress differs from what they expect (management style of the senior executives will be discussed in section 8D.16, 17 and 18).

In the first two years, TianJin's sales were mainly handled by the marketing and sales department in the headquarters. Thus, the responsibility of setting prices was shared between the HK office and Ming. When the JV's own marketing department is up and running, Ming will resume a full control of this aspect. In theory, it is the GM's job.

> "Indeed, it is not possible for the Group to set prices for us. Prices are determined by many factors and market is the strongest driving force for the pricing decisions. If the market can only afford to pay $10 per unit of your products, and our parent insists on selling them at $12 each, we would not be able to do it. We can only set prices according to the market and I am in a better position to understand the market and the cost of production." Ming said.

8D.16 <u>The roles played by the HK headquarters and the TianJin JV</u>

Ming said that the TianJin JV is defined by the head office as a profit centre. The profit responsibility seemed to contradict the "build" mission/strategy that the JV is given (Govindarajan & Gupta, 1985). Anyhow, I decided not to interfere in the flow of discussion and question the apparent contradiction at that point.

Ming continued to state that he had a great extent of operational autonomy, except in one area. The HK headquarters centrally controlled the accounting and finance functions of all the subsidiaries. Senior management in the head office holds a tight grasp on spending in, and resource allocation to, the subsidiaries (see section 8D.18). The accounting department in TianJin JV plays a record-keeping role. They produce a set of accounts, profit and loss, balance sheet and cash flow statement, for the HK headquarters on a monthly basis for consolidation and control purposes (see section 8D.19).

8D.17 The roles played by the HK headquarters and the video division

Sam mentioned that the video division did not directly deal with the money they spend or earn. For example, at that time they borrowed/hired three floors of production capacity from the audio plant. The audio plant acted as a sub-contractor and they absorbed all the material and overhead costs that were incurred in the video production. In return, the video division paid them a sub-contraction fee per unit of output they produced. Money involved in the intra-group dealings was dealt with by the headquarters. No money physically changed hands between the divisions.

On the other hand, any expenses that the video division spent on buying tools for the factory or travelling expenses for David and the visitors needed to be approved by the centre or by Sam. As the Director of the division, Sam was only given the authority to approve small amounts of operational expenses. Tight financial control has been widely applied in the Group.

8D.18 Centralised parental control

Throughout the meetings with the executives and the factory visit, I could hear, feel and see the extent of tight parental control exercised by the HK headquarters, more precisely, by the two Chairmen. The two founders of the Group, Mr. Leung and Mr. Lin, have remained in full control after the Group went public in 1991. Although both of them are engineers and ethnic HK Chinese, Mr. Leung has a more outgoing personality and he is very good at handling customers, especially the foreign ones. Based on this background, Mr. Leung has overseen sales and marketing functions of the Group.

On the other hand, Mr. Lin, a strong but rather introverted character, has looked after the production side of the business. Although Pearl has grown into reasonable size, Mr. Lin is reluctant to delegate power down the hierarchy. Any slightly important decisions need to have his approval. Owing to an increasing size of the operation, Mr. Lin is overloaded with both important and trivial operational matters. He keeps forgetting things that managers tell or ask him. To certain extent, efficiency of the Group is hindered by the highly centralised control.

Mr. Lin's interference has also undermined the divisional heads' authority. Mr. Lin does not speak English and he feels uncomfortable to deal with foreigners. Due to a combination of these factors, he does not like Sam visiting the video plant. Mr. Lin has considered Sam's visit to the factory as a waste of time. Firstly, Sam is not an engineer, and secondly he cannot speak Chinese and is unable to communicate with the workers. Sam is better off to spend time on getting more business for the division. For that, Sam has to rely on David to act as a middleman between himself and Mr. Lin.

For example, the main reason why David went to the factory on the day of my visit was to persuade Mr. Lin (he also visited the plant that day) to allocate more workers to the video production. They had a few important Christmas orders that must be delivered on time. As was mentioned before, the video was sharing the audio plant's facilities at that time. The Audio Plant Manager resented the headquarters' decision and he was hostile towards David and Hong, the video plant manager. Requesting more workers would certainly cause further grievance from the Audio Manager. David needed Mr. Lin's permission and backup. One may wonder why the Vice-Chairman is involved in recruitment and allocation of workers. It is the way in which Pearl is run, and it is the prevailing management style of the Group. As David said, it was a way of life and they were used to it.

Despite the current management system and style adopted by the headquarters demonstrating many weaknesses, David sees that it has one advantage. The decision making channel is short and direct. When David seeks approval, he only needs to approach one person. From this perspective, it is a fairly efficient decision-making mechanism.

8D.19 <u>How often does the TianJin JV report to the HK headquarters?</u>

All Chinese subsidiaries, both wholly owned and JV, are required to report different types of information to the HK headquarters on a daily, monthly[10], and annually basis. The daily fax report covers production information, such as daily output, pass and reject rates, and

[10] Except the video division. Since they used the audio plant as their sub-contractor, operational expenses that were incurred in the plant were absorbed by the audio division and were included in their monthly financial reports. At that time, financial matters of the video division were handled by the accounting department in the headquarters.

the progress of various orders. Since the TianJin JV's sales were handled by the HK office, the sales teams in HK needed to know the progress of their orders. Mr. Lin, the Vice-Chairman, has been very keen to keep a close eye on all aspects of production. Questions will be asked, immediate actions are required, and direct interference from Mr. Lin is expected, if production progress shown on the daily reports is considered as "abnormal".

The monthly reports include both financial and management information. The TianJin JV provides the head office with a set of financial accounts for consolidation and performance control purposes. In addition, the JV is required to prepare monthly reports to show general business and management development.

Budgeting is a yearly exercise. According to the headquarters' long- and short-term strategies and yearly budgets, the GM designs and implements operational strategies for the JV. For example, at the time it was Pearl's strategy to reduce the overall production cost and make inroads in China to facilitate the Group's future development in the country. Based on this framework, the JV needed to develop its own strategies, such as searching for, and building up, a cheap and reliable local supply of raw materials, building up a strong relationship with important customers and local authorities, and establishing its own marketing and sales function, in order to achieve the Group's long-term goals. In the JV's monthly report, it had to illustrate the progress of business development with the identified important parties.

In addition to written reports, there is very regular telephone and fax contact between the TianJin JV and the HK office. Although it was not on a daily or weekly basis, Ming travels to HK several times a year. Face-to-face discussions and exchange of information is possible during his visits to the headquarters. At the time of the interview, Ming just returned to HK for a longer stay. The headquarters sent a deputy GM to TianJin to release Ming to go back to HK to finish off some duties for the headquarters. The deputy GM brought with him instructions from the Chairmen, while Ming would discuss with the Chairmen the major problems that he encountered in TianJin (see section 8D.24). Ming could also collect any information that he needed during his visit to HK.

The reporting systems and other mentioned channels form a two-way communication mechanism between the HK office and the JV, as shown in Figure 8D.1.

Figure 8D.1

Two-way communication mechanism between the HK Headquarters and TianJin JV

HK Headquarters

↑	↓
- Daily contacts via telephone & fax	- Annual budgeting exercise
- Daily and monthly written reports	- Senior executives' personal visits to the JV plant
- Production of operational strategies	- JV managers' personal visits to the HK headquarters
- JV senior managers' personal visits to the HK office	- Daily contacts via telephone & fax

TianJin JV

8D.20 The currencies used for reporting purposes

HK dollars (HK$) and the Chinese currency RMB are the main currencies used in reporting from the Chinese subsidiaries, wholly owned and JV, to the HK headquarters.

8D.21 Which party is responsible for any foreign exchange gains or losses?

As the TianJin JV's products are mainly used for export, I was intrigued to find out which party was held responsible for any foreign exchange gain or loss. Ming revealed that:

> "US$ has actually been depreciated against RMB in these few years. It was US$1 to RMB 8.8 - 8.9 not long ago. The exchange rate now is down to RMB 8.2 - 8.3. It has affected our total income".

If the JV income has been adversely affected, which party is accountable for the losses? In a profit centre, it seems natural that the JV GM will get the blame.

> "I cannot control the exchange rates and they are influenced by the world economy, government policies, and many other factors. Therefore, I should not be held responsible for the losses. However, if I foresee a loss due to a foreign exchange fluctuation, I will inform the HK headquarters in advance and let them prepare for it". Ming replied.

At that time, the TianJin JV's sales were handled by the HK office. The sales department would take into account exchange rate fluctuations when they set foreign currency selling prices to customers.

Internal management reports are prepared in HK$ and RMB. Subsidiaries and their managers are assessed according to performance in both currencies. Since the HK head office holds full control of the subsidiaries' accounts and financial functions, production of financial reports for external reporting purpose rests in their hands. Any profits or losses that arise in translation of foreign currencies into HK$ are absorbed by the Group. It was stated in attached notes of the 1994 annual report (p.26) that:

> "Transactions in foreign currencies during the year are converted into Hong Kong dollars at the rates of exchange ruling at the transaction dates. Exchange differences are dealt with in the profit and loss account.
>
> The financial statements of overseas subsidiaries are translated into Hong Kong dollars at the approximate rates of exchange ruling at the balance sheet date. Exchange differences are taken to an exchange equalisation reserve".

8D.22 <u>Have the subsidiaries encountered any particular difficulties in the foreign exchange control or movement of funds in China?</u>

Similar to the comments expressed by the interviewees of the other three case studies, neither Sam nor Ming personally experienced or had heard of any particular problems, which are related to foreign exchange control or movement of funds, that hindered the Group's business activities in China. The majority of Pearl's production is for export purposes. Therefore, balancing foreign exchange has not been a problem to them. In fact, along with the progress of the economic reforms, the Chinese government has gradually relaxed their control on foreign exchange.

8D.23 <u>How is the performance of the TianJin JV being evaluated?</u>

Performance evaluation of the JV is based on the investment objectives of why it was founded, which were to build a base in northern China to support the Group's future investment in the region. According to the JV mission, the headquarters focus on the JV's operational performance, such as whether the production is running smoothly, whether quality of the products is up to the required standards, if the local supply of raw materials are reliable and economical, whether contacts with the important parties are built up, and whether the management systems and processes used in the JV are appropriate.

When I mentioned that most of the performance criteria seemed to be difficult to quantify and measure, Ming immediately gave me a number of examples to illustrate the feasibility of using these criteria:

> "Actually, all these aspects can be measured in different ways. Our products are mainly for export, all items have to be tested and approved by internal QC (production report is sent to HK head office on a daily basis). When our customers receive their orders, they will give us an acceptance report if the products meet their requirements. Customer satisfaction and market response are clear indicators of performance. The products manufactured in our JV are highly rated within our Group. It proves that TianJin has got a good industrial foundation and higher quality workers to produce good products. However, the problems we face in TianJin are high production costs and long lead time".

8D.24 <u>What are the problems in TianJin?</u>

The reply above suddenly opened up a new topic for our discussion. What are the problems in TianJin? It was explained that the root of the problems is the backward investment environment in TianJin. The city was once a major industrial centre in the 19th and first part of the 20th century. A relatively better industrial foundation was laid down. However, there has been not much development since that point of time. There was little government investment in the region, as all attention and resources were drawn to Guangdong, the coastal areas and Shanghai, the favourite spots for foreign investment. It was only until the early 1990s that some foreign investments were attracted to TianJin. This relatively small amount of foreign interest cannot rectify all the problems caused by lack of investment in the region over the past few decades. The business environment is generally poor.

The TianJin JV encountered difficulties in getting raw materials, components and sub-contraction[11] facilities that were needed for production. They were either not available locally, or the local supplies were either not up to the standards or too expensive. Because of that, in the first two years the JV largely sourced from southern China and/or from HK. Relying on supplies from the same sources as other Pearl's factories located in Guangdong

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[11] As discussed in section 8D.3, Pearl's overall strategy in China has been to minimise capital investment. They rely heavily on sub-contraction, since it is a way to reduce investment on expensive machinery and tooling.

contradicted the JV's investment objectives, which were to establish a base in the north and reduce the extent of reliance on the HK operations. Also, delivering materials and finished products between TianJin and southern China/HK and relying on the underdeveloped transport systems in China inevitably inflated the production cost, lengthened the production lead-time and reduced the flexibility. For small to medium sized FDI which rely heavily on external support, it is very difficult for them to operate successfully in northern China.

Finding the challenge tougher than expected was by no means easy for the headquarters and the JV GM to face up, as a comment Ming made indicates:

> "Our original plan was to have ten production lines in TianJin. It was our original plan, it was an ideal plan. However, we have not received enough orders and production has had to be cut back. There is a worldwide drop in demand for audio products. The plan is only a document, but we have to face the reality. They are two different things."

One may argue that if reality turned out to be very different from the original plans, it reflects the management's inability to forecast and control the sales and the business environment. Also, using the ideal type of standards in a new venture seemed to be inappropriate. However, Ming said that they kept a close eye on the market and updated their plans on a regular basis. The conflicting information made me suspect that the headquarters might have originally set down very optimistic targets. Hence, although the JV gradually cut back the size of production, the capacity still exceeded the level of demand that existed in the market at that time.

In the following discussion (section 8D.25), Ming indicated that he had talked to the headquarters about the specific problems in TianJin and the unrealistic plans they had worked on. However, the senior executives stuck to their original ideas.

8D.25 <u>Has the experience affected the Group's decision to explore northern China?</u>

> Ming answered, "it has affected mine, not the Group's decisions. Pearl knows that at the current stage of development, the business environment in TianJin would not be ideal. It is a long-term strategy to go into northern China before our competitors...

> I submitted a report to the headquarters some time ago and advised the Group to stop any new investment in the north. From my personal point of view, I feel that our Group has made up its mind to invest in northern China a bit too early at this stage. I also feel that we have made the move too rushed without proper planning. I do believe the potential of northern China in the future. But it takes time to build up a proper investment infrastructure in the north".

I could sense the bitterness from Ming's words. It is the beauty of using case study and personal interview. Researchers can hear and feel the empirical reality. The richness could be lost if a survey method, such as questionnaire, was adapted. From the Pearl Group's point of view, forming the TianJin JV was not seen as an inappropriate decision. The JV has adapted slowly to the local environment, established its foothold, and identified some reliable local suppliers and sub-contractors. From the JV GM's prospective, Ming saw that his operation could have done better if it was not located in the so-called bottleneck area. Ming was disappointed by the small pay-off from the huge amount of effort that they put into the JV. Also, the pressure was enormous being the head of the only loss-making subsidiary within the Group.

8D.26 <u>Have the initial results affected the partner relationship in the TianJin JV?</u>

In terms of co-operation between partners, there have not been major issues. The Chinese partner, NS, is willing to take on an assistant role in the partnership. However, there was tension in the relationship owing to the fact that NS ran out of funds to allow the slow progress to continue. Ming stated:

> "Our Chinese partner is not short-term profit orientated, and they are also looking for long-term prospects. Having already lost that amount of money, I believe that they will not quit now. The problem is that NS cannot afford any more losses and they have already requested to reduce their equity stake (sell their shares to Pearl) to cover the extra capital required. They do not have the money to further invest into the JV... Since our JV is making losses in both the first and second year, it is very difficult for NS to apply for more funds from the government authority...
>
> The problems are mainly due to the investment environment rather than the co-operation between partners. The environment in TianJin is a bottleneck. Indeed, these are the real dilemmas recognised by both partners, and they have to be resolved gradually".

In the last three case studies, what I heard from the interviewees was mostly good experiences and results in China. The above discovery was unexpected, and it provided a contrast to the rosy stories that I came across so far. The findings shed light on the types and extents of difficulty of working in different parts of China.

8D.27 Performance measurement of the JV managers

It was disclosed that the managers are assessed according to the same set of criteria as the JV (see section 8D.23). The criteria are built on the objectives why the JV was formed, and the HK parent would look at production efficiency, business development and customer satisfaction. Ming added:

> "The JV is two years old and it has been making losses in these two years. However, the unsatisfactory financial results are not due to bad management, they are caused by the bottleneck geographical location and the inadequate industrial infrastructure in the area. Our JV has been trying very hard to find a feasible way forward...
>
> Therefore, the Group will not purely use financial measures to evaluate performance of the JV and the managers. It must be based on the objectives why the JV was formed. Otherwise I, as the JV GM, will not be here talking to you... I would have been sacked long time ago".

The emphasis placed on operational and production measures confirms a suspicion I raised in Section 8D.16 that the TianJin JV is only a pseudo profit centre, at least up until this stage. The JV was used to test the market, logically financial measures should not be used as the sole or primary tool to assess and control the JV performance. Having said that, the headquarters have not loosened up their control on the JV's finance. When Ming heard me say that, "given the circumstances financial measures and control would be inappropriate", he gave the following comment:

> "No way. The JV has been losing money and how would the headquarters loosen up their control? The Group has accepted the fact that we will not be able to make any profit in the first few years, but they do expect us to minimise the losses. So they have kept a close eye on every penny we spend in the JV."

There is evidence of conflict between strategy and control that the HK headquarters applied to the TianJin JV. Borrowing Miles and Snow's (1978) typology, in the first decade of operation Pearl adopted a "defender" corporate strategy, which emphasised low-risk specialisation in production (see Chapters 6 & 7 for definitions). Under that type of situation, centralised and cost-efficient control was widely used and also proved to be successful (Miles & Snow, 1978; Simons, 1987). Now, Pearl decided to gradually switch its strategic direction to a hybrid operation, and introduced a "prospector" strategy to explore northern China. In the transitional period, the senior management did not make sufficient adjustments to the original control and performance evaluation systems according to the dynamic environment the TianJin JV faced.

Ming, Sam and David's experiences demonstrate a high extent of centralised control exercised by the HK headquarters (see section 8D.18). Towards the end of the empirical investigation conducted in Pearl, I gathered a lot of bits and pieces, which allowed me to map a wider picture of the Group as a whole, its key personnel and the complex company politics. I started to understand Ming more, why he was sensitive to certain topics and behaved so formally in the headquarters, and his authoritarian management style. He and other staff in the JV had to deal with not only the difficult environment in TianJin and the complicated investment objectives, but also the tight parental control imposed by the headquarters. They have learnt from and adapted to the overall culture of the Group and the investment environment in China. As Ming described:

> "Actually, the management system adopted in our JV is a by-product between the basic management approach that is used in our HK headquarters and the outcomes of a careful study of management techniques that are feasible under the distinctive investment environment in China. This set of management strategies have complied to the business objectives of our Group".

8D.28 <u>Have the Chinese subsidiaries fulfilled their objectives and how do you see the future of investing in China?</u>

For Pearl, it was a mixture of results from its Chinese investments. Regarding the TianJin JV, at that time it was too early to assess whether a two, three year old operation had fulfilled its mission in a difficult environment. There was progress on local adaptation and learning. The standard of its output has been good. Nonetheless, the extent of difficulty and costs were higher, and the progress was slower, than expected. Regarding the future of investing in China, Ming said:

> "We are a HK-based company. If we want to be in the manufacturing business, we have to move our production base to China. We have to make use of

China's cheap land and labour in order to reduce the production costs and enhance our competitive advantage.

In the long run we should be positive, as we believe that China is the best place to invest. In short term though, I feel negative towards investing in northern China".

In the Dion JV, its outstanding performance was openly praised by the Chairman. It was stated in the annual report (1994:10) that the co-operation not only enabled Pearl to expand into new mobile electronics markets, such as automotive security, it also allowed the Group access to high-technology manufacturing. The achievements are crucial contributions towards Pearl's long-term strategy to become one of the pioneers in the electronics field. Therefore, as far as I could see, the HK-Japanese JV brought a lot of benefits to Pearl, and fulfilled parts, if not all, of its investment objectives.

Regarding the video division, Sam and David are very confident in the prospect of China. As was mentioned before, they were very much hoping to set up a production JV in China in the near future. Before the interviews, JV negotiation with a potential local firm had begun. However, the progress was slow and frustrating, and there were a few areas of which mutual agreement had not yet been achieved. Sam stated:

"We have been trying to set up a JV with a local company. There are so many problems. The discussion we had was just like a circle, and we were going round and round the same things. Although we are a HK company, we have encountered so many problems. That is the reason why I consider HK investors may have 80% chance to succeed in China, because they know about the problems. Before they put their feet into China and form a JV there, they assess carefully and take all necessary measures to safeguard their interests".

Despite the frustration they experienced in the lengthy negotiation process, Sam and David's enthusiasm of forming a JV in China was not affected. Indeed, Sam wanted to move the division's HK administration base to China in two years' time, once the JV is up and running. He saw the move as an ultimate solution to reduce operational cost and travel time, enhance control, and integrate the two functions of management and production into one cohesive business. I asked Sam how he justified the risk of moving his complete base to China, given that he had just complained about the country's lack of systems.

"If you want to explore the local market, China can offer you the opportunity. Basically the country had nothing, but now the local people want to have

> everything... Nowadays, the world is very competitive and all major markets are declining... You can achieve growth only in less developed countries, such as China and India. You cannot afford to ignore it. There is risk, but you just cannot afford to ignore it. If you are not in what may be the largest market in the world, your business will die anyway.
>
> The reality is that today our business relies so much on China. If anything bad happens in China, that is it". Sam answered.

8D.29 Conclusion

Moving to China is an overall trend among HK businesses. As Ming stated, "the decisions of investing in China are driven not only by confidence, but by needs". It is a one-way street, and Pearl has no other better alternatives. Up until that time, the Group's nine production plants were all located in China, and they are highly exposed to any adverse changes in the country. Under this situation, they need to be positive.

The majority of Pearl's subsidiaries have been doing well. Their performance enabled the Group to expand at a rapid pace over the last decade. The senior executives are confident in the future of China. They believe that the country's reforms, as with their FDI in China, are irreversible. The situation encourages the country as well as its investors, such as Pearl, to move forward, since there is too much to lose if they withdraw or rapidly change their direction now.

> "It is not possible for the Chinese government to reverse the open-door policy and go backward. It is absolutely impossible". Ming replied.

The last case study of the series is now completed. The four in-depth case studies, Superior, Marlee, Silky and Pearl, provide fascinating accounts of the sample firms' experience of forming and controlling JVs in the unique environment in China. Chapter 9 records the sense-making journey to understand and compare the four cases using the skeletal model of IJV control, which was built in the first stage of the theory formation process of this research.

Chapter 9

Case study analysis - the sense-making journey

9.0 Introduction

Full versions of the four case studies are shown in Chapter 8. The details have provided much insight into why and how the four MNEs formed and controlled IJVs in China. The current chapter has sought to understand and compare characteristics of the four cases using the skeletal model of IJV control, which was developed in Stage 1 of the theory formation process, to guide the analysis. In the meantime, I will use the empirics to further develop the skeletal framework and make the model specific to the context from where the theoretical model is drawn.

9.1 Missions of the IJVs

The analysis will start from the outside parameter of the skeletal model of IJV control, as the shadowed section in Figure 9.1 shows. As discussed in Chapters 6 and 7, a firm's investment motives play a significant role in their choice of location, entry mode and control system. Under a contingency perspective, various objectives require different settings and resources, which in turn dictate a suitable form of organisation and/or a set of control systems that should be adopted in a particular situation (Miles & Snow, 1978; Harrigan, 1984, Govindarajan & Gupta, 1985; Simons, 1987; Emmanuel et al., 1990; Geringer & Hebert, 1989; Otley, 1988; Groot & Merchant, 2000). Strategy-structure-control fit is the key concept underlining the skeletal model of IJV control. As Chandler (1962) suggested, structure has to follow strategy. IJV mission is the starting point of designing a control package.

A clear message revealed in the four cases is that the MNE parents need to be in China in order to achieve a set of purposes (as summarised in Table 9.2), which are derived from their corporate goals as well as the environments that they are working in. In each case, the investment aims may be production driven, marketing orientated, or a combination of both. In order to analyse the way in which investment motives influence the focal MNEs' choice of organisational arrangements, the subsequent choice of partners and systems of control in a systematic manner, it is useful to divide the MNEs into two groups according to their country of origin, size and business history in China. A summary of the four focal parents' background (see Table 9.1), which was first presented in Chapter 8, is reproduced in this chapter to help readers to follow the discussion.

<u>Figure 9.1</u>

<u>A reproduction of the conceptualisation framework of IJV control - (4)</u>

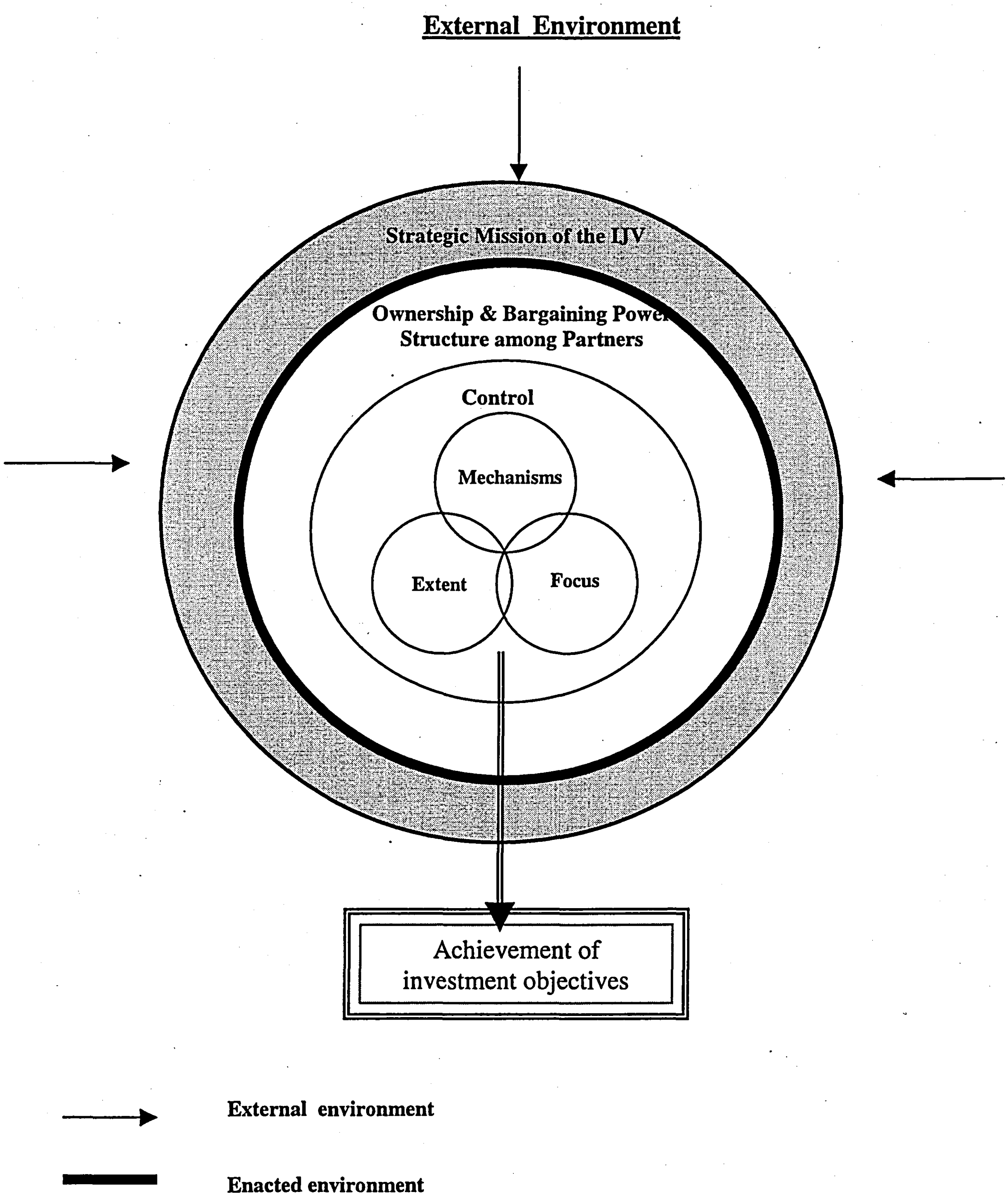


Table 9.1

Background information of the four focal partners of the case studies - A reproduction

	Superior	Marlee	Silky	Pearl
Country of origin:	United Kingdom	UK & Holland	Hong Kong	[1]Bermuda registered, Hong Kong-based operation
Consolidated turnover of the group:	£10,300 million	£31,500 million	HK$150 million (approximately £12.5 million based on an exchange rate of £1 = HK£12)	HK$1,358 million (approximately £113 million)
The time that the firm started trading/ investing in China	• Trading with Chinese merchants started from 1880. • FDI from 1926 and ended in 1956. • 2nd round FDI started from 1994	• FDI from early 1920s and ended in 1953. • 2nd round FDI started from 1986.	FDI from 1986/7	FDI from 1980s
Number of investments in China	2	12	4	9
Forms of investments in China	• 2 x JV	• 1 x holding • 2 x wholly owned • 9 x JVs	• 2 x PCTA[2] • 1 x wholly owned • 1 x JV	• 7 x wholly owned • 2 x JVs

[1] The company was founded in Hong Kong and its current registered address is in Bermuda. It is stated in Pearl's annual report (1994:3) that the Group's head office and principal place of business remains in Hong Kong.

[2] Process and compensation trade agreement.

Table 9.2

A summary of the four focal partners' motives of investing in China

Superior	Marlee	Silky	Pearl
1. To penetrate the Chinese domestic market. 2. Water based texture requires paint production near to final markets to avoid thickening during long transit. 3. Lower cost of production in China to serve the local market. 4. Strategic motive - to complete the group's production network in Southeast Asia. 5. Defensive reaction.	1. Comply with Marlee Group's key objective, which is to become a real world-wide business via overseas expansion 2. Strategic importance of China to the group's current business strategy - to invest in emerging markets. 3. Defensive reaction. 4. To penetrate the Chinese market.	1. High production cost in HK forced local firms to seek alternative production bases to remain competitive. 2. To get access to vast supplies of cheap land and labour in China. 3. Lower operation cost in China. 4. Availability of raw materials in China at a lower cost. 5. Geographic proximity between HK and China.	China in general: 1. High labour and land cost in HK squeezed out production. 2. To get access to vast supplies of cheap land and labour in China. 3. Lower operational cost in China. 4. To establish production bases in China and reduce reliance on the HK operation. 5. To improve profitability. 6. To explore the China domestic market. TianJin JV: 7. To establish a foothold in northern China to support the group's future FDI in the region. 8. To become one of the pioneers to invest in consumer electronics production in northern China.

9.1.1 Investment motives → cost-benefit analysis → ownership decisions

Superior and Marlee

According to their large size, long history and rich business experience, both Superior and Marlee have aimed to become leaders in the fields that they operate. The tool that they have been using to achieve this ultimate goal is to become a real worldwide business through overseas expansion. "Winning in growth markets world-wide" and "building strengths in the right places" are respectively Superior and Marlee's key strategies, which have directed their global activities.

The rationale behind the two MNEs' strategies can be explained by the notions of internalisation theory (see Chapter 4) which suggests that FDI is the by-product of various forms of market imperfection (Hymer, 1976; Hood & Young, 1976; Buckley and Casson, 1976, 1985; Rugman, 1981, 1982, 1985; Dunning 1973, 1980, 1981, 1988; Kogut, 1983; Hernart, 1991). National and international market imperfections both permit a firm to acquire its monopoly advantage in the domestic environment and explore this via FDI. By investing in the overseas countries directly, Superior and Marlee can transfer resources across borders within their internal networks. Through this way, not only the use of firm-specific assets (FSA), but also the return of owning the FSA, are within internal control.

Moreover, the life cycles of products or technology, which was developed through expensive and/or long periods of research development, can be extended through overseas expansion (Vernon, 1966, 1979; Hood & Young, 1979; Casson, 1987). China, a country that comprises one-fifth of the world's population, has presented a lot of opportunities to investors. Having set a goal to become the world leader, Superior and Marlee cannot afford not being in China. For Superior and Marlee, to put FDI in China is like putting a big missing piece to complete the jigsaw of production and distribution networks in the Asia Pacific Rim. Establishing a strong foothold in the world fastest growing region has important strategic implications for the MNEs' global positions (The World Bank, 1997).

To implement their strategies in China requires not only speedy local adaptation, but also a high level of skill and capital investment. The level of uncertainty in China deepened Superior and Marlee's needs to find other partners, who possessed the required resources, to share costs and risks. A combination of internal and external factors encouraged the

MNEs to choose JV. As Gomes-Casseres (1989) stated, the stronger the needs for partners' resources, the stronger the incentives for co-operation.

Under the influence of the Confucian ethnic, the Chinese have long been placing great value on human relations. Indeed, all interviewees expressed their awareness of the importance of the "guanxi" way of doing business in China. However, building up relationship properties is costly and time-consuming. These characteristics again reconfirm the appropriateness of using JV, a form of organisation which facilitates transfer of organisationally embedded knowledge or relationships that are difficult to blueprint through other channels, such as contracts or other arm's length transactions (Dunning, 1981; Contractor & Lorange, 1988; Maxon & Geringer, 1985; Beamish & Banks, 1987; Franko, 1989; Kogut, 1987; Tsang, 1994; Martinsons & Tsang, 1995).

Holding a primary aim to explore the domestic market, Superior and Marlee need a license to do so. Many people may take it for granted that selling in the host countries is somewhat a direct result from putting FDI there. However, the investment environment in China is not that simple. Mainly JVs, Sino-foreign JVs in particular, are granted the privilege to access the domestic market. Under the overall enacted environment in China created by their global or regional/business groups' strategies, it is not surprising to see that Superior and Marlee have extensively used the JV form of organisation in the country.

<u>Silky and Pearl</u>

For Silky and Pearl, their key motives to go into China were driven by the environment in HK. Along with the take-off of the HK economy from the early 1980s, domestic manufacturers, especially those who were operating in labour intensive industries, were badly hit by the shortage of labour supply and the surge of cost in every aspect of the business. The situation forced Silky, Pearl and many HK firms to consider alternative production bases. Again, these are typical examples of market imperfections which drive firms to internalise the failing external market that imposes excessive cost on its users (Hymer, 1979; Rugman, 1981, 1982; Buckley & Casson, 1976, 1985; Hood & Young, 1976; Agmon & Hirsh, 1979; Casson, 1987; Dunning & Rugman, 1985; Hennart, 1991).

Under the environment characterised by the 1980s, there was a trend for many HK companies to move their production to southern China. Geographically, HK has a land border with southern China. The proximity was crucial to many HK businesses', which included Silky and Pearl's, FDI decisions. In the early 1980s, China was just opened up to the outside world. At that point in time the country's infrastructure and business development was far from that considered adequate to support foreign funded operations in the country. The short distance between HK and China enabled materials, technical and management support from the HK headquarters to be delivered to the Chinese subsidiaries at a lower cost and shorter time. The convenience to a great extent guaranteed a smoother start of their investments. Furthermore, the proximity also allowed finished products to be delivered to HK for re-export to final customers. It can be seen that location choice has significant impact on cost, control and risk of FDI.

In addition to geographical distance, psychic distance was another vital consideration (Buckley & Casson 1976; Hood & Young 1979; Kogut & Singh, 1988. See Chapter 5 for detail). In HK well over 90% of its population are ethnic Chinese. For the two HK-based firms, investing in China is very different from going into other countries, as they are more familiar with the ways in which the Chinese systems and people work. Silky's contrasting experience in America and China provides empirical evidence to illustrate the effects of psychic distance.

The similarity in culture, language and background between the headquarters, Chinese subsidiaries and local business contacts could minimise the cost of administration and communication. Also, based on a reasonable level of understanding in culture and business practices, a greater extent of trust could be built up between different parties (Casson, 1990). As the literature review recorded in Chapter 5 revealed, the sense of trust in turn encourages more open communication, and a higher degree of commitment between different transaction parties (Beamish & Banks, 1987; Casson, 1990; Barney, 1990; Mohr & Spekman, 1994). These are crucial ingredients for business success, especially for the JV form of organisations. In sum, the close geographic and cultural distance explained why HK and Macau became the biggest source of FDI in China in the first two decades of its opening up, as investigation conducted in Chapter 3 revealed (see Tables 3.8 & 3.9).

The above findings lend support to an argument drew up in Chapter 5 that transaction cost analysis should not focus only on cost of legal enforcement of contracts, but also on social, cultural and behavioural mechanisms on the costs of running and controlling a FDI

(Casson, 1990). The FDI decision-making behaviour of Silky and Pearl has demonstrated a rationale for the above statement. The longer the so-called psychic distance between home and host countries, the higher the level of cost and perceived risk of the FDI. This result is consistent with prior research studies, which found that firms tended to start investing in countries with a similar language and cultural background (Stopford, 1976; Caves, 1982; Thomsen, 1992).

For Pearl and Silky, their initial objectives to go into China were to establish a low cost production base at a convenient distance. The extent of benefit that could be gained from having business partners might not be strong enough to change their entry mode decisions in favour of JV at the beginning stage of their investment in China. However, their change of preference towards JV in recent years demonstrates the ways in which strategies influence entry mode decisions.

For example, having achieved significant success as being a low-cost producer in the 1980s, Pearl started to put greater emphasis on acquiring advanced technology in product designs and production systems. Accordingly, forming a JV with Dion, a Japanese leading electronic group, was undoubtedly a direct channel to fulfil these targets at a lower cost. Pearl's decision once again illustrates that the needs for partner's resources encourage co-operation and forbearance (Buckley & Casson, 1988, 1989; Gomes-Casseres, 1989). In addition, being a follower in the first decade of its formation, Pearl wanted to play a pioneering role this time. The goal drove them to set up a foothold in northern China before their competitors. However, investing in the north for the first time meant a different environment that the group needed to cope with. All these factors encouraged Pearl to use JV in TianJin. This finding supports a point highlighted in Chapter 5 that the inter-regional diversity in China presents a high level of uncertainty to foreign investors and the situation reinforces the suitability of using JV.

9.1.2 IJV mission → sources of income and control → form of organisation

Besides the advantages of internalising partners' specific assets and faster adaptation process that have already been discussed in section 9.1.1, JV's income- and control-enhancing potential is another attraction, which encouraged the four sample firms to adopt it as one of the vehicles to approach China. The majority of the four MNEs' jointly owned Chinese subsidiaries are so-called hybrid JVs. The hybrid model is a mix of equity with other contractual arrangements. It was revealed in some previous studies that the hybrid form of JV was indeed widely used by multinationals in other parts of the world (Contractor, 1985; Beamish & Banks, 1987; Beamish, 1985, 1988). This research adds further detail to existing literature and shows that the hybrid JV phenomenon has spread to China.

For instance, most of Marlee's JVs are a mixture of equity JV with licensing agreements for using Marlee's brands and technology. Their Chinese subsidiaries (except a couple of strategic JVs, which were built to access local leading brands) need to pay royalties that in general account for 3% of their turnover. Marlee aimed to establish a billion-dollar turnover business in China around the year 2000/2001. Royalties of 3% of the growing turnover, together with dividends that they are likely to receive if the set target is hit, provides Marlee with a healthy return on their Chinese investments.

Indeed, hybrid JV agreement is not only a way to diversify sources of income, but also a channel to reduce risk of bringing in brands and new technology to the JVs (Contractor, 1985). This point is particularly important to foreign investors in China, whose underdeveloped legal system to protect intellectual properties has caused a lot of controversy. Marlee's FDI's tend to be large. However, dividend payments in large investments normally do not start immediately. By negotiating a JV attached with a licensing agreement, the group can secure an immediate repayment of the technology they have brought into the operation. An early repayment in turn can reduce the level of actual or perceived risk of investing in China.

On the other hand, Superior's Chinese JV contracts are formally or informally attached with licensing and material supply arrangements from other sister companies of the group. Their Chinese JVs produce and sell only Superior's paints. Indeed, it is an effective channel to generate sales for both paints and material production of the group. In addition, sourcing from sister companies enhances Superior's control in quality and price of material inputs in the JVs.

In Silky and Pearl's JVs, they also included various types of contracts, such as materials supply, management and technical support, as well as product buy-back. The benefits along with these agreements are clear. First, quality of inputs, such as materials, technology, management, is under the focal partners' control. Moreover, reliable sources of product supply from their Chinese factories are secured and perhaps at a lower cost. The three parties involved, two partners and the JV, seem to benefit from the hybrid agreements.

9.1.3 Similarity of entry mode choice between the sample firms

Despite the difference of background and investment motives, one similarity shared by the four MNEs is that they have used JV, along with other investment modes, in China. On a number of occasions, the sample firms considered partial integration as the best option to serve their purposes and provide them with the highest net benefit (Beamish & Banks, 1987; Shan, 1991). The similarity of choice reflects that JV is one of the most popular forms of investment not only in developed and developing countries (Dunning, 1981; Schaan, 1983, 1988, Contractor & Lorange, 1988, 1988b; Franko, 1989; Beamish & Banks, 1987), but also in traditional centrally planned economies, such as China (Shan, 1991; Beamish & Wang, 1989; Casson & Zhang, 1991; Newman, 1992).

In addition, according to the income- and control-enhancing potentials of hybrid agreements, almost all the four focal partners' Chinese JVs have added this kind of extra arrangement into the JV contracts. The focal parents' strategies to insert control over inputs and outputs of their JVs are similar to the policies adopted by well-established Sino-American JVs identified by Newman (1992). The commonality provides support to Newman's argument and findings that tight control of inputs and internal operation is effective in the Chinese environment, where local people tend to lack self-initiative and concepts of international business and quality (Newman's study will be further discussed in section 9.3.1). The focal partners' tactics also demonstrate a key advantage of being a multinational, which is the flexibility to transfer resources through internal network to maximise control and minimise cost (Kogut, 1983; Rugman, 1982; Buckley & Casson, 1976, 1985; Hood & Young, 1976; Anderson & Gatignon, 1986; Casson, 1991).

9.1.4 Findings that add value to the skeletal theory of IJV control

The analysis illustrated in this section has made several contributions to the original knowledge of IJV formation. Firstly, in response to a common fallacy noticed by Geringer and Hebert (1989), the usefulness of the strategy-structure approach was ignored by the majority of prior JV/IJV studies, despite the concept being used extensively in strategic management literature. This research has filled the gap. The four case studies shed light on the strategy-structure relationship and demonstrated that the fit between these two elements exists between parents and subsidiaries, which include JV type of subsidiaries. The empirics indicate that the reasons, which led the sample firms to China, constructed a layer of distinctive environment for their Chinese subsidiaries. The enacted environments require specific sets of structures and control systems and processes (Govindarajan & Gupta, 1985; Govindarajan, 1986). On various numbers of occasions, the four MNEs considered JV as the best option to serve the specific conditions that they face in China.

Secondly, the case studies give empirical evidence to elaborate on an argument of Beamish (1985, 1988), who pointed out that there has been a common misconception as to whether countries do or do not require foreign investors to use JVs. In many LDCs, the legal guidelines are seldom clear, and the business environment is rarely straightforward. For example, from the legal perspective foreign investors are allowed to use a range of entry modes to approach most of the industries in China. However, mainly JVs are entitled to sell in the domestic Chinese market. For those firms, who hold a primary aim to penetrate the Chinese market, there is only one practical entry mode that they can effectively choose from. Under this situation, how can we make a clear judgement on whether it is a legal requirement to use JV or a free choice when analysing investment motives and their impact on control? I would argue that the distinction between the two is vague in today's complex business environment.

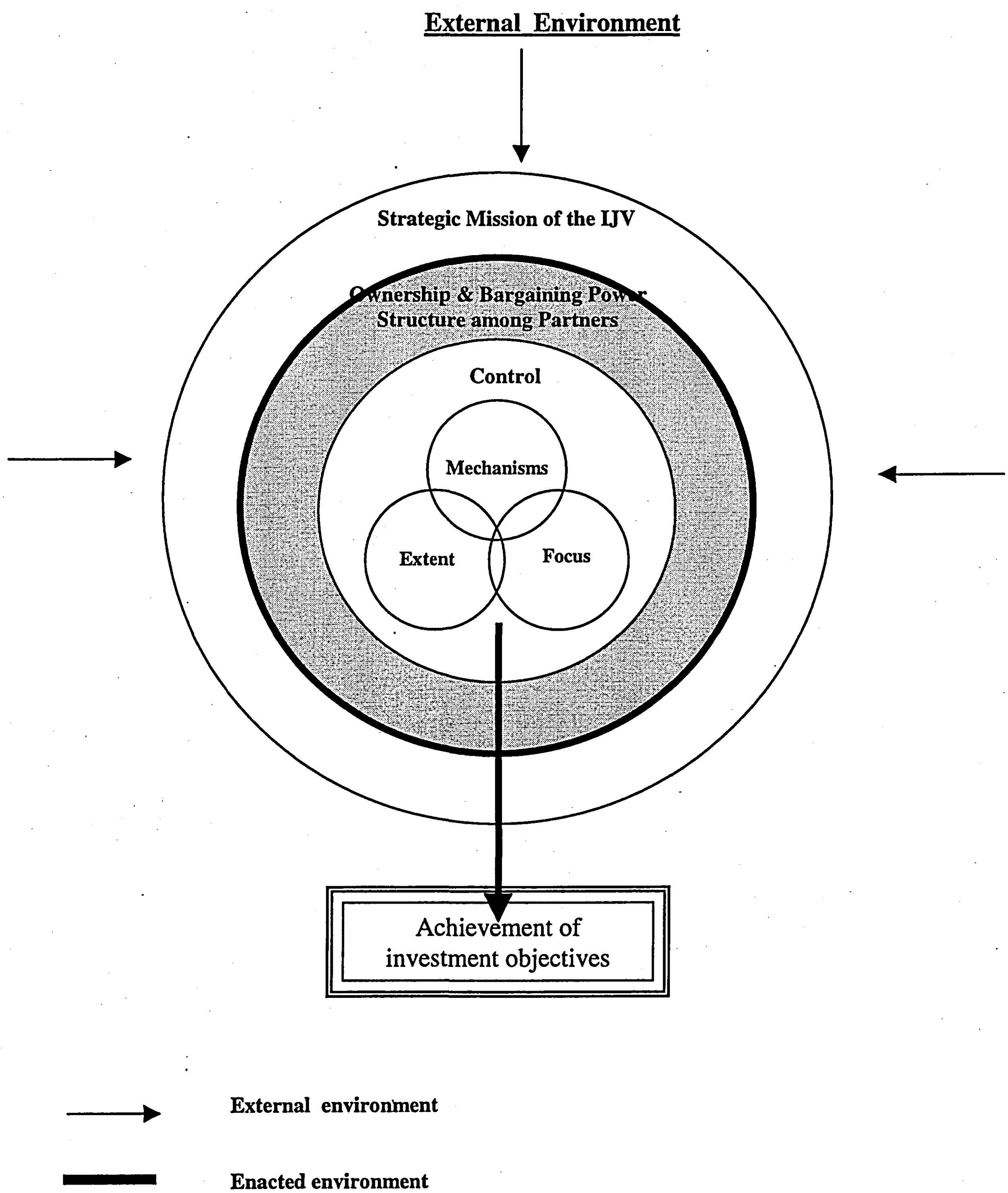
Moreover, findings of this section show that distinction between various investment forms, such as export, contract and FDI, have become blurred in a world where hybrid JV is widely used by firms to accommodate a broad range of purposes (Contractor, 1985; Beamish & Banks, 1987; Beamish, 1985, 1988; Buckley & Casson, 1988, 1989). Often, some apparently clear-cut arrangements are attached with formal and/or informal contracts. Hybrid JV indeed combines the features of hierarchy and market contract in one form. The evolution of the patterns of foreign investment makes the classification more and more difficult but less and less useful. Along with the rapid development of JV, some conventional concepts can no longer be used in a rigid way to analyse nowadays' complex business activities. We need to go beyond the surface to search for meaningful understanding of the nature of FDI and its control in the modern world. It is a fundamental principle driving this research.

9.2 The choice of partners and bargaining power structures of partnership

The analysis now turns to the second parameter of the IJV control model, as shown by the shaded area in Figure 9.2. With reference to strategic missions of IJVs that were discussed in the last section, analysis here includes implications of the choice of partners and bargaining structures towards the subsequent control systems and processes adopted.

Figure 9.2

A reproduction of the conceptualisation framework of IJV control - (4)



9.2.1 Ownership decisions → selection of partners → costs and patterns of control

Analysis in section 9.1 illustrated a link between investment objectives and entry mode choice. Having decided, or at the same time of deciding entry mode, investors need to understand that JV performance is influenced not only by the extent of fit between strategy and ownership structure, but also the bargaining power structure among partners in the venture (Janger, 1980; Yan & Gray, 1994). From individual investors' point of view, the right choice of business companions, who possess compatible objectives and capabilities, can create preconditions for robust co-operation, which is crucial in the implementation of strategies and control, and the subsequent achievement of their objectives (Harrigan, 1986, 1988; Parkhe, 1993a; Axelrod, 1984; Geringer & Hebert, 1989). Similar to Schaan's (1988:7) view, "the effective control of joint ventures relies importantly upon an articulation at the outset of the objectives and expectations of the partners to the venture". How to choose and whom to choose are all parts of a holistic control package. It is an important assumption underlying the skeletal model of IJV control that was drawn up in Chapter 7. The four MNE parents of this research have adopted their separate ways to identify and choose JV partners.

Superior and Silky prefer to form JVs with known parties. Previous acquaintance provides various parties with understanding and confidence to do business together. Given that JV is a mechanism to develop and build trust, the pre-requisite harmonious relationship between partners further encourages open communication, co-operation, and commitment to the partnership (Gomes-Casseres, 1989; Casson, 1990; Blodgett, 1991). Both case studies have showed that pre-JV relationship is a good channel to screen potential partners and identify the extent of compatibility.

Driven by their investment objectives, Marlee is using a different approach in partner selection. The MNE tends to prefer large local firms, who possess well-established plants, distribution networks and/or local leading brands. Through the JV mechanism, Marlee is keen to internalise its partners' assets and leading brands in order to shorten the local adaptation process and strengthen their worldwide position.

Under the political structure in China, top players are often state-owned enterprises, which are under direct provincial or municipal government control. Also, with a world-class player like Marlee, its FDI in China naturally draws attention from senior government officials and the media. High profile Sino-foreign JVs may mean more bureaucracy and/or government intervention in JV negotiation, operation and partnership maintenance. In other words, choosing a powerful local partner can alter and complicate the external and internal enacted environments in China.

It can be argued that local partners' strong background could bring to the JVs a lot of benefit, relationship assets in particular. I believe that they are crucial factors that Marlee might have already taken into account when they made their choice. However, the situation can work both ways. Partner's influential background represents a strong bargaining composition in the partnership (Yan & Gray, 1994). Moreover, a celebrity JV marriage means that the couple's day-to-day activities and decisions are subject to external scrutiny and criticism, which in turn puts pressure on partnership maintenance.

Using Root's (1988) terminology (see Chapter 5), serving the Chinese market through forming JVs with local oligopolists influences not only the level of transactional risk, but also contextual risk. The overlapping forces of transactional and contextual environments further complicate the already complex JV issues. It is no surprise that Marlee is the only one out of the four focal partners who has encountered incongruent business objectives and more serious conflicts of self-interests between partners in some of their JVs, where Marlee does not hold the majority shareholding[3]. In fact, from their emphasis on equity to sustain control, we can tell the state of partner relationship. It was disclosed that a lot of on-going negotiation and reconciliation are required.

Pearl's TianJin JV with a small local firm is another example to illustrate why size and background matters. Due to the recession and a lack of FDI interests in the region, NS, Pearl's local partner was struggling to remain in business during the pre-JV days. Forming a JV with foreign firm was perhaps the only way to turn round their business. The Chinese partner's situation guaranteed a high level of co-operation and it gave Pearl a strong position in the partnership. Although the partners were disappointed by the slow progress and high cost of operation, a respectful partner relationship was maintained. The findings seem to suggest that bargaining power among JV partners is decided by who brings what and how important the resources are to the JV operation (Harrigan, 1986; Yan & Gray,

[3] In these operations, the division of control between partners was formal and adhered to the "mutual benefit" ideology highlighted by the open-door policy in the 1980s.

1994; Harrigan & Newman, 1990). Pearl's experience illustrates how the selection of partner shapes the pattern of control that individual partners subsequently insert into an IJV (Yan & Gray, 1994).

9.2.2 Findings that inform and extend the skeletal theory of IJV control

An interesting finding identified in the case studies of Superior and Pearl contributes towards the understanding of partner selection. Some previous research, such as Agarwal and Ramaswami (1992), Beamish and Banks (1987) and Shan (1991), suggested that owing to the importance of local knowledge and contacts, foreign investors would tend to form JVs with local firms to overcome problems caused by their alien status. However, I would argue that country-specific assets are not necessarily only possessed by indigenous players. Foreign firms can acquire local knowledge and contacts over time.

For instance, the empirics show that from the Japanese partner's point of view, they considered Pearl's experience in running production as an important asset to guide them through their very first FDI in China. In addition, both Pearl's HK nationality by birth and Bermuda registration obtained in its later life, allow them freedom of trade and movement of capital. Together with their knowledge of audio production and international business, they added further attractions which distinguished Pearl from other local firms in Dion's choice of JV partner.

Superior's key partner, Giant, has a wide experience of investing and running businesses in China and other Asia Pacific countries. They have been through the stiff learning curve. The time and resources they invested in learning the practices and cultures that prevail in different countries now make them a quasi-indigenous firm with a foreign status in those countries where they have significant investments. The knowledge gained has bridged the psychic distance (Buckley & Casson 1985; Hood & Young 1979; Kogut & Singh, 1988), which has been a main barrier of FDI in unknown markets (Stopford, 1976; Caves, 1982; Thomsen, 1992). It demonstrates the power of being a MNE. Giant's double identities, being an old-China hand and a major British MNE, make them a compatible partner to Superior. Findings in this section have proved that the growth of collaboration between oligopolists is now playing a changing role in the evolution of national institutional structure and international competition (Kogut, 1987).

In addition to the above, there are other discoveries in this section, which add detail to existing contingency literature and the skeletal theory I used to understand the case studies. As was discussed in Chapter 6, a few previous studies, such as Miles and Snow (1978) and Govindarajan and Gupta (1985), advocated that firms create their enacted environments through a series of strategic choices. Their studies demonstrated that the relationship between environment and organisation/control design is neither simple nor linear. These findings challenged the assumptions of a direct and linear relationship between the two forces[4], an assumption which had underlined many of the early contingency studies. This research supports Miles and Snow (1978) and Govindarajan and Gupta's (1985) argument, and demonstrates that the strategic mission of an IJV creates an enacted setting, which reflects criteria of who should be chosen as partners (Yan & Gray, 1994). In addition to that, my investigation discovers something extra.

The empirics indicate that the selection of partners establishes a particular bargaining power composition, and the relationship has impact not only on transactional, but also contextual environment facing an IJV. In other words, the choice of partners can alter the original enacted setting, which was created by the decisions on investment objectives, and establish a new environment that will shape the patterns of control that individual partners and the JV adopt. Marlee's experience with local monopolist/oligopolist JV partners illustrates how the choice of partners changed the internal and external conditions the group faced in China. This discovery indicates that there are multiple layers of interactions, perhaps in a circular motion, between environments and decisions on various components that comprise a control package.

Now I understand that the decisions for investment objectives/JV mission create an enacted environment which influences the choice of JV partners. Nonetheless, the subsequent choice of JV partner(s) will on one hand establish a specific bargaining power composition among partners that may change the original enacted setting faced through the partnership's influence over the transactional and contextual environments, and on the other hand form a new enacted condition that shapes the future decisions for the three control dimensions. This process then creates multiple layers of enacted environments between different contingency variables comprising a control package.

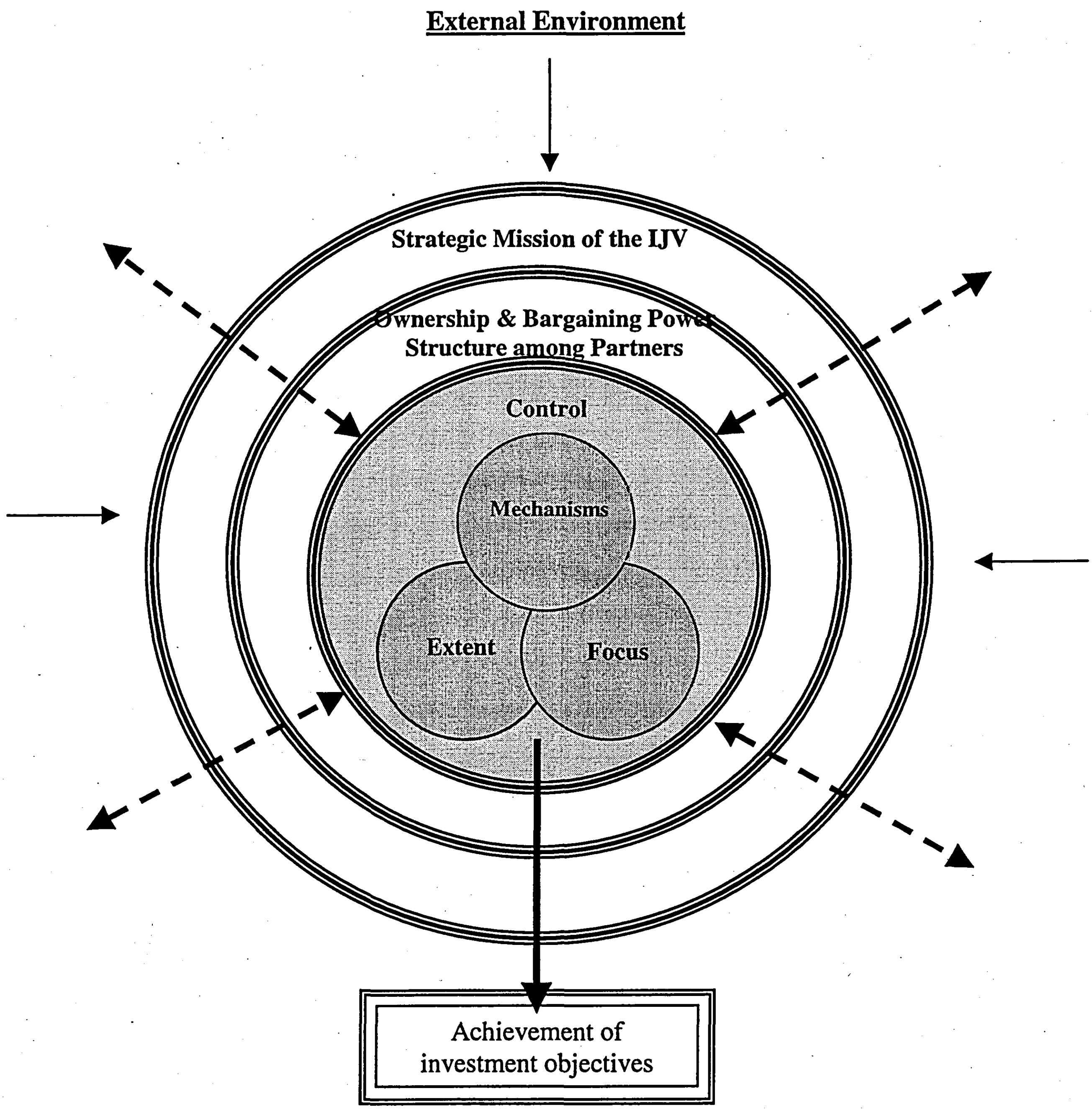
[4] Otley (1980), Hopper & Powell (1985) and Emmanuel et al., (1990) also made similar criticisms on the simple linear assumptions that underlined many early contingency studies.

The findings above refuted parts of the original conceptualisation and the differences prompted re-examination of the skeletal model. The reflexive process makes me recognise that the original assumptions of single-layered interaction between a parent's investment objectives/JV mission and the control environment, as Figure 7.3 shows, are indeed over simplistic (see Chapters 6 & 7 for the process of developing the original conceptualisation). This new understanding depicts parts of the processes of how enacted circumstances underlining control applied to the sample Chinese JVs might have been arrived at. The new insights inform and further develop the skeletal framework that was drawn up in Stage 1 of the theoretical formation process. The required modification on the conceptualisation model is graphically showed in Figure 9.3.

Figure 9.3

Modification (1)

Conceptualisation of IJV control developed from the skeletal model



Represents multiple layers of enacted environments.

Represents the influence of external environment on the investment objectives/mission of an IJV.

Represents the continuous interplay between the choice of investment objectives/IJV mission, ownership and bargaining power structure among partners, control in terms of mechanisms, extent and focus, and the external environment facing an IJV.

9.3 IJV control

In the last two sections, relationships as well as the degree of strategy-structure fit in the four MNEs' Chinese JVs has already been discussed. In other words, the two outer parameters of the conceptual framework of IJV control have been examined. The findings have shed new insights into the processes of which multiple layers of control in the sample IJVs might have arisen. Now, the investigation turns to the central core of the skeletal model to examine the three dimensions, mechanisms, extent and focus, of control (as the shaded parts in Figure 9.3 show). The analysis will cover discussion of relationships between various contingent components, environment, IJV mission, partnership/bargaining power composition among partners and control, comprising a holistic control package.

9.3.1 The "mechanism" dimension of IJV control

The mechanism dimension is described as the instruments being used by individual partners to exercise control over various activities in an IJV (see Chapter 7.1 for details). Taking reference of previous studies on this perspective of IJV control (notably Schaan, 1983; 1988; Glaister, 1995), I examined the control tools that the four focal partners used.

The empirics show that the MNE parents have adopted a wide range of tools to exert meaningful control in their Chinese JVs. It seems that they are playing safe in their choice of mechanisms to ensure that their strategies are going to be met. Some instruments are serving similar functions and purposes. There is a certain degree of overlapping and/or repetition of coverage. This phenomenon is similar to the one Schaan (1983) identified in Mexico, a country which forbade foreign majority ownership in JVs during the 1980s. Schaan's samples adopted a broad range of instruments to overcome their minority equity positions and exert the types and scope of JV control they needed. My samples also apply a play-safe approach in their choice of control mechanisms to deal with the unique enacted environments in China. Table 9.3 outlines the key types of instruments they used.

Although some differences are found, most of the control mechanisms identified are fairly similar from one case study to the other. The commonality of choice between the sample parents may indicate that the chosen tools are appropriate to the general enacted environments they face in China. On the other hand, despite the similarity of control tools used, the investigation reveals that the degree of emphasis and the exact ways (orientations) in which the instruments are implemented in the IJVs can be quite different from one case to another. In addition, relationships among the chosen control mechanisms, and between the control tools and other contingency elements in each control package show a certain degree of uniqueness.

The empirics depict that various control instruments adopted in each case individually or collectively serve positive[5], negative[6] (see Chapter 7.1.5 for details on control orientations), and/or hybrid[7] orientations. In summary, the mechanisms are carefully put together to maximise the focal parents' influence over strategically important areas in their IJVs. Each of the control mechanisms is now analysed in detail in the following sections.

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[5] Positive control mechanisms are often employed by parents to promote certain activities and/or decisions in a way that is consistent with their own or the JV's interests (Schaan, 1983, 1988; Beamish, 1988; Geringer & Hebert, 1989). This type of control is an on-going process of influence (Killing, 1983; Geringer & Hebert, 1989).

[6] Negative control mechanisms are used to prevent certain types of unfavourable activities and/or decisions from being implemented in the JVs (Schaan, 1983, 1988; Beamish, 1988; Geringer & Hebert, 1989).

[7] Hybrids are crossed nature control tools, which can be used to serve positive, negative or both positive and negative purposes. It is a new finding in the field of mechanisms of IJV control and the contribution this study makes will be discussed in section 9.3.1.10.

Table 9.3

A comparison of control mechanisms adopted by the four focal partners in their IJVs in China

Types of control mechanisms	*Orientations	Superior	Marlee	Silky	Pearl
Staffing, nomination of key JV managers, GM in particular	P	✔✔	✔✔	✔✔	✔✔
Resources supply to the JVs:	P				
Firm-specific assets		✔✔	✔✔	✔✔	✔✔
Raw materials		✔✔	✓	✓	✔✔
Sales & export opportunities		✓	✓	✔✔	✔✔
Design of budgetary system and process	P	✔✔	✔✔	✓	✓
Design of performance evaluation and reward systems	P	✔✔	✔✔	✔✔	✔✔
Design of reporting system and relationship	P	✔✔	✔✔	✔✔	✔✔
Internal exclusive agreement.	H	✗	✗	✔✔	✗
Bargaining power	H	✔✔	✔✔	✔✔	✔✔
Veto right	N	✓	✓	✓	✓
Conflict resolution provisions	N	✗	✗	✓	✗

*** P = positive, N = negative, and H = hybrid orientations.**

✔✔ = an important control mechanism and is heavily used by the focal parent.
✓ = a chosen control mechanism and is used to only some extent by the focal parent.
✗ = a control tool that is not chosen by the focal parent.

9.3.1.1 Staffing - nomination of JV GM and/or other key functional managers

The ability to nominate JV GM and other key functional managers is an important positive control mechanism in the four sample parent firms, regardless of their shareholding in the IJVs. This discovery is consistent with Schaan's (1983, 1988) results, which showed the importance of staff provision and the way in which minority partners exercise disproportionate control through providing JV managers. Nonetheless, my findings are slightly different from parts of Glaister's (1995) results, which indicated that British parents' emphasis on appointing the JV GM is often correlated with their equity stake in the IJVs. The empirics reflect that all of the four focal parents, regardless of differences in nationality and equity holding in their Chinese JVs, have considered nomination of JV senior staff, the GM in particular, as a powerful means to direct behaviour of JV personnel towards the achievement of investment objectives. The focal parents' emphasis on this tool is not difficult to explain.

According to the Chinese JV Law, GMs of Sino-foreign JVs are granted the highest operation authority to execute decisions made by the Board of Directors (Li et al., 1994). Therefore, the ability to nominate this influential position can significantly improve the chance that the administration system of the JV is designed and implemented in conformity with the parent firm's standards and best interests (Schaan, 1983, 1988; Yan & Gray, 1994). In other words, the parent's investment objectives and strategies are likely to be properly integrated into the JV operation. It is a major control instrument that the four focal parents are eager to achieve.

In addition, the JV GMs and most of the senior managers assigned by the four focal partners are expatriates who are transferred from HK or other Asian Pacific subsidiaries. These managers tend to possess both linguistic and cultural abilities to run businesses in China. The power to transfer resources and personnel between subsidiaries can shorten the psychic and geographical distance between home and host countries. The flexibility empowers the focal partners a higher degree of control over both internal and external environments[8].

Also, previous experience and a close relationship greatly facilitate communication between the parents and the expatriates who work for the Chinese JVs (Schaan, 1988; Yan

[8] This type of flexibility, however, cannot help Pearl to fully overcome the problems embedded in the investment environment in TianJin.

& Gray, 1994). Having filled the key posts with their loyal staff, first-hand and more complete information about the JVs, other partners and overall business environment becomes more accessible (Killing, 1982, 1983). The empirics reflect that this type of information is useful not only for control of the JVs concerned, but also for the parents' other investments in the same country. For instance, in the Marlee case the holding company has tried to co-ordinate its eleven sister companies in China as one operation. Often, decisions of one or a group of Chinese subsidiaries will become inputs for the others. The holding company has taken up a central role to raise and transfer funds or expatriates from one operation to another. The situation makes the right to nominate JV senior managers, the GM in particular, vital to the implementation of Marlee group's strategies in China.

Indeed, nomination of JV senior managers is identified by a number of prior research studies in developed and LDCs as a key control tool (Tomlinson, 1970; Killing, 1982, 1983; Schaan, 1983, 1988; Beamish, 1985, 1988; Beamish & Banks, 1987; Blodgett, 1991; Tretiak & Hlozmann, 1993; Yan & Gray, 1994; Tsang, 1994; Glaister, 1995). The commonality may suggest that it is a well-recognised instrument to exercise effective parental control in JVs located in different parts of the world. This research adds further details on previous findings by refining the crucial considerations as well as implication associated with the provision of JV GM and/or other functional managers as a powerful mechanism of control within the specific environment in China.

9.3.1.2 Resource supply to the IJVs

Provision of resources is used as a major control mechanism across the four case studies. It is a type of positive tool, which promotes contribution to the JVs and an interdependent relationship between JV parties. My finding lends empirical support to Lecraw (1984), Harrigan (1986) Harrigan & Newman (1990) and Yan and Gray (1994), who also discovered that the degree of control a partner obtained depends on the importance of assets they injected into the JV. The more the JV operation relies on those assets to succeed, the more the power the supplying partner gains.

9.3.1.2.1 Supplying firm-specific assets (FSA)

Technology, production systems, marketing expertise, product designs and brands are some typical resources that the four focal partners brought to the ventures. In a majority of circumstances, the four samples' Chinese JVs produce and sell only their branded products. Based on a resource dependent relationship, the supplying party will enjoy a strong bargaining position among all participating interests in a JV (Harrigan, 1986; Harrigan & Newman, 1990; Yan & Gray, 1994). Moreover, the exclusivity of producing their products means that design and implementation of production, administration and marketing policies are likely to be under the supplying firms' control.

Furthermore, successful transfer of the technological type of assets often requires close supervision from the providing party (Tsang, 1994). The situation in turn enhances the supplying firm's ability to nominate their personnel as JV GM, plant manager, and/or other senior functional heads of the JV to facilitate the transfer process (see section 9.3.1.1 for discussion on benefits of staff provision). The overall situation has a positive effect on the supplying firm's status and makes the parent an inextricable part of JV management and operation. From this example, we can see how one mechanism reinforces the effectiveness of other tools of a package to maximise the synergy of parental control.

The significance of providing FSA as a control mechanism is reflected in the fact that all of the four focal parents have heavily relied on it to exercise effective control in their IJVs. Exceptions were only found in Marlee's strategic investments[9] and in Pearl's Dion JV[10]. In these investments, control of design and implementation of administration systems are relatively less important. Rather, getting access to partners' specific assets is the top priority for Marlee and Pearl. This finding gives empirical support to the literature review recorded in Chapters 6 and 7 that different investment strategies/motives would have different structural and control requirements (Franko, 1971; Schaan, 1983).

9.3.1.2.2 Sourcing and/or supplying of raw materials

The four focal parents are providing or helping their Chinese JVs to source raw materials locally and/or abroad. Through this indirect channel, the MNE parents have exerted further positive control over material inputs and hence quality of outputs of the JVs.

As was revealed in the interviews, there is a wide range in quality of local supply of materials. Running loose standards and erratic delivery are characteristics of many Chinese

[9] Which aimed to internalise partners' local brands.
[10] Which targeted to internalise the Japanese partner's advanced technology.

factories (Newman, 1992). Foreign investors, who aim to produce quality products in China, need to carefully select, educate and tightly control their local suppliers. It is in fact one of the key elements of so-called "focus strategy' adopted by some successful Sino-American JVs revealed in Newman's (1992:68) study. Tight control of material supplies is seen as a fundamental step to secure good quality outputs. Also, improvement in quality, wastage and lead-time will contribute to cost minimisation in the JVs (Newman, 1992; Bromwich & Bhimani, 1994).

It was disclosed in the Superior case study that one of the key raw materials used in SGP China is imported from the group's Malaysian chemical plant. This arrangement not only enhances control of inputs in the Chinese JV, but also provides the Malaysian sister company with steady orders. Moreover, Superior's HK trading JV mainly sources from SGP China. Bromwich and Bhimani (1994) identified the cost reduction benefits from establishing inter-dependent buyer-supplier relationships to control bought-in materials. As firms establish the relationships, it is important that they apply appropriate measures to control performance of their suppliers. What Superior tries to do is to make the two parties concerned in a purchaser-supplier relationship to be internal subsidiaries. For cost, quality and control purposes, the MNE aims to locate both input and output control of different subsidiaries within the internal network. This example illustrates the ways in which MNEs' internal control decisions change the nature and structures of global competition.

Moreover, the four focal parents' emphasis on providing qualified managers to run the JVs and supplying FSA and raw materials to the JVs lend empirical support to Newman's (1992) argument that tight control of suppliers, employees and internal operation is appropriate to the Chinese environment, where local people often lack self-initiative and knowledge of international business and quality control. Design of any control system has to be based on the internal and external environments a JV operates in.

9.3.1.2.3 <u>Sales and export opportunities</u>

In the Silky and Pearl[11] cases, they have provided sales and export channels to their Chinese JVs. The local counterparts depend entirely on the two HK partners to bring them wider local sales and/or export opportunities that they were unable to achieve on their own. Based on resource dependent forces, sales and export superiority can greatly enhance

[11] Referred to the TianJin JV.

supplying firms' bargaining power (Harrigan, 1986; Harrigan & Newman, 1990; Yan & Gray, 1994). Again, their personnel are likely to be in charge of key operational functions, and the provision of managers will generate further advantages to the supplying parents (see 9.3.1.1 for benefits of staff provision). This mechanism has a positive effect on promoting contribution from individual partners.

The above finding is another example to illustrate the way in which chosen instruments within a control package complement and reinforce effectiveness of one another in assisting the parent to exert meaningful control and achieve the desired end results.

9.3.1.3 Design of budgetary system and process

This instrument is used to a different degree by the four MNE parents in China. The case materials suggest that the importance of this control tool is directly related to parent firms' size, investment objectives and culture. According to these factors, the four sample firms can be conveniently divided into two groups in the following discussion.

9.3.1.3.1 Superior and Marlee

Borrowing Miles and Snow's (1978) typology, Superior and Marlee are prospector firms, who operate in a dynamic environment and consistently stress new product/market development. They are real global businesses and have hundreds of subsidiaries established across the continents. The two groups have adopted a multi-local multi-cultural strategy, which aims at integrating regional/business group policies with local characteristics. To achieve this strategy, constant environmental scanning and inputs from local management are crucial.

As information theorists and linguists suggested, it is necessary to have structure to bring meaning to information and conversation (Campbell et al., 1982). The same logic can be applied to organisation design. According to Superior and Marlee's size and diversity of business activities, formal procedures are necessary to effectively co-ordinate the flow of information, provide guidance, allocate responsibility, motivate and evaluate performance of subsidiaries and their management. Indeed, there is an interactive relationship between formal process and strategy (Simons, 1990).

Directed by a prospector strategy, budgeting is a major annual exercise in Superior and Marlee, and all senior subsidiary managers around the world are required to take part (Miles & Snow, 1978; Simons, 1987). It is a process-orientated control mechanism, which proactively inserts influence into planning and decision-making processes (Geringer & Hebert, 1989). The defined procedures and established structures of responsibility contain within them an equal amount of, if not more, requisite variety for control than is included in the budgets (Berry et al., 1995). According to the law of requisite variety, within a huge and complex organisation, for effective control the system used should contain variety at least equal to the systems that it intends to control (Beer, 1981). Nevertheless, complex systems need to be understood and accepted by individual managers before these personnel can effectively act upon them (Hopwood, 1974).

Based on the considerations of providing requisite variety for control and in the meantime maintaining clarity and being consistent, Superior and Marlee are keen to transfer their corporate budgetary planning and control systems to all subsidiaries, wholly and jointly owned alike. In addition, various activities, such as budget participation, budget presentation, GM meetings, executive conferences and training courses, organised by the Singaporean headquarters are administrative tools Superior used to secure the required understanding and acceptance from subsidiary managers on the systems and structures that the group created (Hopwood, 1974). As the Chairman of SGP China stated, the participation policy allows individual managers, who have possessed regional and industry-specific knowledge, to contribute in the budgetary process. Feedback from managers is integrated into the top-down input to form the foundation of regional strategies and budgets. The whole budgetary system creates a two-way communication channel between headquarters and subsidiaries.

In sum, the power to design or replicate their budgetary systems and processes is a vital mechanism that Superior and Marlee adopted to exert proactive influence into their Chinese JVs (Schaan, 1983, 1988; Geringer & Hebert, 1989). This result agrees with those revealed in some prior studies, such as Killing (1983), Schaan (1983, 1988), Yan and Gary (1994) and Glaister (1995), that parents may gain control through structures and processes of their JVs.

9.3.1.3.2 Silky and Pearl

As compared to Superior and Marlee, Silky and Pearl use budgets to a less extent and in a fairly different way. The difference seems to be related to their strategies, structures and culture. Silky and Pearl are both defenders, in the sense that they have adopted low-risk strategies in products and markets, and competed through low cost (Miles & Snow, 1978; Simons, 1987). Despite Pearl taking its first adventurous step to establish a JV in TianJin, the group largely remains as a risk-averse defender. Basically, founders of the two HK-based firms are figureheads of their respective businesses. Although the companies have continuously grown in size, their involvement at both corporate and operational levels has not reduced. Up until this moment, the degree of delegation to subsidiary managers is limited to operational and small-amount capital expenditure decisions. Finance and budgetary functions remain under centralised control of the HK headquarters.

For instance, Peter Lee, owner of Silky will consult GMs of the Chinese factories with the production targets assigned to their operations. However, this consultation process is a somewhat symbolic exercise, which aims to obtain managers' agreement on the set targets rather than their inputs to refine the proposed budgets. Pearl's budgetary system is also highly centralised with little inputs from subsidiary managers. According to the size and scope of the business of Silky and Pearl, centralised planning and decision-making systems are considered as and being proved to be satisfactory, at least up to this moment. The founders do not see a pressing need for greater decentralisation and active participation from subsidiary managers in the process.

As compared to Superior and Marlee, the headquarters of Silky and Pearl have exerted a tighter and more direct control over inputs, operation and outputs of their Chinese subsidiaries. The difference in control approaches between the two groups of MNE parents reflects their experience of operating in China, which in turn determines the extent of appropriateness of using focus strategy (Newman, 1992). This finding lends empirical support to an argument raised by various scholars (such as Robbins & Stobaugh, 1973; Moriscato, 1980; Demirag, 1990) that MNEs of different size and degree of international commitment advocate and use control mechanisms in a different way.

On the other hand, managers in Silky and Pearl appear to accept and adhere to the top-down centralised approach in a positive manner. Culture seems to play a key role in this phenomenon. Both groups are Hong Kong based operations[12]. According to a few representative studies of relationships between organisations and national culture, such as Hofstede (1980) and Hofstede & Bond (1988), Western and Asian cultures occupy opposite poles of work related attributes of individualism and collectivism. People in many Asian countries generally show a lower desire for independence and higher tendency of integration into cohesive groups than their western counterparts.

In addition, under the influence of Confucian thinking, the Chinese are used to placing great value on human relations, social harmony and obligations (see Chapter 5.7). According to Hofstede (1980), ethnic Hong Kong Chinese generally demonstrate a low degree of individualism, and a higher degree of tolerance for long distance power and ambiguous circumstances. Whitley (1999) suggested that co-ordination and control systems are closely linked to societal contexts in which economic activities are carried out. Many HK-based firms, such as Silky and Pearl, may consider adopting a decentralised structure and participation control system would not stimulate enough motivational effects on staff performance, and in turn has little economic payoff in terms of organisational effectiveness (Vroom, 1960; Hopwood, 1972; Brownell, 1981, 1982).

The experience I gained from the investigation conducted in Pearl provides interesting examples to illustrate how culture affects control system design and managerial reaction. On one occasion I went to the video division's production base with David Wong, the production manager. The main purpose of David's visit was to speak to Mr. Lin, the co-founder of Pearl. Why could David not speak to Mr. Lin in the HK head office? It shows that the vice-chairman might spend a fair amount of time in the factories. The issue David wanted to discuss with Mr. Lin was to recruit more workers for video production. Why did operational decisions, such as recruiting workers, need to go to the vice-chairman? It was disclosed that Mr. Lin has tightly grasped the control of all sorts of production decisions. Along with the growth of operation, Mr. Lin is overloaded with information and he often forgets things that managers ask him.

[12] Pearl was founded by two ethnic Hong Kong Chinese. Its root and headquarters are also located in Hong Kong, despite the fact that the group moved its country of registration to Bermuda when they went public.

Although David disagrees with the bureaucracy, he knows how to work round the traditional Chinese business culture. Despite the drawbacks, he acknowledged that centralised control does have one advantage, it is that decisions only need to go through one person. The decision making channel is short and direct. However, the Maltese divisional head Sam does not share the same opinions. He considers some of the systems as illogically designed, difficult to understand and bureaucratic. "Crazy" is the word that Sam has often used to describe the management style and systems in Pearl.

Mr. Lin feels uneasy to deal with foreigners and has avoided working with Sam directly. David works as a middleman between Sam and other board members, Mr. Lin in particular. During the day of my visit, Sam phoned up the factory several times to check if David had spoken to Mr. Lin. David was waiting until production stopped for the day then Mr. Lin would see him. A simple operational decision turned into a major issue. This story illustrates how culture influences the ways firms design/use their control systems and the ways managers react to control systems and processes imposed on them.

9.3.1.4 Design of performance evaluation and reward systems

Although the four sample MNEs use budgets to a various extent and in a different way, they all appear to rely on performance evaluation and reward system as a pair of mechanisms to exercise control in their Chinese JVs. This finding disagrees with parts of Simons' (1987) results, which indicated that mainly defender firms are keen to tie reward with control, and place emphasis on bonus remuneration based on the achievement of budget targets. My empirics reflect that both defenders and prospectors, have relied on this instrument to reinforce and focus employees' efforts (Coates et al., 1991).

As Kaplan & Norton (1992) described, companies get what they measure. People tend to pay more attention to those aspects of their performance that will be assessed, and especially rewarded (Kaplan & Norton, 1992; Coates et al, 1991). According to all the potential benefits, gaining control over design and implementation of the pair of mechanisms attaches with it a lot of power. The power comes from the fact that by linking JV managers' rewards and career prospect with the performance evaluation system, the designing parent can insert influence on managers' decisions that are in line with their and/or the JVs' best interests (Schaan, 1983; 1988). A direct link between reward/punishment to desired results gives out clear signals of desired actions to the JV managers (Groot & Merchant, 2000). As a result, strategies of the designing partner are likely to be closely integrated into the JV and being carefully implemented, as managers know that their performance is being measured against the achievement of these targets.

As was discussed in section 9.3.1.3.1, partners can gain control through structures and processes of their JVs (Killing, 1983; Schaan, 1983, 1988; Yan & Gary, 1994; Glaister, 1995). The four MNE parents have replicated their ways of planning, managing and measuring in their Chinese JVs with the hope to exert proactive control into the operations.

9.3.1.4.1 Performance evaluation: JVs Vs managers

Virtually all of the four focal MNE parents are using more or less the same methods to measure performance of their JVs and managers. In Silky and Pearl, budgets are set centrally by the headquarters with minimal participation from subsidiaries. JV managers simply implement the headquarters' decisions. As a result, some of the strategic decisions, which have impact on the subsidiary performance, are out of the control of the managers. On the other hand, under Superior and Marlee's policies, the headquarters have reserved control over certain decisions that will have wider implication to their worldwide, regional or business groups' profitability and/or market shares. Also, under a global business culture and prospector strategy, subsidiary managers are often encouraged to make decisions that benefit the group as a whole. For instance, Marlee China aimed to run all of the eleven companies in China as one operation. Consequently, performance of a subsidiary might be reflected in other sister companies or in the Greater China[13] region's overall performance.

One may argue that the performance measurement systems applied to the sample firms' Chinese JVs are unfair to the JV managers. According to the central thrust of responsibility accounting, unit managers should not be held responsible for costs and/or activities that are beyond their scope of authority (Al Hashim, 1980; Demirag, 1987). Although the idea of separating performance evaluation of managers from operations has its academic supporters, practitioners seem to share a different view. In fact, many prior research studies (such as Horngren, 1972, 1986; Czechowicz & Choi, 1983; Robbins & Stobaugh, 1973; Al Hashim, 1980; Morsicato, 1980; Demirag, 1987; Martin, 1983; Shapiro, 1984; Drury et al. 1993) discovered that firms tended to use the same methods to assess their foreign operations and managers. The four sample parent firms of this research

[13] It includes Hong Kong, Macau and China.

demonstrate no major difference in choice on this aspect and the distinction between managers and units in performance evaluation either does not exist or is vague. There are some possible reasons to explain the phenomenon.

As Hofstede (1968) hinted more than three decades ago, budgets would have little motivational effect unless managers accept them as their personal targets. By using the same methods and criteria of performance evaluation for both managers and units, it would promote an integrative culture that encourages managers to internalise JV budget targets. The policy can also broaden managers' interests to all aspects of the business, rather than only focus on areas that are classified as controllable in their performance reports.

In decentralised firms, it is the subsidiaries' obligation to provide the headquarters with sufficient local information. For example, Marlee and Superior have been using a participative approach to encourage subsidiary managers to contribute local- and industry-specific knowledge to form the foundation of regional/business group strategies and budgets. An effective way to increase awareness on all major aspects of business, that may cover both controllable and non-controllable areas from the management point of view, is to integrate those areas into the performance evaluation and reporting systems. The assessment mechanisms can have significant influence over behaviour (Coates et al., 1991; Schaan, 1988; Kaplan & Norton, 1992).

Secondly, using a unified system for managers and subsidiaries enables parents to sustain the required level of simplicity and clarity. It is an important consideration to MNEs of different size. In large organisations, such as Superior and Marlee, simplicity facilitates efficient communication and allows clear signals to be exchanged between centres and subsidiaries (Goold & Campbell, 1987). For smaller operations, such as Silky and Pearl which have limited resources and expertise, they may find a single approach of evaluating subsidiaries and managers more suitable. Today, the founders of Silky and Pearl have remained in full control of the businesses. They are in favour of exercising direct personal control, and the preference may make the unified approach more appropriate. As Whitley (1999) stated, the ways in which managers control performance of organisational units are closely linked with the nature of firms they are members of and the cultural systems they are embedded within. Simplicity and clarity are two important considerations in design of any control systems. Firms have to find a happy medium between increasing sophistication in their systems to cope with dynamism and sustaining the required level of simplicity they need (Scapens, 1991).

The empirics show that although the same evaluation methods are used for JVs and their managers, special considerations are often given to the latter. Concessions tend to be given to those aspects that are genuinely beyond the control of JV managers. For example, it was revealed in the Superior case that the Asian Pacific headquarters understood that the cost to run the new Guangdong plant was likely to be higher than other established subsidiaries due to a stiff learning curve and the high depreciation charge on a green field plant. The regional head office took into account these conditional factors when they evaluated the performance of SGP China and its managers. The additional considerations seem to act as moderators to minimise dysfunctional effect that may be caused by using a unified system for units and managers.

The above finding is consistent with results of some former research in MNEs' performance evaluation practices, such as Czechowicz and Choi (1983) and Demirag (1987), which also discovered that extra judgmental factors[14] tended to be used in the evaluation of managerial performance. This research has made a contribution to the knowledge of performance evaluation practices by extending the topic to an IJV context.

9.3.1.4.2 Performance evaluation methods

The analysis above has repeatedly reported that the performance evaluation systems the sample IJVs adopted are derived from the focal parents' strategies and are chosen to support the JV missions. Both financial and non-financial methods are commonly used, as Table 9.4 illustrates. This finding is inconsistent with some prior studies (such as Cunnningham, 1978; Czechowicz & Choi, 1983; Choi & Mueller, 1984; Kaplan, 1984; Johnson & Kaplan, 1987; Coates et al., 1991), which identified that financial measurement is often the dominant, if not the exclusive tool that MNEs use to evaluate their subsidiaries' performance.

This research finds that while the financial measure still plays a crucial role, the evaluation system is not built on a single-method approach. Both financial and non-financial

[14] For example, Demirage's (1987) study identified that some of his sample parents allowed their subsidiary managers to explain why, for example, certain financial objectives were not met. In some cases, the sample firms excluded all non-controllable items, such as taxes, interest paybale, and exchange gains or losses when these were determined centrally at the parent headquarters.

performance measures are carefully chosen by the sample firms to complement one another and create optimal conditions for the focal parents to achieve the intended results (Kaplan & Norton, 1992, 1993). These findings do not support the controversial criticisms initiated by Johnson and Kaplan (1987) that management accounting practices become subservient to financial accounting requirements and lose relevance in today's competitive business environment. Further detail of the argument is illustrated as 9.3.1.4.2.1.

Table 9.4

The comparisons of performance evaluation methods and criteria adopted by the focal parents in their Chinese IJVs

SUPERIOR	MARLEE	SILKY	PEARL
JVs Vs. managers Same methods and criteria are used. METHODS & CRITERIA Financial measures: • return on net assets • budget compared with actual return on net assets • cash flow • actual profits • budget compared with actual profits • turnover per head • working capital to sales • various types of ratio analysis	JVs Vs. managers Same methods and criteria are used. METHODS & CRITERIA Budget and actual comparisons of targets and periodic progress set down in JVs' annual plans: Financial targets: • turnover • ROI • IRR • Cash flows	JVs Vs. managers Same methods and criteria are used. METHODS & CRITERIA Financial measures: • costs • profitability	JV Vs. managers: Same methods and criteria are used. METHODS & CRITERIA Financial measures: • operational costs • production costs
NON FINANCIAL MEASURES Customer satisfaction • right first time. • on time delivery in full. Health & safety measures • number of dangerous incidents of classified injury • loss of working days due to work related injury Operational efficiency: • Quality • just-in-time • on-time delivery Environmental performance Comparative measures • between all paints subsidiaries. • between subsidiaries & main competitors.	NON FINANCIAL MEASURES Non-financial targets • launching new products.	NON FINANCIAL MEASURES Operational measures: • on time delivery. • product quality. • operational efficiency. • management skills - ability to recruit and train employees. Comparative measures: • between JV & other similar garment operations in HK and/or China.	NON FINANCIAL MEASURES Operational measures: • extent of smooth operation. • product quality. • customer satisfaction. • channels and prices of material supplies. • the management methods used in the JV. • progress of building up a strong base in northern China.

9.3.1.4.2.1 Have management accounting practices lost relevance in today's competitive business environment?

As was discussed in section 9.3.1.3, Superior and Marlee used budgets extensively as a crucial mechanism of control. Budget/actual comparisons have played a crucial role in their performance evaluation systems. For example, on a monthly basis, all Asian Pacific paint subsidiaries within Superior group are required to conduct detailed ratio analysis on various business aspects, such as finance, production, sales, marketing, delivery, and health and safety. Within each business function, the analysis covers individual aspects of responsibility. Both financial and non-financial analysis has come into play and no one measure completely dominates the evaluation system.

In addition to that, the regional headquarters also adopted the comparative method as an informal means to assess the subsidiary performance. Two types of comparisons are commonly used - (1) between paint subsidiaries of the group located in the same region, (2) between subsidiaries in the region and key competitors. The comparative outcomes provide inputs of standards for the annual budgetary exercise. The overall assessment outcomes have significant impact on subsidiary managers' career prospect and year-end bonuses.

Superior has been using a complex performance evaluation strategy and the group has put a lot of emphasis on this mechanism as an effective means to control their Chinese JVs. Appleyard et al., (1990) identified that British firms are sophisticated in their dealings with foreign subsidiaries at the budget formulation stage and the subsequent evaluation of subsidiary performance. Being one of the UK leading firms, Superior's systems have demonstrated the sophisticated characteristics, highlighted by many British multinationals.

In Marlee, subsidiaries and their managers' performance are assessed according to their achievement of periodical milestones set down in the budgets. These targets are linked cross functionally and are developed from each of the business group's strategies. Both financial and non-financial measures are adopted. Again, the achievement of budget targets is tied to career prospect and year-end bonus for subsidiary managers. The system used in Marlee, as in Superior, matches with characteristics of the balanced scorecard approach advocated by Kaplan and Norton (1992). Each business group in Marlee chooses measures that are critical to the achievement of its strategies, and uses them to drive performance of their subsidiaries (Kaplan & Norton, 1992, 1993).

Another finding revealed in the Marlee case is the intertwined relationship between financial and non-financial performance measures. The case details indicate that the distinction between these two types of performance methods is seldom clear-cut. For instance, at the current stage Marlee places its priority on growth and market share in the Chinese market. Nevertheless, in the year when the interviews were conducted, the business group headquarters chose neither growth rate nor market share as the performance indicators, but preferred to use turnover as the key performance target. From a casual observation, one might conclude that Marlee relies on traditional financial measure, which is widely criticised by many scholars as either too aggregated to provide useful information (Chenhall & Langfield-Smith, 1998; Merchant, 1990), or as providing misleading signals for non-financial activities, such as innovation and quality that today's competitive environment demands (Kaplan, 1984; Johnson & Kaplan, 1987; Kaplan & Norton, 1992). However, this casual judgement is incorrect.

The business group assessed the growth rates and market shares of individual product lines and subsidiaries in China through an examination of their turnovers. I would argue that it is just an alternative method to examine the same thing, as turnover reflects the growth rate and market share. As Otley (1999:376) stated, "just because an item does not appear on the scorecard does not imply that it is no longer measured and reviewed". Financial success is often a logical consequence of doing well in fundamental aspects, such as innovation, quality, production, internal organisation and marketing, (Kaplan & Norton, 1992). Improvements on operational measures can lead to enhancement on financial measures on a scorecard, provided the spare capacity gained from a greater efficiency is eliminated or effectively used to generate extra benefits (Otley, 1999; Norreklit, 2000).

In a competitive market, performance on products, marketing, distribution and customer service is impossible to hide from turnover results. Under Marlee's corporate culture, basic success factors are almost taken for granted and they are pre-requisite requirements for any strategies. Therefore, by selecting turnover as an annual target, the business group would be able to promote and control performance in several sub-targets that are directly related to turnover. In addition, by using turnover, the headquarters can assess and feedback to the subsidiary managers whether the improvements they made on products and operation actually lead to a better financial performance (Otley, 1999; Norreklit, 2000).

Whereas other important aspects, such as the number of new products launched, which cannot be easily examined from purely looking at turnover, Marlee made it a particular performance criterion for the year. This system empowers the business group headquarters to minimise information overload through reducing the number of measures and focusing on the most important strategic areas (Kaplan & Norton, 1992, 1993; Otley, 1999).

In addition to the big players, some interesting information of how smaller firms design their performance measures is found in the Silky case. Silky has adopted a simple operational structure, the HK headquarters are responsible for marketing, sales, and administration functions of the business, while the Chinese subsidiaries focus on production. Peter stated that the Chinese subsidiaries were profit centres. Although profit is used in the assessment of JV performance, this criterion, in fact the financial measure, does not play a major role. Peter has stressed quality, then production scheduling and on-time delivery, and only finally on profitability. The degree of emphasis placed on various assessment criteria would in some respects seem inconsistent with the profit centre status of the subsidiaries. However, further investigation has shed light on the logic behind the design of the performance evaluation system.

The case details show that the Chinese factories work as cost centres, rather than profit centres as Peter claimed, in the sense that their orders come from the HK office and their budgets, order prices and level of spending are all decided by the headquarters. Based on these arrangements, when the HK office places orders to the Chinese factories, they have already kept a profit margin. They work as a trading company, who earns a commission from providing orders to the factories. Because of that, any further profit from the same orders at the subsidiary level becomes less important to the group as a whole. Rather, the factories' performance on production scheduling, quality and delivery is crucial to the future businesses that will have significant financial implication to the whole business.

Accordingly, adopting performance evaluation and reporting systems in the Chinese subsidiaries, where subsequent incentives are in line with the corporate strategies, means the desired levels of quality, productivity and eventually profitability are likely to be achieved (Shapiro, 1984). Silky's story once again demonstrates a key advantage of being a MNE, which is the ability to transfer resources and even profit through internal networks across national borders with an ultimate aim to maximise return on their investments.

Under today's competitive environment, MNEs responsively adopt some tailor-made performance evaluation and reward systems that are incorporated with their and/or their IJVs' strategies. These systems are by no means straightforward as one might once assumed, as non-financial methods motivate only operational results, whilst financial measures assess pure financial performance. Indeed, the two types of performance often bear an interdependent and circular relationship (Norreklit, 2000). This research lends empirical support to a point Otley (1999) raised that improvements made on products/services need to be recognised by customers and turn into greater financial results, if both operational and financial measures on a scorecard are said to be achieved.

The above analysis has illustrated how the four focal parents design their assessment and reward systems, which span across the conventional boundaries of financial and non-financial measures, with the aims to promote desired behaviour from subsidiary managers. The findings have made a contribution by extending existing knowledge of performance evaluation practices to an IJV context.

9.3.1.5 Design of reporting system and relationship

The four MNEs use reporting structure and relationship extensively to exercise control in their Chinese JVs. The common choice seems to correspond with their reliance on using performance evaluation and reward systems to influence behaviour and drive performance of JV managers. Implementation and effectiveness of the latter two instruments depends entirely on the supply of relevant and timely information (Otley, 1999). As a result, the right to design the reporting system is vital to the operation of the other two control mechanisms. Once again, the case materials demonstrate the interdependent and reinforcing nature of various elements within a control package to maximise the focal parents' control over critical success factors. Furthermore, the analysis shows that the ability to replicate their corporate reporting structures in the JVs can further strengthen the designing partners' influence over the reporting processes (Killing, 1983; Glaister, 1995; Yan & Gray, 1994; Schaan, 1988; Geringer & Hebert, 1989).

The above findings lend empirical support to Glaister's (1995) study, which also identified that regular reporting represents not only a top-down, but also a bottom-up, control mechanism. Through the reporting mechanisms, subsidiary managers can exercise upward influence by expressing their interpretation of difficulties and/or performance of their operations to the parent firms. Also, they could use the mechanisms to build up a good relationship with the headquarters in order to ensure their attention when decisions on resource allocation or rewards are made.

This upward communication channel is found to be particularly important to centralised MNEs, such as Silky and Pearl, whose subsidiary managers have little power to make budget and capital spending decisions for their operations. Through regular contact and reporting to the headquarters, JV managers could communicate with the headquarters about their problems and needs. From a psychological point of view, subsidiaries managers may feel that their opinions and needs are not totally ignored by the distant parents. This mechanism can minimise some of the dysfunctional effects caused by a lack of participation in the budgetary and decision making processes. Ming, the GM of Pearl's TianJin JV, seemed to be comforted by the availability of various informal means to communicate with the HK headquarters.

9.3.1.5.1 Frequency and nature of reporting - from IJVs to regional/business group/Hong Kong headquarters

A summary of the materials and frequency of reporting adopted by the sample IJVs to their regional headquarters/business group or HK head offices are illustrated in Table 9.5. Some notable findings are revealed in the analysis. First, the frequency of reporting shows a direct relationship to the size of focal parents' operation. Monthly, quarterly and annual intervals are used in all of the four cases. However, only Silky and Pearl use daily and weekly reports. In addition, the details included in different types of reports seem to be correlated with the intervals of reporting.

Secondly, the empirics demonstrate that various frequencies and types of report details are chosen to incorporate into, and support the operation of, two other control mechanisms, performance evaluation and reward systems, that the focal parents use. The potential synergy of adopting these three control tools together in a control package is to strengthen the relationship between JVs and designing parents and promote desired actions from the

JV personnel. Nature and frequency of each type of reports is now analysed in detail in the following sections.

Table 9.5

Materials and frequency of reporting adopted by the sample IJVs to their regional offices/business groups or the Hong Kong headquarters

	Daily	Weekly	Monthly	Quarterly	Yearly
Production information e.g. Units produced and reject rates	Pearl	Pearl Silky	Silky (in more detail)		
Some important production information			Marlee		
Financial information[15] e.g. production cost and total operational expenses			Silky Pearl		
Financial information: Profit & Loss Balance sheet			[16]Superior Marlee Pearl	Marlee (in more detail)	
Financial information: Ratio analysis			Superior		
A set of financial accounts					Superior Marlee
Various management accounting reports			Superior Marlee		
Sales and marketing information			Superior Marlee	Marlee (in more detail)	
Operational effectiveness			Superior		
Safety and health			Superior		
Environmental performance			Superior		
Progress report of business development			Pearl		

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[15] In Silky and Pearl, the finance and accounting function is centrally controlled by the Hong Kong headquarters. Based on the monthly financial information the subsidiaries report, the headquarters prepare the annual financial accounts for the groups and subsidiaries accordingly. Therefore, it is not an annual reporting exercise as such for financial information in Silky and Pearl's Chinese JVs.

[16] It was revealed in the interviews that the JVs also provide Giant, Superior's key JV partner, with a set of summarised financial statements on a monthly basis. The monthly type of financial reports is the only reporting link between the JV and Giant. The overall reporting systems in the JVs are designed by and highly integrated into Superior's regional system.

9.3.1.5.1.1 Daily and weekly reports

Out of the four focal examples, only Silky and Pearl have chosen daily and weekly intervals for internal reporting. These two types of reports tend to include mainly production information, such as production volume, progress of various orders and pass/reject rates. The focus on production information seems to match with the focal parents' investment objectives, which were set to establish reliable production bases in southern China and TianJin respectively. The emphasis on reporting production information on such a regular basis also coincides with Silky and Pearl's choice of assessment criteria on performance scorecards of their subsidiaries. Silky stresses the importance of operational efficiency, whereas Pearl aims to promote desired actions on both production and financial aspects. To reinforce effectiveness of the performance evaluation and reward systems, the two HK-based parents have introduced a complementary reporting system to generate timely and relevant information (Otley, 1999).

Furthermore, founders of Silky and Pearl remain active in control at both corporate and operational levels. They are keen to know everything about their businesses. For these two HK-based MNEs, the founders and the systems in the headquarters can still manage that level of detail and frequency of reporting from their subsidiaries, at least up until this stage.

For Superior and Marlee, who have hundreds of subsidiaries worldwide, their headquarters would have been overloaded if daily or weekly reporting on production performance had been adopted. Effective control in large organisations requires a specific set of arrangements to handle the increasing complexity of operation and needs of information (Galbraith, 1973). Decentralisation is the strategy that Superior and Marlee follow. Operational information is reported to the JV managers, who deal with day-to-day issues on the spot. Whilst the headquarters focus on corporate planning and decision-making.

9.3.1.5.1.2 Monthly reports

On the other hand, it is found that both financial and non-financial information is often included in the monthly type of reports.

Silky and Pearl require their JVs to report monthly on costs, such as cost of production and total expenditure of the operation. As was discussed in section 9.3.1.4.2, although the Chinese subsidiaries are regarded as profit centres by their respective headquarters, they indeed work more or less like cost centres. Their real identity explains why various types of cost information are required in their monthly reports to allow the HK head office to monitor the subsidiaries and their managers' performance. The principles of responsibility accounting seem to be included in the designs of subsidiaries' reporting systems.

Whereas Superior and Marlee's Chinese JVs are real profit centres, and they are required to report both non-financial and financial information on a monthly basis, the designs correspond to their respective performance assessment and rewards systems. Details of the non-financial kind of information that their Chinese subsidiaries reported have already been discussed in Section 9.3.1.4.2. In this section only a summary is given.

Superior's Asian Pacific headquarters require all subsidiaries to report monthly on finance, production, sales and marketing, and health and safety performance in a ratio analysis format[17]. The regional head office then uses the information to conduct variance analysis to assess subsidiaries and their managers' performance. As the executives revealed in the interviews, the assessment outcomes have significant impact on their career prospects as well as rewards in terms of year-end bonus. In addition to that, the regional headquarters also use the reported information to conduct comparisons to assess subsidiary performance. Two types of comparisons are commonly used - (1) between paint subsidiaries of the group located in the same region, (2) between subsidiaries in the region and key competitors. The comparative outcomes reinforce the performance evaluation systems and provide inputs of standards for the annual budgetary exercise.

In Marlee, the Southeast Asia & Australia head office requires its subsidiaries to report monthly on performance against budget targets. As previously discussed in the design of performance evaluation section on 9.3.1.4.2, the milestones selected for the Chinese subsidiaries are linked cross functionally and are developed from the business group's strategies. In any given period, both financial and non-financial targets are included in the scorecard to direct performance (Kaplan & Norton, 1992, 1996). The subsidiaries report monthly on their progress on achieving the performance milestones set down in their budgets.

[17] Superior has got standardised monthly ratio analysis reports for subsidiaries to fill out.

On the financial information side, both Superior and Marlee's subsidiaries are required to report their turnover and profitability performance through providing the headquarters with summarised profit and loss accounts and balance sheets. Under Marlee's policy, their subsidiaries are also required to prepare a more detailed set of financial accounts for the headquarters on a quarterly basis.

The financial controller revealed that the monthly financial reports serve both internal and external purposes. Under Marlee's rules, all subsidiaries around the world report monthly. On the other hand, under the Chinese law JVs, are also required to provide the local authority with summarised profit and loss accounts and balance sheets on a monthly basis. This type of external reporting mainly serves tax and foreign exchange balance audit purposes. The same interval for internal and external reporting adopted by Superior and Marlee in their Chinese subsidiaries begs a question, is the internal reporting system being driven by the external requirements, or is it only a co-incidence?

Johnson and Kaplan (1987) criticised senior management for having blindly allowed their internal management information needs to be driven by external financial accounting rules, and become subservient to the latter. They argued that separate systems should be used for internal and external purposes. In Superior and Marlee's cases, the monthly management reporting system is respectively the two MNEs' world-wide and Asia Pacific regional policy, which is not designed specifically to meet the foreign exchange audit requirement imposed by the Chinese JV law. However, I would submit a possibility that when the headquarters designed reporting systems for their overseas subsidiaries, they might aim to make their internal policies, such as frequency and nature of reports, to be consistent with the requirements of the majority of countries where they have investment interests.

My rationale for the above comment is that the two MNEs have a large number of subsidiaries spread across different continents and industries. If they have to make their internal systems totally separate from the external sets, as Johnson and Kaplan (1987) suggested, Superior and Marlee would need to run dozens of sophisticated accounting systems. It was revealed in Section 9.3.1.3.1, firms need formal structures and processes to provide a common language and meaning of information to their personnel. It is important to take into account the specific environment facing each subsidiary or region. In the meantime, maintaining a certain level of consistency, simplicity and clarity is equally important in system design (Horngren, 1986; Holzer & Norreklit, 1991; Scapens, 1991). Organisations need to strive for a healthy balance between the two based on the rule-of-thumb of cost and benefit analysis. Results of Goold and Campbell's (1987) research on how UK multinationals manage their portfolio of businesses can provide empirical evidence to support my argument.

Goold and Campbell hypothesised that different SBUs in a diverse portfolio respond better to different management styles. Because of that, when business nature or environment changes, the headquarters should adjust the style adopted in the related unit. From the theoretical point of view, the assumptions seem to make a lot of sense. However, the empirical findings showed that owing to the importance of simplicity and consistency to facilitate communication between centres and subsidiaries, diversified firms tend to employ a uniform management style across most of their businesses. In fact, changes of management styles seldom occur.

In addition to Goold and Campbell's research, other empirical studies also discovered a similar pattern that organisations make no significant changes to their management accounting systems, and traditional costing methods remain widely used by industries (Bright et al., 1992; Drury et al., 1993; Drury & Tayles, 1995). There is no clear evidence of external reporting requirements adversely affecting management accounting practices (Hopper et al., 1992; Holzer & Norreklit, 1991).

Referring back to this research, monthly financial statements adopted by Superior and Marlee seem to be a multi-purposed medium to meet both internal and external needs. Monthly reports, on one hand, work as an information source to produce various financial statements to cope with monthly, quarterly, half yearly and/or annual external financial and auditing requirements of different countries. On the other hand, the system provides headquarters with timely information to conduct performance evaluation and effectively control their subsidiaries. Also, the headquarters' demand for regular monthly profit reports for both internal and external purposes encourages subsidiary managers to adopt efficient costing systems to record, trace, allocate and/or apportion costs (Drury & Tayles, 1995). The monthly reporting system forms a feedback and learning mechanism, which provides feedback to the subsidiary managers whether the improvements they made on operational targets lead to better financial results set on their scorecards (Otley, 1999; Norreklit, 2000).

There is no clear evidence to judge whether or not external requirements in different countries have influenced the ways in which the four sample firms designed their internal reporting systems. However, I consider that it is not the similarity of information produced and/or frequency of reporting between financial and management accounting per se that decides which system is subservient to the other, but the ways in which managers choose and use the information (Drury & Tayles, 1995). If managers find an arrangement that fits both internal and external requirements, they have reasons to use a common system to serve both purposes from both cost and simplicity perspectives. I agree with the following comment Scapens (1994:316) made.

> "...we cannot expect all firms always to adopt the textbook techniques and procedures - hence the 'gap between theory and practice' should be neither surprising, nor worrying".

This research aims to explain the empirical reality, rather than to join in the historical debate on which system is subservient to the other. As Horngren (1986) stated, there is a cost of keeping costs. "The quest for complexity in decision models, simply as a means of better representing the underlying reality, is not necessarily going to provide 'ideal methods' which will be more useful to practitioners than the rather simpler models already available" (Scapens, 1991:137). The choices of accounting systems are often optimal responses to the costs and benefits of information provision (Holzer & Norreklit, 1991; Scapens, 1991).

In addition to my findings, Drury et al.'s (1993) research in management accounting practices of the UK industries identified that 97% of their samples prepared internal profit statements on a monthly basis. While Glaister's (1995) study of UK IJVs also discovered that 90% of his equity JV samples adopted monthly reporting in their overseas JV subsidiaries. Drury et al, Glaister and this research seem to reflect that monthly reporting is a popular interval and medium that is widely used by the industries to fulfil a wide range of internal and external requirements.

Besides cost-benefit reasoning, we need to realise that system designs include subjective human choice. As Otley (1999) stated, organisational control systems are often built up by different elements that are added onto the package by different people at different times. For researchers to study such systems, we cannot always expect to find rational explanations for the empirical realities. Perhaps, the choice of using one system is mainly or partly based on the senior executives' personal preferences of being consistent by keeping internal systems in line with external measures (Hopper et al., 1992; Drury & Tayles, 1995).

9.3.1.5.1.3 Yearly reports

Finally, for external reporting and consolidation purposes, Superior and Marlee's subsidiaries provide the regional or business group headquarters with a set of financial accounts on a yearly basis. Whereas, the finance and accounting functions in Silky and Pearl are centrally controlled by the HK headquarters, according to monthly financial information the subsidiaries reported (see section 9.3.1.5.1.2 for content of monthly reports), it is the headquarters' job to prepare annual financial accounts for the groups and subsidiaries. In the Chinese subsidiaries, annual interval is not adopted in their internal reporting systems to the HK head offices.

The above analysis demonstrates the complexity of parents' choice of control mechanisms. The discussion has also revealed the possible synergy of putting the right combinations of tools together in order to maximise control and benefits from the IJVs. The following section examines an unusual instrument that is only found in the Silky case.

9.3.1.6 Internal exclusive right agreement

Silky has been using an internal exclusive right agreement as an effective mechanism to exercise outright control in the JV. Among the four MNE partners, Silky is the only one who adopts this control instrument. In fact, the use of internal exclusive agreement as a mechanism to exert effective parental and partnership control in IJVs has not been reported in other prior studies in the field. Owing to its uniqueness, a further investigation of how the tool works is conducted.

When the JV was formed, Silky acquired 44% while its Chinese partner obtained 56% of equity. Having encountered a difficult start, the Chinese partner soon became pessimistic and suggested converting the JV into a sub-contractor to offer exclusive production services to one or two larger customers. Peter Lee did not agree with this early judgement.

Holding a minority equity position, Peter decided to take up the exclusive right himself. Silky bought out full control from its local partner in order to ensure that decisions made in the JV would contribute towards the achievement of its investment objectives in China. A fixed periodical payment according a fair share of forecasted profits if the JV were working as a sub-contractor would be paid to the Chinese counterpart by Silky.

From the Chinese partner's viewpoint, this agreement has provided them with steady income without bearing the risk of business fluctuation. However, being bound by the contract, the Chinese partner is now acting like a "cumulative preference shareholder" in a limited company, who shares a fixed return but has no voting rights on business decisions. From Silky's standpoint, the contract has empowered full control of the JV, and allowed them to enjoy any profit that exceeds the fixed payment to the Chinese partner. However, using an exclusive agreement does not mean that Silky would exclude its partner completely from the game. On the contrary, the MNE has still required the Chinese partner to help on import and export matters and applications for various types of licences and public relations. Indeed, it is a series of clever strategic manoeuvres.

First of all, forming a JV with a local partner could reduce capital commitment and speed up the local adaptation process. Once knowledge and confidence was built up, Silky bought out the complete control from the Chinese counterpart. It is true that "buying out" JV partners is not a new finding in JV research. For instance, Tsurumi (1984), Harrigan (1984), Anderson and Gatignon (1986), Blodgett, 1991, Contractor (1985), Yan and Gray (1994) and Casson (1990), also identified that JVs are often re-configured once partners have gained enough knowledge of the markets which they previously did not understand. In addition to these points, this research has discovered something extra that can broaden our knowledge of different versions of "buying out the JV partners".

Silky bought out the partner's right of control, not their equity. It is a cheaper way to achieve complete control, as Silky could continue to use the Chinese partner's 55% of capital without paying interest. Moreover, the HK partner can continue to benefit from having a JV status, and using the partner's local knowledge and contact. This finding has implication for firms who consider investing in industries or countries of which full foreign ownership is either legally prohibited or indirectly discouraged by the host country governments.

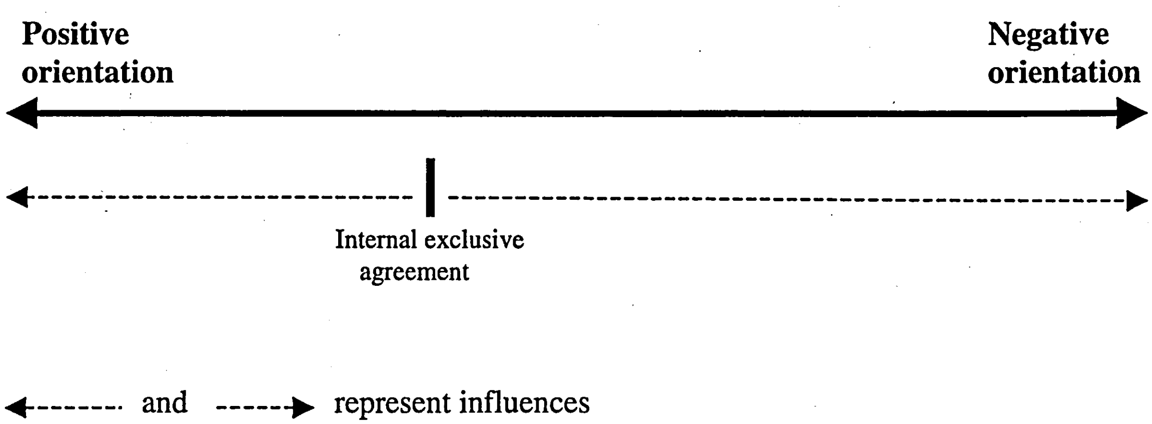
Silky's experience illustrates that positive and negative forms of control mechanisms are not necessarily mutually exclusive (Schaan, 1983). It is possible to think of different control mechanisms on various scalars ranging from positive to negative orientation of a bipolar continuum. There are control instruments located at different positions across the continuum that can be used to achieve positive, negative, or both positive and negative purposes at the same time.

Silky used an exclusive agreement to buy the outright control, which was welcomed by the local counterpart who did not want to take on undue risk and wait for any longer for the JV business to pick up. Being bound by the agreement, the Chinese partner cannot challenge the way in which Silky runs the JV. So far, both partners are happy with the arrangement and the mechanism has a more positive than negative influence on partners' behaviour and relationship. In Silky's case, the internal exclusive agreement, while locating in the central area of the positive-negative control continuum, is more closely associated with the positive end of the spectrum, as Figure 9.4 illustrates.

Figure 9.4

Positive-negative control continuum - Internal exclusive agreement

From Silky's perspective



9.3.1.7 Bargaining power

All of the four cases show that the MNE parents have been using bargaining power to encourage and/or pressurise their partners to adhere to the "rules of the games". If partners break the rules and/or deliberately act against their strategies in China, the focal firms will seriously consider withdrawing from the partnership. For example, the financial controller of Marlee China suggested that if the difference of opinions cannot be resolved through negotiation, "then Marlee will take another way forward that might mean forming a new JV (with a different partner)". Peter Lee of Silky uses the same tactics. He stated in the interview that "once I feel that I cannot control the (JV) operation, I will sell it and buy another one".

According to the central thrust of bargaining theories originating from the negotiation discipline, the level of dependence on the negotiation relationship and outcomes will determine each party's bargaining power (Harrigan, 1986; Tung, 1988; Yan & Gray, 1994). The party, who holds a wider range of alternatives to achieve the same goal and can walk away from the negotiation, is likely to win compromise from others, who rely more on the relationship (Tung, 1988; Yan & Gray, 1994). The greater the dependence of the resources from partners, the stronger the motivation for co-operation and forbearance (Gomes-Casseres, 1989; Buckley & Casson, 1988, 1989).

At the current stage of the economic development in China, there are many state-owned corporations and township enterprises looking for potential partners to bring them capital, new technology, equipment, product designs and/or JV status (Davidson, 1987; Kemp, 1987; Shenkar, 1990; Martinsons & Tsang, 1995). It was the position that Pearl's TianJin local partner held before the JV was found. The situation provides foreign investors with a favourable starting position in the on-going bargaining process. The possibility that foreign counterparts, such as Marlee, Silky and Pearl, may walk out from the ventures if things go against their interests, imposes pressure on the local partners, who tend to heavily rely on the relationships. The bargaining structure among partners has a significant influence on the behaviour of various JV participants (Yan & Gray, 1994; Harrigan, 1986; Harrigan & Newman, 1990). Nonetheless, we need to realise that the favourable bargaining positions that many foreign investors hold at the moment are likely to change when the Chinese economy is further developed and when the local businesses gain sufficient knowledge of international business.

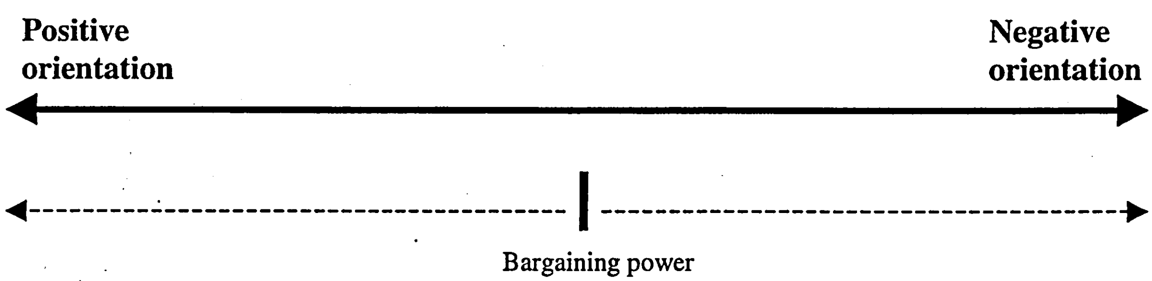
From the case details, I realise that bargaining power indeed is a multiple-purposed mechanism, which has both positive and negative effects on partners' behaviour. It depends on the way in which the tool is introduced and executed in each situation. For example, in Marlee's case, the group has made clear to the local partners its objectives in China and the things that are critical to them, such as the use of Marlee's brands and quality of products and services. Marlee is prepared to negotiate as long as these fundamental conditions are not challenged. Otherwise, the group may take another way forward. Marlee's tactics bring both motivation and threats to their local partners.

Following up the new understanding gained from the analysis of internal exclusive agreement (section 9.3.1.6), it is possible to think of various mechanisms on different scalars of the negative-positive control continuum. Bargaining power is a hybrid control instrument which has both positive and negative influences over the behaviour of JV participants. Figure 9.5 demonstrates the conceptual position of this control tool on the positive-negative continuum.

Figure 9.5

Positive-negative control continuum - Bargaining power

From the focal partners' perspective



←------- and ------→ represent influences

The fact that the execution of negative instruments, which include the extreme negative aspect of the bargaining power mechanism, could seriously damage the withdrawn party's reputation, may go some way to explain why none of the four MNE partners emphasise the use of this kind of unfriendly mechanism. Although Marlee encountered difficulties in the older JVs with major local Chinese players, the group managed to sort things out through negotiation and compromise. No JV has yet got divorced.

As was previously discussed in Chapter 5, the overall social and business culture in China highlights a mixture of Confucian and communist characteristics. The Chinese's emphasis on social harmony and human relationships is likely to impose pressure on JV partners to avoid using the extreme negative control tools, which can leave them with long-lasting damage to the reputation (Blackman, 1997; Luo, 1997). Triandis (2000) observed that collectivists could be extremely hospitable, co-operative and helpful to the in-groups. On the other hand, they can be exploitative and even hostile to the out-groups. The four focal partners of this research have invested a lot of time and effort to build up their guanxi networks in China. They are unlikely to take drastic decisions to jeopardise their in-group status, a critical success factor of doing business in China and other Chinese dominated Southeast Asian countries, where Silky and Pearl's roots lie and where Superior and Marlee own significant investments.

Moreover, for JVs to succeed in the long-term, mutual trust between partners is crucial (Beamish & Banks, 1987; Buckley & Casson, 1988; Casson, 1990; Mohr & Spekman, 1994; Schaan, 1983). The use of negative tools should be minimised when positive control instruments are properly in place to promote the desired behaviour and results (Schaan, 1983). It has never been easy to make a relationship work and it clearly requires a lot of give and take. Internal exclusive agreement and bargaining power are examples of hybrid control mechanisms that the focal partners use in order to avoid the extreme negative and positive measures.

9.3.1.8 <u>Veto rights</u>

According to the Chinese JV Law, the Board of Directors of Sino-foreign JVs must discuss and decide on business issues based on the principles of equality and mutual benefit (Li et al., 1994). Moreover, specific strategic decisions and other determinant issues, such as amendment of JV contract, termination of JV, change of registered capital and merger, can only be made by consensus of all board members (Li et al., 1994). The law empowers JV partners to exercise the veto rights as an effective channel to safeguard their interests. It is a formal negative control mechanism that all partners are entitled to use, if the situation demands it.

As discussed in the above sections, the implementation of negative type of control instrument can cause long-lasting side effects on reputation and partner relationships. The loss of reputation can jeopardise the in-group identity that the focal partners have established in China. It may be one of the reasons to explain why none of the four samples rely on veto rights to exercise control. Except in Marlee's case, the other executives rarely mentioned in the interviews the use of veto rights against their partners' decisions.

9.3.1.9 Conflict resolution provisions

Another unique control mechanism was found in the Silky case. Owing to differences of knowledge in international business and background between foreign and local partners, Peter Lee of Silky emphasised the needs to stipulate as many foreseeable problems and problem resolving procedures in the JV contract as possible (Davidson, 1987). Groot and Merchant (2000) labelled these kinds of tools as conflict resolution provisions. In the other three case studies, the focal partners discussed with their counterparts at the JV formation stage procedures and possible solutions for foreseeable problems in their ventures and relationships. However, Silky is the only one, who introduced this control tool in a more formal manner.

Provision of conflict resolutions is a negative control instrument. Same as other negative tools, its establishment is to serve one main purpose - to defend the immediate interests of individual partners. If unfavourable incidences occur, there are written agreements and problem resolutions to direct what various parties should do. Again, veto right can be exercised in major decisions, which significantly affect JV operation or survival.

9.3.1.10 Findings that inform and extend the skeletal theory of IJV control

The analysis of the mechanism dimension of IJV control has revealed that besides positive and negative forms, there are instruments, such as internal exclusive agreement and bargaining power, bearing a hybrid nature that can serve either or both positive and negative purposes at the same time. Instead of applying extremely positive and/or negative control tools, this study discovers that IJV partners may employ hybrid mechanisms in order to safeguard their interests on one hand and promote the desired behaviour on the other hand.

A key point revealed in the analysis above is that the range of orientations and mechanisms of IJV control are more realistically considered as a continuum, rather than just two polar categories - positive and negative, as Schaan's (1983) pioneer study suggested. There are different types of hybrids located at various positions across the positive-negative control continuum that can serve either or both of the purposes (illustrated in Figures 9.4 & 9.5). The findings of this research have broadened existing knowledge of the breadth of control instruments and their orientations. The discovery informs and continuously refines the conceptualisation framework of IJV control, which was last updated in section 9.2.2 (see Figure 9.3). This second modification is illustrated in Figure 9.6.

In sum, the analysis recorded in this section reflects that the four focal parents have adopted various combinations of positive, negative and hybrid mechanisms across the continuum in order to exert the types of control they need in the Chinese JVs. Table 9.6 provides a summary of the range of control instruments and their orientations that each of the four focal parents has chosen. In the next section 9.3.2, the sense-making journey will turn to the extent dimension of IJV control.

Figure 9.6

Modification (2)

Conceptualisation of IJV control developed from the skeletal model

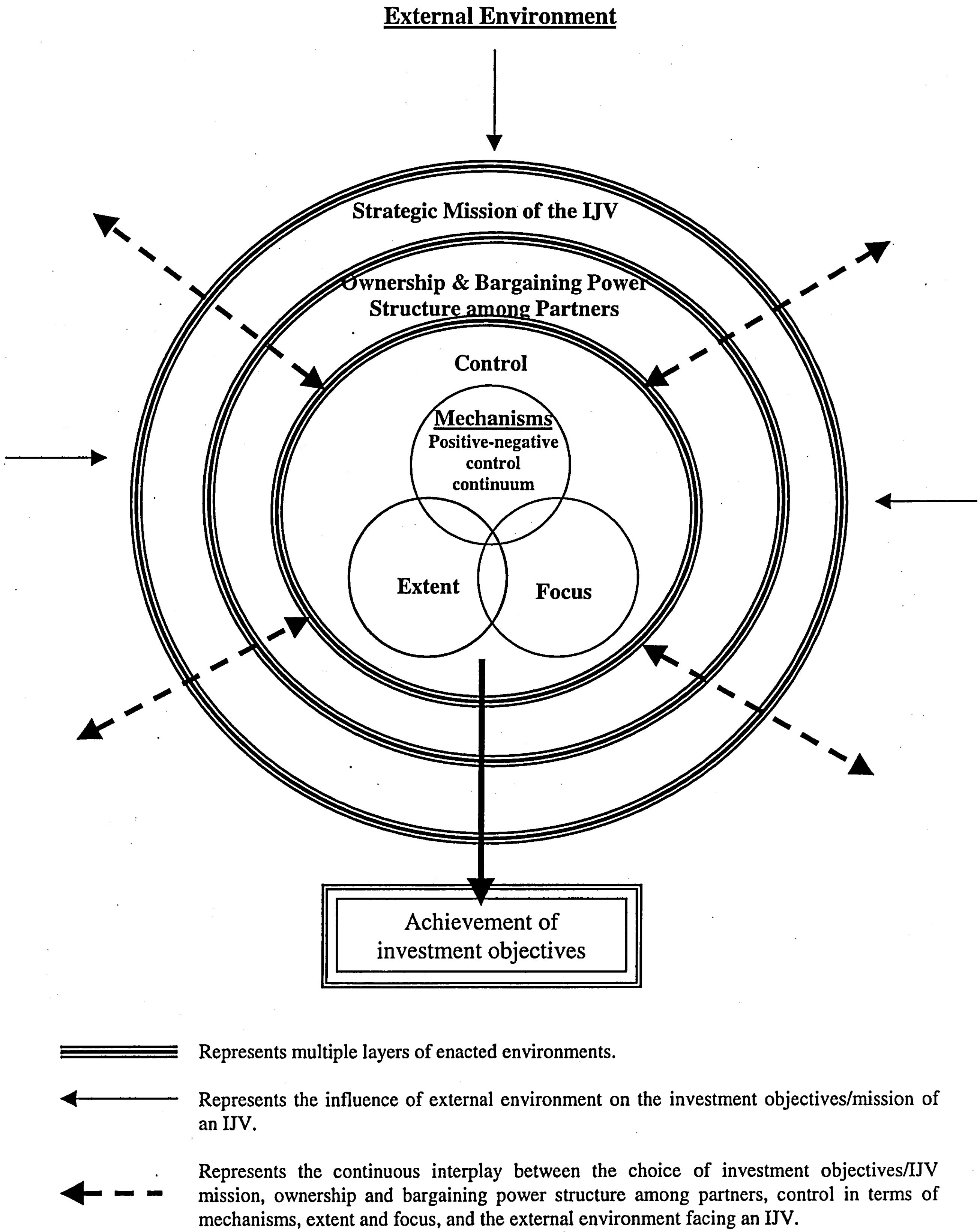


Table 9.6

The positive, negative and hybrid control mechanisms adopted by the four focal partners in their Chinese IJVs

	Superior	Marlee	Silky	Pearl
Positive Control Mechanisms	1. Providing services and resources to the JVs. • management - GMs and most of the key functional managers • brands • technology • training • marketing expertise • production expertise • raw materials 2. Ability to design and decide: • management structures. • products. • production methods and processes. • business strategies. • planning, reporting, & performance evaluation processes and systems.	1. Providing services and resources to the JVs: • management - GMs and most of the key functional managers • brands • technology • training • marketing expertise • production expertise 2. Ability to design and decide: • management structure. • products. • production methods and processes. • business strategies. • planning, reporting, & performance evaluation processes and systems.	1. Providing services and resources to the JV: • management - GM and plant manager • management support • product designs • brands • technology • training • production expertise • raw materials • orders • export opportunities 2. Ability to design and decide: • management structure. • products. • production methods and processes. • business strategies. • planning, reporting, & performance evaluation processes and systems.	1. Providing services and resources to the TianJin JV: • management - GM and deputy GM • management support • product designs • brands • technology • production expertise • raw materials • training • orders • export opportunities 2. Ability to design and decide: • management structure. • products. • production methods and processes. • business strategies. • planning, reporting and performance evaluation processes and systems.

Positive Control Mechanisms	3. Ability to tie management reward into budgeting and performance evaluation systems. 4. Close relationship with key JV management 5. Relationship established in the pre-JV days encourages co-operation from Giant. 6. Senior JV management's participation in Superior's regional meetings, training, and conferences. 7. Informal communication via: • memos and circulars • regular telephone and fax contacts 8. Understanding and relationship established in the pre-JV days encourages co-operation between the partners	3. Ability to tie management reward into budgeting and performance evaluation systems. 4. Close relationship with key JV management.	3. Ability to tie management reward into the performance evaluation systems. 4. Close relationship with key JV management. 5. Relationship established in the pre-JV days encourages co-operation from the Chinese partner. 6. Daily and other regular reporting. 7. Personal control exercised by the founder. 8. Informal and regular contacts via: • telephone calls • fax • personal visits • social gatherings	3. Ability to tie management reward into the performance evaluation systems. 4. Close relationship with key JV management. 5. Daily and other regular reporting. 6. Bargaining power derived from the Chinese partner's reliance on Pearl's contributions. 7. Personal control exercised by the two founders. 8. Informal and regular contacts via: • telephone calls • fax • personal visits

Hybrid Control Mechanisms	1. Strong bargaining position - the JVs sell and/or produce only Superior branded paints. The JV operation depends entirely on Superior's inputs of products and technology.	1. Strong bargaining position forces partners to co-operate. Otherwise, Marlee will take another way forward.	1. Internal exclusive agreement. 2. Strong bargaining power - Silky may sell off its JV equity and form a new one with another partner if the majority control is not available.	1. Strong bargaining power - Pearl would not have injected crucial resources into the TianJin JV if the majority control was not achieved from the start.
Negative Control Mechanisms	1. Voting & veto rights: significant/ majority share holding in each JV. 2. Approval required for: • how Superior's brand name is used. • nomination of the GM & other functional managers of the Chinese JV. • any change of strategies, budgets, and scope of business.	1. Voting & veto rights: significant/ majority share holding in each JV. 2. Approval required for: • all important business decisions, especially those related to strategies, budgets and marketing.	1. Voting & veto rights: significant share holding. 2. Conflict resolution provisions.	1. Voting & veto rights: majority share holding.

9.3.2 The "extent" dimension of IJV control

Having examined the mechanism perspective, the investigation now turns to the extent dimension on the central core of the skeletal model (see Figure 9.6). The extent perspective of control is concerned with the degree of influence that each partner exerts into different types of business decisions (Killing, 1983; Geringer & Hebert, 1989). Evidence from all of the four case studies shows that the focal parents are keen on achieving the majority control in their Chinese JVs. Marlee, Silky and Pearl considered securing significant control as the most important criterion that must be fulfilled before they would agree to progress further in any JV negotiation process. Exceptions are only found in Marlee and Pearl's strategic JVs, which aimed at accessing partners' specific assets. Superior has adopted a similar attitude towards the issue and regarded gaining significant control as their business philosophy.

9.3.2.1 Why is significant control so important?

It was revealed in section 9.3.1 that the four MNEs have been using a wide range of control mechanisms to ensure that their strategies will be incorporated into JV operation, properly implemented and eventually achieved (Miles & Snow, 1978; Govindarajan & Gupta, 1985; Groot & Merchant, 2000). In other words, the scope of control individual parents targeted for is largely determined by their investment objectives, i.e. what they want to achieve from engaging in JVs in China.

For example, Silky's main objective to invest in China is to establish a cheap production base. The company needs to ensure that the JV can produce products up to their quality requirements at a reasonable level of cost and speed. Correspondingly, control over production cost, scheduling and quality is of paramount importance to the company. Another example of strategy-control fit is found in Marlee case. The extent of control the group needed bears a close relationship with its overall strategy of investing in China. Marlee has targeted to achieve a significant growth in China in order to improve their worldwide competitiveness. They aimed to become a billion-dollar-turnover business in China around the year 2000/2001. As the financial controller described, to achieve this goal requires huge infrastructure, training, recruitment and central treasury management to raise cash. That co-ordination is much easier to organise if they hold the majority control of the Chinese JVs.

In addition to supporting investment objectives/JV missions, the empirics demonstrate that the importance of majority control also lies in the need to ensure smooth transfer and minimise the risk of dissipation of firm-specific assets. From a contributing partner's point of view, this type of concern is not difficult to understand. Firstly, advanced technology always consists of tactical knowledge, hence successful transfer often requires close supervision from the supplying partner (Kogut, 1987; Tsang, 1994; Martinsons & Tsang, 1995). Naturally, these kinds of needs require direct and extensive participation from the supplying partner in the transfer and adaptation process in the JV. This is why Superior, who contributed cutting-edge paint production technology and brands to its JVs, has gained significant control in SGP HK, China and Shanghai.

On the other hand, all of the four focal partners have contributed brands and product designs to their JVs. Disclosing technological and marketing secrets to JV partners and local employees opens up the risk of this information falling in the hands of competitors operating in the same environment in China, a country characterised by an under-developed legal framework to deal with copyright piracy (Casson & Zhang, 1991). The situation may have deepened supplying partners' concerns over the risk of dissipation before full rent of developing those assets is recovered (Hymer, 1976; Rugman, 1982; Teece, 1980, 1981; Caves, 1982; Ingham & Thompson, 1994; Contractor, 1985). A combination of effects encourages the focal parents to exert close supervision over the use of and access to the special assets.

Furthermore, achieving significant control is found to have confidence-enhancing effects. For instance, Pearl, who provided the TianJin JV with critical resources to begin business, would not have done so unless significant control was available from the start. The local partner conceded the majority of control to show respect to Pearl's contribution. This type of gesture can boost confidence and have positive effect on the partnership. Co-operation between partners is a vital source of input for JV success (Mohr & Spekman, 1994; Beamish & Banks, 1987; Buckley & Casson, 1988; Casson, 1990).

9.3.2.2 <u>To which "extent" control is considered as "significant"?</u>

Achieving the majority of control is undoubtedly very important to the four focal partners. In order to understand and measure to which extent control is considered as "majority" or "significant", I have adopted Killing's (1983) taxonomy to examine the number of JV decision areas that individual partners exert influence over. I also aim to examine the relationship between the chosen extent of control, mechanisms of control, and other contingency variables, such as JV mission and partnership structure.

In total there are eleven functional areas included in the measurement framework: pricing policy, product design, production scheduling, production process, quality control, nominating JV GM, nominating or replacing functional managers, budgeting of sales targets, budgeting of cost targets, budgeting of capital expenditure and public relations. Nominating JV GM and the last two items of the above list were not included in Killing's original taxonomy. Nonetheless, I believe that the distribution of control over these aspects can shed further insight into the extent of control that JV parents exercise under the environment in China.

As was discussed in section 9.3.1 with respect to the mechanisms of control, according to the Chinese JV law, JV GMs are empowered with the highest operational authority to deal with both internal and external affairs. A lot of power is associated with the ability to nominate this influential post. Hence control over this important aspect should be included in the measurement of the extent of control that individual partners achieve.

On the other hand, it was discussed in Chapter 5 that under the influence of Confucian thinking, the Chinese are used to placing great value on human relations. The ability to manage relationships is seen as an important asset when doing business in the Chinese societies (Kemp, 1987; Hofstede & Bond, 1988; The Economist, 18/7/1992; Blackman, 1997; Luo, 1997). Therefore, it is useful to identify which party is responsible for the sample IJVs' public relations.

In addition to identifying the scope of control, more precisely, I want to analyse the ways in which decisions are made in terms of the extent of "jointness" of decision-making between various parties. I aim to measure how joint their ventures are (Glaister, 1995). Glaister's framework, which is fundamentally built on Killing's (1983) research, is adopted to facilitate the measurement of jointness of decision-making.

In total there are seven types of decision-making methods included in my framework to assess the degree of jointness: (1) by the JV senior managers alone, (2) by the local parent alone, (3) by the foreign parent[18] alone, (4) by the JV senior managers with input from the local[19] parent, (5) by the JV senior managers with input from the foreign parent, (6) by the local and the foreign partners, and (7) by the JV senior management and all partners.

Full detail of the analysis is outlined in the following sections. Table 9.7 gives a summary of the findings on the jointness of decision-making over the eleven selected business aspects and extent of control that the four focal parents applied to their Chinese JVs.

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[18] While SGP HK and Shanghai are formed between Superior and Giant, SGP China is founded by Superior, Giant and a local partner. Throughout the discussion in this section in relation to Superior and Giant's JVs, the term "foreign partner" included in decision-making methods (3), (5) and (6) refers to Superior unless otherwise stated.

[19] Throughout the discussion in this section in relation to Superior and Giant's JVs, the term local partner(s) included in decision making-methods (2), (4) and (6) refers to Giant and the Chinese partner IDC unless otherwise stated.

Table 9.7

A summary of the extent of control and jointness of decision-making in eleven selected business aspects of the sample Chinese IJVs

Business decisions	JV managers alone	Local partner alone	Foreign partner alone	JV & local partner	JV & foreign partner	Local & foreign partners	JV & all partners
Product pricing	Superior Marlee		Silky Pearl				
Product design			Superior Marlee Silky Pearl				
Production process	Superior Marlee Silky				Pearl		
Production scheduling	Superior Marlee				Silky Pearl		
Quality	Superior Marlee Silky Pearl						
Nomination of JV GM			Superior Marlee Silky Pearl				
Nomination / replacement of functional managers			Silky			Superior Marlee Pearl	
Sales Budget			Silky Pearl		Superior Marlee		
Cost Budget			Silky Pearl		Superior Marlee		
Capital Expenditure Budget			Silky			Superior Marlee Pearl	
Public Relations							Superior Marlee Silky Pearl

9.3.2.3 Extent and jointness of control

Through a long investigation, some interesting facts related to jointness of decision-making among JV parents are discovered. For example, some decision-making methods, such as (1) "JV management alone" and (5) "JV and foreign partner", are more popular than the others, like (2) "local partner alone" and (4) "JV and local partner". However, there is no one type of practice that can represent the ways in which decisions in all of the identified business functions are being made. They are indeed hybrid cases, which are characterised with decisions that are made by various combinations of interested parties and are not arrived through an uniformed manner (Yan & Gray, 1994; Glaister, 1995). There are several possible reasons to explain the phenomena.

As was previously discussed in section 9.3.1, all of the four focal partners brought into the Chinese JVs firm-specific assets. From a supplying firm's point of view, the authority to decide and monitor the use of these assets is in their immediate interests. They need to achieve decision-making power over these areas directly or otherwise. Nomination of JV GM and other key functional managers is a typical tool they use to secure direct control over JV operation (see 9.3.1.1 for nomination of staff). To reinforce the effectiveness of staff provision, the four foreign partners have also secured the right of designing performance evaluation systems and tying JV managers' rewards with the achievement of JV missions as a pair of control instruments to promote desired actions and results. The findings here illustrate the interdependent relationship between parents' choice of mechanisms and extent of control.

On the other hand, in areas, such as the production process, scheduling and quality, a more decentralised pattern of control is commonly used among the four focal partners. JV management are granted more autonomy in the production function, and allowed to make related decisions either independently or jointly with foreign partners. There are some possible reasons to explain the practice. Owing to their huge size of operation, Superior and Marlee's headquarters are unable to get heavily involved in day-to-day operational decisions in their subsidiaries, and need to delegate authority down the hierarchy to avoid information overload and maintain efficiency. Moreover, production related decisions often require direct involvement and first hand information. These requirements constitute a situation of which the JV management is the most appropriate group of people to be in charge. The finding above lends empirical support to Glaister's (1995) study, which also discovered that higher JV independence is often granted to production related decisions.

The same logic can be used to explain how Superior and Marlee control budgetary decisions in their Chinese JVs. It was revealed in the case studies and section 9.3.1.3 that the two MNE parents take annual budgetary exercises seriously and have been using it as a key mechanism of control in their subsidiaries. In order to achieve timely and relevant local information to set realistic targets, monitor performance and motivate managers, Superior and Marlee have adopted a joint decision-making policy (between foreign partner and JV management) in budgetary decisions. This finding disagrees with parts of Glaister's (1995) results, which indicated that "all partners together with JV managers" was a common way in which budget decisions were made in UK IJVs.

On the other hand, the founders of Silky and Pearl, who are still active in management at both strategic and operational levels, remain using personal and direct control in their subsidiaries. In areas, such as pricing, product designs and budgeting, the founders tend to keep the decision making power at the headquarters, while other aspects, like production process, production scheduling and quality, which require inputs from local managers, use a joint decision approach. These arrangements appear to match with their primary objectives of investing in China – to secure a low-cost production base. It may be recalled from section 9.3.1 that JV GMs and the majority of senior functional managers are appointed by the focal parents. Founders of Silky and Pearl have personal knowledge of and significant influence over the JV managers. Therefore, the joint decision-making mode is somewhat of a pseudo autonomy policy, since the founders' control over production decisions in the Chinese JVs has not been diluted.

A different combination of interested parties is found to be responsible for another two groups of decisions. It is discovered that all partners are involved in decisions related to nomination or replacement of functional managers, as well as capital expenditure. For the first type of decisions, I have found the classification, which was adopted from Killing's (1983) study, too ambiguous to reveal meaningful information. This is because which party(ies) is (are) in charge of appointing functional managers often depends on what type and which level of manager that each appointment is concerned with.

If we refer to senior posts, such as the JV GM and deputy GM, the parties who have the authority to nominate candidates will be agreed by all partners before a JV starts operation and this agreement will be stipulated on the JV contract, as the Chinese JV Law states. In a general sense, the nomination or replacement of junior to middle level managers rests on the JV GM, who represents the Board of Directors to handle all operational affairs. The JV partners appoint the Directors. Therefore, I consider that "all partners" is the best description of the jointness of decision-making for this aspect.

The second type of business decision, where and how much to spend on capital investments, seems to be the concern of all JV partners. It is stipulated in the Chinese JV law that Directors of all Sino-foreign JVs must discuss and decide important business issues based on the principle of equality and mutual benefit (Li et al., 1994). Capital investments, which often involve large capital outlays and long life spans, are important decisions, and therefore are likely to be included in this category which requires approvals from the Board of Directors who represent different JV partners.

In this research, the new area of public relations that was added on to Killing (1983) and Glaister's (1995) frameworks shows a different combination of decision-makers. The analysis indicates that decisions over this aspect tend to draw on knowledge of different parties. Some likely reasons to explain the practice are that public relation activities require first-hand information and personal contacts. It is particularly important in China where guanxi is vital in business dealings (Kemp, 1987; Davidson, 1987; Shenkar, 1990; Newman, 1992; The Economist, 18/7/1992; Blackman, 1997; Luo, 1997; Tsang, 1994; Martinsons & Tseng, 1995). It is true that JV managers, most of which were expatriates appointed by the foreign partners, are on the spot to obtain first-hand information and act independently. Nonetheless, we need to understand that relationships are difficult to establish and transfer from one party to another.

Local partners[20], who tend to possess country- and relationship-specific assets, are proved to be appropriate, particularly at the early stage of the JV establishment, to be in charge or at least being involved in helping the foreign partners and JV managers to build up their bamboo networks (DFAT-Australia, 1998; Weidenbaum, 1996). On the other hand, foreign partners, who provide their Chinese JVs with capital, technology and/or products,

[20] For Superior, their UK partner Giant is an old Chinese hand, who has a long experience of running businesses in China.

have often gained a high social status in China. For the world-class players, such as Marlee, Superior and Giant, their investments in China often attract attention from the media and senior government officials. A high social status forms the foundation of their guanxi building and has put them in an advantageously competitive position in China. A joint effort from all parties in public relations will benefit the JV as a whole. These merits drive the focal parents to share control and encourage all parties to pool their strengths.

9.3.2.4 Extent of control - styles of parental control and classifications of the sample IJVs

The extent and jointness of decision-making was outlined in the above section. Based on the scope each partner controls and the ways in which decisions are made in the sample Chinese JVs, the focal partners' control styles would be categorised into: (a) dominant control, (b) shared management, (c) independent, or (d) split control (Killing, 1983. See section 7.2.1 for definitions).

A key message repeatedly reported in the analysis of mechanism and extent dimensions is that the four MNE parents have achieved significant control in the Chinese JVs. It can be seen from Table 9.7 that the existing co-operation in decision-making is mainly between foreign partner and JV managers, who are expatriates appointed by the former. The evidence seems to suggest that the four MNEs' control styles and their Chinese JVs should be classified as dominant partner JVs, in the sense that one partner plays a dominant role in the majority of decisions (Killing, 1983; Beamish, 1985, 1988). Despite the apparent overwhelming evidence, I have reservations in putting the sample firms into the dominant category, since their overall characteristics demonstrate subtle differences from the definition advocated by Killing (1983).

The four focal parents have had significant influence over a wide scope of JV functions and partner relationship. They have also replicated their systems and structures in the Chinese JVs. From this angle, the control styles they applied to the Chinese JVs demonstrate the characteristics of dominant partner JVs (Killing, 1983; Beamish, 1985). My reservation however is that despite holding an influential position in their Chinese JVs, the MNE parents have not fully excluded their partners from the game and run the JVs as if they really had only one parent. On the contrary, based on some reasons, which will be discussed in section 9.3.3, the focal parents have voluntarily conceded control over some business functions to their partners and JV managers. Although the number of areas applied may be fairly narrow, it is not the point of the argument. The underlying intention of allowing partners to have a say in and contribution to management and/or operation makes this form of parental control different from running the JV as if it was having only one owner. Because of this difference, it is incorrect to classify the samples' control styles and their IJVs into the dominant control category.

On the other hand, although decisions are made by different combinations of interested parties, I consider that it is incorrect to classify the four MNEs' control styles and their IJVs as shared management JVs (Killing, 1983; Beamish, 1985, 1988; Geringer & Hebert, 1989). It is because control over all or the majority of the eleven identified business aspects is not divided up equally between partners, as the key characteristic of shared management suggests (Killing, 1983). The four cases have adopted a hybrid strategy, and control in their Chinese JVs is shared between various parties according to the pressing interests and/or strengths (Cantwell & Dunning, 1984; Geringer & Hebert, 1989; Yan & Gray, 1995; Glaister, 1995). These characteristics indeed match with the central thrust of an emerging form of JV control - "split control" (Cantwell & Dunning, 1984; Schaan, 1983; Geringer & Hebert, 1989; Glaister, 1995; Gray & Yan, 1995). Under a split control arrangement, individual partners have played distinctive roles in JV management.

My result is consistent with Glaister's (1995) finding, which revealed the use of split control in his UK IJV samples. However, Glaister (1995) stated that split control could be thought of as shared management. I disagree with this view because of the fundamental differences in principles that underline these two kinds of control styles.

In sum, various JV parties are playing different roles and share various extents of authority in decision-making with the hope to achieve their objectives of getting involved in JVs. Through applying the tailor-made control packages, the four focal partners have obtained a larger share of control of their Chinese JVs. In some areas, no matter how narrow the scope may be, the MNE parents prefer to share the authority with their partners and/or JV managers. Indeed, their partners adopt the same approach. These passive partners have tailor-made their scope of control. While the extent may be seen as fairly tight, the narrowed focus is, however, driven by their strategies, and the small scope of control is what they wanted at that stage of the JV investment. There seems to be a notion of parsimonious and contingent usage of resources for controlling IJV among the passive parent firms (Geringer & Hebert, 1989; Schaan, 1983).

The analytical results above disagree with parts of Beamish's (1985, 1988) findings, which identified that shared control is particularly appropriate to JVs located in less developed countries, and its adaptation bears a direct relationship with superior JV performance. Findings of this study also contradict Beamish's (1985, 1988) argument, which suggested that foreign partners' influential positions in JV operation and partner relationship would have negative impact on JV performance. This study demonstrates that it is not the control structure per se, but the process of how the control structure of a JV is arrived at, that reflects partner relationship and influences JV performance (see section 9.4 for the sample IJVs' performance).

As Geringer and Hebert (1989) stated, relationships between different JV parties and the interactions among various factors of control in contemporary JVs are far more complicated than scholars might once perceive when research efforts were first attracted to the field of JVs/IJVs. The classifications advocated by Killing (1983) and Beamish (1985) that this study adopted to measure the extent and styles of control are no longer rich enough to fully explain the dynamism of parental control in the modern business world. Glaister's study (1995) in the 1990s discovered the use of split control among his UK IJV samples. This research lends empirical support to Glaister that split control is commonly used among the four focal partners in China.

In the next section 9.3.3, the investigation will continue to look at the third control dimension, focus, on the central core of the skeletal model.

9.3.3 The "focus" dimension of IJV control

Having looked at the mechanism and extent perspectives, the investigation now progresses on to the third dimension, focus, of IJV control. In fact, the above analysis on control extent opened up the discussion of the focus perspective of IJV control. It was revealed that the majority of the eleven business aspects in the sample IJVs are under the focal parents' direct or indirect control. However, it needs to be stressed that the quantity of decision areas is not the key point of discussion here. This part of the analysis aims to investigate control focus through examining the degree of strategic importance of individual areas that each parent controls in their Chinese JVs.

As was indicated in the discussion above and in Table 9.7, although the focal partners have emphasised the importance of significant control, they have not monopolised the control over every single type of business activities. On the contrary, the sample firms tend to select important strategic aspects, and share out the control over other areas between their partners and/or JV managers. For example, capital expenditure and public relations are two common areas that other parties are encouraged to get involved with their activities.

A noteworthy point is found in the analysis of the extent dimension. It seems to be a common misconception that partners fight against one another for control. Along with this line of thought, the presence of multiple parents has often been regarded as one of the key factors leading to poor JV performance (Killing, 1983; Harrigan, 1987; Shenkar, 1990). I would submit that these assumptions are not applicable to some JVs, especially those established by partners, who trust one another and possess compatible objectives and resources. Indeed, the investigation reflects that the current control configurations in the sample IJVs are joint products created by individual partners' strategies. There are a number of examples in the four cases that lend empirical support to the above argument.

For instance, in Pearl's TianJin JV, most of the systems, such as management, accounting and marketing, are derived from the HK partner. It is a one-sided control. An interesting fact is that the dominant control composition is encouraged by the Chinese partner NS. When the JV was formed, NS had limited knowledge of international business. They needed a partner who possessed the relevant knowledge to guide them through it. Because of that, NS preferred to let Pearl take up the leading role in decision making for the JV.

The division of control in Pearl's Dion JV followed the same logic. Pearl takes up a deputy position in management to help Dion to set up their first production base in China. Their role is rather similar to the one NS plays in the TianJin JV. Pearl's relaxed control approach in the Dion JV is driven by their investment objectives, which are to get access to the Japanese partner's advanced production technology and car security market. Pearl is happy to let Dion have a louder voice in control, particularly over the use of technology, product design and quality. The needs for its partner's resources encourage Pearl to forebear and co-operate (Gomes-Casseres, 1989, Casson, 1990). Nonetheless, Dion's reliance on Pearl's knowledge of local environment and production works as a balancing element of bargaining power among partners (Harrigan, 1986; Tung, 1988; Yan & Gray, 1994).

The case materials repeatedly show that if partners are holding compatible objectives, whether the JVs are run by one partner or all parties should not become a source of conflict. In the above quoted examples, the partners trusted that under the leadership of Pearl and Dion, they stood a better chance to achieve the goals that they were unable to fulfil on their own (Beamish & Banks, 1987; Casson, 1990; Mohr & Spekman, 1994; Blumenthal, 1995).

Giant's original paint factory was relatively small. Without a significant injection of capital and technology, the small-scale plant had little chance to succeed. However, by forming a JV with Superior, this goal became real. Giant is willing to take a back seat in JV control in exchange for a prosperous future in the paint field and a long-term relationship with Superior. Commanding a small range of business functions is not synonymous to failure in controlling JVs. Similarly, controlling a broad range of JV activities does not necessarily mean success. As prior contingency research revealed, different strategies have different control requirements, which in turn lead to various control configurations (Dermer, 1977; Emmanuel et al., 1990; Govindarajan & Gupta, 1985; Simons, 1987; Langfield-Smith, 1997; Otley, 1999). This set of assumptions can be extended to an IJV context.

According to Superior's investment objectives, marketing, production process, quality, and product design are critical towards the achievement of their strategies in China. They have to exert control directly or otherwise over these functions. Giant aimed to expand the paint business at a lower cost, and their key contribution to the JVs is capital in terms of money and knowledge of distribution in China. Accordingly, their main concerns are how the JV funds are being used, and whether or not the JVs are profitable and growing. Capital investment is an area of decision making that all partners are involved in through their Directors' representation on the JV Board. Giant has also been involved in public relations to help the JVs and Superior to establish their relationship and distribution networks in China. It was revealed that alongside the formal reporting responsibility to Superior's regional headquarters, the JVs also provide Giant with a set of summarised financial reports on a monthly basis. Following their investment strategy, control over a small range of functions and the concise monthly financial reports are what Giant needs.

In Superior and Giant's relationship, one party wants to control more and the other needs less. They are compatible in terms of objectives and resources. In additional, the two partners also work on their relationship. For instance, Superior let Giant appoint the Chairman for SGP HK. This Chairman is merely a symbolic figurehead, while the Managing Director Richard Mather, an experienced expatriate of Superior, is the boss of the JVs. Based on courtesy, Richard will acknowledge the Chairman and ask for his approvals on all major decisions. There is a lot of give and take in the JV marriage. As the skeletal model suggests, partner selection is a key part of the whole control package. The choice of right business companions can create the preconditions for robust co-operation (Harrigan, 1986, 1988; Parkhe, 1993a; Axelrod, 1984; Geringer & Hebert, 1989; Schaan, 1983, 1988). The satisfactory experience achieved in SGP HK and SGP China demonstrates that a focus strategy, which is based on immediate interests and strengths of partners to divide JV control, works.

Approaching the final stage of the sense-making process, I have accumulated more and more understanding with which to draw up a fuller picture of the control package that each of the four focal firms adopts. It can be seen that the current control configurations in their Chinese JVs are not the results of a hard battle between partners. Rather, they are joint products derived from individual parents' strategic choice (Schaan, 1983; Lecraw, 1984; Geringer & Hebert, 1989, Parkhe, 1993a; Glaister, 1995; Merchant et al., 2000).

If we believe that the main reason to get involved in a complex JV relationship is to benefit from the association with other partners (Beamish & Banks, 1987; Casson, 1990; Mohr & Spekman, 1994; Blumenthal, 1995), successful parents should adopt a selective approach and focus their efforts on strategically important activities and decisions (Schaan, 1983; Poynter, 1982; Geringer & Hebert, 1989; Glaister, 1995). As Schaan (1988) rightly pointed out, interests of one parent are best served when those of everyone else are also fulfilled. It is undoubtedly difficult for one JV parent to achieve its strategy without conflicting with the interests of other partner(s) (Blumenthal, 1995). A necessary pre-condition for this to happen is to select partners, who hold compatible strategies and resources. The complementary nature of partnership allows all partners and the JV to pursue their respective objectives at the same time without interfering with the interests of one another. In China, foreign investors may well be confronted with greater needs of adaptation, networking and information, thus reinforcing the appropriateness of forming JVs with compatible partners (Beamish & Banks, 1987; Harrigan, 1988).

Having completed the investigation of the three control dimensions, a fuller picture of their roles, inter-relationships and interactions with other contingency variables comprising a control package is revealed. The following section summarises new insights generated from the analysis above that can further develop the skeletal model of IJV control, which was last updated in section 9.3.2 (see Figure 9.6).

9.3.3.1 New findings that inform and extend the skeletal model of IJV control

The analytical process above has generated new understanding which challenges the original set of assumptions concerning the central core of the skeletal model. As was revealed in Chapters 6 and 7, Geringer and Hebert's (1989) ideas had significant influence on the development of the skeletal theoretical framework. Their views, which consider that control in an IJV context consists of three dimensions, mechanisms, extent and focus, were adopted and integrated into the conceptualisation. The skeletal model assumed that under the influence of IJV mission and partnership bargaining power structure, parent firms then design the mechanisms, extent and focus of IJV control accordingly. The three dimensions were presumed to position on the same level, and under the same degree of influence from the other contingency factors of a control package. However, the investigation on the focus dimension discovered something different.

The analytical findings have demonstrated that the enacted control settings created by the mission of an IJV and the bargaining power structure among JV partners determine the "critical functional areas" that individual partners "should focus on". Once the control focus is identified, the extent of business functions/decisions and the combination of mechanisms (in terms of positive, negative and/or hybrid) to support the strategic focus of control can be designed accordingly. The combination of choice that the designing partner subsequently makes on the three perspectives at the central core of a control package will then form another layer of enacted environment, which may articulate or hinder the implementation of investment strategies as well as partner relationship. It depends upon whether the choice of the three control dimensions is congruent with the enacted environments they face.

For example, Superior went to China with the objectives of penetrating the domestic market and completing its production network in Southeast Asia. Driven by these objectives, the group formed a JV, SGP China, with Giant[21] and IDC[22] in order to internalise the partners' existing knowledge/contacts and speed up the local adaptation process. Also, with JV status, the operation is eligible to sell domestically. The investment objectives, together with the bargaining power composition among partners in the JV, created a specific enacted setting that shaped the choice which Superior subsequently made on the three control dimensions.

Having set a target to penetrate the local market and bring their brands, products and technology into the Chinese JVs, there are critical JV functions such as product designs, production, sales and marketing that Superior needs to focus on and gain control over. In order to support the critical strategic focus, the group has carefully selected and mixed the mechanisms and extent of their control package. For example, Superior secured the right to nominate the JV general manager (GM) and some other key functional managers. According to the Chinese JV Law, the GM possesses the highest operational authority in a JV to deal with both internal and external affairs. Indirectly, through the staff provision mechanism, Superior gained involvement and control over decision making relating to all important JV functions. Moreover, the expatriates, who are transferred from other Southeast Asian operations of Superior, possess the knowledge of the Chinese culture and language. It gave Superior a better control over the enacted environments that were created by decisions made on various contingency variables comprising their control package.

To reinforce the effectiveness of staff provision, Superior also secured the rights for designing the performance evaluation system and tying the JV managers' rewards to the achievement of JV mission providing them with a pair of positive tools to promote the desired actions and results from the JV senior managers. In addition, reporting system and

[21] As compared to Superior, Giant had a wider investment and richer experience in running production and distribution in China at that time. However, Giant did not have access to technology or resources that Superior had in the paints industry. According to their strategies, Giant is willing to play a passive but supportive role in management in their paint investments with Superior.

[22] IDC is the government authority who is in charge of the development of the investment zone where SGP is located. This local partner is an investor who owns 10% equity in the JV. They play only a small part in the management of the JV.

relationships and various forms of personal tools, such as GM meetings, executive conferences and budget presentations, were used to facilitate the operation and reinforce the effectiveness of other selected mechanisms.

Superior has been using a number of control mechanisms, some of which cover the same or similar areas. They have also secured decision-making control over a wide extent of JV functions directly or otherwise through the JV managers whom they appointed. The trend seems to suggest that Superior is playing safe in order to ensure that the critical focus is sufficiently covered. The combination of choice on the three perspectives at the central core of the control package formed a layer of enacted environment, which has articulated the implementation of Superior's strategies as well as supporting the current bargaining power composition among JV partners.

The other three focal partners are using a similar approach in the designs of their control packages. They have carefully selected and put together various combinations of mechanisms and extents of decision making in order to achieve the control foci that are critical to their investment objectives in the IJVs. For example, in order to penetrate the Chinese market, Marlee's strategic focus in the majority of their Chinese JVs includes product design, production/quality, and marketing. Marlee provided these Chinese JVs with their household brands, products and production technologies. The provision of firm-specific assets (FSA) has earned Marlee a strong bargaining position among JV participating interests. Moreover, the provision of FSA has also strengthened Marlee's position in gaining control over the use and implementation of technologies in the production and/or marketing activities. Similar to the arrangements that Superior has made, Marlee has secured the right of appointing the GMs for all of their Chinese JVs. In addition, the group has obtained the decision making control over the designs of budgetary systems, reporting and performance evaluation systems. The combinations of choice of control mechanisms and extent have supported the strategic focus and helped Marlee to launch their overall investment strategies in China.

Meanwhile, in order to fulfil the objectives of establishing a low cost production base in China, Silky's focus has been on production, in terms of scheduling, quality and pricing. This was the reason why, when the Chinese partner suggested converting the JV into an exclusive sub-contractor, which would allow customers to have a bigger say in production scheduling and production methods, Silky decided to take up the exclusive agreement itself. Silky could not afford to lose control over the critical production function that is fundamental to their investment strategy in China. The situation encouraged or forced Silky to adopt this influential mechanism to buy out full control of the JV. Silky's decision to take up the exclusive right is welcomed by their Chinese partner, who prefers to receive a regular sharing of profits without taking on any undue risk, and the mechanism has a positive influence over the partner relationship.

From the case analysis, I am therefore now able to see that the three control dimensions, mechanism, extent and focus, are playing "different roles" and are in fact located at "different levels" within the central core of a control package. Various contingency elements comprising a holistic control package are in fact having a "circular motion of interactions and relationships" with one another. They are influenced by, and at the same time influence other components, and the process goes "circular".

Having gained a fuller picture of parental control adopted by the sample firms in their Chinese JVs, some of the understanding and findings, which were held at earlier stages of the analytical process while my view of the empirical realities was only partial, have been changed or enriched by the new insights gained at a later stage of the sense-making journey. The change of views is not a sign of weakness. Rather, it reflects the strengths of the middle-range thinking (MRT) approach adopted by this research (see Chapter 2), which empowers me to learn, reflex, absorb and learn more throughout the sense-making process.

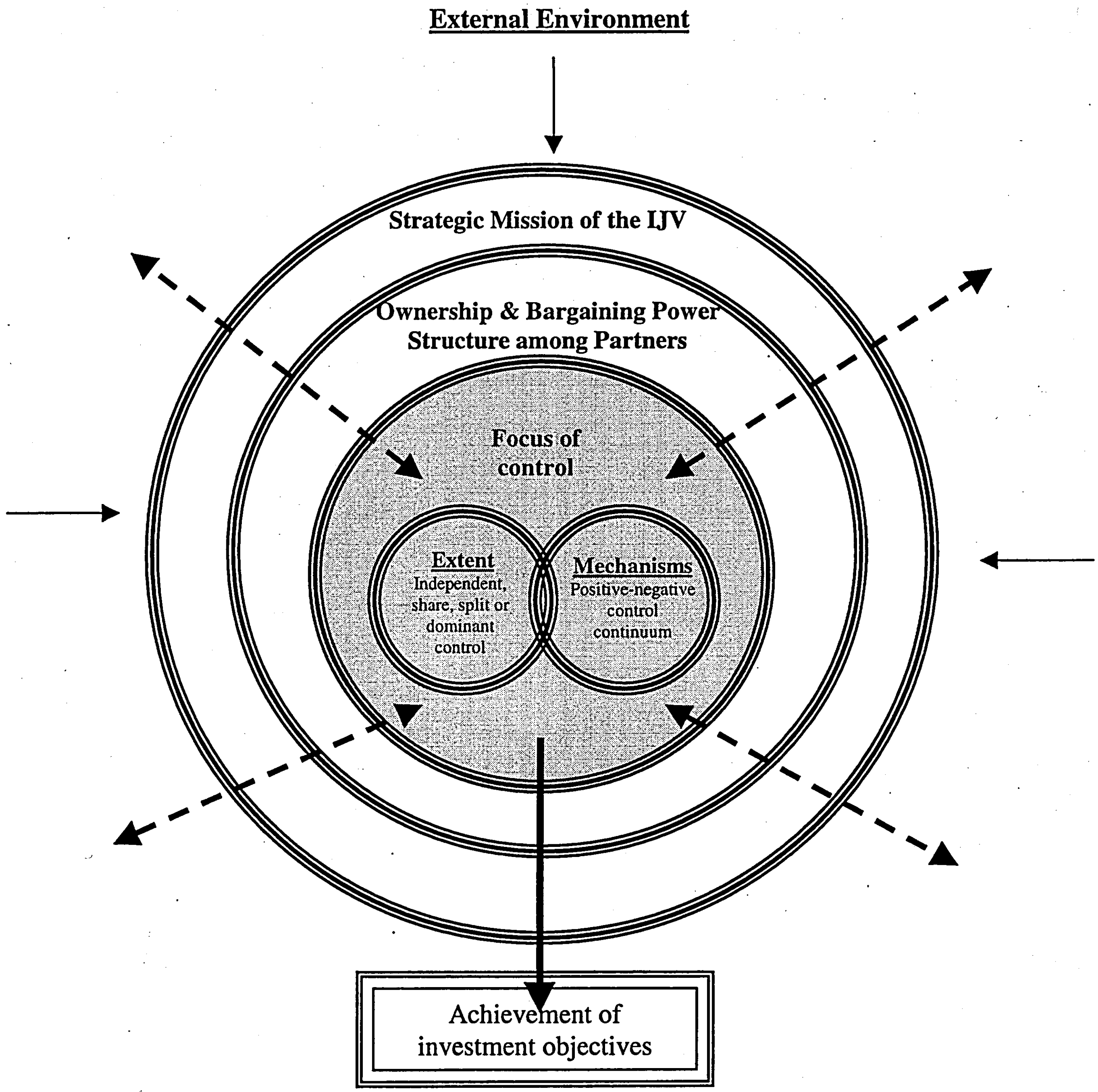
The central thrust of the MRT approach is that the model that was used to guide the empirical discovery is only of skeletal nature (Laughlin, 1995). New understanding generated from the focus dimension provides another layer of intellectual make-up to re-define the skeletal framework, which was last updated in section 9.3.1.10 (see Figure 9.6). The third modification is a continuation of the theory-empiric dialogistic exchange to refine the roles and relationships of the contingency elements comprising a skeletal model. The three dimensions, focus, mechanisms and extent, are indeed located at different levels and playing distinctive roles within the central core of a JV parent's control package. Also, decisions for the three control perspectives are influenced by, and at the same time influence the enacted settings that are created by the JV mission and partnership bargaining power structure of the JV. The interchanging forces go circular around the control package. The JV mission and partnership bargaining power composition of a control package are likely to evolve over time, so are the strategic focus and the choice of mechanisms and control extent.

Upon the completion of the last stage of refinement, a final version of the IJV control theoretical model, which highlights the specific enacted environments created by the Chinese context and the internal conditions of individual parents and the IJVs, is established and presented in Figure 9.7.

Figure 9.7

Modification (3)

Conceptualisation of IJV control developed from the skeletal model



Represents multiple layers of enacted environments.

Represents the influence of external environment on the investment objectives/mission of an IJV.

Represents the **continuous interplay and circular interactions** between the choice of investment objectives/IJV mission, ownership and bargaining power structure among partners, control in terms of focus, extent and mechanisms, and the external environment facing an IJV.

9.4 Designs and implementation of the holistic control packages - IJV performance

In IJVs, same as in any other forms of organisation, the ultimate aim of applying control is to effectively deploy strategies and facilitate the achievement of objectives (Lorange et al., 1986; Lorange & Probst, 1987; Anderson & Gatignon, 1986; Geringer & Hebert, 1989; Yan & Gray, 1995; Glaister, 1995; Groot & Merchant, 2000). Hence, in any meaningful study of control, it is important to examine the impact of control systems and processes on organisational effectiveness (Otley, 1980). This research has assumed that there is a close link, but not a direct, simple correlation, between control package and organisational performance (Otley, 1999; Norreklit, 2000). The last part of the analytical journey here is to investigate the means-ends relationships between the focal parents' control packages and the achievement of JV missions.

It was repeatedly reported in the analysis above that the four focal parents had paid a lot of attention to the design of control packages applied to their Chinese JVs. They have carefully identified their strategic foci, and selected the right combinations of mechanisms in order to exercise control over the extents of activities that are critical towards the success of their Chinese JVs. In each of the interviews, executives were asked if various partners, focal partners in particular, and the JVs have fulfilled their investment objectives. Given that the majority of the interviewees are expatriates[23] appointed by the focal partners to work for the JVs, they should have the first-hand information. Superior, Marlee and Silky considered that performance of their Chinese JVs had either met or exceeded the initial aspirations they set down when the operations were formed. Their achievement and strengthened confidence is reflected from their continuous FDI in China.

When the interviews were conducted, Superior, Marlee and Silky respectively had already decided to establish other subsidiaries in the country. For example, Superior's third paint JV with Giant in Shanghai already started construction at that time. The executives indicated that Superior and Giant would put further paint investments in different parts of China in order to cope with the increasing local demand for quality paints. Whereas Silky's new dyeing factory was also in the formation stage. Marlee formed two new JVs in China in fourteen months since the interviews were carried out. The sample firms' decisions to put more FDI in China, either in JV or wholly owned forms, at such a quick

[23] I have recognised that their views can be bias towards the focal parents. Moreover, the executives revealed only limited information on whether the other partners have fulfilled their investment objectives. These limitations will be further discussed in Chapter 10.

pace were greatly influenced by the good experience with partners and satisfactory results of their existing investments.

Pearl is the only one focal parent who encountered a difficult operating environment in TianJin which resulted in high production cost, low sales and financial losses. The JV GM claimed that the problems were mainly caused by the inadequate industrial infrastructure in the region to support small-sized investments. Undoubtedly, the TianJin JV did not meet most of the objectives that Pearl set. However, what other forms of investment modes could significantly change the external environment and the results if Pearl had to go to TianJin anyway? Perhaps the strategy, the decision of moving to northern China at that time, rather than the choice of JV, was inappropriate. There were elements embedded in the enacted environment in TianJin that Pearl's control package was unable to influence and cope with.

In fact, Pearl was wise to use JV to test the new territory. If there were no contributions from the Chinese partner, the risk and learning curve would have been even steeper and their financial loss would be ever greater. One of the JV objectives was to find out the business environment in northern China. The TianJin JV's experience should have provided the headquarters with the answer - it is a bit early for small scale FDI. Making financial losses is not equivalent to complete investment failure. Indeed, it is a good example to illustrate the wide range of purposes that JV serves. The disappointing results deterred the group's expansion into northern China at that time. However, it did not significantly reduce Pearl's confidence in the potential of the country as a whole and using JV as a vehicle to approach China. In the group's annual report (1994:11), the following business objective is found:

> "Continues to pursue JV opportunities with right strategic business partners to expand production capacity in China".

Despite high JV failure rates or poor performance repeatedly reported by many prior research studies (such as Franko, 1971; Killing, 1982; Beamish, 1985; Gomes-Casseres, 1987; Kogut, 1988, 1989; Harrigan, 1986, 1988; Geringer & Hebert, 1989; Parkhe, 1993, 1993a; Yan & Gray, 1995; Groot & Merchant, 2000), the overall satisfactory results my samples achieved in China are consistent with Davidson (1987) and Newman's (1992) findings in performance of Sino-American JVs. Davidson's study showed that his sample

American partners went to China with high expectations[24]. Although facing unique conditions in the country, over two-thirds of the JV samples reported that they had achieved or exceeded their expectations to date. Both the American and Chinese managers of the samples expressed intense interest in their JVs. Newman (1992) research also revealed satisfactory results achieved by his samples, which adopted focus strategy based on the overall social and investment environments in China.

To sum up this section, the four samples' experience demonstrates that it is by no means simple to use JV as a vehicle to approach the unfamiliar and complex Chinese market. Similar to a conclusion Davidson (1987:94) drew, "setting up a JV in China can be highly profitable, but there are many hurdles, much red tape, and much of the legacy of Mao to overcome". The process of creating and managing a JV in China is a mixture of challenge and frustration. Superior, Marlee and Silky's experience shows that with a properly designed control package and by making necessary compromises, JV mode can provide the best solution to deal with the problems embedded in the unique environment in China (Beamish & Banks, 1987; Shan, 1991; Casson, 1990; Shenkar, 1990; Davidson, 1987; Newman, 1992).

Different contingency variables within a control package will evolve over time according to the change of internal and external environments over the life of a JV (Lyles, 1987, 1988). Nevertheless, the current modes of investments, choice of JV partners, bargaining power compositions among interested parties and the three dimensions of control, are individual partners' strategic choice, which are found best suited to their needs at that particular period of time. The positive experience achieved by Superior, Marlee and Silky from their existing FDI in China has strengthened their confidence. Pearl has learnt its lesson from the TianJin JV and become more cautious in their future choice of FDI locations. However, its confidence in China has not been significantly affected by the disappointing initial results in TianJin.

The four focal partners' further FDI in the country have reflected that their overall strategies of investing in China remain full-steam ahead. Some comments the executives made in the interviews are quoted here to end the last section on achievement of investment objectives.

[24] Almost half of them (45.4%) set their anticipated payback period between 3 to 5 years, and another 27.3% stated 5 to 7 years.

> "Regarding the China market, I think it will be volatile in the short-term. However, according to the rapid rise of GDP and the steady development of the whole country, from a long-term point of view I believe that the opportunity is there and the future of China should be very positive and prosperous!" Danny Wong of Superior said.

> "So far I have not regretted the decisions of investing in China and getting involved in JV. I only have a few factories and so far each factory is doing well and making profit... Yes, I am always optimistic about the prospect of China... If there are future opportunities for FDI, I will invest in China rather than in America or Canada." Peter Li of Silky replied.

> Last but not the least, the Finance Controller of Marlee China stated that "Providing the political environment (in China) is stable and the government continues to move towards what they called a market economy, all the evidences have proved that they want to do that and will continue to do that, then the prospects are very good!"

9.5 Conclusion

This chapter used the skeletal model, which was built in Stage 1 of the theoretical formation process, to understand and compare the four case studies. The empirical details demonstrate a high level of complexity in parental control in contemporary JVs, which includes circular interactions between internal and external factors.

The whole analytical process represents a continuous empiric-theory interplay mechanism. There are findings, which are consistent with the original conceptualisation, providing empirical flesh to enrich the skeletal model (Laughlin, 1995). Also, there are discoveries that were not recognised by prior JV/IJV studies. These new inputs have broadened my view and further developed the skeletal framework under the specific enacted environments facing the sample Chinese JVs.

Moreover, there are findings which challenge the original assumptions underlining the skeletal model and/or the understanding gained at earlier stages of the analysis while my view on the holistic control packages the four focal partners adopted was only partial. The differences prompted further investigation. The reflexive process generated new understanding and led to three modifications on the skeletal model at three different stages of the case study analysis (see Figures 9.3, 9.6 & 9.7).

The sense-making journey continuously developed the skeletal framework as well as my understanding of IJV control. The knowledge expedition resulted in the establishment of an integrative theory of parental control of IJVs in China, which highlights the unique enacted conditions in which the control packages are implemented and from where the theory is derived (see Figure 9:7).

The fruitful results generated by this research demonstrate the appropriateness of adopting the MRT approach, which provided me with guidance as well as freedom of choice in the theoretical conceptualisation, empirical investigation, analysis and theory refinery processes. Meanwhile, the use of the case study method in the empirical investigation enabled me to search beyond the surface and seek an in-depth understanding of the individual contingency variables comprising a holistic control package, and also the interactions among these elements. In summary, the use of an MRT approach in the choice of theory, methodology, change and the case study method to develop an integrated theory of IJV control are the strengths of this research.

In the next chapter, I will revisit and summarise the major findings and contributions of this research. The discussion includes a self-assessment of how I perceive the four objectives of this study to be met. It is followed by recommendations on future research in the field. The limitations of contingency theory, which underlines the skeletal model, and the provisions made during the theory building process are recaptured. The concluding chapter ends with a reflexive account of personal experience gained throughout the whole research.

Chapter 10

Summary and conclusions

10.0 Introduction

In Chapter 9, I used the skeletal model in an attempt to understand and compare control packages used by the four focal partners in their Chinese JVs. The sense-making process generated a mixture of results. Some discoveries supported the conceptualisation underlying the skeletal model. Others challenged some of the assumptions and/or understanding gained from the earlier parts of the analysis. In addition, there were findings, which were not recognised by any prior studies in the field of JV/IJVs. The contradictions and unexpected findings prompted further investigation. The reflexive process led to new understanding. The empiric-theory interplay developed the skeletal theory to its final form, as Figure 9.7 shows, which is specific to the context in which the control packages are implemented and from which the theory is derived.

The final chapter summarises the major research findings from the investigation and draws out some conclusions. Firstly, the chapter recaptures the research objectives. It then revisits the two-stage theory formation process. Major findings generated and their implications will be discussed. The chapter includes a reflexive account of how I perceive the four research objectives are met. It is followed by an analysis of the strengths and weaknesses of the research approach and method. Also, the recommendations for further research will be outlined. The chapter ends with an account of personal experience gained from the research.

10.1 Research objectives

There are four objectives for this study. The **first** objective is to study the overall changes in patterns of global competition, and to understand the factors driving the rapid growth of the JV form of organisation. **Secondly**, to identify the essential elements that comprise a holistic control package in an IJV context. The **third** objective is to understand and critically discuss the design and implementation of control packages that the sample firms applied to their IJVs in China. The **fourth** ultimate aim of this research is to develop an integrative theory of IJV control, which highlights the specific context in which the control strategies operate and from which the theory is derived.

In the following reviews, I will summarise the theory development process and measure major findings and contributions against the objectives that this research has set out to achieve.

10.2 Revisit the intellectual journey of building and developing the integrative theory of IJV control

The journey of developing this research also meant a journey of self development. My viewpoints were sharpened by the experience gained throughout the long journey.

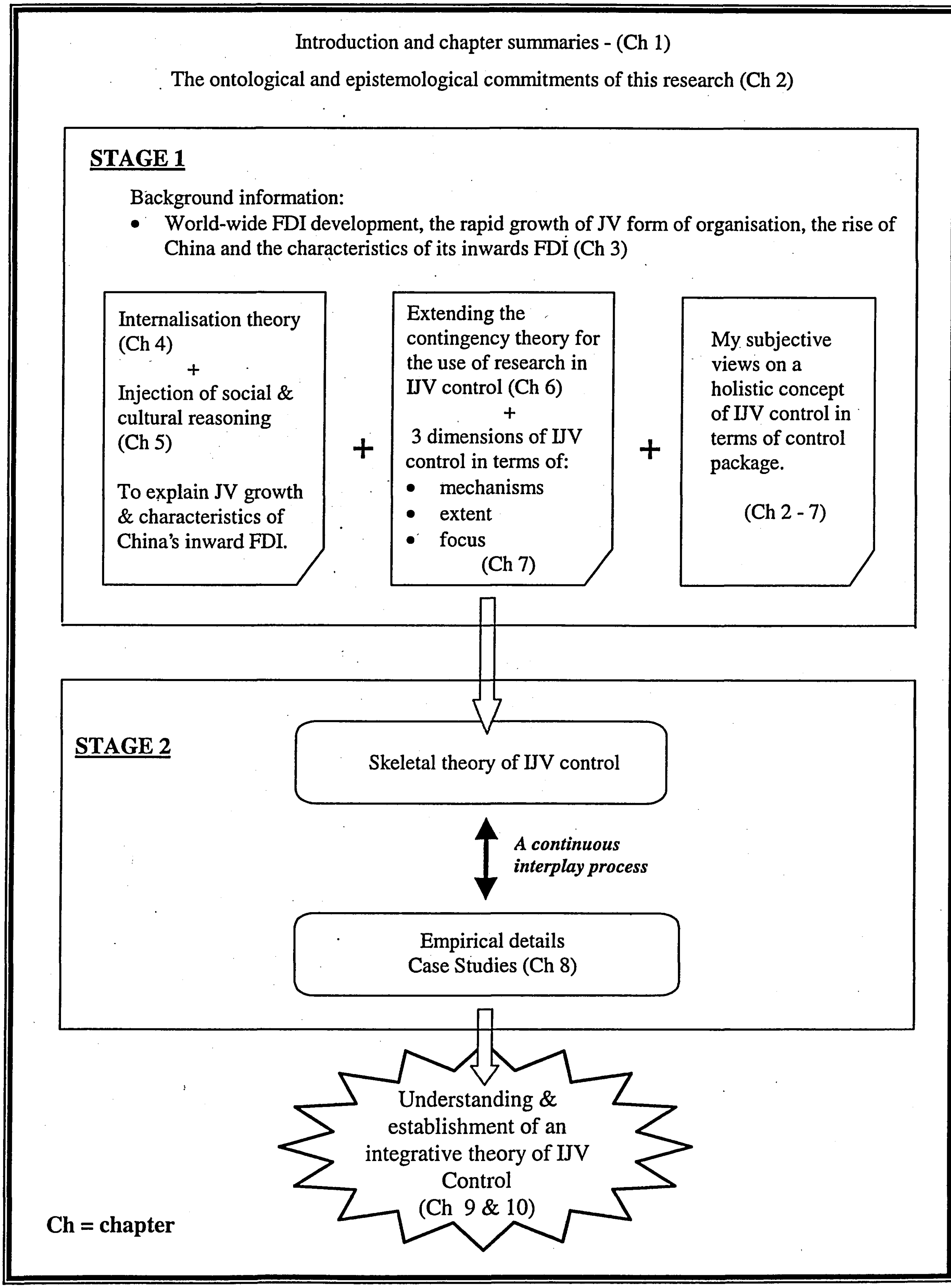
Corresponding to my ontological and epistemological standpoints (see Chapter 2), I adopted a middle-range thinking (MRT) research approach (Laughlin, 1995). The basic assumptions of the MRT are that there is no one best approach for understanding complex social reality, and all empirical research is bound to be incomplete. Therefore, by taking a middle position, I did not commit myself to either one of the two dominant schools of thought that occupy the two ends of each of the three key elements, theory, methodology and change, comprising a research approach. Without rigidly constraining my thoughts, I became a pluralist, who was free to choose and learn from others (Johnson, 1989).

The medium stance on theory and methodology encouraged me to build a skeletal model of IJV control to guide the empirical investigation to an extent which still allowed for subjective variety and diversity in the process. In my effort to understand various areas of inquiry, I brought in different theories. I strongly believe that it is more beneficial to draw on wider sources that may offer a richer insight into the complex concept of IJV control (Geringer & Hebert, 1989; Parkhe, 1993). The skeletal model included a certain degree of generality and subjectivity, but it remained incomplete and required empirics collected from the sample IJVs to make it meaningful and definable. This is the rationale behind the use of a two-stage process to establish an integrative theory of IJV control.

Before I start to summarise the essence of each of the two stages of theory formation, it seems useful to reproduce the map, which was drawn up in Chapter 1, to help the readers to follow the discussion. The map is recaptured as Figure 10.1.

Figure 10.1

Revisit the two-stage theory formation process - a guiding map



10.2.1 Stage 1 of the two-fold theory formation process

Stage 1 was fundamentally an idea-searching process to build the skeletal model. The first objective of this research is to study the overall change of the industrial structures and patterns of competition. Although my naïve assumptions proved to be over simplistic at a later stage, at that moment I considered FDI as basically business transactions, thus transaction cost economics should be able to shed light on FDI decisions and the change of competitive structures (Williamson, 1985; Spicer, 1992). Internalisation theory (Hymer, 1976, Buckley & Casson, 1976, 1985; Rugman, 1981, 1982; Hood & Young, 1979) was chosen and it provided persuasive explanations of why firms prefer FDI rather than other alternatives (see Chapter 4). However, the theory, which is built purely on an economic ground and emphases full control, could not explain the worldwide surge of JV form of investments.

The problems made me realise that FDI decisions are driven not only by economics factors, but also by an amalgamation of complex social, behavioural and cultural considerations. The economics based internalisation theory does not take into account those important "soft" factors that can have major emotional costs on FDI and control (see Chapter 5). The majority of FDI in China coming from a single source, overseas ethnic Chinese (see Table 3.8 & 3.9), is an example to demonstrate the economic value of cultural and family linkages (Kemp, 1987; The Economist, 18/7/1992; CND, 1/8/1994; Weidenbaum, 1996, DFAT-Australia, 1998). The trend reflects the effects of soft factors on FDI and control that changes the patterns of global competition.

However, there was no existing JV theory which covered both economics and behavioural reasoning. In fact, very few previous studies looked into the intertwined relationship between these two kinds of forces in FDI decisions. Again, I decided to build a theoretical model for this research by using existing ideas. I took on board the ideas of Beamish and Banks (1987), Buckley and Casson (1988), Casson (1990), Franko (1987, 1989), and Geringer and Hebert (1989) that it is possible to extend the transaction cost framework to explain JV by loosening up the rigid ways in which economics rationale were used. It inspired me to inject vital social and cultural elements into the internalisation theory. The modified theory provided coherent explanations of why firms prefer JV and the likely ways in which JVs are managed. This understanding formed a foundation for the next level of ideas search to explain control in an IJV context.

I considered a number of control theories, such as cybernetics, accounting, behavioural and contingency approaches. It was the latter that fit the MRT assumptions underlying this research. Similar to my standpoint, contingency theorists have taken a medium position, which is distinctive from either the universalistic or individualistic views held by the mainstream accounting and social/behavioural researchers respectively (Kast & Rosenzweig, 1985; Emmanuel et al., 1990; Berry et al., 1995). Contingency theory recognises that there is no one best control system for all organisations in all situations, and an appropriate design is contingent on various internal and contextual factors (Kast & Rosenzweig, 1985; Emmanuel et al., 1990; Berry et al., 1995; Otley, 1980; Merchant & Simons, 1986). These concepts significantly influenced the subsequent theory development of this study.

I agree with Geringer and Hebert (1989) and Groot and Merchant (2000) that contingency theory has a significant role to play in the early stage of IJV theory development. There is existing literature in both inter-firm and intra-firm contexts, which empirically suggests that the design of control systems and processes is contingent on different variables, such as strategy (e.g.: Chandler, 1962; Dermer, 1977; Govindarajan & Gupta, 1985; Simons, 1987), structure (e.g.: Burns & Waterhouse, 1975; Mintzberg, 1983; Belkaoui, 1986; Emmanuel et al., 1990) and environment (e.g.: Galbraith, 1973; Gordon & Miller, 1976; Otley, 1980; Govindarajan, 1984). This research attempted to extend the strategy-structure-control fit contingency concept to an IJV context. In this study, control is not treated as an independent phenomenon, but is seen as a part of the wider "control package", which includes other essential variables - strategy and structure. A holistic control package has an interchanging relationship with its environment. This set of presumptions formed the first part of the conceptualisation of IJV control systems and processes.

From their review on existing literature, Geringer and Hebert (1989) identified that control in the complex IJV context is multi-dimensional and it consists of three vital aspects - mechanisms, extent and focus. Their findings were important inputs, which helped to develop my initial thoughts into something more IJV specific. The information collected at different parts of the intellectual journey gradually refined my tentative thoughts. Now, design and implementation of control, in terms of mechanisms, extent and focus, is seen to be contingent on the strategic mission and partnership power structure of an IJV. The three intertwined elements, strategy, structure and control, form a holistic control package, which bears an interactive relationship with the environment the IJV operates in.

This final advancement completed the skeletal model of IJV control, which would be used in Stage 2 of the theory formation process to direct the investigation and the interpretation of empirics. In section 10.2.2, I make public my acknowledgement of the limitations behind contingency theory, which had significant influence on the development of the skeletal model. Section 10.2.3 outlines major findings and the way in which empirics developed the skeletal model into the final form of an integrative theory of IJV control.

10.2.2 Limitations of the contingency theory

In the discussion above and in Chapter 5, weaknesses of the traditional transaction cost economics to explain the worldwide surge of the JV form of investments were analysed. In this part, the limitations inherent in the contingency theory, which underlines the skeletal model of this research, will be discussed. Also, the provisions made in the theory formation process to address some of these problems will be recaptured.

Otley (1980) criticised many contingency studies for lack of clear definitions, measurements and conceptualisation of the key contingency variables. Emmanuel et al. (1990) also pointed out that the impact of specific combinations of control used in conjunction have not yet been investigated in detail. In this research, the process of conceptualisation and variables used were explained in the sections above and in the main body of the thesis. Moreover, in Stage 2 of the theory formation process, the case study method was used to investigate control systems and processes in their natural settings. This step enhanced the ecological validity[1] of this research (Scapens, 1990; Gill & Johnson, 1991). The use of case study also attempted to address another criticism raised by Hopper and Powell (1985) that many previous contingency studies relied heavily on quantitative methods to take snapshots of temporary structural manifestations.

Otley (1980), Hopper and Powell (1985) and Emmanuel et al. (1990) commented on some accounting studies, which adopted simple linear assumptions on environment, organisation designs and accounting system designs. Indeed, this weakness was addressed by Miles

[1] This criterion is concerned with the extent to which it is possible to generalise from the actual social context in which the research has taken place and data are gathered, to other contexts and settings. This is also related to the issue of how artificial the research setting is relative to natural context typical of normal, everyday life (Scapens, 1990; Gill & Johnson, 1991).

and Snow (1978) and Govindarajan and Gupta, (1985), who refuted the deterministic assumptions of firms responding passively to the predetermined conditions, a long time ago. This research has made clear its views that there is an interchanging relationship between organisations and their environments. In addition, it has taken a broad view to examine IJV control in terms of a holistic control strategy. Empirical details were used to reveal the intertwined relationships between various contingency components comprising a control package. These decisions were responding to critics on the inextricable nature of many organisational components, and control cannot be studied in isolation from its wider context (Otley, 1980; Hopper & Powell, 1985). The two-stage theory development scheme demonstrates a close link between theory and empirical study. The final stock of the IJV control theory was completed by the empirics, which were drawn from the IJV samples located in China. The theory is definable in the unique context from which it is derived.

Furthermore, the means-ends relationship, in terms of the effectiveness of control towards the achievement of investment objectives, was examined. This decision was responding to criticisms of many prior contingency studies, which failed to provide practical guidelines in relation to the links between specific contingencies adopted and appropriate control systems (Otley, 1980; Hopper & Powell, 1985)

Throughout the theory formation process, provisions were made to address as many criticisms of various theories that were brought into the research as possible. However, I submit that there are no perfect solutions to all the issues and a number of weaknesses remain (some of these weaknesses are discussed in section 10.4). As a comment Casson (1990) made, theories should not be purely judged by being right or wrong, but by being more or less useful to explain the areas of inquiry. Each choice reflected my belief, understanding, and the needs of this research at that particular stage. The choice may seem to be inconsistent, and other scholars may refute my ideas. If the latter occurs, this research has already achieved one of the goals that it is set to achieve - to raise awareness of the widely neglected but important topic of IJV control and stimulate intellectual debates. Sharing the same view as Barney (1990), I believe that the ultimate winner of any healthy debate is the related field as a whole.

10.2.3 Stage 2 of the two-fold theory formation process - a review of the major findings

The skeletal model established in Stage 1 of the theory formation process was used in Stage 2 to help me understand and interpret the empirical details. This section summarises major findings and illustrates the ways in which empirics completed and informed the skeletal framework. Contributions made will be used to measure the degree of achievement of the four objectives that this research is set out to fulfil.

10.2.3.1 Investment objectives/JV mission

The four focal partners' experience reflects a high level of complexity in parental control in contemporary JVs. It is crucial to take the right course of action and decisions on each step of the investment process in order to create a condition for robust co-operation between partners and effective control of the IJVs (Parkhe, 1993a; Axelrod, 1984; Yan & Gray, 1994). The design of each control package begins from the investment objectives of why an IJV is adopted.

The four focal firms came to China in order to fulfil different objectives (see Table 9.2). In general, Marlee and Superior were driven by marketing motives to enter China. Whereas, Silky and Pearl were initially motivated by low production cost and at a later stage by a combination of marketing and cost rationale. Despite the differences of background (see Table 9.1) and investment motives, one similarity shared by the four samples is that they have used JV in China. On various occasions, the firms considered JV as the best option, which provides them with the highest net benefits (Beamish & Banks, 1987; Shan, 1991). The similarity of choice among the four samples seems to support that JV is one of the most popular forms of investment not only in developed and developing countries (Dunning, 1981; Schaan, 1983, 1988; Contractor & Lorange, 1988, 1988b; Franko, 1971, 1987, 1989; Beamish & Banks, 1987; Glaister, 1995; Groot & Merchant, 2000), but also in the centrally planned economies, such as China (Shan, 1991; Beamish & Wang, 1989; Davidson, 1987; Casson & Zhang, 1991; Newman, 1992; Yan & Gray, 1994; Tretiak & Holzmann, 1993).

Most of the four MNEs' Chinese JVs are hybrid JVs, in the sense that they have combined the equity mode with other contractual arrangements. This contemporary form is used to maximise the overall benefits, minimise the risk of using JV, and/or widen the channels of income and control. The broad-purposed nature of JV explains why it is the most popular form of FDI in China (see Chapter 3 and Table 3.7).

It was revealed in some previous studies that the hybrid JV is widely used by MNEs in other parts of the world (Contractor, 1985; Beamish & Banks, 1987; Beamish, 1985, 1988). This research adds to the existing literature and shows that the hybrid JV trend has spread to China, a region of growth recognised by many investors, which include my sample firms (Financial Times, 10/12/1992; Blackman, 1997; Luo, 1997, 1998; United Nations, 1992; The World Bank, 1997, 1997a; Shaw & Woetzel, 1992; Sender, 1993; Abramson & Ai, 1999; Paik & Tung, 1999). "Joint ventures are the wave of the future", as Anderson (1990:19) suggested. The empirical findings of this study provide the practitioners and researchers with updated information on the diversity of investment modes and forms of competition prevailing in China.

10.2.3.2 Choice of partners - bargaining power structure

As the skeletal model indicates, partner selection is one of the key parts of the whole control package. Driven by their respective JV objectives, the four focal firms use different criteria to choose their business companions. For example, Silky and Superior prefer to form JVs with known parties. Previous acquaintance provides various parties with understanding and confidence to do business together. Whilst, Marlee tends to choose local monopolists/oligopolists, who can help them to speed up the local adaptation process.

Despite the differences in approaches, a common criterion the sample firms use is to choose candidates who possess compatible resources, which include country-specific knowledge. Potential partners can be indigenous Chinese enterprises, HK and foreign firms owned by overseas ethnic Chinese or non-Chinese owned foreign companies. There is a common misconception that local knowledge is only possessed by local firms (Agarwal & Ramaswami, 1992; Beamish & Banks, 1987; Shan, 1991). Indeed, foreigners can acquire local knowledge over time. Their experience bridges the psychic distance (Buckley & Casson 1976; Hood & Young 1979; Kogut & Singh, 1988), which has been considered as a key barrier of FDI in unknown markets (Stopford, 1976; Caves, 1982; Thomsen, 1992). Superior and Giant, and Pearl and Dion's JVs are examples to illustrated the above point.

Giant is a British MNE who possesses a wide range of experience in running production and distribution in China. Pearl is a Hong Kong based firm. However, Dion relied on Pearl to guide them through the first FDI in China. Indeed, Giant and Pearl's double identities, being a foreign firm and an old Chinese hand, made them more attractive as JV partners to explore China. Superior and Giant, and Pearl and Dion's cases demonstrate the changing nature of national and international competition through the use of JV (Contractor, 1985; Contractor & Lorange, 1988; Beamish & Banks, 1987; Buckley & Casson, 1988; Beamish, 1985, 1988; Kogut, 1988, 1989; Parkhe, 1993a; Anderson, 1990; Newman, 1992).

The four focal parents' experience has widened our knowledge of the choice of JV partners. Indeed, the choice of right companions with compatible objectives and resources is a pre-requisite to promote co-operation, and enable individual partners and IJVs to achieve their respective objectives without contradicting the interests of one another (Geringer & Hebert, 1989; Harrigan, 1984, 1988; Parkhe, 1993a; Axelrod, 1984; Schaan, 1983, 1988; Luo, 1998). It is a contribution of this research, which has important implication for firms planning to use JV to serve various purposes.

From the analytical investigation, it was also found that partner selection and the subsequent bargaining power composition in each JV affects not only the transactional, but also the contextual conditions. Partners may bring to the JVs resources that can facilitate internal operation and speed up the local adaptation process. However, their background also creates strong bilateral bargaining forces, and their relationships with various government bodies can further complicate the already complex JV environments. Marlee's difficult experience in securing the types and extents of control the group needed in some of their Chinese JVs with local monopolists/oligolopists is an example to illustrate the above points.

Now I understand that the decisions for investment objectives/JV mission create an enacted environment which influences the choice of JV partners. Nonetheless, the subsequent choice of JV partner(s) will on one hand establish a specific bargaining power composition among partners that may change the original enacted setting faced through the partnership's influence over the transactional and contextual environments, and on the other hand form a new enacted condition that shapes the future decisions for the three control dimensions.

This process then creates multiple layers of enacted environments between different contingency variables comprising a control package. These findings challenged parts of the original conceptualisation. The reflexive process made me recognise that the original assumptions of single-layered interactions between a parent's investment objectives/JV mission and the control environment are indeed over simplistic. The new insights led to the first modification on the skeletal model, as Figure 9.3 illustrates.

Up until this stage, I feel comfortable with the extended understanding of IJV and how the rapid growth of co-operative ventures changes the nature and patterns of global competition. This knowledge worked as a springboard which helped me to launch the next part of investigation into the central core of a holistic control package. Based on the new understanding gained, I have considered that the first objective of this research (see section 10.1) is successfully fulfilled.

10.2.3.3 Central core of a holistic control package - focus, extent and mechanisms

As the analysis progressed to the central core of the theoretical model, there were major discoveries that reshaped the conceptualisation of the three control dimensions.

Firstly, a key finding revealed in the investigation of the mechanism dimension is that positive and negative forms of control are not necessarily mutually exclusive (Schaan, 1983). It is possible, and indeed more appropriate, to think of different control mechanisms on various scalars ranging from positive to negative orientation of a bipolar continuum. There are hybrids located at various positions across the positive-negative control continuum that can serve either or both of the purposes. The four focal parents have adopted different combinations of positive, negative and hybrid mechanisms in order to exert the types of control they need in the Chinese JVs (see Table 9.6). The use of internal exclusive agreements and hybrid type of control mechanism was not reported in prior research studies in the field and they are original contributions to knowledge that this research makes. The new insights continuously refined the conceptualisation of IJV control and the understanding led to the second modification on the skeletal model, as Figure 9.6 shows.

Secondly, the investigation revealed that although the four focal partners emphasise the importance of significant control, they have not monopolised control over the entire range of business activities and excluded their partners from management as if the JVs had only one parent. On the contrary, the focal parents tend to focus on a range of critical functions, and share control over other areas with partners and/or JV managers (see Section 9.3.2 and Table 9.7). Interestingly, their motives to share out some degree of control are to maximise the overall control and benefit that they could subsequently gain from the Chinese JVs.

Capital expenditure budget and public relations are two common JV functional areas that all parties are involved in with respect to their activities and decision-making. The focal partners realise that "guanxi", the human relationships, is a vital asset of doing business in China (Kemp, 1987; Davidson, 1987; Shenkar, 1990; Newman, 1992; The Economist, 18/7/1992; Blackman, 1997; Luo, 1997; Tsang, 1994; Martinsons & Tseng, 1995). However, building up relationship properties is costly and time-consuming (see Chapter 5 for details of guanxi in the Chinese societies). These characteristics reinforce the appropriateness of drawing on the strengths of various parties on public relation activities.

It was found that JV management is granted more autonomy in making production related decisions either independently or jointly with foreign partners. The trend might be driven by the fact that production decisions often require direct involvement and first hand information. JV management becomes the most appropriate group of people to be in charge. Nonetheless, we need to realise that many JV senior managers are in fact expatriates from the focal parent firms. The headquarters have personal knowledge of, and influence over, these executives (Schaan, 1983, 1988; Geringer & Hebert, 1989; Groot & Merchant, 2000). Therefore, the joint decision-making mode is somewhat a quasi-decentralised policy, as the focal partners' control over production decisions of the JVs has not been diluted. They only benefit more from involving the JV managers.

In sum, different types of decisions in the sample IJVs are made by various combinations of interested parties. Because the distribution of authority is often based on pressing interests and/or the strengths of individual parties, partners' contributions are complementary rather than contradictory to one another (Glaister, 1995). These characteristics match with the central thrust of an emerging form of JV control - split control (Cantwell & Dunning, 1984; Schaan, 1983; Geringer & Hebert, 1989; Glaister, 1995; Gray & Yan, 1995).

Under a split control configuration, different parties play different roles and obtain different amount of authority in decision-making. Driven by their respective investment strategies, the four focal partners have tailor-made their control packages and obtained a larger share of control of the Chinese JVs. In fact, their JV partners have adopted the same type of approach. While the scope of functions that these passive partners control may seem to be tight, the narrow focus is what they need at this stage of the investment. Commanding a small range of functions is not synonymous to failure in controlling the JV subsidiaries. Similarly, controlling a broad range of activities does not necessarily mean success. There are financial and emotional costs of holding too little or too much control (Schaan, 1983, 1988; Anderson & Gatignon, 1986; Mascarenhas, 1982; Agarwal & Rawaswami, 1992; Geringer & Hebert, 1989; Groot & Merchant, 2000). The current control configurations in the sample Chinese IJVs are joint products derived from individual parents' strategic choice (Schaan, 1983; Lecraw, 1984; Geringer & Hebert, 1989, Glaister, 1995).

Thirdly, the conceptualisation originally assumed that within the central core of a control package, mechanism, extent and focus dimensions are located at the same level and are under the same degree of influence from the other contingency variables. However, the case study analysis discovered something different. The analytical findings demonstrate that the enacted environments, which are created by the investment objectives/JV mission and partnership bargaining power structure, determine a control focus which can lead to the successful achievement of strategies. The focus of control in turn decides the extent of functional areas that are strategically important, and the types of mechanisms that the designing partner may use to secure control over the critical JV functions. The combination of choice that the partner subsequently makes on the three dimensions will form another layer of enacted environment, which may articulate or hinder the implementation of investment strategies and partner relationship. It depends upon whether the choice of the three control dimensions is congruent with the enacted conditions they face.

The case details reveal that the four focal parents have carefully selected and mixed the mechanisms and extents of their control packages in order to ensure that the strategic foci are sufficiently covered. The combinations of choice each focal partner made on the three perspectives at the central core of the control package formed a layer of enacted environment, which has articulated the implementation of their strategies in China (except Pearl's TianJin JV investment) as well as supporting the current bargaining power compositions among JV partners (see Chapter 9.3.3.1 for further detail of the examples which illustrate the new findings).

The understanding gained at the early stages of the case study analysis was gradually sharpened or modified upon the new insights obtained at a later stage. Towards the end of the investigation process, the empirics reflect a wider picture, which shows that the three control dimensions, focus, extent and mechanism, are playing "different roles" and are in fact located at "different levels" within the central core of a control package. Various contingency elements comprising a holistic control package are in fact having a "circular motion of interactions and relationships" with one another. They are influenced by, and at the same time influence other components, and the process goes "circular".

This new understanding not only challenged the simple linear assumptions on environment and organisation designs that had underlined many of the earlier contingency studies, but also the more recent views of a two-way relationship between the two forces suggested by other scholars (such as Miles & Snow, 1978; Govindarajan & Gupta, 1985; Otley, 1980; Emmanuel et al, 1990; Hopper & Powell, 1985). The empirics demonstrate that their links are circular, not just one- or two-way. It is a critical finding of this research, which challenged parts of the original presumptions underlying the central core of the skeletal model. The new understanding led to two modifications on the skeletal framework demonstrated in Figures 9.6 and 9.7.

It was repeatedly reported in the analysis that the four focal parents placed a great deal of attention on the designs of the control packages. In this research, control is considered as having a close link, but not a simple, direct correlation (Otley, 1999; Norreklit, 2000), with organisation performance (Hopper & Powell, 1985; Otley, 1980). The ultimate aim of applying control is to support strategy and fulfil objectives (Lorange et al., 1986; Lorange & Probst, 1987; Anderson & Gatignon, 1986; Geringer & Hebert, 1989; Yan & Gray, 1994; Glaister, 1995; Groot & Merchant, 2000). The final part of the empirical exploratory journey was to investigate the ends-means relationship between control packages adopted and the JV performance.

Applying their respective control packages, three out of the four focal partners either achieved or exceeded the aspirations set down when the JVs were formed. During or soon after the empirical work was conducted, Superior, Marlee and Silky were already committed to other new FDI in China. Their decisions to put further investments in the country, either in JV or wholly owned forms, at such a quick pace were greatly influenced by the overall good experience with JV partners and satisfactory results from the existing FDI. The outcomes of current investments become inputs of strategies and control packages of future FDI in China.

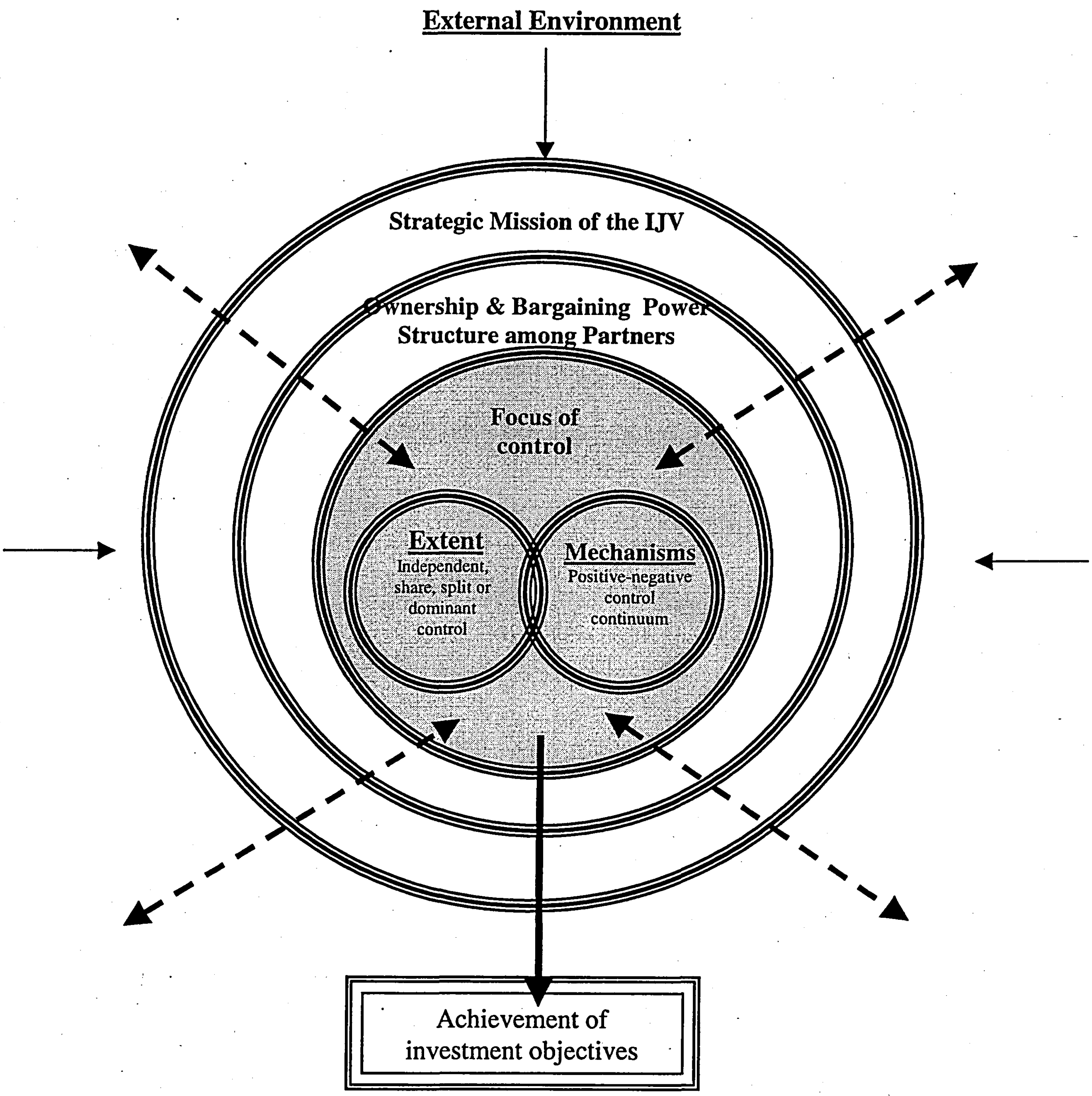
Pearl was the only focal parent who did not fulfil the majority of its JV objectives in TianJin. The JV GM stated that the problems were mainly caused by the inconvenient geographic location and inadequate industrial infrastructure in the region to support small investments. Having gained a broader view, I could see that there were fundamental problems embedded in the contextual environment in TianJin that Pearl was unable to overcome through using JV and the control package. There were major defects on the outer parameter of Pearl's control package that decisions made on the other elements could not alter the enacted environments they faced. TianJin JV's experience should have provided the head office with the information they needed about the potential of northern China at that time. The experience however has not significantly reduced Pearl's confidence in China and using JV as a vehicle to approach the country.

The sense-making journey was completed. A fuller view of the design, implementation and end results of applying a holistic control package in each of the focal partners' situation was established. My understanding of individual contingency factors, more importantly their relationships and potential synergy, was continuously refined at Stage 2 of the theory development, and the process led to the establishment of an integrative theory of IJV control in China. The final version of the theoretical model is recaptured as Figure 10.2.

According to the advancement made on the understanding of, and theory development in, IJV control in China, I consider that this research has achieved, indeed exceeded the second, third and the fourth ultimate objectives that it was set out to fulfil (see section 10.1). The case study method has successfully played the dual roles, being exploratory and informing (see section 2.7). This research has made significant contributions that have important implication for future studies of organisation control, control in an IJV context in particular, in terms of research areas, approaches and methods. The implication will be further discussed in section 10.3.

Figure 10.2

The integrative theory of IJV control



Represents multiple layers of enacted environments.

Represents the influence of external environment on the investment objectives/mission of an IJV.

Represents the continuous interplay and circular interactions between the choice of investment objectives/IJV mission, ownership and bargaining power structure among partners, control in terms of focus, extent and mechanisms, and the external environment facing an IJV.

10.3 Contributions of this research and implication for the practitioners and academics alike

The fruitful results this research achieved demonstrate the appropriateness of adopting the middle-range thinking (MRT) approach (Laughlin, 1995).

From the beginning to the end of this research, my ontological and epistemological viewpoints on control have not been changed. On the contrary, my belief has been strengthened by the empirical findings. In this study, control is not treated as a discreet phenomenon, but is seen as a wider package, which consists of various elements, that are used to articulate strategies and achieve the desirable results (Lorange et al., 1986; Lorange & Probst, 1987; Anderson & Gatignon, 1986; Geringer & Hebert, 1989; Yan & Gray, 1994; Glaister, 1995; Groot & Merchant, 2000). Control as a holistic concept is empirically examined in this research. It is a vital finding that has significant implications for the conceptualisation of organisation control in general, and control in IJVs in particular.

As discussed in Chapters 2 and 6, Parkhe (1993) observed that not all aspects in the field of JV/IJV are in a pre-paradigmatic stage. Much greater scholarly attention has been attracted to, and thus theoretical advancement is made on studying outcomes (such as JV performance and stability), rather than processes (such as partner relationship and control) (Parkhe, 1993). The uneven development might be due to the fact that many researchers tried to ignore the complex "soft" issues and focus on the "hard" outcomes that are easier to measure (Parkhe, 1993; Bettis, 1991; Daft & Lewin, 1990). A high level of prior theorisation and methodological closure was the common standpoint underlying the majority of these prior studies. These researchers seemed to have forgotten that "observable outcomes are merely the end products of invisible processes (Parkhe, 1993:262). The two are "quintessentially connected" and cannot be treated as "surgically separable" outcomes (Parkhe, 1993:247) that can be casually broken down into individual pieces for "empirical snapshots" (Morgan & Smircich, 1980:498).

The circular relationships among various contingency elements and the means-ends link between control and JV performance identified by this research demonstrate a high level of inextricability between different components comprising a control package. There are plenty of examples in the analysis showing the danger of misinterpreting the empirical reality if surface views were to be taken (see Chapter 9). The findings further highlight the problems of breaking down a holistic control package into individual pieces, and simply examining one or two components as if they are totally independent from, but representing, the rest (Parkhe, 1993). Indeed, they are common weaknesses underlying the majority of previous research in the field of organisation studies and JVs/IJVs (Geringer & Hebert, 1989; Bettis, 1991; Daft & Lewin, 1990; Parkhe, 1993). These prior studies can only provide the readers with fragmented or even distorted information (Geringer & Hebert, 1989; Parkhe, 1993). It may be the key reason to explain why many disciplines of organisation studies, which include IJV, are "a source of recurrent disappointment" (Daft & Lewin, 1990:1), and "theory struggles to catch up to practice" (Parkhe, 1993:262).

As Parkhe (1993:247) rightly pointed out, the major barrier hindering the theory development in the field of IJV is that many previous studies "only skirt around the core concepts in IJV". However, "hard data sources are unlikely to capture the soft core concepts" (ibid.:230). Control is a broad concept and any meaningful attempt to study control in an IJV context must take a holistic view. There are repeated paradigmatic proposals, which call for breaking free from the normal science straightjacket (Daft & Lewin, 1990; Bettis, 1991; Parkhe, 1993), and the use of a qualitative approach to focus on the uniqueness of social research at the current stage of development (ibid; Morgan & Smircich, 1980; Scapens, 1990; Schwenk & Dalton, 1991, Dent, 1991; Spicer, 1992; Otley & Berry, 1994; Humphrey, 2001; Scapens & Bromwich, 2001).

For any research, which aims to investigate the acts and/or decisions of organisations, it is in reality a study of lives of the social actors involved (Maslow, 1971; Dent, 1991; Gill & Johnson, 1991; Daft & Lewin, 1990; Bettis, 1991; Scapens, 1990; Otley & Berry, 1994). The concept of control being socially constructed is even more critical to this research, which investigates IJV control in China, a form of organisation that is characterised with multiple partners, motives, nationalities, cultures and languages, and a country/race which places predominant emphasis on human relationships (see Chapters 5 & 6). According to the location and the pre-paradigmatic stage of the theoretical development of IJV control, a qualitative case study method was chosen to approach the empirical scene.

"Part-constrained and part-free" is the unique nature of the middle-range thinking (MRT) methodology and method that this research adopted (Laughlin, 1995:84). Semi-structured interviews with senior executives, who had direct involvement in managing their Chinese JVs, were used in the empirical discovery. Questions asked in the interviews were derived from the skeletal model of IJV control. However, these questions were applied only as skeletal rules, the executives were encouraged to express their opinions. A great extent of flexibility and diversity was preserved in the discovery process for new insights. It can be seen from the case studies that the set of questions asked often led to different development of conversation. There were times that the discussion touched some sensitive topics, which prompted unexpected reactions from the executives. For example, Peter from Silky could not withhold his resentment towards the American legal systems, Harry from Marlee hated people misusing the word "foreign" to describe normal international business practices, and Ming from Pearl was disappointed by the lack of progress of the TianJin JV despite all the hard work he and his staff put in.

As a researcher, I paid attention to activities and conversations inside and outside the interview rooms. I also observed my interviewees' manners, tones and even small gestures. The case study method allowed me to adopt a holistic orientation to investigate control phenomena as parts of a unified social system. It also enabled me to get closer to the actions and search beyond the surface. Being an ethnic Chinese myself, the cultural and linguistic understanding of both the East and the West was a great asset, which helped me to generate wider pictures about the companies, interviewees and other staff in the offices[2]. The direct contact with interviewees reduced some barriers of communication and problems of misunderstanding if interpreters had to be used in all situations. The richness of empirical detail was largely preserved. It is another strength of this study.

In addition to personal interviews, secondary sources, such as annual reports, newspaper articles, internet homepages, autobiographies and personal knowledge were used to complement the primary source of information. The secondary information worked as a mechanism to reduce bias in the interpretation of empirical details.

Throughout the investigation, there was continuous theory-empiric dialogistic exchange. The skeletal framework provided guidance to the discovery process, at the same time it was informed and modified by the empirical flesh (Laughlin, 1995). In the analytical process,

[2] Except in the Silky case. I conducted the interview with Peter Li in his house and I only met his wife. However, during the interview, there were a number of phone calls from the China factory to update Peter on the status of production and delivery of an urgent order .

constant references were made to relevant prior studies. There was a strong link between this research and the existing literature. Totally, three modifications were made on the skeletal model, illustrated in Figures 9.3, 9.6 and 9.7, in light of the new findings and understanding. Gradually, the skeletal model was shaped into its final form, which characterises the unique enacted environments that the four sample firms faced in China.

The formation of an integrative theory of IJV control in China is considered as a major contribution of this research. Equally, the choice of a MRT approach and a case study method is the contributing factor to the fruitful results. I agree with Geringer and Hebert (1989) and Groot and Merchant (2000) that contingency theory has a role to play at the pre-paradigmatic stage of the theory development of IJV control. I extended the contingency theory by integrating its core assumptions into other ideas gathered from the transaction cost economics and the social reasoning to form the conceptualisation of IJV control. It is another contribution of this study.

There are many firms getting involved in JVs, who are ill prepared or who have been forced to bypass the potential JV option (Geringer & Hebert, 1989). High JV failure/instability rates and poor performance has repeatedly been reported by prior research (Franko, 1971; Killing, 1982; Beamish, 1985; Gomes-Casseres, 1987; Kogut, 1988, 1989; Harrigan, 1986, 1988; Geringer & Hebert, 1989; Parkhe, 1993, 1993a; Yan & Gray, 1995; Groot & Merchant, 2000). However, the majority of these former studies focused on the output end of the control-performance relationship, and their findings only further confused the practitioners of the use and control of JVs/IJVs. There is a lack of research and hence understanding of the overall poor JV performance, more importantly the possible solutions to correct the problems. There is a gap between the industrialists and academics' interests.

This research has attempted to bridge this gap and bring closer the focuses of both sides. China is widely considered as a region of growth (Financial Times, 10/12/1992; Blackman, 1997; United Nations, 1992; The World Bank, 1997, 1997a; Shaw & Woetzel, 1992; Sender, 1993; Abramson & Ai, 1999). Whilst JV/IJV is regarded as an increasingly important vehicle to serve a wide range of business objectives (Schaan, 1983, 1988; Contractor & Lorange, 1988, 1988b; Franko, 1987; Beamish & Banks, 1987; Glaister, 1995; Groot & Merchant, 2000; Shan, 1991; Beamish & Wang, 1989; Harrigan, 1984, 1988; Casson & Zhang, 1991; Yan & Gray, 1994; Anderson, 1990; Parkhe, 1993, 1993a). Both the topic and the location are of paramount importance to the practitioners and academics alike. The establishment of an integrative theory of IJV control highlighting the unique environments in China at the current stage of development has fulfilled the fourth ultimate objective of this research. The case-based study has also satisfied the middle-range role in changing some aspects of the status quo and informing managers and fellow researchers of the significant topic of IJV control in China. These are the main contributions of this research project.

10.4 <u>The limitations of this research</u>

Despite the fruitful results generated from a long research process, I submit that this research has several limitations. It has examined control strategies applied to IJVs mainly from the perspective of the focal partners. Although other parents' investment and control strategies were discussed to some degree, I have simplified partner relationship and the overall environments underlying the design and implementation of each control package. My research suffers from the same weakness as some of the prior studies in the field, such as Franko (1971), Geringer and Hebert (1989) and Glaister (1995). As Yan and Gray (1995) criticised, examination of strategy-structure fit from only one parent's perspective downplays the multiple and possibly conflicting objectives and relationships of all players in an IJV. I acknowledge the problems. My decision to concentrate on focal partners was driven by the high degree of integration between the focal parents and the JV operations. Rightly or wrongly, I believed that by concentrating on the focal parent, it would shed light on both the focal partner and the IJV's control strategies. Given that it is an ambitious project to examine the holistic IJV control packages, I decided to concentrate on the focal partners in order to keep the study to a manageable size.

Another related problem is that I interviewed only a small number of executives (from one to four) in each case study. Given that Marlee and Superior are global leaders in their separate fields, the small samples might have resulted in partial and/or biased information about the partners and/or the IJVs. Owing to the difficulty of securing access, I did not have much choice regarding whom I preferred to meet in each company. However, the executives participating in the investigation are the key people who make decisions for their Chinese JVs. Their close links with the IJVs enhance reliability of the information they revealed and compensate for some of the problems caused by small sample size.

This research followed the MRT approach to build a skeletal model to guide the empirical discovery (Laughlin, 1995). The skeletal model remained incomplete and needed the empirical flesh to make it definable. There is a high degree of flexibility behind the approach and the skeletal model to accommodate the richness of the empirics (Soin, 1996). However, the flexibility can be seen as both a strength and a weakness of this research.

The strength lies in the fact that the middle-range standpoint allows for both learning and subjective diversity. I could learn from prior studies and make generalisations with a broad understanding of the topic of IJV control and relationships among various control elements. At the current stage, theory development takes priority to precise hypothesis testing in the field of IJV control (Parkhe, 1993; Groot & Merchant, 2000). The case study method enabled me to get closer to the empirical scene and heart of the research questions. The insights would not have otherwise been achieved through using a questionnaire method and/or statistically testing the surveyed data. Parkhe (1993:232) criticised that "at a stage of development where phenomena are not well understood and the relationships between phenomena are not known, precise experiments that precede rather than succeed field studies amount to being precise about vagueness". This research has successfully developed an integrative theory of IJV control, which serves as a springboard for launching future research and theory refinement (Parkhe, 1993). The MRT approach and the case study method are the key contributing factors.

On the other hand, the flexibility behind the MRT approach may cause the skeletal model to become unspecific and uncritical (Soin, 1996). Given that this research aimed to examine the holistic packages of IJV control, the integrative theory subsequently developed may be seen as trying to explain too broad a topic and including too many sub-elements. The specific explanatory power of the theory is reducing while the scope of study is expanding. There is a trade off between flexibility and speciality. I admit that it is an ambitious research project. However, the decision to investigate the holistic packages of IJV control was driven by the ontological and epistemological commitments of this research. The richness of the case studies and the two-stage theoretical formation process are the main contributions of this study. The fine tuning process to improve the focus of the integrative theory of IJV control is left for the future research.

The MRT approach reflects that as a researcher I am not divorced from the research process (Soin, 1996). The inextricable relationship between the research and myself means that there is a high extent of human subjectivity in the process of understanding and explaining social reality (Johnson, 1989; Gill & Johnson, 1991; Scapens, 1990). Although provisions were made to reduce bias (see Chapter 2), "there can be no such thing as an 'objective' case study" (Scapens, 1990:277). I submit that researchers, as interpreters of observed social reality, cannot be treated as neutral independent observers, as we are "theory-laden" (Johnson, 1989:100).

In sum, the retrospective review of the limitations opens up a range of opportunities for further research. As the MRT approach denotes, it is possible to learn from others. I have learnt from prior studies' strengths as well as weaknesses. This research will play a similar role in the field of IJV control to inspire fellow researchers and help investors to form and control their IJVs. The next section highlights future research opportunities.

10.5 Recommendations for future research

First, Yan & Gray (1994) hinted that control in JVs is not unilaterally chosen by one or the other partner(s), but is a result of bargaining. Hence, a wider picture of control-performance relationship can only be obtained when the patterns of control and achievement from all partners' points of views are examined. Future research can target to fill this gap and examine the control packages from different partners' perspectives.

Further efforts may be devoted to investigate the roles played by passive partners, who are willing to take a back seat in JV management. Very few marriages are made in heaven. There is a lot of give and take to make a relationship work. This research emphasises the focal partners and unavoidably understates the parts that passive partners play (Yan & Gary, 1995). It is important to understand the position that each party adopts in an IJV, regardless whether it is dominant, equal or submissive. There is scope for future development on this interesting aspect of partner relationship and its maintenance in IJVs.

As Schaan (1988) stated, interests of one parent are best served when those of everyone else are also fulfilled. A necessary pre-condition for this to happen is to select partners, who hold compatible traits, such as compatible strategies, resources and cultures (Schaan, 1988; Parkhe, 1993a; Blumenthal, 1995; Luo, 1998). The complementary nature of the partnership allows all partners and the JV to pursue their respective objectives at the same time without interfering with the interests of one another. Future studies may look into criteria and processes of partner selection and the subsequent bargaining power structures among participating interests. The degree of fit between partners' objectives and JV performance from different partners' perspectives can be explored.

Fourthly, given that this research entails intensive study of a small number of cases, it is unable and also incorrect to claim for population validity in the examination of external validity (Scapens, 1990; Gill & Johnson, 1991). However, the natural context in where the empirics were derived, together with the part-free, part-constrained investigation process, adds credibility to the ecological validity of this case-based research (Scapens, 1990; Gill & Johnson, 1991; Laughlin, 1995). The integrative theory of IJV control this research developed needs to be fine-tuned and replicated in a larger number of IJV samples in China or other countries. Researchers of different nationalities and backgrounds can be brought into the team to reduce bias in observation and interpretation of empirical details.

This study only examined IJVs located in China. Control packages that are used to deal with the unique environment in China may be different from the sets applied to developed and/or developing countries (Beamish, 1985; Beamish & Banks, 1987; Schaan, 1988; Glaister, 1995, Groot & Merchant, 2000). Future work may replicate this research to examine control in IJVs located in other types of countries. Comparisons can then be made between these studies to examine how control packages change in terms of the combinations of contingency elements and the emphasis that placed on different variables, according to different kinds of enacted environments they operate in. Attention should also be paid to those variables that do not change regardless of nationality, culture, industry or size of operation of the parents or IJVs.

Owing to the difficulty of securing access (see Chapter 2), the final case study sites were chosen opportunistically, and the in-depth interviews arose from what might be termed as "accidental access" (Otley & Berry, 1994:51). Rather than rely on cross-section of information, future studies can replicate this research in different types of industries. Comparisons can then be made to identify the similarities and differences in control packages across various types of businesses in production and services.

This research revealed a wide range of mechanisms, which serve positive, negative and/or hybrid orientations, located at various positions across the positive-negative control continuum. As research advances in the field, fuller explanations of individual tools and a deeper understanding of their nature and inter-relationships should be developed.

The taxonomy that this study adopted from Killing (1983) and Glaister (1995) to measure the extent and jointness of decision-making among JV partners needs to be refined in the future studies. For example, this research included eleven business decisions in the taxonomy. These eleven aspects can be broken down into smaller functional areas in order to reveal more details of how the decision-making power is distributed between participating interests. In addition, other JV functions may be included in the measurement so that a more accurate picture of the extent of control each JV party holds can be established.

This research adopted environment, strategy/JV mission, bargaining power structure and three dimensions of control as the key contingency elements comprising a holistic control package. However, other variables that are important in different types of IJV settings remain unknown (Groot & Merchant, 2000). Further work in the field should address this deficiency and identify other factors that may affect both partners' choice of using the JV form of organisation and designs of control packages under different circumstances.

Furthermore, this research discovered a circular motion of interactions between different contingency variables comprising a control package. JV mission and partnership bargaining power structure determines a strategic focus that is critical towards the achievement of the designing partner's investment objectives. The subsequent decisions that the partner makes on the mechanism and extent dimensions aim to support the strategic focus. The JV mission and bargaining power composition are likely to change over time, so are the critical focus and the choice on the mechanisms and control extent. Longitudinal studies are appropriate to observe how the roles of, and relationships between, various contingency elements evolve over time (Glaister, 1995).

This study has provided answers to the research questions set down. At the same time however, it has generated further questions that wait to be resolved. Knowledge pursuit is a never-ending process. The completion of this research project only means the beginning of a number of future studies. I intend to follow up some of the opportunities mentioned above and further pursue my interest in IJV, a fascinating form of organisation, and its control. I am confident that there will be other researchers joining me to work in this important field that is of immediate interest to both practitioners and academics alike.

10.6 Personal experience and comments

I experienced numerous cycles of ups and downs throughout the course of the research. I have learnt and matured along with the development of this study. I have lost count of the numbers of times that I thought I would not be able to continue, not to mention to complete, this research. Pressure was multiplied when I could not gain access to any IJVs to conduct the empirical investigation. Owing to the complexity of the topic, I agree with one of Groot and Merchant (2000:606) comments, "studying IJVs is relatively difficult research to do". However, the bad experience had a vital effect on me, it made me stronger, academically and mentally.

Although no solid contact for empirical investigation was established, at the end of 1995, I decided to travel to China in order to get closer to the empirical scene. Being a proud individual, I use to hate asking for help. Now I have learnt the skills to seek for ways out and favours. The visit to Hong Kong and China was a rewarding and educational journey. The process of writing up the four in-depth case studies and analysing a large volume of complex case materials was a tough but crucial training for me as a researcher. Throughout the course of the research, I have developed not only an in-depth understanding of IJV control, but also the skills of using materials, generating questions, listening and reacting to comments.

As I mentioned before, the end of this study only means the beginning of other projects. Through this research, I aim to communicate my research experience and findings to business and academic audiences. Researchers need support from the practitioners. On the other hand, practitioners need relevant information from the academics. If this research can raise awareness and bring closer the interests of managers and researchers on the important subject of IJV control, it will fulfil a major objective that it set out to achieve.

No matter how much I did and how hard I tried, one has to accept that all empirical research is partial and incomplete, and mine is no exception (Laughlin, 1995; Parkhe, 1993). This study is not striving for perfection. Aiming at perfection is indeed against the MRT standpoint that I adopted. I have honestly done everything I could to establish a less imperfect integrative theory of IJV control in China. I now feel confident to offer this study to you.

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