

INTERNALIZATION OF IJVS AND INSTITUTIONS

ABSTRACT

International Joint Ventures (IJVs) are temporary organizational forms. They may evolve to become wholly owned subsidiaries. Such internalization of the IJV by one of the parent firms is highly likely as they know about the joint venture more than the other firms in the market. Thus, the cost of due diligence and integration would be lesser for either parents compared to the other firms in the market. However, there has been very little research on who among the parents internalizes the IJV. This thesis examines the impact of the institutional environment on which the parent (foreign or local) gets to internalize the IJV.

The thesis argues that in highly regulated environments, the local parent firms are more likely to internalize the IJVs than the foreign ones. The need to know all the regulations and handle their complexity increases the transaction costs for the foreign firms. Such costs can be reduced with local expertise. Hence, in the more regulated environments, the foreign firms prefer joint ventures with the local firms than to operate independently. Moreover, in highly regulated environments, the host

country has a higher bargaining power than the foreign firms. Nationalist sentiments too may provide regulatory protection to the local firms. Hence, the likelihood of the local partner firm acquiring the IJV is higher when compared to that of the foreign partner.

With regulation comes the possibility of rent-seeking and corruption. The corruption should reduce the impact of regulations and thus, reduce the favourable conditions the local partner has. However, the local firms which have the stronger and the more historical political networks may be more influential than the foreign firms. Moreover, the corruption indicating a political hazard would increase the transaction costs for the foreign firm. Hence, the foreign firms might choose to find a new joint venture partner rather than to go for the wholly owned subsidiaries. Thus, the foreign firms facing a higher level of corruption in the host country of the IJV, compared to the local firm belonging to the home country, will be less likely to internalize the IJV.

The foreign firm might consider reducing the disadvantages listed above by bringing in its home country regulatory resources to intervene and negotiate with the host country government. If the trade relationships between the host country of the IJV and the home country of the foreign firm are strong, then the foreign firm may get favourable outcomes. Thus, the likelihood of the foreign firm internalizing the IJV may increase.

This study tests these assertions using a sample of IJVs in India, where the local partner is an Indian firm. Since liberalization in 1991, regulations have reduced in many industries in India. Joint ventures are not a government mandated mode of entry anymore in most industries. India is used as a context for this study after over a decade of liberalization. Thus, the firms are au fait with the liberalized regulation regime. A new dataset is constructed and used on the presence of regulation in the industries in India for this study. India as a country is a different context compared to the developed countries. India is a novel context that has a democratic capitalist economy reflecting the institutional environment more prevalent in many other countries. To test the same in the developed countries, the hypotheses are tested on a sample of IJVs in the United Kingdom.

The data regarding the IJV internalization is obtained from the SDC Platinum Mergers and Acquisitions database. The regulatory environment is considered at the industry level. The difference in the corruption level between the IJV host country and the foreign parent home country is obtained from the Transparency International's Corruption Perception Index. Various firm-level controls are obtained from the CMIE Prowess database, Thomson One Banker, annual reports, company websites, and news sources. Whether the parent firms continue in the same industry in the host country, even after the joint venture termination, is verified. The dependent variable being a binary variable, the logistic regression is used

to test the model. The results suggest that the local firms in India are more likely to internalize the IJV in the more regulated industries. Meanwhile, this hypothesis did not find support in the UK. Apart from the statistical analysis, also qualitative enquiry has been conducted to understand the context and the reason behind the findings better. For the same, few cases from the India study are analysed in detail. Also, an interview is conducted with a person who had worked at an US MNC overseeing and executing decisions related to joint ventures in India including those on their internalization.

Very few studies have considered what happens after the joint venture termination. The present study contributes to this under researched aspect and focusses on the internalization of IJVs. The study can inform the wider literature on the joint venture strategy, the mode change strategy, and the regulations. This thesis also focusses on the measure of the diplomatic relationship between the two countries by the Affinity of Nations index which can be very useful for research in the international business. It also brings in the index of regulations in the industries, which is relevant for corporate political strategies.