A Model of Control Parity and Strategic Stakes

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Abstract

Results of extant research into how ownership control affects performance of International Joint Ventures (IJVs) have been inconclusive. Using IJVs in China as the study background, we offer a two-step conceptual model to solve the seemingly conflicting findings. First, we state the importance of a balanced relationship between ownership and operation for parent firms, termed as *control parity*. Particularly, operational control by foreign parent firms in proportion to their ownership control is vital to performance of IJVs. Second, we analyze the criticality of the concept of *strategic stakes*, a contingency variable that however can disrupt the balanced relationship between ownership and operation. Two IJVs initiated by the French multinational enterprise Danone with two Chinese domestic firms are used to illustrate the conceptual model. Propositions are developed followed by discussions.

Introduction

Establishing International Joint Ventures (IJVs) is considered a common method for firms from developed countries such as the U.S. to enter emerging economies (Hitt, Ireland, & Hoskisson, 2010). Doing so enables firms from developed countries to seek growth outside their saturated home markets, and firms from emerging economies to increase global competitiveness (Pearce & Branyiczki, 1997). For example, the Chinese government approved 405,180 joint ventures with total capital of $419.8 billion USD between 1979 and 2002 (Li, Zhang, & Jing, 2008). Managing IJVs, however, has never been an easy task; it is expensive with high failure rates (Kogut, 1988), and more so in emerging economies such as China (Luo, 2007a; Steensma & Lyles, 2000). One critical factor in studying IJVs is ownership structure. Nevertheless, the importance of ownership is cast in doubt, as the empirical findings are inconsistent (Dhanaraj & Beamish, 2004; Li et al., 2008; Luo, 2007b). This paper theoretically explores the complexity of ownership structure in conjunction with the operational control mechanism. In addition, it analyzes the complexity furthered by the contingency effect of strategic stakes. The paper illuminates the theoretical model by investigating the failure of two IJVs in China, which were once highly regarded by foreign firms outside China.

To assist the discussion, we use IJVs in China as the investigation background. The simplification can be extended to other countries and nations. An IJV, in this study, is thereby defined as an establishment between one or more foreign companies, enterprises or other economic organizations, or individuals and one or more domestic (e.g. Chinese) companies, enterprises or other economic organizations, in accordance with the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (Li et al., 2008). The parent firms jointly exploit their combined resources, identify and create capabilities and core competences to capture market opportunities primarily within the Chinese market. In general,

Chinese firms provide knowledge about government relationships, laws and customs, and consumer preferences while foreign firms provide financial resources in addition to technological and managerial expertise. As a critical resource for growth, financial resources provided by foreign firms have received the extensive research attention in terms of ownership control (Beamish & Banks, 1987; Dhanaraj & Beamish, 2004; Killing, 1983). This reflects the reality in China, where most Chinese entrepreneurial firms are in great need of financing to develop their domestic market, and establishing IJVs provides a practical way for them to tap into traditionally deeper financial resources provided by foreign partners. Consequently, ownership control is perceived as a highly visible, fair and practical control mechanism for foreign firms to rely on, and thus forms a critical concern for foreign firms in managing their IJVs in China (Duan & Chuanmin, 2007; Li et al., 2008). Nevertheless, inconclusive results concerning ownership control have been found in empirical studies (Dhanaraj & Beamish, 2004; Li et al., 2008; Luo, 2007b).

Researchers have suggested exploring additional control mechanisms besides ownership control. For example, Steensma and Lyles (2000) introduced the idea of examining a dual control system concurrently, as measured by ownership control and other non-ownership controls such as structural controls, resource controls and technological controls. The seminal work by Geringer and Hebert has drawn the attention to operational control that is not a strict consequence of ownership (1989), upon which this study will build its theoretical model. Operational control was especially developed to understand IJVs' management control issues in developing countries such China (Geringer & Hebert, 1989), and its critical importance is reviewed in IJVs that engage China (John, 2002). We continue this line of research by advancing the argument towards a notion of a balanced relationship between ownership and operational control. We postulate that such a balance would reduce the conflicts between parent firms in IJVs and thus enhance IJVs' performance.

The complexity in IJVs is nonetheless beyond adjusting the relationship between ownership and operational control. Efforts to investigate contingency variables are called for (Yan & Gray, 1994). For example, we are advised to study contingency variables like goal congruency, IJV experience and strategic independence (Guidice & Cullen, 2007; Pangarkar & Klein, 2004). Albeit the interesting findings of these studies, exploring additional variables and nuances can broaden our understanding of the complexity in managing IJVs. Strategic stakes is one such variable. It describes the degree of importance of the IJV to parent firms that motivates them to seek control in IJVs. The concept of strategic stakes in IJVs has not been systematically studied yet we believe analyzing strategic stakes illustrates the complexity of control issues facing parent firms in IJVs. We state that recognition of strategic stakes can explain the inconclusive results of ownership control.

The study has two main contributions. First, we advocate establishing a balanced relationship between ownership and operational control in IJVs. Such a structure would reduce potential conflicts between parent firms in managing IJVs. Second, we introduce the contingency variable of strategic stakes, understanding it would instrumentally prepare parent firms to manage potential disruptions in IJVs. For practitioners, the paper suggests that foreign firms in China should design a balanced relationship between multiple controls. In addition they should be aware of contingencies that disrupt the balance, and thereby would be better off by setting up an exit strategy upon entering the Chinese market.

Literature Background

Ownership control

Foreign parent firms in their Chinese IJVs usually contribute substantial financial resources, and their capital investment is normally incorporated into IJV equity (Child, 2002). Foreign parent firms also contribute non-capital investments such as systems, management service and training; however, these are not incorporated into equity (Yan, 2000). The degree of capital injection into IJVs determines ownership control, i.e. equity control, by foreign parent firms. Equity control in general is stratified into three categories: majority-controlled structure by one parent firm (i.e. either by foreign or Chinese domestic firm), jointly-controlled structure, and minority-controlled one.

A generally accepted view of majority-controlled ownership structure is that, this structure should lead to better performance of IJVs than the other two structures would because majority-controlled ventures offer a more stable environment, which benefits the business development (Killing, 1983). This logic is broadly tested. For instance, studies of IJVs in China show that both foreign and Chinese majority-controlled ventures have better performance than jointly-controlled ventures (Li et al., 2008). Some researchers even specify that it is foreign firms' majority equity control that enhances IJVs' survival in an overseas market (Dhanaraj & Beamish, 2004). Other researchers nevertheless disagree. Blodgett failed to find that ownership affects the stability of IJVs (1992), and Kogut failed to confirm that majority ownership enhances IJVs' performance (1988). The failure of majority-controlled IJVs, according to some studies, is caused by the opportunistic behavior in IJVs (Geringer & Woodcock, 1989; Lyles & Salt, 1996), which is believed to be more severe in emerging markets such as China (Luo, 2007a, b). Opportunistic behavior could be reduced by changing the organizational form, for example, from an IJV to a wholly-owned subsidiary (Hu & Chen, 1994). It is argued that when there are less government constraints on wholly-owned subsidiary by foreign firms, we would observe more IJVs transformed to wholly-owned subsidiaries (Hu & Chen, 1994). In a study of U.S. initiated IJVs abroad, foreign parent firms (U.S. firm) with majority equity structure were found to follow this pattern, as a way to cope with the opportunistic behavior in uncertain business environments (Contractor, 1990). However, a wholly owned subsidiary is not without cost. Researchers point out that wholly-owned subsidiaries in China lack the capability of tapping into local knowledge and taking advantages of local distribution networks, thereby generating costs that are more than the benefit of the unity of control by foreign firms (Yan & Gray, 1994).

The inconclusive results of studies of majority-controlled IJVs stimulated examinations of jointly-controlled ownership structures (Choi & Beamish, 2004; Luo, 2007b). Luo studied 188 IJVs in China and found that environmental volatility of emerging economies increases opportunistic behaviors (2007a), under which a jointly-controlled ownership structure helps to reduce unwelcome behaviors through trust building (Luo, 2007b). In short, the jointly-controlled ownership structure creates a similar result of reduced opportunistic behavior that a wholly-owned subsidiary also aims to achieve. Moreover, this structure facilitates trust building between parent firms and enhances the commonality of goals and institutionalization of goals, which ultimately leads to better performance of IJVs (Yan & Gray, 1994). Still, the evidence of the effect of cooperation facilitated by jointly-controlled structures on performance of IJVs is mixed in China (Child, 2002; Hebert &

Beamish, 1997). It remains unclear why some jointly-controlled structures fail to generate superior performance than other ownership structures (Li et al., 2008).

IJVs with minority-controlled ownership by foreign parent firms are not common in China (Child, 2002). Foreign firms engaging this type of ownership structure are perceived as having the least preparation of long-term planning in the Chinese market (Bleeke & Ernst, 1995). Although there are concerns of the issues facing foreign parent firms in this category of ownership structure, there are also positive effects, such as controlling experimenting costs in uncertain environments (Child, 2002). This may be a lower cost method of examining the viability of investment in emerging economies. We conclude that the result of minority-owned structure in IJVs, at best, needs further empirical testing.

Operational control

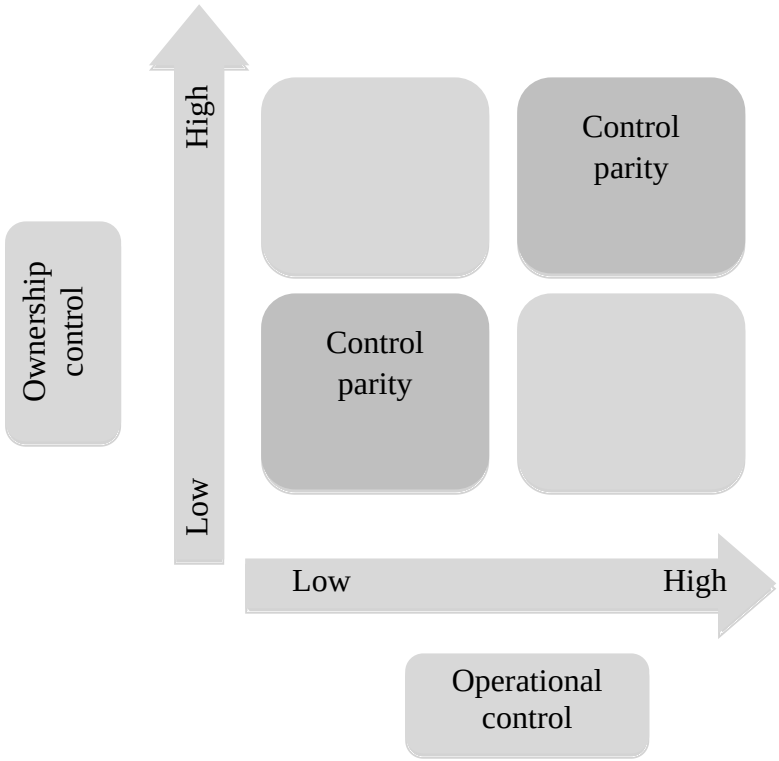
Operational control is carried out through controlling daily business operations in IJVs, rather than through controlling ownership stakes as discussed earlier. Operational control has been approached by analyzing: 1) the similarity between the management systems of the IJV and parent firms, 2) the nationality of the general manager of the IJV, and 3) the managerial control of the technical and sales departments (Child, 2002; Yan & Gray, 1994). For instance, if the management system of an IJV is similar to that of its Chinese parent firm, but deviates from that of its foreign parent, then operational control of the IJV is very likely in hands of the Chinese parent firm. Similar to ownership control, operational control is sought to ensure higher performance of IJVs, although research indicates mixed empirical findings. For example, Yan and Gray in their study of IJVs in China found that foreign parent firms that controlled management systems were high in performance satisfaction, albeit foreign parent firms that shared operational control with their Chinese counterpart were also high in performance satisfaction (Yan & Gray, 1994). It seems that the predictive power of operational control alone may not be sufficient either, suggesting a possibility of combining ownership control and operational control together to understand IJV performance.

There can be a discrepancy between ownership control and operational control. It creates risks for IJVs. For example, the foreign parent firm has obtained a majority-controlled ownership in an IJV, and while the Chinese counterpart has obtained the most of operational control. There is a possibility that the Chinese counterpart with operational control but little ownership control runs the IJV at its own discretion. As a result, it generates costs for the foreign parent firm with little operational control, conflicts arise between the parent firms, and performance of the IJV declines.

Control parity

We argue that ownership control and operational control are equally important mechanisms, and only when both mechanisms are equally treated in the decision-making, a situation we term as control parity, conflicts will be reduced and IJVs' performance will be enhanced. In essence, control parity argues for a balanced relationship between ownership and operational control. Control parity therefore reflects a match: A high level of ownership control should be matched with a high level of operational control, and a low level of ownership control with a low level of operational control. We present control parity in Figure 1.

Figure 1. The Realization of Control Parity



In the earlier example, when the foreign firm has obtained a majority-controlled ownership structure, the ability to exercise operational control in proportion to its ownership control would allow the foreign parent firm to maintain a proper supervision over the daily business. Control parity thereby facilitates a timely response to stop managerial malfunctions, to reduce conflicts, and to strengthen performance of the IJV. This leads to our first proposition:

Proposition 1: Control parity would reduce conflicts between parent firms and enhance performance of IJVs.

Two Failed IJVs

Application of case studies to analyze IJVs is widely used, and has greatly advanced our knowledge of IJVs (Parkhe & Shin, 1991; Yan & Gray, 1994). Given the turbulent business environment in China and high failure rates of IJVs (Kogut, 1988), examining failed IJVs with previous successful records should bring more insights in understanding the complexity of control.

Two cases were selected. Both are IJVs initiated by the French conglomerate Danone (Groupe Danone S.A.) with two local Chinese partners in the dairy market in early 1990s. These Chinese firms are Wahaha (HangZhou Wahaha Group Co., Ltd., 娃哈哈) and Bright

Dairy (Shanghai Bright Dairy & Food Co., Ltd., 光明乳业). Both IJVs were dissolved in 2007 and 2009 respectively. Secondary data was collected from various sources including Wall Street Journal, Financial Times, China Daily, company financial reports, corporate brochures, published case descriptions, and Chinese news reports.

We selected these two IJVs for the following reasons. First, both IJVs were once highly praised, profitable IJVs as viewed by Chinese government as well as international media in 1990s and early 2000s (Zhang & Van Deusen, 2010). Internationally, Danone is also well-known for its Danone/Dannon brand yogurts and Evian water. Danone's IJV involvement in China became the example for foreign firms who wanted to explore the Chinese market. Second, the IJVs were dissolved respectively after 12 and 15 years' operation in China. Their failures after more than a decade's operation helps us to identify some fundamental managerial problems, which appeared to be unimportant in the beginning but grew more critical over the life of each IJV. Although there are limitations concerning the number of cases selected and generalizability to other industries, exploring the two cases deepens our understanding of peculiarities and complexity of managing IJVs in China.

Wahaha and Danone

In 1994, Danone approached Wahaha through Danone's IJV with a Hong Kong based firm Bai Fuqin. Danone proposed US$450 million in cash, which Qinhou Zong, the general manager of Wahaha, accepted (Bai, 2008). In 1996, an IJV was formed among three companies: Wahaha (owned by Hangzhou municipal government with Zong as the managing director) owned 49 percent of the IJV, and Bai Fuqin and Danone each had 25.5 percent share (Dickinson, 2007). In 1998, Danone bought out Bai Fuqin and thus augmented its ownership stake to 51 percent as the largest owner.

In the following years, the IJV grew fast and contributed roughly five to six percent of Danone's global profits in 2006. In addition, Wahaha became the largest beverage producer in China and the fifth largest worldwide with sales revenue of US$1.4 billion (Krug & Rothlin, 2009).

Initially, only the five best performing subsidiaries of Wahaha joined the IJV. By 2007, the original five venture companies had grown into 40 venture companies, besides which, Wahaha had also created more than 40 non-joint venture companies that sold the same products under the same Wahaha trademark, and most of the non-joint venture companies were controlled by Zong, his daughter and wife (Bai, 2008). The creation of non-joint venture companies was not an issue until 2005, when Danone learned of this direct competition from non-joint venture companies with the IJV and insisted on controlling 51 percent of the non-joint venture companies for a contribution of US $513 million in 2006. Zong refused the request, complaining the asset value was already US $691 million and Danone's price was too low. Bitter verbal attacks started and soon escalated into high-profile media wars, and fights about foreign monopoly, protectionism, and national economic security (Krug & Rothlin, 2009). The dispute continued until September 30, 2009 when Danone withdrew from the IJV for a monetary settlement that both sides had agreed upon.

Bright Dairy and Danone

The cooperation between Danone and Bright Dairy started from two yoghurt projects in Shanghai in 1994. Bright Dairy was the top dairy producer in China at that time (PR news,

2000), and Jiafen Wang, the CEO of Bright Dairy was concerned about Danone's intention of obtaining ownership control in the joint venture, and was cautious in permitting Danone to expand ownership stake in the IJV with Bright Dairy (Wang, 2008). For example, in 2000, Danone only obtained a five percent ownership stake in the IJV with Bright Dairy that also consolidated operations of the early two dairy projects. Danone gained little control in operation of the IJV. Without operational control, Danone earned US $225 million by granting Bright Dairy authority to produce and market Danone brands products inside China. Over the next few years, Danone yoghurt became popular in the middle-eastern and the middle-southern part of China with a market share of about 15 percent in east China and 40 percent in south China in 2006 (Xinhua news, 2007).

In 2003, Emmanuel Faber, the president of Danone Asia Area and former chairman of the IJV with Wahaha, suggested restructuring the IJV with Bright Dairy, in order to increase the ownership stake of Danone. By the end of April, 2006, Danone's ownership stake was increased to 20.01 percent from five percent in 2000, thus Danone became the third largest shareholder. The general manager Jiafen Wang was forced out of the management team in the process; nevertheless, Danone still had little operational control: A consolidation plan with other four companies in Shanghai formed a conglomerate, Bright Foods, blocking Danone' goal of operational control (Vivian, 2007). In December 2006, Danone started another IJV with the fast-growing dairy firm Mengniu, in which Danone negotiated 49 of ownership stake in the IJV on the condition that Danone ended its business relationship with Bright Dairy, leading to the termination of the IJV with Bright Dairy in 2007.

Analysis

The lack of control parity

Various reasons for the failure of these IJVs have been suggested, such as trademark transfer problems and the hasty relationship between Danone and Wahaha (Krug & Rothlin, 2009). However, we could observe a situation of unbalanced relationship between ownership and operation in both cases, which created conflicts of interests that were unable to amend. We attribute the lack of control parity as one critical cause to the failure.

In the two cases, Danone's goal of acquiring ownership control as a means to influence IJV management is clear. It started by controlling a small share in both IJVs, and expanded its ownership control over years. For example, in the IJV with Wahaha, Danone's ownership stake increased from 25.5 percent in 1996 to 51 percent in 1998. In the IJV with Bright Dairy, Danone's ownership stake also improved from five percent in 2000 to 21.5 percent in 2006. Yet, the rising ownership stake failed to ensure desired managerial behavior at the operational level.

Operational control, as stated earlier, includes the control of management systems, the selection of the general manager, and impacts on sales and technical operations. Both cases describe a rather unbalanced position between ownership and operational control. For instance, in the IJV with Wahaha, Danone had acquired 51 percent ownership in the IJV; however Danone's operational control only concerns: 1) decision on producing bottled water and dairy products and 2) providing technical support for the production. Almost all operational activities were controlled by Wahaha. Danone was not responsible for selling the products, neither the management system. The general manager was from Zong from

Wahaha, and Danone had little impact on the structure of management system, which was designed and controlled by Zong. Danone controlled technical support, although its role in providing this service is dubious, as one economic commentator, Wu, pointed out that the degree of technology required in the dairy production is hard to qualify and quantify, and is perhaps less sought than that in other industries such as telecommunications (Wu, 2007). If Danone had had a better grasp of daily operations of the IJV, the damage caused by non-joint venture companies perhaps would have been detected much earlier, and therefore managed on a much smaller scale.

In the case of the IJV with Bright Dairy, Danone had little operational control at the beginning. Bright Dairy was in charge of sales of yoghurt products including Danone brand, the general manager was Jiafen Wang, the CEO from Bright Dairy, and the management system resembled that of Bright Dairy. Although Danone gradually raised its ownership stake from five percent at the beginning to 20.01 percent, and become the third largest shareholder by 2006, a consolidation plan among other dairy companies in China took place, which only reshuffled operational control in hands of Chinese firms including Bright Dairy (Vivian, 2007). In short, we see a disconnection between the two control mechanisms.

These cases review a clear disconnection between ownership and operational control, where foreign parent firm, Danone, had a higher ownership control than operational control. It is understandable that foreign parent firms have treated ownership stake as a "must-have" element in managing IJVs; however Chinese firms could interpret ownership control differently from foreign firms: a firm with 51 percent ownership control but without operational control is unlikely treated as a majority owner of an IJV (Zhang & Van Deusen, 2010).

Disproportionate control would increase the propensity of failure. On the one hand, too little control in operations when foreign firms hold a majority ownership structure would create inevitable weaknesses in fighting opportunism by domestic firms. It is easier for Chinese parent firms to manipulate IJVs without proper supervision by foreign firms. This may be one explanation of why Danone's China strategy characterized as "using capital investment to enter the market" does not work (Wang, 2008; Bai, 2008). On the other hand, too much control in operations when foreign firms have a minority ownership stake in IJVs could also be problematic: Chinese parent firms are discouraged to leverage their local resources, as the ownership title fails to empower them in the operation (Yan & Gray, 1994). The key is to establish operational control in proportion to ownership control.

Empirical studies show that obtaining control parity is feasible in China (Child, 2002). Child studied 20 IJVs in China, he first classified the IJVS into majority-controlled, jointly-controlled and minority-controlled IJVs by foreign parent firms. Then he studied the level of operational control under each ownership group (2002). In three out of nine majority-controlled IJVs by foreign parent firms, the key general managers were nominated by foreign parent firms, and foreign parent firms had a controlling position in operations, consequently these three IJVs achieved control parity between ownership and operational control. In four out of seven jointly-controlled IJVs, the difference between foreign and Chinese parent firms' influence on operation is very small, indicating these four IJVs had also established control parity. In one out of four minority-controlled IJVs, the foreign parent had less influence in operations than its Chinese counterpart, suggesting this one IJV had built control parity as

well. This study, however, did not examine relationships between control parity and financial performance of IJVs.

A contingency model

It is reasonable to assume that Danone was aware of the importance of operational control, and would like to increase operational control to match its equity investment. The failure to do so thereby indicates that obtaining control parity is difficult, if not impossible. Using the concept of *strategic stakes*, we propose a contingency model to outline challenges facing control parity.

Strategic stakes describe a degree of importance of resources that motivates individual parent firms to seek control in IJVs. The importance reflects two sides: importance of resources injected by parent firms to IJVs, and the importance of IJVs to parent firms. The idea of examining strategic stakes was brought up by Yan and Gray in their seminal work of bargaining power in IJVs in China (Yan & Gray, 1994), where strategic stakes as one source of bargaining power would influence control in IJVs. Yan and Gray demonstrated that bargaining power of parent firms decides the structure of control such as ownership and operational controls in IJVs, which in turn affects performance of IJVs. They defined bargaining power as "*the bargainer's ability to favorably change the bargaining set to win accommodations from the other party and to influence the outcome of a negotiation*" (1994 : 1480). In essence, bargaining power reflects the ability of bargainers to mobilize resources (Bacharach & Lawler, 1984), and these resources could be financial capital, relational capital and knowledge. Studies of bargaining power have shown new insights in IJVs in China. For example, one study found that Chinese parent firms, though lacking financial resources, are able to leverage their bargaining power from relational resources with the local government to gain managerial control in IJVs (Luo, Shenkar, & Nyaw, 2001).

Departing from analyzing bargaining power as ability to control resources, we apply bargaining power with a focus on perceived importance of resources, which includes: 1) the relative importance of resources contributed by parent firms to IJVs, and 2) the relative importance of IJVs to the success of parent firms.

Relative importance of resources. Drawing from resource dependence theory (Pfeffer & Salancik, 1978), parent firms are the fundamental factor behind the success of IJVs (Luo, 2007b; Pfeffer & Nowak, 1976; Saxton, 1997) because parent firms are sources of knowledge that generate abnormal returns for IJVs (Kogut & Zander, 1993). The impact of resources brought by parent firms, however, can differ. For example, Steensma and Lyles (2000) found that managerial support but not technical support by foreign parent firms enhances IJV learning. Different impacts result in relative importance of resources that shape various needs for control. For instance, when one resource becomes more important than others for an IJV, the parent firm providing that resource has a strong bargaining power to seek a higher level of control in the IJV. We say this parent firm faces a higher degree of strategic stakes by leveraging the critical resource to the IJV, and it would optimize its control in the IJV to ensure the IJV's performance.

The emphasis on resource provision can be perceived differently in different countries (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). In general, technological knowledge and financial capital are considered important by Chinese parent firms (Duan & Chuanmin, 2007; Steensma & Lyles, 2000). To illustrate, Li et al., (2008) identified cases where Chinese

parent firms lacked funds and were unable to raise capital that was considered critical to the success of IJVs. Foreign parent firms who successfully entered the Chinese market with sufficient capital thereby obtained more control of the IJVs than their Chinese counterparts. Nevertheless, the importance of financial resources may vary from case to case, thus should not be taken for granted. Duan and Chuanmin (2007) conducted a three-case analysis of IJVs between parent firms from China and the U.S.. In all three cases, technological capabilities were regarded as one key resource that all three IJVs needed. As a result, the U.S. parent firms gained more control by having access to technologies, even though none of the American parent firms acquired a majority ownership in their IJVs respectively.

Relative importance of the IJV. Parent firms' resources determine their IJVs' success, and in return, the IJVs can function as a resource that affects parent firms' success. According to resource dependence theory (Pfeffer & Salancik, 1978), when an IJV becomes an important key to success for one parent firm, this parent firm has incentive to enhance its control in the IJV to secure the benefit. For example, in a case where the ownership structure of an IJV determines how much revenue from the IJV is sent back to each parent firm for further consolidation (Duan & Chuanmin, 2007), assuming there are no governmental capital restrictions, and if revenue from the IJV contributes to the Chinese parent firm more than that of the foreign parent firm, then the Chinese parent firm would be more motivated than the foreign parent firm to ensure performance of the IJV. In this case, the Chinese parent firm has a higher level of strategic stakes than its foreign counterpart, and is more motivated to strengthen its control to protect the gains. It is important to notice in this example that, even when the foreign parent firm has a majority-controlled ownership, and therefore gets more of revenue generated by the IJV, the relative importance of the IJV to the foreign firm may still be low. This is because the contribution of the IJV to the foreign parent firm as a percentage of the total revenue is relatively small.

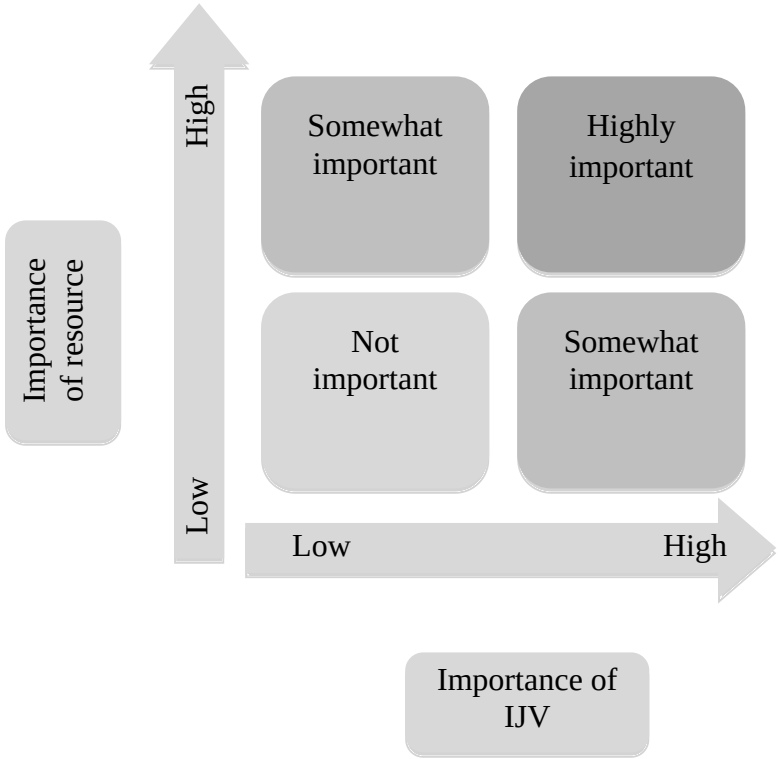
We analyze strategic stakes using a two by two matrix as shown in Figure 2. The degree of strategic stakes depends on the combination of the perceived importance of the two types of resources. Specifically, a parent firm has a high level of strategic stakes when the two resources are perceived highly important, the parent firm has a medium level of strategic stakes when only one of the two resources is perceived highly important, and the parent firm has a low level of strategic stakes when none of the two resources are perceived important. In this way, the degree of strategic stakes is stratified into three categories: high, medium and low level of importance. The different levels of importance can either strengthen or weaken the desired control parity.

Rationally, a parent firm with a high level of strategic stakes will try to increase its control of the IJV; it provides critical resources to the IJV's success, and its own success in return depends on performance of the IJV. A parent firm with a low level of strategic stakes, on the other hand, has less motivation and thus puts less attention and perhaps less effort into running the IJV. After all, the effort it spends on the IJV may not match the contribution the IJV generates back to the parent firm.

Strategic stakes reflect one specific aspect of strategic consideration by parent firms. That is, strategy modifies organizational structure and ultimately affects performance (Geringer & Hebert, 1989; Yan & Gray, 1994; Guidice & Gullen, 2007), and accordingly, strategic stakes affect the control structure and performance of an IJV as well. For example in one study, researchers found that strategic stakes strengthen bargaining power sources that

change managerial control structure in IJVs (Yan & Grany, 1994). In other studies, strategic stakes affect the life span of an IJV as strategic stakes of the IJV to parents' overall strategies are reduced or phased out over time (Barlett & Ghoshal, 1986; Harrigan & Newman, 1990).

Figure 2. The Degree of Strategic Stakes

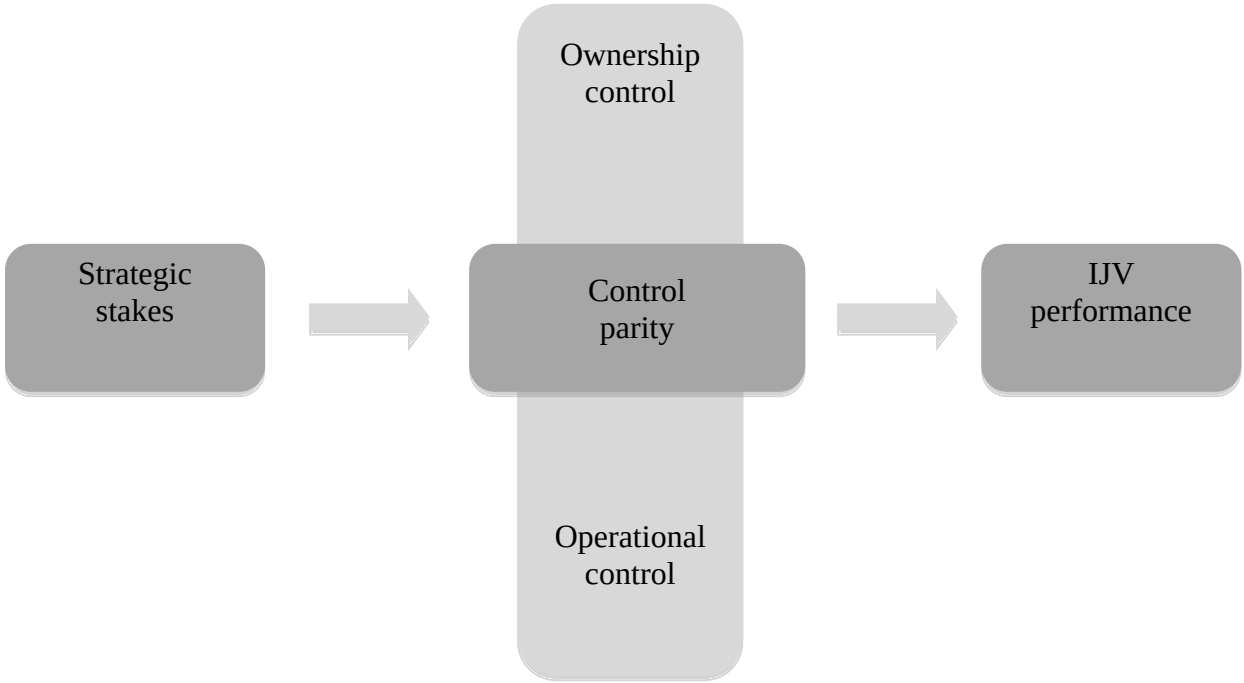


We postulate that parent firms with various levels of strategic stakes elicit different control seeking behavior. The control behavior further interacts with the need of establishing a balanced relationship between ownership and operational control, and forms the contingency model in Figure 3.

Specifically, when the degree of strategic stakes for a foreign parent firm is high, the foreign firm would be better off by increasing both ownership and operational controls to ensure performance of the IJV. Otherwise, a high ownership control with low operation control will increase unfairness perceived by both parent firms, for example, the foreign parent firm would blame its Chinese counterpart for failing to follow the spirit of contract, and while the Chinese parent firm would view the foreign counterpart's ownership influence as unjustified intervention of the daily business run by the Chinese firm. Conflicts intensify between the two parent firms, and further hinder performance of the IJV. This leads to the following proposition,

Proposition 2: The high level of strategic stakes of a foreign parent firm will enhance the effect of control parity on the IJV performance, where the foreign parent firm holds a majority-controlled ownership with a proportionate operational control of the IJV.

Figure 3. The Contingency Model



When the degree of strategic stakes for a foreign parent firm is low, the foreign parent firm would be better off by decreasing both ownership and operational control. Otherwise, it makes little economic justification. That is, the cost of control is higher than the benefit of it. For example, there are financial capital investments to secure ownership control, and human capital investments to secure operational control. The investment decision fails to optimize resource utilization where they are needed most, that is, in areas with higher strategic stakes. Consequently, a low degree of strategic stakes for foreign firms should result into a low level of ownership and operational control in IJVs. This leads to the following proposition,

Proposition 3: The low level of strategic stakes of a foreign parent firm will lower the effect of control parity on the IJV performance, where the foreign parent firm holds a majority-controlled ownership with a proportionate operational control of the IJV.

Evaluation of strategic stakes of the two failed IJVs

In the IJV between Danone and Wahaha, strategic stakes were perceived differently by each of the parent firms. First, let's examine the importance of financial resources provided by Danone. Typically, the financial resources contributions by Chinese parent firms are generally low. The vice section chief, Hongbin Zhang, from the Foreign Trade Cooperation Office in Zhejiang once pointed out, "*Wahaha's problem is not in the management, but the lack of funding*", in that cash for growth was not available (Wu, 2007). However, the urgency of financial need is questionable. For instance, under Zong's

leadership, Wahaha was profitable with annual revenues of US $125 million and net profit of US $25 million when the IJV took place in 1996. Perhaps there was no "emergency" that Wahaha had to acquire additional financing or it would exit the market (Qiu, 2007); rather if Wahaha would like to maintain its previous levels of strong growth, additional financing became necessary. Yet, insuring an IJV's success also requires other resources besides capital investment. For example, during Wahaha's early growth in the niche market for children's nutritional drinks, Wahaha gained recognition and support from local government, a critical intangible asset of doing business in China (Chen, 2001). Financial resources are important for the IJV's growth, but may not be perceived as critical when we compare other resources provided by Wahaha such as relationships with the local government.

Second, let's examine the importance of the IJV to the two parent firms. During 1990s and 2000s, Danone operated multiple IJVs in emerging economies to expand its saturated domestic market. Its market expansion reflects Danone corporate strategy over the past decade: establishing IJVs, particularly in fast-growing emerging economies like China, India and Pakistan (Krug & Rothlin, 2009). For example, Danone acquired a 49.5 percent share in Pakistan's Continental Biscuits Limited in 1984 and formed an IJV with Britannia Biscuits in India in 1995 (David, 2007). In China, Danone also operated several IJVs in parallel such as the IJV with Wahaha, Bright Dairy, Mengniu, Guangdong Robust Group, and others (Qiu, 2007). The importance of the IJV with Wahaha would have been more significant to Danone if Danone did not have multiple IJVs in China and other countries. For Wahaha, the IJV was the only alternative to gain faster growth and to conquer the increasingly competitive domestic nutritional drink market (Zhang & Van Deusen, 2010). We may conclude that the IJV was more important to Wahaha than to Danone. This importance was reflected in the initial ownership structure, where Wahaha initiated a majority control in ownership structure (Wahaha owned 49%, Danone 25.5 %, and the Hong Kong based firm Bai Fuqin) in 1996 with a controlling position in operation as well. After Danone bought out the other partner and increased its ownership to 51 percent in 1998, the market competition intensified. Wahaha created separate non-joint venture companies, and their growing revenues depended on the usage of the brand name Wahaha that was supposed to be solely used by the IJV.

Consequently, strategic stakes—the importance of resource provisions to the IJV and the importance of the IJV to parent firms—appear to be higher for Wahaha than for Danone. Wahaha had strong incentives to defend its operational control, and made the already unbalanced structure between ownership and operation more vulnerable.

In the IJV with Bright Dairy, we could draw a similar conclusion. The financial contribution by Danone was less critical than the local sales network built by Bright Dairy, as exemplified by the sales revenue of Danone brand yogurt through the Bright Dairy distribution channel. Similarly the IJV was more important to the success of Bright Dairy than to Danone. For example, Jiafen Wang, the CEO of Bright Dairy, listed four tough requirements for Danone: Bright Dairy could purchase the two earlier projects in Shanghai at discount; all yogurt business of Danone would be combined with that of Bright Dairy, Danone should not continue in yogurt business alone; Bright Dairy could make use of Danone brand name for ten years with no fees; and Danone could only purchase five percent of minority share with high premium (Ye, 2007). Danone accepted all requirements in order to obtain the five percent stake in the IJV with Bright Dairy. These criteria ensured that total

operational control was in hands of Bright Dairy, consistent with a high degree of strategic stakes facing Bright Diary.

Discussion and Conclusion

Studying ownership structure alone has generated mixed findings, and we try to address these inconclusive results by analyzing ownership structure and operational structure concurrently. Two IJVs in China were examined in this study: one is the IJV between Danone and Wahaha, and the other IJV involves Danone and Bright Dairy. Using foreign parent firms as the anchor, we propose that control parity defined as operational control by foreign parent firms in proportion to their ownership control would lead to better performance of IJVs. Control parity by foreign parent firms however is difficult to build because of the concept of strategic stakes. Nevertheless, awareness of strategic stakes would help foreign parent to build control parity and deliver better performance.

The study has two main contributions. First, we have shown that a balance is needed between ownership and operational control in IJVs in emerging economies such as China. Specifically, the study calls attention to establish operational control in proportion to ownership control, a situation termed as control parity. Departing from promoting a specific type of ownership structure (majority-, jointly- and minority-controlled structure) for practitioners (Dhanaraj & Beamish, 2004; Killing, 1983), we propose that all three ownership structure can work in emerging economies as long as a proportionate relationship is built between the two control mechanisms.

A second contribution of this study is the integration of strategic stakes with control parity perspective. The analysis of strategic stakes depends on 1) the importance of resources provided by parent firms that IJVs need to survive, and 2) the importance of the IJVs that enables parent firms to thrive. Strategic stakes bring us additional understanding of resources provided by parent firms. For example, when examining financial resources provided by foreign parent firms, we recognize that it fastens the speed of Chinese parent firms in conquering the domestic market; however, financial resources are not the only resources required by the IJV. Meanwhile, the relative importance of the IJV to foreign and domestic parent firms varies. As a result, strategic stakes perceived by domestic firms hinders the goal to establish control parity by foreign parent firms.

Future research

There are limitations in this study. First, this paper has focused on examining strategic stakes that shape the behavior of parent firms in seeking control. We recognize that other contingency variables influence the effect of ownership structure as well, such as goal congruency, IJV experiences and size (Pangarkar & Klein, 2004; Guidice & Gullen, 2007). Lowen and Pope (2008) used survival analysis techniques and found that parent firms' leadership turnover, size differential, host and parent country's political stability and partner experience significantly contribute to the IJVs' life span in addition to the relative ownership levels. Future studies should build a more complex model by taking into consideration additional contingency factors.

Second, empirical testing of the model in a quantitative manner would be an important contribution by future studies. This study only explored two cases, which need

further empirical tests to validate the model and test the propositions. In this process, future studies could also contribute by developing the measurement of the concept of strategic stakes.

Third, as a growth strategy, increasingly more Chinese firms are starting to explore international markets. Consequently, multi-market contacts between Chinese firms and foreign firms could be formed, that is, Chinese and foreign firms would encounter each other in more than one market (Gimeno & Woo, 1999). Competitive relationships between parent firms would change as a result, providing a good opportunity to study how the new competitive relationships could influence control behaviors of parent firms. For example, researchers suggest that a high level of multi-market contacts may reduce the competition intensity since the familiarity with strategies of the rival increases from experiences in other markets, leading to more cooperation rather than competition (Hughes & Oughton, 1993). Therefore, when Chinese parent firms gradually increase their multi-market contacts with foreign parent firms in other international markets, this new context perhaps would modify strategic stakes perceived by Chinese parent firms.

Despite these shortcomings, the study has contributed to the research of IJVs in emerging economies such as China. It suggests that establishing control parity between ownership and operational control is more critical than deciding the form of ownership structure.

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