Internationalization of SMEs through Joint Ventures

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Abstract

The world is having a fast growing economy and provides great business opportunities. Due to globalization, international business expands and international market is continually converting into boundary less environment. These conditions also affect SMEs. The SMEs are traditionally considered as home based industry but their survival is no more possible with local business. Joint venture is a type of entry mode to foreign markets. This thesis is an attempt to investigate how to improve joint venture relationship between foreign Swedish SME and local Indian firms by identifying and investigating the effecting factors. Throughout our study, the experience of case company Amokael remains focal point. Indian government is still imposing restrictions on certain industries in which foreign firms have to establish business through joint venture. Joint ventures of Swedish SMEs with Indian partners on Indian soil are considered to be critical due to the cultural and societal differences.

Key worlds: Joint Ventures; SMEs; Internationalization; Competitive Advantage

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1. Introduction

Globalization has been an important trend since the last decade and companies that felt safe with international borders now face competition. Due to the continuous growth in international trade, companies become more international in perspective and committed to the international market. (Kirby and Kaiser 2003). The third wave of internationalization increased the importance of emerging markets. Now companies from mature countries try to establish themselves in emerging markets. Internationalization is a gradual process in which companies learn how to do business in the foreign market through a gradual learning process (Jansson, 2007). One of the two main problems that companies face in their international growth concerns the entry strategy. Mainly how do companies gain access to new customers in new geographic markets? Also how companies should start their business and market to establish a strategic position in the host country and maintain that position. The second topic refers to the internationalization strategy. It deals with the globalization of business by expanding the company to several countries (Jansson 2007).

The attractiveness of internationalization and therefore, possible profitability encourage not only multinational companies but also SMEs to concentrate and increase their international business activities. SMEs usually have limited resources, such as finance, product range and administrative capacity to enter the foreign market (Jansson & Sandberg 2008). Small and medium-sized enterprises (SMEs) oriented towards the home are internationalizing their commercial operations, becoming more global. The reduced physical and psychological distances make it less risky to operate in foreign markets. Internationalization is seen as a gradual process through a series of small steps. It is observed that the first companies move towards similar and nearby markets and then gradually towards other markets different and unknown. Companies usually start with intermittent exports that are then organized by independent agents or other intermediaries in the market and finally establish their own subsidiaries (Forsgren & Holm & Johanson, 2005).

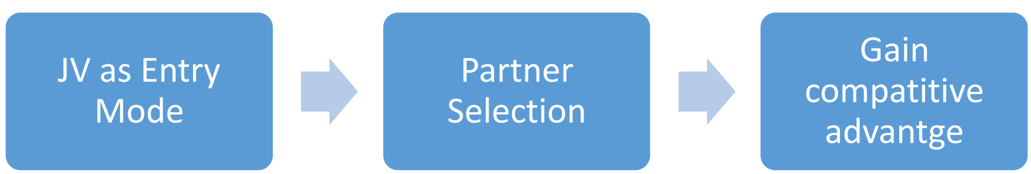
When Western companies enter and expand into markets in emerging countries, they need to learn many new things. Therefore, knowledge and learning are key factors in internationalization. New stages of internationalization are established with the firm that extends its business from one important type of market to another important type or from one type of foreign environment to another. These environments or market contexts of foreign countries are defined as institutional environments. Therefore, the process of internationalization is determined by the institutional distance between the markets of the countries. This concept implies great differences between how societies are organized. It is a broader concept than psychic or cultural distance. Rather, it improves cultural distance as a concept for international business research that changes from a country-level characteristic to an institutional country profile based on institutional theory. It is assumed that the institutional distance is great when the internationalization processes are carried out from the old EU countries to the new members and also to the Asian countries. The country's market is particularly a restricted entity. The markets of the country is surrounded by fences corresponding to economic, institutional and cultural barriers for business. Institutional and cultural barriers are important obstacles to the entry and management of foreign markets. In general, it is assumed that the form of organization used in a foreign country is chosen in order to overcome psychic and cultural distances in an appropriate manner. For example, direct export differs from acquisition or investments in the green field in this regard. The choice of a mode of entry by SMEs can greatly affect the performance of companies and the organizations decide about the mode of entry by viewing their resources; larger companies tend to have greater economic and managerial resources for the investments required for own representation in the entry market than smaller companies. The entry strategy for the international market is an integral plan in which the evaluation of alternative entry modes plays an important role in choosing the best mode of entry for the particular market (Backlund and Suikki 2005). Companies can enter the foreign market through intermediation or by establishing their own subsidiary that offers an export option, FDI or joint venture (Jansson 2007).

The main purpose of the research is to help Western SMEs to expand their business in emerging markets through joint ventures. The study deals with a specific dimension of spectrum that is the partner selection criteria for joint ventures. The technique adopted to achieve this purpose is the content analysis. This study highlights the issues Western SMEs face when selecting a partner for joint venture from an emerging market and what they need to do to overcome these problems? Joint venture is the working arrangement between two partners. Joint ventures are usually established to combine different strengths of two firms in a field. It is really important for the firms to choose right partner. It will help the SMEs to find the best partner. The study is having the following main research question;

How to choose the right partners for JVs?

The overall aim is to improve the joint venture relationship and in the figure 1 it is seen how problems are interlinked and improved the business relationship

Figure 1: Joint Venture Relationship & its Advantage



2. Literature Review

2.1. Joint Venture

International joint ventures involve companies from different countries that cooperate beyond national and cultural borders. Most international joint ventures involve two partners, one from a foreign country and the other from a local country. Joint ventures are legally and economically independent organizations that operate as independent firms that perform regular business activities like any other independent firm (Yan & Luo 2001). Companies seek partnerships to stay ahead of the competition in today's global economy. There are multiple uncertainties that a company can obtain through joint ventures, including lack of knowledge of the local market, risk sharing and the ability to combine different values of the strength of the chain. The joint venture with the local company helps to reduce this gap, on the contrary, it is also a good option for the local company to learn about foreign technology (Byung 2008).

According to Jansson & Boye (2010), SMEs traditionally oriented to the domestic market have a disadvantage in international trade. Therefore, these companies considered as low degree of internationalization. This problem can be solved by developing a joint venture in which two or more of two companies work together to obtain a competitive advantage. This can be achieved by sharing resources. Joint ventures open up new business opportunities. According to (Backlund & Suikki, 2005) SMEs expect joint ventures due to their limited resources). The intention to do business in cooperation is to use the external resources of the partners. The joint venture is a beneficial tool in those markets where high uncertainties or trade barriers gave local companies an advantage over foreign companies. The joint venture can not only reduce cultural differences but also useful in those markets where it exists. The instability affects the performance of the business. The potential of a high volume of sales increases the importance of the joint venture in countries like India and China. The joint venture is a favorable option in those countries where there is cheap labor and good raw material available, technical facilities in that case. Under the umbrella of the joint venture, two companies merge their resources to obtain the benefit that is useful for both companies; one can learn market knowledge and another can obtain technical knowledge. Foreign companies can work as a local business entity in this way and obtain internal knowledge of the market. It is also favorable from the point of view of investment, since SMEs have limited resources, so the joint venture will be a good option for the company to enter the international market.

Joint ventures are the most common and safest way to enter international markets for SMEs due to limited resources (Kirby & Kaiser 2003). It is considered the best entry strategy for SMEs that minimizes the risk of the company in the foreign market and increases productivity. Joint venture is a beneficial tool to learn new market knowledge while having a direct interface with the client. Normally, there are four main reasons for a company to choose a joint venture as a mode of entry:

market entry, risk sharing, technology exchange and joint product development. The joint venture provides the opportunity to establish political connections and commercial relationships (Kirby & Kaiser 2003). Hewitt (2005) divided joint venture into two groups. This classification is based on practical way of working rather than based on legal entity. The types are;

2.1.1. Equity Based Joint Venture

This form is used where partners willing to contribute capital to a joint venture that has a separate entity from its parent companies. Both Parties share the profit and loss on the basis of their share in the business.

2.1.2. Non-Equity Collaboration

These types of alliances are not generally based upon establishing a separate entity from its parents and not deal direct profit based activities. The main focus remains on sharing resources like R&D, joint productions and network alliances. These types of ventures are merely contractual. Both types have differences on the basis of degree of control and motivation of partners. Generally a new entity of organization established under Equity Joint Ventures.

2.2. Driving Forces for Joint ventures

Peter Drucker, the world famous economist considers joint venture as an important pillar of the business in future. He elaborates it more by saying that no company hold total control under current climate and firms will be mutual depended to each other to survive. According to Lynch (1990) there are several competitive forces that play an important role for the growth of joint ventures and strategic alliances. His classification is as followed;

2.2.1. Hybridization of Technologies

The development of new products may require expertise in diversified technologies. The firms usually have expertise in one particular area and failed to do new developments. This dilemma is a driving force for firms especially in technology sector to think about joint ventures for making new products. Current international markets require integrated system where different technologies available in one component. Firms can analyze and choose the joint venture partner by considering the lack area (Lynch 1990).

2.2.2. Need to Bring Products to Market Faster

Current economic world opens a window where early introduction of product in market play a major role for competitive advantage. A partner having massive marketing and distribution channel can play a major role to get competitive advantage in foreign markets and sometime even first mover advantage. Firms often adopt this strategic option to grasp the market at deep level in foreign market (Lynch 1990).

2.2.3. Sharing Risks of Enormous Capital Expenses

The joint venture helps firms to produce and develop products by reducing cost factor by combining their expertise. New products or technologies often cost a lot but there is a threat from competitors to come in market with same type of product. So, by combining expertise of partners in joint ventures possibly decrease the risk factor on single arm. Good joint ventures will possibly the cause of complement each other’s weakness (Lynch 1990).

2.2.4. Problems of Insufficient Management

Companies often lack of sufficient management skills when it comes to extremely complex task for example construction of business. The problem become intensive when firms want to enter in new market or new industry where previous experience consider little value. It is hard to have all skills in one hand so firms work jointly to overcome the weak areas (Lynch 1990). Partners pooled their skilled managers in joint venture in order to achieve the objective. Due to the criticality of the feature a functioning combination of people is very important.

2.2.5. Insufficient Capital

Smaller firms have financial problems but growth potential. Joint venture helps firms to overcome the financial problems because investment shared by partners which allow firms to keep focusing on its expert areas (Lynch 1990). Sometimes firms looking for an acquisition and it is impossible for them to go for it alone due to financial issues. Joint venture is rather considerable option to increase financial strength and make deals affordable (Hewitt 2005). Potential partner with sufficient cash flow is needed for future plans.

2.2.6. Disappointing Merger and Acquisition Results

The result of merger and acquisition during 1980's firms learnt a lesson that it is very hard to manage. One of General Electronics study shows that 95% of acquisition gave disappointments to the parent company. During last decade companies adopt and formulate a new strategy to go for joint venture rather than acquire a company. Joint venture is a less costly and less risky option for not only SMEs but MNCs as well (Lynch 1990).

2.2.7. Cost of Communication

International Joint Ventures possibly able to reduce the communication gap between two different cultures especially when the distance is high. Firms face troubles to manage business in foreign markets alone, joint ventures help firm not only to reduce the societal gap but provide a good management skill. Due to the cultural distance many authors consider Joint Venture a better tool than wholly owned subsidiary (JIBS 2009).

2.2.8. Enter to Restricted industries

Joint venture is the only option to enter in such industries where government policies discourage or forbid full ownership of foreign investor. International firms got success to resources that controlled by local firms in particular industry (Gocmen, 2004).

3. Methodology

To achieve the objectives of the study, inductive approach was applied which is used for inducting general explanation of phenomenon from a particular one. The actual role of inductive research approach is to build theory and this approach is typically related with qualitative methods of research (Bryman & Bell, 2007). Qualitative research deals with soft data like social sciences where attributes, perception and human behavior involved. Our study is merely based on qualitative research method. The reason of this choice is based on the research problem which deals with the joint venture issues. Due to the importance of social and cultural factors the qualitative method considered more relevant because it is hard to get quantitative data on soft factors. Cooper and Schindler (2006) describe that, the reason of using qualitative research strategy is to collect data which portray a detailed picture of events, situations and interactions with people & things and qualitative research is more relevant to study social relations. On the basis of qualitative approach, we applied “qualitative content analysis” technique for information analysis. Content analysis is the classical procedure to analyze textual material without any concern with source or media. The material analyzed for the study was collected from internet and library sources by using the words inter partners’ compatibility and joint venture problem in internationalization through joint venture. Total documents selected were 20. The time span of these documents was ranges from 1990 to 2010. These documents included Books, Research Papers, Research Reports and web publications and news articles. The data was transcribed into (N-vivo 10) software to analyze different queries. We found the model of factors that must be considered in partner selection while go for joint venture. The model then interpreted to explore the contribution of the factors that must be considered for partner selection in joint venture.

Figure 2: Factors for consideration while going for Joint Venture

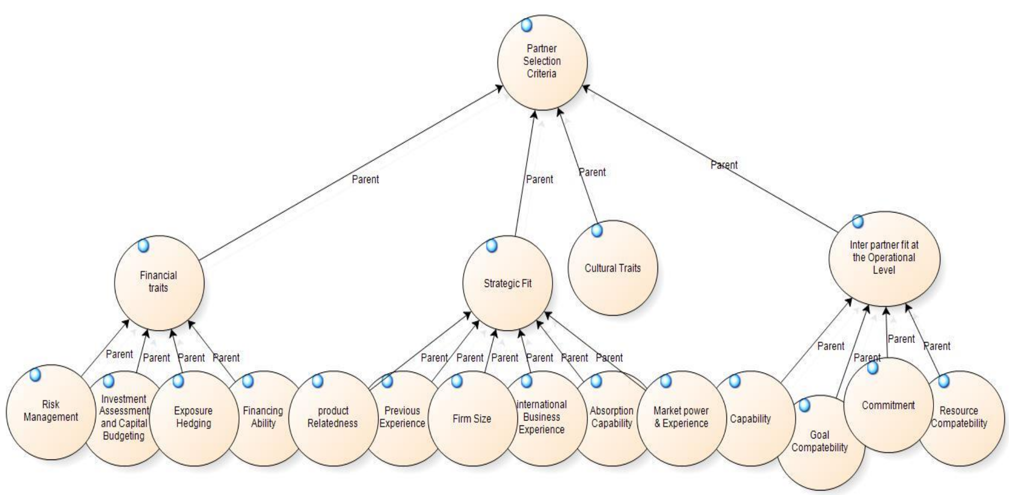
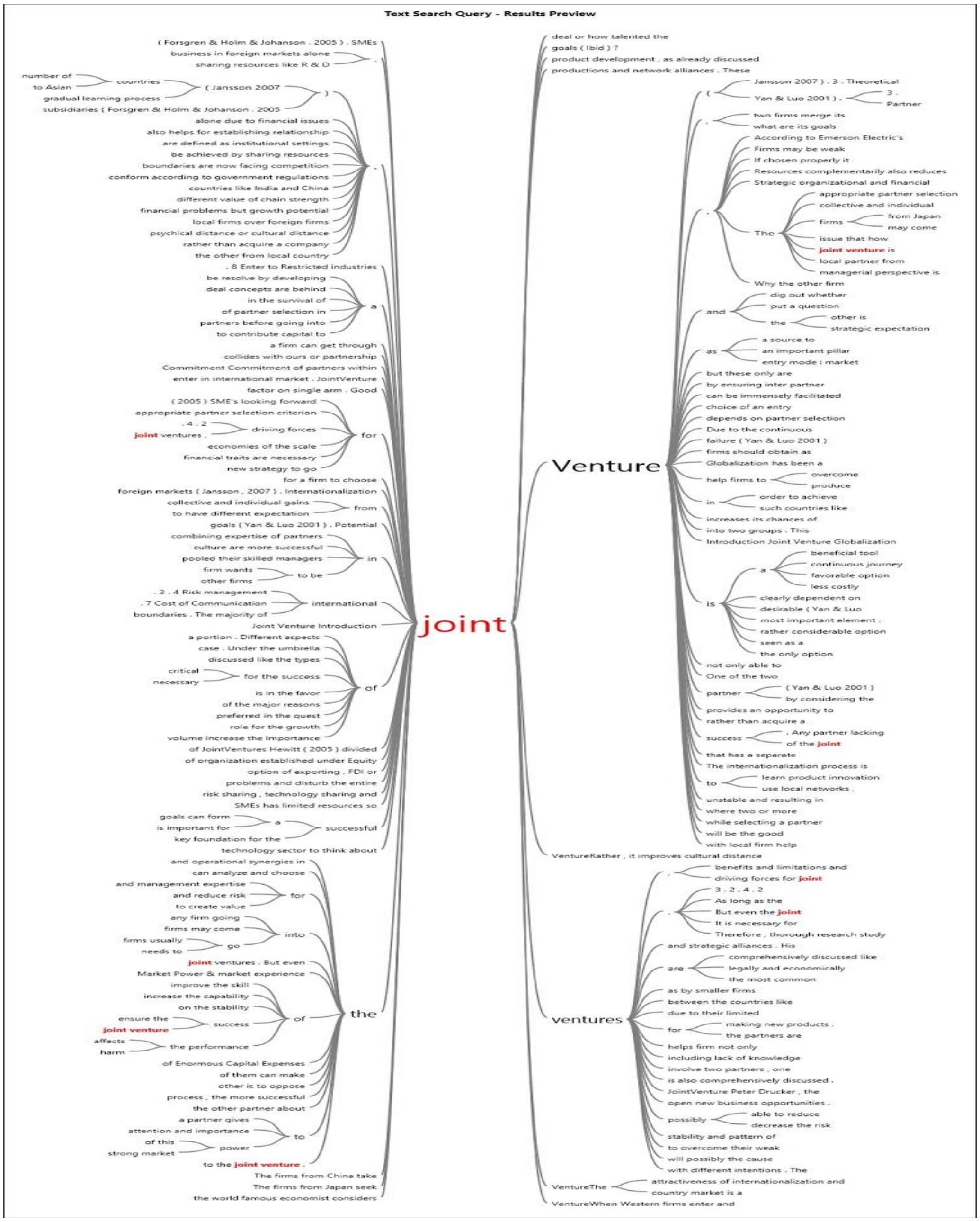


Figure 3: Word Tag Cloud

Figure 4: Word Tree Map



4. Discussion

Inter partner compatibility is the key foundation for the successful joint venture. The collective and individual gains from joint ventures for the partners are dependent on it. Culture, strategy, organization capabilities and financial traits are most important areas for inter partner compatibility (Yan & Luo 2001). Selection of both local and foreign partner is important for a successful joint venture. The local partners from host country can reduce the risk and increase the capability of the joint venture to use local networks and market resources. The foreign partners can bring advance technology, international know how and management expertise for the joint venture. The appropriate partner selection criteria should be defined before the formation of Joint Ventures. The two broad types of criteria for partner selection are operation related and cooperation related. The strategic competitiveness and skills of the partner like absorptive capacity, product relatedness, market position and industrial experience are included in operation related cooperation. While cooperation related deals with the organizational or inter organizational traits like previous inter partner collaborations, experience in overseas operations, organizational form and firm size (Yan & Luo 2001).

4.1. Cultural Traits

Achievement of cultural synergy is necessary for the development of mutual trust. The mutual trust is necessary for the success of joint ventures. Therefore, thorough research study of both types of cultures is important; national and organizational. The problems usually start when a partner unilaterally imposing its culture without considering the others. This includes both national as well as organizational cultures. The organizational structure, business strategy, decision making process, management flexibility and conflict management are vitally important while developing organizational culture compatibility (Yan & Luo 2001).

4.2. Strategic Fit

The different aspects of the strategic fit which play important roles are as under;

4.2.1. Absorption Capability

The absorption capability of the partners and their skill to exploit new knowledge are important while making a joint venture. This capability works much better when partners have different skills. The skills of one partner can help other to overcome the deficiencies of skills of other and vice versa (Yan & Luo 2001).

4.2.2. Market Power & Market Experience

The joint venture can be immensely facilitated by already established parent firm in the local market. An appropriate local partner is the one that brings strong market power to the joint venture. If chosen properly it can improve the skill of the joint venture to use local networks, increase local market commitment and give more bargaining power to negotiate with government and other stake holders (Yan & Luo 2001).

4.2.3. Product Relatedness

Product relatedness between the foreign and local partner can create some unique benefits which is not possible in the case of diversified products. The existing marketing channels, distributors, agents and suppliers of the local partner can be used. The customer loyalty with the local partner can be exploited and the relations with the government agencies can be used (Yan & Luo 2001).

4.2.4. Firm size

The capability of a firm to contribute in the survival of a joint venture is clearly dependent on its firm size. Large firms can contribute more in removing the entry barriers, reducing risks and achieving economies of the scale for joint venture. The managerial perspective is different in the large firms in the form of over sea conglomerate which may not give as much strategic attention and importance to the joint ventures as by smaller firms (Yan & Luo 2001).

4.2.5. International Business Experience

Due to the lack of trust, a misunderstanding may occur between the partners. The international experience of partners can help them to understand each other and helps them to adjust with each other (Yan & Luo 2001).

4.2.6. Previous Corporative Experience

The previous experience between the partners certainly increases the chances of the success. It will strengthen the relationship if partners already know and understand each other. The embedding of this power to the joint venture increases its chances of success (Yan & Luo 2001).

4.3. Financial Traits

The different aspects of the strategic fit which plays important roles are as under;

4.3.1. Investment Assessment and Capital Budgeting

The effective investment assessment and capital budgeting is critical for the success of joint ventures. It is necessary for the local partner to understand the effective allocation of the financial resources in the host country as these capabilities are highly country specific. The complexities of investment increase in cross country relationship, so it heavily depends upon the ability of the local partner to understand the investment opportunities in the local country and act accordingly (Yan & Luo 2001).

4.3.2. Financing Ability

It is difficult for foreign investor to get financial resources in the local market. Therefore, the ability of the local partner to maintain relationships with local financial institutes is really important. The foreign investor investigates the ability of the local partner by checking these three areas. (1) Cost control ability, to increase revenue and reduce taxes and expenses and maximize operational efficiency. (2) allocation and utilization of capital which includes the ability to allocate and use working capital, attain local financing, use and control debts, and managing risks (3) assets management, including the ability to optimally deploy assets and resources, manage accounts receivables and cash flows and manage fixed and intangible assets (Yan & Luo 2001).

4.3.3. Exposure Hedging

In dynamic and volatile host markets it is difficult to operate business. It is especially difficult for any foreign firm to maintain its cash flow and all the sources of income in such an environment. In these circumstances a local partner with the capabilities to handle these circumstances and reduce risk for the joint venture is desirable (Yan & Luo 2001).

4.3.4. Risk management

International joint ventures stability and pattern of growth depends on the risk sharing ability of its partners. For example, the currency rate fluctuation can effect on earnings and cash flows. Management of currency rate fluctuation is really important because its area of effect is really large. It affects the return value to the international partner. It involves timely, frequent and sometimes even strategic decisions. Like the decision to adjustment of operation variables like pricing output and sourcing. The bigger decisions like altering assets ownership structures, relocating plants, and restructure the entire organization sometimes needed to be taken to cover this risk. To understand and handle such crucial risk partners need each other's ability of risk management (Yan & Luo 2001).

4.4. Inter Partner Fit at the Operational Level

Inter partners fit is necessary for the success of joint venture. Strategic organizational and financial traits of the partners should be complimented and congruence for the inter partner fit. All strategic, organizational and financial traits are necessary for joint venture success. Any partner lacking in any of them can make the joint venture unstable and resulting in the failure of the business (Yan & Luo 2001). It is advisable for the firms to look at the above described static characteristic of their future potential partners before going into a joint venture but these only are not enough. It is also of equally important to see that how the partner firms work together in their daily operations. It has been said in the literature on the internationalization of the companies that the companies from similar country culture are more successful in joint ventures. But even the joint ventures between the countries like America – Britain, China – Japan and France – Italy have operational problems. To ensure the success of the joint venture by ensuring inter partner fit we need to look at the operational level criteria for partner selection (Yan & Luo 2001).

Operational level criteria for inter partner fit includes;

4.4.1. Goal Compatibility

The difference or resemblance between the partners about their goals affects the performance of the joint venture. The issue that how well-designed the considered deal concepts are behind a joint deal or how talented the participants are, is of less important than the ability of the allies to be competent enough to work together. Goal consistency harmonizes the interests between the firms that would otherwise give way to opposed sub goals pursuits. The firms should evaluate the goals of other firms to be in joint venture and dig out whether they are compatible with their own goals or not. The more similar goals increase the cooperation between the partner it is easy for one partner to predict the behavior of the other in any situation. It will increase the financial and operational synergies between partners. This will certainly increase the commitment of partners that will certainly increase the possibility to invest more resources into it (Yan & Luo 2001).

The conflict of goals ultimately arises the conflicts between parent organizations which will harm the performance of the joint venture and put a question on the stability of the joint venture. The firms may come into the joint ventures with different intentions. The firms from a specific geographical area usually have common needs to go into the joint venture. The firms from Japan seek joint venture to learn product innovation from Western firms while western firms want to learn process innovation or want market expansion. The firms from China take joint venture as a source to learn and acquire new technologies and the foreign firms wants to explore the market expansion opportunities in the Chinese home market. These goal differences convert into inter firm conflicts. This clash of goals discourages the partners to share their resources and this is one of the major reasons of joint venture failure (Yan & Luo 2001).

This is not necessary that only identical goals are the sign of compatibility. The firms usually go into the joint ventures to overcome their weak areas. It is natural for the firms to have different expectation from joint ventures. As long as the firms respect each other's goals and the goals of one firm are not in direct conflict with other firm's goals. The firms with different sets of goals can form a successful joint venture and the strategic expectation of both the companies can met simultaneously (Yan & Luo 2001).

4.4.2. Resource complementarily

The more resource complimentarily between the parent firms the higher will be the functional and operational synergies in the joint venture. Resources complementarily also reduces governance and coordination cost stimulates information and most importantly improves the learning curve (Yan & Luo 2001).

4.4.3. Commitment

Commitment of partners within joint venture is most important element. All other things have nothing to add if commitment is missing. It means that how much consideration a partner gives to the joint venture. The joint venture is a continuous journey of trust building among the partners. The lacks of commitment from partners disturb this trust building process. If partners are not committed, then the minor conflicts may convert into big problems and disturb the entire joint venture (Yan & Luo 2001).

4.4.4. Capability

Any partner who can help the firm to overcome its weakness to achieve business objective is a desirable partner. The partners with multi-faceted and distinctive capabilities are welcome, without distinctive capability it is not possible for the partner to create value for the joint venture.

Firms may be weak individually lacking in different skills but collectively they can be powerful. Partners need to determine which particular capability they require from each other. The managers must seek uniqueness in the relationship and this uniqueness is of three types "(1) unique capability that cannot be traded easily across companies (2) unique capability that cannot be easily substituted (3) unique capabilities that cannot be easily developed or replicated with a reasonable time frame" (Yan & Luo 2001).

4.5. Guiding Principles of Partner Selection in a Joint Venture

Success of the joint venture depends on partner selection process. The more meticulous and regimented the partner selection process, the more successful the joint venture. According to Emerson Electric's Chairman and C.E.O, Charles F. Knight, "when certain rigorous pre and post venture guidelines are followed you can succeed where others have failed" (Yan & Luo 2001).

Seven guiding points which should be considered by any firm going into the joint venture while selecting a partner are;

i. The capabilities of the potential partners should be judged by a team of professionals. This team of professional contains persons from every field like financial, operational and marketing professionals.
ii. Partners assessment should not be based on partner's own description. Some companies like Emerson Electric form two teams one is in the favor of joint venture and the other is to oppose the joint venture.
iii. Partner selection should be incorporated with the focal company's strategic goals.
iv. Potential joint venture firms should obtain as much information as possible about their potential partners.
v. The existing corporative relationship should be preferred in the quest of joint venture partner.
vi. It is advisable to collect firsthand information during site visit. The employee mind-set, morale of managers, operational efficiency, technology, equipment, cash flow, overall financial health and the effectiveness of the management system should be observed immaculately. Several candidate firms should be visited to increase the bargaining power. The government officials if involved should be visited early for the collection of firsthand information.
vii. It is important to understand as early as possible the intention of the other partner about the joint venture. Why the other firm wants to be in joint venture, what are its goals and does its goals collides with ours or partnership joint goals?

5. Conclusion

The choice of the partner is the basic building stone of the joint venture. If this building stone will not be laid properly the joint venture can never be successful. The firms must investigate external and internal factors while choosing partners. The one reason of the failure of firms is to ignore proper search about partner. The firms form joint ventures to replace their weakness with the strength of their partner. Joint Venture turned into great failure and not a suitable option if the interests and objectives of the partners are not aligned. Selection of the local partner from host country can reduce the risk and increase the capability of the joint venture to use local networks and market resources. However, the success of a joint venture is dependent on the inter partner compatibility. We found through content analysis that inter partner compatibility is dependent on the issues of Culture, strategy, organization capabilities and financial traits. These factors play vital role in partners' selection within or outside the national boundaries because Joint ventures are very difficult to manage. Joint ventures are full of obstacles right from its formation to the everyday operations. Situation becomes much worse when long geographical and big cultural distances exist Joint venture is not a popular option for firms due to lack of control especially when firms prefer to have their own subsidiaries.

Although with all these problems the joint venture is still the best option for SMEs to enter in International market. It requires less resources and it is the most effective and secure source to get experimental practical market knowledge. All other entry modes either provide limited market knowledge like intermediaries or too costly or risky for SMEs like acquisition or a subsidiary at foreign soil. Joint venture is long term business relationship so investigation about the partner should cover all aspects from Culture, strategy, organization capabilities to financial traits. The purpose of the joint venture for the firms is to replace their weakness with the strengths of their partners. The firms must collect all the information about their potential partners. What are strengthens and weaknesses of all partners and either the potential partner firm will fulfill their requirement or not? The most important requirement we identified is the goal compatibility, which is really important for the joint ventures. Firms with conflicting goals can never make a successful joint venture. It can often be difficult for firms to know what to expect from partners and to know in what way they think.

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