Interfirm Network Ties and Resource Procurement of IJVs

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1. Introduction

Formations of international joint ventures (IJVs) have been considered to be one of the effective strategies for corporate globalization (Yan, 1998). IJVs are legally and economically separate entities created by two or more parent organizations that pool a portion of their resources to pursue certain strategic goals, in which the headquarters of at least one parent organization is located outside the country of operation of the joint venture (Geringer and Hebert, 1989). IJVs surge as an entry strategy that effectively reduces local market uncertainties by enabling foreign entrants to pool and share resources and information with local partners (Hennart, 1989). However, other scholars suggest that IJVs are inherently unstable and problematic organizational forms (Kogut, 1989). In fact, Geringer and Hebert (1991) report that estimates of unsatisfactory IJV performance have ranged from 37% to over 70%.

These two contrasting observations are fundamental motivations of this study. In particular, this study addresses two gaps in the IJV literature. First, most of the previous studies have focused on IJVs ultimate outcomes per se such as growth and survival. However, these studies have not explored the effects of the ability of IJVs on the procurement of subsequent resources such as capital, technology, employees and buyers substantially required for their survival and growth (Pfeffer and Salancik, 1978). The effect on performance is certainly worth looking at, but the findings can only be attributed to organizational capabilities to procure these needed resources.

Second, there is a growing notion that existing network ties signal a firm's quality, which decrease the uncertainties faced by external resource holders and thereby facilitate the resource procurement of firms (Baum and Oliver, 1991; Podolny, 1994; Stuart et al., 1999). However, in the context of IJVs, which are notably susceptible to greater challenges in obtaining legitimacy and promoting their organization and products in a host country (Kostova & Zaheer, 1999), little effort has been made to provide insights into how existing network ties can help them procure needed resources from local markets.

This study therefore seeks to fill these gaps and examine how existing network ties of IJVs affect their abilities to acquire new organizational buyers. Using an event history analysis of manufacturing IJVs in Japan between 1985 and 2000, this study shows that interfirm network ties of IJVs account for patterns in acquiring new organizational buyers. Our findings imply that IJVs should astutely form their network ties and leverage the signaling effects of those ties to enhance their ability of acquiring organizational buyers in a local market.

2. Theoretical Framework

Purchasing decision for organizational buyers is a complex process (Webster and Wind, 1972), involving great exchange-specific uncertainties that if ignored, would place their organizations at risk (Kohli, 1989; Johnston et al., 1999). Two types of uncertainties confront the prospective organizational buyers of IJVs: one about the quality of IJV products or services and one about the intended continuity of IJVs, arising because of information asymmetry between IJVs and prospective organizational buyers.

The former relates to the information asymmetry

in the initial qualitative differences of IJVs, making it difficult for potential organizational buyers to diagnose the reliable performance of the IJV products. This is further magnified by the IJVs' liability of foreignness, as reflected by the buyers' lack of information about IJVs (Kostova and Zaheer, 1999). The uncertainty about the intended continuity of IJVs, on the other hand, concerns the asymmetry about unobserved or hidden intents of IJVs in entering the local market. Intended continuity of operations varies across IJVs. Some IJVs are designed to have low barriers of exiting the local market as a result of resource pooling between partners (Kogut, 1988; Geringer and Hebert, 1991). This aspect of IJVs leads to reluctance of organizational buyers to purchase products from IJVs, since expected continuity of a relationship to take place is a crucial concern for organizational buyers prior to any transactions (Anderson and Weitz, 1989). Consequently, not only potential buyers are discouraged by the limited information about the quality of IJVs' products and services, but also they tend to favor products and services from firms that guarantee long-run durability (Thorelli, 1984; Heide and John, 1990). Thus, these two types of uncertainties confronting potential organizational buyers pose challenges to an IJV because a reduction of these uncertainties would facilitate the IJV's efforts to acquire organizational buyers.

Previous studies suggest that IJVs can overcome such challenges by transferring technological and managerial resources from parent firms (Geringer and Hebert, 1989; Lyles and Salk, 1996) or adopting local practices through imitation (Rosenzweig and Nohria, 1994). The former strategy, indeed, can enhance the quality of the IJV products and services. However, enhanced functionality or modified reliability of product quality enters the organizational buyer's awareness slowly because of the asymmetry of information between the IJV and potential buyers (Spence, 1974). Imitation of local practices, on the other hand, may lead to a loss of organizational competence of the IJV that might have been available to it and may result to poor IJV performance (Zaheer, 1995). Further, it is difficult for potential buyers to infer the continuity of the IJV through these strategies because intents of the founders are not conveyed.

This study highlights mechanisms by which IJVs can reduce both of the two types of uncertainties confronting their prospective organizational buyers through interfirm network ties. Signaling theory (Spence, 1974) suggests that quality perceptions may be driven by a number of signals or cues that do not have direct bearings on product quality. In uncertain circumstances, organizational buyers tend to rely on these signals as cues for their purchasing decision (Moriarty and Spekman, 1984). Since many of the determinants of a venture's viability are unobservable, the affiliation-based signaling model claims that in order to reduce uncertainties, resource holders such as buyers will value affiliation-based signals as indicators of potential value, which are observable and better understood (Baum and Oliver, 1991; Podolny, 1993). These signals are generated by a focal organization's existing network ties, i.e., exchange ties (Hoang and Antoncic, 2003). For instance, since high-status exchange partners are exclusive in their selection of associates to protect their own reputation, which may be damaged if they transact with low-quality ventures, high-status affiliations signal the viability of the focal venture (Stuart et al., 1999). A large number of empirical studies based on various contexts provide evidence on this process, including Camic (1992), Podolny and Stuart (1995), Baum and Oliver (1991), and Chang (2004).

Further, existing network ties from which an IJV procures crucial resources can also effectively signal intended continuity as they reflect its exchange partners' expected duration of the exchange (Terreberry, 1968), which depends, to a large extent, on the levels of commitment and support provided by these partners (Williamson, 1985; Anderson and Weitz, 1989). Notwithstanding, the extent to which a partner provides its commitment and support may vary according to its ability and incentives. Some partners may be less capable or willing to commit and support the firm with which they have transactions due to their limited resources and/or precautions to avoid incurring high costs and risks associated with the exchange. Accordingly, a current partner that is perceived to be highly committed and supportive of the focal firm through its ongoing exchange relationships will be viewed by external constituents as particularly concerned for the long-run durability of the focal firm (Heide and John, 1990).

In sum, to increase the likelihood of acquiring new organizational buyers, an IJV can utilize its network ties to signal its product quality as well as intended continuity, which are crucial concerns of their potential organizational buyers, because buyers unfamiliar with IJVs have very limited methods to reduce their uncertainties and thus will rely upon affiliation-based signals available from the IJV's interfirm network ties.

3. Hypotheses

3.1. Ties with Prominent Parents

Prospective organizational buyers will consider prominent parents' investments on IJVs as a valuable signal of IJV's managerial and technological capabilities, and future value because prominent parents having a stake in IJVs have strong incentives to enhance the performance of IJVs in order to protect their reputation (Stuart et al., 1999). It connotes that once prominent firms invest in an IJV, their interests in maintaining their status-quo with which they are satisfied generate confidence in the high quality production and long-run durability of the IJV. Hence,

Hypothesis1a. There exists a positive relationship between an IJV's ties with a prominent parent and the IJV's ability to acquire new organizational buyers.

External constituents acknowledge an IJV as a progeny of the foreign and/or local parent of which they track the records of these parents' past performance to infer the quality of the IJV. By doing so, they accumulate information about the reliability of the parents as well as the IJV. In the case where a parent satisfies the evaluation criteria of the external constituents as in the case of a prominent foreign (local) parent, the information on the prominence of the partnering local (foreign) firm may be of less importance and vice versa. This leads to a diminished effect of the other parent's prominence on the IJV valuation of organizational buyers. Therefore,

Hypothesis 1b. When the foreign (local) parent is prominent, the prominence of the local (foreign) parent has less impact on the ability of the IJV to acquire new organizational buyers.

3.2. Downstream Exchange Ties with the Parents

The parents can signal the intended continuity of the IJV through indications of their levels of commitment and support to the IJV (Anderson and Weitz, 1989). We propose that when parents are not only owners but buyers as well, potential organizational buyers can infer that these parents have greater incentives to provide high levels of commitment and support to the IJV. The parents as buyers deliberately create specific assets such as

major components, product design and technological know-how (Kotabe and Murray, 1996) and bear high switching costs when the IJV discontinues operating. Also, when the parents intend to resell the IJV products, they are not only exposed to high set up costs associated with IJV formation but also with their non-recoverable marketing investments such as setting up distribution channels for the IJV products, training of sale staffs, and advertising campaigns. Given these efforts, the parents should have strong incentives of generating more returns from the IJV operations and thereby, indicate high levels of parent commitment and support.

Downstream exchange ties with the parents can also signal high-quality products of the IJV. Parents as buyers have very strong concerns about quality when purchasing products from IJVs because they may incur costs of defective supplies from IJVs and risk their reputations and brand images by distributing flawed products to their channels. However, unlike other organizational buyers, parents have material access to the management of IJVs and greater amount of information about the true quality and reliability of IJV products. Hence, the fact that the parents as buyers have both greater incentives and abilities to monitor signals to potential buyers that diligent monitoring for high-quality production is available. This eventually reduces the buyers' uncertainties about the product quality and increases the likelihood of their purchases. Therefore,

Hypothesis 2. There exists a positive relationship between an IJV's downstream exchange tie with a parent, i.e., a parent is a buyer and the IJV's ability to acquire new organizational buyers.

3.3. Ties with Non-equity Buyers at founding

When IJVs are able to secure exchange relationships with non-equity buyers at the time of their founding they can mitigate their liabilities upon entering the market. The mere fact that that these buyers are acquired when the true quality of the IJV is least well known guarantees the viability of this IJV and influences the perception of other buyers about the quality and reliability of its products (Baum et al., 2000). External buyers unlike parents have less information on the true quality of the IJV and hence incur greater risk when they engage into an exchange tie with the IJV at founding. Given expectation of continuity (Anderson and Weitz, 1989), these customers would only accept the risk if they can expect compensating returns, such as those offered by high-quality IJVs. Hence,

Hypothesis 3. There exists a positive relationship between an IJV's number of ties with non-equity organizational buyers at founding and the IJV's ability to acquire new organizational buyers.

3.4. Close Ties with a Foreign Bank

Banks have been known as information producers and as an effective instrument of overcoming asymmetric information about actors involved (Gibson, 1995). Nevertheless, not all IJVs' bank affiliations will lead to an advantage in acquiring new resources. IJVs' close ties with foreign banks, in particular, may rather lead to a lack of confidence about their viability among organizational buyers. In a study on the performance of commercial banks, Miller and Parkhe (2002) find that foreign banks are less efficient than host country banks and conclude that foreign banks suffer a liability of foreignness that can present long-term challenges. Thus instead of sending favourable signals, close ties with foreign banks may rather increase the uncertainties faced by organizational buyers as these banks that are

supposed to back up IJVs in times of turbulence are likewise associated by uncertainties concerning IJVs. Hence,

Hypothesis 4. There exists a negative relationship between an IJV's close tie with a foreign bank and the IJV's ability to acquire new organizational buyers.

4. Methodology

4.1. Data and Model

Data were collected for manufacturing IJVs in Japan that were established between 1985 and 1990. We compiled our IJV data from the *Gaishikei kigyo soran* (Foreign Affiliated Companies in Japan: A Comprehensive Directory). For the IJV parent data, we used the *Gaikoku kaisya nenkan* (Nikkei Almanac of Foreign Corporations) and Nikkei Economic Electronic Databank System (NEEDS). We identified IJVs as joint ventures of which a foreign parent holds an equity stake between 25% and 95%. Our event history analysis of these IJVs between 1985 and 2000 provided an adequate sample size of 262.

We modeled the ability of IJVs to acquire new organizational buyer as a piecewise-constant rate model, which does not impose strong parametric assumptions or restrictions about the hazard rate (Stuart et al., 1999). We estimated the rate models using maximum likelihood with standard errors adjusted for within-sample clustering (Sorenson, 1999).Before we proceeded to our estimation of the above model, we first generated a selectivity variable labeled as λ, which we included as a regressor into the original model to control for a sample selection bias arising from the exit of other samples (Heckman, 1979).

4.2. Measures

The dependent variable is a binary variable that takes the value of 0 from the date of founding onward until an IJV has acquired a new organizational buyer, taking then a value of 1. A new organizational buyer is identified as a firm without equity holdings of the IJV.

Prominence of the parents was measured by an indicator of whether the foreign parent was prominent in the previous year. Using the listings of the *Gaikoku kaisya nenkan*, we coded *foreign parent prominence* as 1 if the foreign parent of an IJV is listed at time t-1 as the leading corporations under the same industrial category of the IJV and 0 otherwise. We tracked the report every year to update. For the *local parent prominence*, we first obtained an annual ranking of all Japanese firms based on total sales from the NEEDS. IJVs were then coded as 1 if its local parent with a minimum of a 5 percent equity share was ranked as among the top 30 in the same industry of the IJV and 0 otherwise (Gulati and Higgins, 2003). *Downstream exchange tie with the foreign parent* was coded 1 if the foreign parent is identified as a buyer of the IJV and 0 otherwise. *Downstream exchange tie with the local parent* was coded as 1 if the local parent was identified as a buyer of the IJV and 0 otherwise. The number of *non-equity buyers at founding* was measured as the total number of buyers during the initial year of the IJV operation, which had no equity holdings in the IJV. *Close tie with a foreign bank* was coded as 1 if the IJV's prime or secondly prime bank was identified as a foreign bank and 0 otherwise.

We included *IJV size*, *foreign parent size* and *local parent size*, all measured as the log of the total number of employees for the previous year to control for each organization's scale economies.

Next, we coded the IJVs for their industry and geographical locations, and country of origin. *Tokyo* was coded as 1 if the main office of the IJV was located in Tokyo and 0 otherwise. We also included industry dummies for machine, chemical

and electronics industries. Also, to control for country origin effects, we used three sets of dummy variables: France, US and Germany.

We also controlled for the *equity share* of the foreign parent to capture the extent of their control exercised over the IJV. To capture the market orientation of the IJV, we included the *export ratio* of IJV under the assumption that the higher the IJV's export ratio, the less effort or incentive for this IJV to acquire new organizational buyers in the local market. Finally, we included exchange rate of the yen over the US dollar to capture for the changes in macroeconomic factors that is likely to cause market and production uncertainties for IJVs (Heinsz and Delios, 2001).

5. Results

Table 1 shows the results of the hazard model. The overall model fit significantly increased from 0.15 of the baseline model (Model1) to 0.27 in Model 2 incorporating the theoretical variables. We thus interpret findings from model 2 for testing Hypothesis 1a, 2, 3 and 4.

Hypothesis 1a posits the effects of prominence of the parent firms. The coefficients of *foreign parent prominence* are positive and significant ($p < .05$), suggesting that IJVs whose equity is owned by prominent foreign parents are more likely (or faster to) procure new customers after entry.

Hypothesis 2 suggests the effects of downstream exchange ties with the parents. The coefficients of

Table 1. Estimates of new organizational buyer acquisition rate

Variable	Model 1		Model 2		Model 3	
Age : <3 years	3.32	(4.19)	20.11**	(7.35)	17.63*	(7.21)
Age : 3-7 years	6.02	(4.60)	23.30**	(7.42)	19.04**	(7.21)
Age : >7 years	7.13	(5.08)	22.76**	(5.27)	16.46**	(6.14)
Ln IJV size	0.88**	(0.33)	1.16	(0.88)	1.21*	(0.48)
Ln foreign parent size	-0.34**	(0.14)	-0.69	(0.43)	-0.43	(0.40)
Ln local parent size	-0.79**	(0.28)	-2.30**	(0.34)	-2.36**	(0.59)
Tokyo	1.58*	(0.72)	4.39**	(1.05)	4.65**	(1.20)
France	2.34	(2.83)	-0.69	(3.95)	-1.69	(2.59)
US	0.86	(1.10)	-2.47**	(0.95)	-1.51+	(0.88)
Germany	1.6	(1.53)	-0.64	(4.09)	-0.9	(2.37)
Machine industry	0.58	(2.56)	-5.77	(5.06)	-8.68*	(3.96)
Chemical industry	0.34	(0.57)	0.55	(4.10)	1.08	(2.61)
Electronics industry	0.6	(0.86)	2.56**	(0.63)	1.59+	(0.82)
Export	-0.07*	(0.03)	-0.14**	(0.05)	-0.05	(0.04)
Exchange rate	-0.02	(0.02)	-0.07**	(0.02)	-0.05**	(0.02)
Equity ownership	0.01	(0.02)	-0.08*	(0.04)	-0.12**	(0.04)
Foreign parent prominence			3.28*	(1.32)	3.86**	(1.06)
Local parent prominence			0.79	(1.80)	3.62*	(1.88)
Foreign parent prominence x local parent prominence					-4.47*	(2.07)
Downstream exchange tie with the foreign parent			6.63**	(2.57)	5.68**	(1.80)
Downstream exchange tie with the local parent			3.63*	(1.54)	3.42**	(0.71)
Non-equity buyers at founding			1.68**	(0.47)	1.47**	(0.29)
Close tie with a foreign bank			-20.94**	(3.11)	-25.09**	(3.79)
λ	-1.12	(2.38)	2.05	(4.71)	4.85	(3.45)
Observations	262		262		262	
Wald chi-square	175.34**		632.38**		1115.84**	
Pseudo R-squared	0.15		0.27		0.28	
△Pseudo R-squared			0.12		0.01	

Notes: (1) Robust standard errors in parentheses; (2) + $p<.10$; * $p<.05$;** $p<.01$.

both *downstream exchange tie with the foreign parent* and *downstream exchange tie with the local parent* are positive and significant ($p < .05$). This finding suggests that an IJV is more likely (or faster) to procure new buyers after entry when the foreign or local parent is one of the buyers.

Hypothesis 3 predicts the advantage of having *non-equity buyers at founding* for exploring local markets. As predicted, the coefficients of non-equity buyers at founding are positive and significant ($p< .01$), suggesting that the likelihood that an IJV procures new buyers after entry increases when it has more non-equity buyers upon entry. Hypothesis 4 claims the hazardous effects of having ties with foreign banks. As the coefficients of *close tie with a foreign bank* indicate, close ties with a foreign bank is negatively associated with the new organizational buyer acquisition event. This finding suggests that IJVs closely related to a foreign bank are slower to acquire new organizational buyers.

In Model 3, we added the interaction term of foreign parent prominence and local parent prominence to test Hypothesis 1b. The interaction term is negative and statistically significant ($p<.01$), as predicted. Thus, the prominence of foreign (local) parent matters less when the local (foreign) parent is also prominent. Overall, the estimation results support all the hypotheses of the paper. As a robustness check, we estimated the equation using an exponential model without time splits (Hosmer and Lemeshow, 1999). The estimated results are found to be consistent with the original model. Also, we adjusted the cutoff for the local parent's prominence to top 25 and top 20 in order to check the sensitivity of the findings. Inserting different measurement of the local parent's prominence into the model did not change the estimated results. Hence, we concluded that our findings are statistically robust.

6. Discussion and Conclusion

Our analyses show that interfirm network ties influence the ability of IJVs to procure resources such as new organizational buyers. Our overall findings on the relationship between parents' prominence and IJVs' resource procurement strongly support our hypotheses. Consistent with previous findings (Stuart et al., 1999; Chang, 2004), the parents' prominence is positively associated with the IJV's new buyer acquisition rate. Further, our results clearly demonstrate that the signaling benefit from a partner's prominence is contingent on the other partner's status, suggesting that the prominence of foreign (local) parent matters less when the local (foreign) parent is also prominent.

The results also support our claim that the acceptance of an existing partner despite of the high risk and cost involved in the exchange with the focal organization appeases the potential partners' perceived uncertainties about the IJV and show that downstream exchange ties with parents and ties with non-equity buyers at founding increase the ability of IJV to acquire new organizational buyers. The findings suggest that the more support and commitment an IJV earned from its initial interfirm network ties, the more able this IJV can procure subsequent resources from a local market.

In contrast, a close tie with a foreign bank appears to curtail the ability of IJV to acquire new organizational buyers, suggesting that some ties with other organizations are favorable for enriching network resources of firms, but some ties are rather hazardous. This finding reinforces the notion of the liability of foreignness and is consistent with the findings of Miller and Parkhe (2002) that foreign firms face a discriminatory barrier and greater challenges endorsing their value

and potentiality.

These findings present critical implications to entrepreneurial firms. IJVs can enhance their performance by forming their network ties strategically. From a foreign entrant's perspective, it can potentially realize the benefits of IJV by partnering with a prominent local firm or engaging to a downstream alliance with a local partner. Also, it can create an external perception that it is of high quality and viable by initially recruiting buyers at founding. Moreover, a foreign entrant that considerably lacks legitimacy should abstain from affiliating with a foreign bank and exert great effort to obtain support primarily from a local bank.

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