The problems associated with managing international joint ventures in Croatia

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Abstract

The problems associated with managing international joint ventures most of the authors regard as the biggest disadvantage of this business arrangement. The problems may appear already in the early stage of negotiations when entering into a joint venture is being considered and also in the later stages of signing a contract and operating the newly formed joint entity.

This paper will analyze problems which are usually present in all three stages of equity joint ventures of Croatian companies with their foreign partners and causes of those problems. Special attention is turned to the structure of the management of the joint ventures of Croatian companies. The paper provides opinions of managers on advantages and disadvantages of each structure. Also, the most common sources of conflicts in the management of the joint ventures which often result in the failure and termination of the joint entities are examined.

The goal of the paper is to detect the most common sources of problems related to managing the joint entities and the most common source of failure (termination) of joint ventures in Croatia.

1. Introduction

International joint venture can be defined as a new, independent business entity formed by two or more independent business entities from different countries, referred to as "parents" or parent companies. The rationale for joint venturing is to achieve competitive advantages by marring the strengths of two or more different organizations. However, declining popularity of joint ventures is evident, and according to many authors, the most common reasons behind it lie with the problems associated with managing joint ventures. The goal of this paper is to detect the problems in managing international joint ventures in Croatia through all stages of that process.

Second chapter deals with stages of joint venture's process with special emphasis on international joint ventures in Croatia. We show the most important partner selecting criteria, as well as importance and difficulty of negotiating points in joint venture agreements. The third chapter copes with three categories of joint ventures: dominant parent joint ventures, shared management ventures and independent ventures. In the same chapter we show advantages and disadvantages of each category according to opinion of top managers of Croatian firms, so as the most common reasons for conflict in international joint ventures in Croatia.

In this paper first we gave theoretical background of analyzed problems and than we show results of our survey. The data for this study were collected in 2006 through a questionnaire which had been mailed to the managers of 200 Croatian companies. The sampling criteria for selecting 200 companies were amount of total revenue. Of 200 companies, 46 agreed to participate in the study, giving a participation rate of 23%. But only 12 companies (26%) have been involved in international joint ventures. We take into consideration only those parent firms.

2. Stages of international joint venturing

When we talk about stages of joint venturing, we refer to partner selection, contracting and structuring the organization and management of joint entity.

Although the importance of selecting the right partner to the success of the joint venture has been widely stressed, relatively little empirical research has been reported in the literature.[i] Geringer contributed to the extant literature by developing a simple twofold typology of partner selection criteria.[ii] He distinguished task-related and partner-related dimension of selection criteria.[iii] Task-related criteria are associated with the operational skills and resources that a venture requires for its competitive success. Typical examples are patents, technical know-how, financial resources and experienced managerial personnel. Partner-selected criteria, in contrast, refer to those variables that become relevant only if the chosen investment mode involves the presence of multiple partners. Typical examples are the national or corporate culture or a partner, compatibility or trust between the partners' management teams, the degree of favorable past association between the partners, and the size or corporate structure of the partner.

It is usually argued that the good local partner is one with complementary skills, and that the lack of complementarities between the partners presents the crucial factor that undermines effectiveness of joint venture process.[iv] Caves and Porter argued that partners' relying on joint venture contributes to stable relation, while different forms of asymmetry have destabilizing effect.[v] Stuckey claims that vertical integration between foreign and local partner is important vehicle for achieving synergy.[vi] Luo states that international joint ventures between vertically integrated partners are more successful than those between horizontally integrated or nonintegrated partners.[vii]

Luo stresses importance of partner selection in developing countries which attracted large amount of foreign direct investment of multinational companies, and argues that multinationals have to be familiar with partner selection criteria generally, and especially with those crucial for achieving their strategic goals.

Table 1: Partner selection criteria for international joint ventures in Croatia

	Number of firms	average	Min	Max	Standard deviation
Access to knowledge of local culture	7	3,29	1	5	1,5
Access to regulatory permits	7	3,29	1	5	1,5
Trust between top management teams	11	3,27	1	5	1,56
Access to local brands	5	3,2	2	5	1,3
Access to knowledge of local market	6	3,17	2	5	1,17
Access to labor	7	3,14	1	5	1,46
Complementarity of partner's resource contribution	10	3,1	1	5	1,2
Access to customers	7	3	1	5	1,41
Experience in technology applications	12	3	1	5	1,48
Financial resources of partner	11	3	1	5	1,61
Size of partner	11	3	2	5	1

Persons who answered our questioner were asked to rank from 1 to 5 (1 – the most important criterion, 5 – the less important criterion) partner selection criteria for international joint venture. In our questioner we offered a few criteria. First group includes accesses to different resources:

knowledge of local market, distribution channels, customers, knowledge of local culture, technology, product itself, capital, permits, labor, etc.

The second group includes: trust between top management teams, interrelationships of partner's businesses, reputation of partner, financial resources of partner, complementarity of partner's resource contribution, established marketing and distribution system, size of partner, international experience, experience in technology application, favorable past association and partner's ability to negotiate with government.

Having selected potential or adequate partner, partners begin to negotiate the terms of future joint venture contract i.e. the issues surrounding the business entity that is to be formed as a result of the joint venture. When potential partners don't know each other well, it can be expected that they will be very careful, especially when companies from different countries and cultural background are considered. Excess precaution, however, results in a long and very detailed contract encompassing even the tiniest details regarding future relationship. As soon as problem emerges both parent companies try to find a solution by going through complex provisions of the contract stipulating various rights and obligations in order to make those works in their favor. The best scenario is therefore to establish mutual trust which cannot be provided by the contract itself. This can be achieved in several ways[viii]:

1. to make sure that the vision and goals of contractual parties are synchronous,
2. to maintain trust during the negotiation phase,
3. to make sure that there is a ground for the long term cooperation; companies can enter in short term or middle term joint ventures, but then they should arrange mechanisms and ways to exit the investment.

In compliance with variety of different forms of joint ventures, every entity from joint venture will be unique considering the purpose of its existence. When forming the joint company, the fact that the long term cooperation is in question should be considered because this form of cooperation demands less strict management style. Long term goals mean that join venture must be based on the internal strength of its management in order for the company to become independent. During the negotiations objectives, management and marketing should be adjusted with the ownership relations. Though, no matter what working model is chosen, it is necessary to cover all aspects of the forming of joint company in written contract.

When in the contract of joint venture are not exactly specified issues like objectives of each side, contribution of each partner to the resources, commitments and responsibilities of partners, their rights, character of business, profit split and way of the profit distribution, dispute settlements, and some other key aspects of the investment, confrontations may occur and cause failure of the joint company. [ix]

Tables listed hereafter show the importance of the certain points of the contracts and issues which caused the most problems during the negotiations.

Table 2: The most important issues in negotiations for the joint ventures contract conclusion of Croatian companies

	Number of companies	**Structure (%)**
Ownership structure	5	41.67
Technology transfer	4	33.33
Staffing	2	16.67
Other	1	8.33
Total	12	100.00

According to the examinees opinion, two the most important issues in negotiations are ownership structure and technology transfer. Ownership structure is not only the most important issue of the negotiations but provokes the most difficulties during the negotiations. The control is not something that is easily to give over to partners, although majority ownership does not imply the control over all aspects of business. Second very important issue is the transfer of technology. It is very important to define strictly which technologies are covered by contract and under which conditions are available to joint company.

Table 3: The most difficult issues in negotiations for the joint ventures contract conclusion of Croatian companies

	Number of companies	Structure (%)
Ownership structure	2	22.22
Technology transfer	2	22.22
Marketing issues	1	11.11
Staffing	2	22.22
Other	2	22.22
Total	9	100.00

Considering the most difficult issues in negotiations for the joint ventures contract conclusion of Croatian companies, there is not consensus among managers of Croatian companies. Opinions are divided; the same number of examinees propounds ownership structure, technology transfer, staff policy and other issues as the most problematic ones.

3. Categories of the management of the joint venture companies

When the categories of the management of the joint ventures companies are analyzed, in fact, the level of the control of the parent companies in the management of the joint company is analyzed, with respect to their influence on making the strategic and operative decisions in the joint venture company.

In compliance with that, joint venture companies can be divided into three categories: dominant parent joint ventures, joint venture companies in which both parent companies play an active role (shared management joint venture) and independent joint ventures in which neither parent company has any significant role. [x]

The basic characteristic of dominant parent joint venture is that it is run by one parent company as it is the case with subsidiary. All operative and strategic decisions are brought by the management of the dominant parent company no matter its location – in the joint venture company or in the parent company. [xi]

In shared management joint venture both parent companies have managerial role in every sense of it. Board of directors has real influence on company, and directors of certain functions come from both parent companies as opposed to the joint venture company with dominant parent company where these directors come only from the dominant parent company. [xii]

In the case of independent joint ventures, management of the joint company is independent of parent companies and has the freedom of making decisions in most of the areas. According to Killing[xiii], independent joint companies have been the most successful ones, but he believes that their autonomy is rather the result of than reason for their success.

Table 4: Structure of the joint venture companies management of Croatian and foreign parent companies

	Number of companies	**Structure (%)**
Shared management	6	50.00
Dominant parent	5	41.67
Independent management	1	8.33
Total	12	100.00

In most of the joint venture companies established as a joint investment of Croatian and foreign partner companies, shared management (50%) is used, then dominant management (41.67%). Independent management is inherent in only 8.33% of joint venture companies.

Table 5: The control which parent companies have over joint venture companies

	Number of companies	**Structure (%)**
Majority	1	8.33
Same as the partner	8	66.67
Minority	3	25.00
Total	12	100.00

Managers are asked to estimate which level of the control their company has over joint venture company. Majority control is present only in one company and most of the companies (66.67%) have the same level of control as their partners. Though, one fourth of the companies have minority control.

Table 6: The impact of the independence of the management on the success of the joint venture company

	Number of companies	Structure (%)
More successfulness as the management is more independent	10	83.33
More successfulness as the management is more dependent	2	16.67
Total	12	100.00

According to the opinion of the managers, in most of the cases (83.33%) joint venture company is more successful as the management is more independent, till only 16.67% of examinees think otherwise.

Table 7: The most important criteria for the decision upon the structure of the management of the joint venture company

Criteria	Number of companies	Share in the total number of companies (%)
Ownership shares	8	66.67
Expertise and experience	5	41.60
Knowing of the market	4	33.33
Managing quality	3	25.00
Social responsibility	2	16.67
Other	2	16.67

The most important criterion for the decision upon the structure of the management of the joint venture company is, as one could expect, ownership share (66.67%). This criterion is followed by knowing of the market (33.33%), expertise and experience (25%), managing quality (25%) and social responsibility (especially protection of the environment) and other criteria (type of the project, and etc.).

Table 8: The advantages of using split management

The advantage	Number of companies	Share in the total number of companies (%)
Split of responsibilities	4	33.33
Better quality of managing	3	25.00

Managers' point out two advantages of using the shared management: share of responsibilities and better quality of managing. Split responsibilities mean that it is less possible the unwanted domination of one partner, it is easier to achieve agreement, jointly resolution of business issues and split of the responsibility and influence. Quality of managing occurs through synergy of knowledge and quick control.

Table 9: The disadvantages of the shared management

The disadvantage	Number of companies	Share in the total number of companies (%)
Slower decision making process	4	33.33
Weak coordination	2	16.67

The main disadvantage of the shared management is slower decision making process, where managers allege more difficult decision making, aversion to the risk, needed negotiation process and consensus. Weak coordination is a result of the sharp margin of the interests and non-coordination.

Table 10: The advantages of the dominant management

The advantage	Number of companies	Share in the total number of companies (%)
Quicker decision making process	8	66.67
Business effectiveness	2	16.67

The main advantage of the dominant management is in quicker decision making process. Managers state it is because of more productively managing, through the fact that dominant partner easier pursues its decisions.

Table 11: The disadvantages of the dominant management

The disadvantage	Number of companies	Share in the total number of companies (%)
Big influence of one parent company	4	33.33
No influence of other partner	3	25.00
Low quality of decision making	1	8.33

Out of the main advantage, disadvantages of the dominant management are supervened. Because of the big influence of one parent company, managers feel that there is a possibility of "kicking out of the game" of the non-dominant partner, weaker support to the partner, and minority partner can be irrelevant unless it is not otherwise in the joint venture contract defined. Managers feel in dominant managements to be irrelevant and review the role of its partner company which can be frustrating. One manager feels that in dominant management the quality of the decisions made is questionable.

Table 12: The advantages of the independent management

The advantage	Number of companies	Share in the total number of companies (%)
Better quality of decision making	5	41.67
Better business organization	3	25.00

The advantages of the independent management occur in greater quality of decision making where managers point out the speed of reaction and flexibility, independence, impartiality and quicker decision making process. Better business organization includes possibility of choosing very competent executives, greater efficiency and managing solely according to the profession regulations.

Table 13: The disadvantages of the independent management

The disadvantage	Number of companies	Share in the total number of companies (%)
Disagreement	4	33.33
Worse business results	3	25.00
Lower quality of decision making	2	16.67

On the other side, independent management hides the possibility of confrontation or disagreement because there are no real guarantees for accepted commitments, the control is rather low and there is no partners' confidence. Worse business results are the consequences of the strategic disorientation, possibilities of business misses because of too big autonomy in decision making and too little accepting specific circumstances. Lower quality of decision making is a result of longer time needed for the decisions to be made and not enough information on which basis decisions are made.

4. Problems in international joint ventures management

When objectives of each partner in a joint venture are not clearly defined by the contract, partners' contribution in resources, their obligations and responsibilities, rights, nature of the job, profit share and it's distribution method, conflict solving, and other key aspects of the investment can cause disagreements and joint venture collapse.

System, culture and relations development, for the purposes of decreasing the risk of a problem appearance in management, presents a major challenge for the joint venture managerial team. Problems may appear on the board level, for example when two executives named by the two partners in a joint venture (50:50 stakes) have opposite stands, or in a case where there is a minority participant, who has and uses the right to veto, thus on that way slows down the process.

Similar problems may occur on the shareholders level, if some decisions and issues are lowered down from the board level and shareholders' approval is needed, hence the problems may arise when two partners have the same shares or when a minority participant uses the right to veto.

There are two basic theories that deal with solutions for the mentioned problems:

1. The one that stands for the set up of an active mechanism for problems avoidance, or for the agreement of solving the problems if they occur, in order to provide clear and undisturbed decision making process, and
2. The alternative theory which prefers negotiating about problems, and tries to deal with them in the moment of their appearance, rather than to try to predict them in advance.

One of the ways of dealing with the potential problems in a joint venture company management is to try to avoid them. Structural measures that help to avoid these managerial problems are[xiv]:

- agreement that from the beginning only one of the partners has clear voting and managerial control,

- agreement that from the beginning the particular partner has control or leadership over the specific area or management responsibilities and decisions (for example one partner controls the decisions about technical issues); this works well in practice, especially if every partner contributes with different skill or resource in a joint venture company,
- creating such procedure or management structure, where most of a decisions are made on an executive level (for example, by an executive responsible for a specific function) without the need for instructions, or approval from the board, and
- similar, restriction for the number of questions that demand the instructions from the stockholders.

These measures are related to specific company's management structure in a joint venture. Hence, many things will depend on partners' approach in the management structure development.

The majority of managers agree that managing the entity in a joint venture is by far harder than to run a subsidiary. The reason for that is not that the task of managing a joint entity is harder, but the organization is much more complicated and harder to control. Because of that, one can say that the joint venture problems are internal, not external.

Talking to many board members, Turowski found the three mayor problems in joint ventures:[xv]

1. lack of control,
2. lack of trust between partners, and
3. insecurity related to the possibility of leaving the joint venture.

The first thing that scares managers is the idea that the complete control in decision making will be replaced with divided control. This represents a problem for the management, especially when the assets that are contributed to joint venture are still strategically important for the parent company.

The majority of managers named the lack of trust as one of the mayor problems of the companies that enter a joint venture. When tensions and problems between the related sides occur, management usually spends a lot of money and time trying to solve them. In extreme cases, disagreements would end up dealing with lawyers and arbitrage.

The third problem, the decision to have a termination regulation defined, and how to structure it, is often very difficult. Executives want to have specific exit mechanisms, if the circumstances change. But the decision about what is fair and reasonable, made on the beginning of the investment, can turn out to be wrong when the time comes to end the cooperation.

Many authors agree that the majority of the managerial problems in a joint entity occur because of the conflicts, which cause worse business practice, and in the end can cause joint entity to collapse.

Fey and Beamish identified four main sources of conflict related to joint ventures:[xvi]

- cultural differences between partners,
- aspiration for control and autonomy,
- own parent company needs, and,
- different objectives of parent companies.

The basic cause for conflicts and problems in joint ventures is the existence of more parent companies, which can have different stands: on joint venture's growth rate, on which products or markets they should concentrate, what kind of an organization they should make, and even what makes management good or bad etc.

There are two specific areas in which the problems of existence of more parent companies occur. The first area is on the board level. Joint venture company's board consists of parent companies representatives, and problems appear because of different priorities, guidelines or/and even the system of values, which can result in a slow decision making, among other things.

Furthermore, the joint venture is different from other organization forms in terms of human resources' politics. In many joint ventures general and functional executives are named from parent companies. Actually, in most cases there are two general directors, one from each parent company, who make sure that the interests of their parent companies are met. The reason for that is the lack of trust between partners, and thus can cause dissatisfaction in the company and inefficiency.

Some joint ventures are easier to manage. That is the case in big projects, when one parent company is no more than a source of resources and knows a little about the business, while the other company actually manages the joint entity.

In joint venture literature and researches, important issue is the question of trust between parent companies, which can be defined as a degree of positive expectations related to the other side. Sarkar detected that there is a positive correlation between the trust and the efficiency of the joint entity. Aulakh's research showed that there is a strong positive correlation between the trust and successful business conduct in overseas partnerships.[xvii] It is interesting to mention that this research discovered that the trust depends on the culture, thus that the culture's role is considerably different in different geographical regions. According to Madhok, trust clearly contributes to efficiency increase, increases the assets' value and hence positively correlates with business success.[xviii]

Büchel names five "mine fields" that can hurt the relations between partners and should be avoided in order to completely accomplish the potential of this strategic partnership form[xix]:

- unclear partners roles,
- unequally divided risk and benefits,
- mistrust between joint entity managers,
- unavoidable crisis,
- nonexistence of exit mechanisms.

The important issue that should be dealt with before any agreements finalizations is how to distribute the value that joint venture makes on parent companies. The key matter for a long-run partnership is to provide a fair (unbiased) risk-benefits ratio.

If the entity from the joint venture begins doing business and everyday operations successfully, and develops stabile relations, everything will be done routinely and without greater problems. But, the joint entity's real test will occur if something unexpected happens. That can cause a gap between partners. To prevent that from happening, joint venture manager should improve the information flow inside a joint venture, which partially requires negotiations with a parent company on the matter of proprietary rights.

When the conflict grows beyond the certain level, and partners find that they cannot cooperate anymore, it is necessary to have formal exit mechanisms, in order to avoid expensive and long lawsuits.

Although there are numerous differences between the company in a complete ownership and an entity from the joint venture, Bamford and Ernst find that some of the rules of good governance can be applied to both:[xx]

- To name at least one external director, who would be responsible to promote the joint venture's interests as a whole, especially when parent companies have opposite goals.

- To name executives or an influential board president. Company should use a highly-specialized joint venture governance model, in which the board members would be individual experts for specific areas, like finances, production and legal issues.

- To control and award the efficiency of board members; for their influence on the strategy creation, success in fulfilling the risk management responsibilities, successful resources collecting, attracting talented people and their ability of assemble the solutions from the parent companies.

- Employ an external audit. Large joint ventures do a fairly good job of generating basic financial and operating data. However, they tend to be less effective at understanding their own economics from the perspective of their corporate parents and at generating second-level management data so essential to grasping the real issues and prospects of a business.

- Create a real challenge process. Too often, and for many reasons, joint ventures are shielded from thorough performance scrutiny. For one thing, they exist on the corporate periphery, outside their parent's normal reporting process. Likewise, their parent companies may be reluctant to invest scarce managerial resources in efforts to oversee them properly. Nonetheless, a company making a large investment in a joint venture should oversee it with the same level of intensity that would be devoted to other business of the same size. One important consideration is how to create a rigorous reporting and review process that engages all of the corporate parents without subjecting the joint venture to "double jeopardy".

- Let the venture's CEO run the business. The board of a joint venture may, fom time to time, have to intervene in its operational affairs or strategy decisions. But board also must empower a joint venture's CEO to operate as its true general, not only for the sake of fast and objective decisions, but also to attract and motivate strong leaders. One thing companies can do is to grant the CEO the power to hire or fire all employees, or at least veto. Another is to give the CEO a reasonably high degree of sign-off authority on capital expenditures and to establish beforehand what percentage of the dividends the joint venture will retain to invest.

Table 14: Items that affects management conflicts in joint ventures

	Number of firms	average	Min	Max	Standard deviation
Own needs of parent companies	12	3,42	3	4	0,51
Need for control and autonomy	12	3,17	1	5	1,27
Different goals of parents	12	3,00	1	4	1,04
The lack of trust between partners	12	3,00	1	5	1,41
Cultural differences between parents	12	2,83	1	5	1,34

Mangers were asked to rank from 1 to 5 how much some of the items listed above cause management conflicts in joint ventures (1- they don't cause conflict, 5- they cause conflict very much). Highly ranked item is the parent companies' own need followed by the need for control and autonomy. The lowest rank is assigned to cultural difference between partners.

5. Conclusion

Many big companies have ten and more joint ventures that take part in their revenues, income and assets with 10-20%. In spite of this, parents don't give them enough attention so the most common reason for their termination is poor management, long lasting and persistent inefficiency, impossibility of adoption and development, and very high costs of management.

The most important criteria for partner selection found in Croatia were access to local culture, access to permits and trust between top management teams.

The most important and the most difficult negotiation points before entering into joint venture agreements were ownership structure and technology transfer.

The most common reason for joint venture termination was conflict of interests and unpreparedness. The conflict was often consequence of parent companies' own needs and need for control and autonomy. In spite of negative aspects and barriers, a large number of managers expect increase in doing business through joint ventures.

The most common form of international joint ventures in Croatia is shared management joint ventures followed by dominant parent joint ventures, while there are only few international joint ventures with independent management. However, according to Croatian managers' opinion, the joint venture is more successful when management of joint entity is independent of their parent companies.

It can be concluded that problems in joint ventures don't lie in the nature of that exact business construction. They are result of bad implementation, poor management, and lack of experience. Thus, if companies pay attention to establishing good connections, good relations between parents and in their joint entity, and if they avoid previously described problems, there is a good chance for their success and success of other forms of cooperation in the future.

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