AN ECONOMIC MODEL OF INTERNATIONAL JOINT VENTURE STRATEGY

Peter J. Buckley*
University of Leeds

Mark Casson**
University of Reading

Abstract. The strategic choice between joint ventures, licensing agreements and mergers is analysed using eight key factors suggested by internalisation theory. The model explains the increasing role of international joint ventures in the 1980s in terms of the accelerating pace of technological innovation and the globalisation of markets. It offers a range of predictions about the formation of joint ventures within industries, across industries, across locations, and over time. It exploits a powerful modelling technique that has many other applications in international business strategy.

ECONOMIC METHODOLOGY

Over the last twenty years, the application of economic theory to international business studies has sharpened the analysis of key issues. Economists aim to ask the right questions and to answer these questions in a rigorous way. This means making their assumptions explicit, for a start. The set of strategies available to the firms that they are studying is clearly specified and the details of each strategy are spelt out.

In a global environment, participation in an international joint venture (IJV) is an important strategic option [Beamish and Banks 1987]. Explicit assumptions are particularly crucial when studying IJVs. No IJV, however configured, performs perfectly, and so to understand why an IJV is chosen, it is also necessary to understand the shortcomings of the alternatives. Moreover, IJVs are configured in many different ways, and different configurations are associated with different kinds of behaviour [Tallman 1992].

Economists invoke the principle of rational action to predict the circumstances (if any) under which a firm will choose a given strategy. When the firm’s objective is profit-maximisation, the choice of any strategy, such as an IJV, is driven by the structure of revenues and costs. This structure is determined by

*Peter J. Buckley is Professor of International Business and Director of the Centre for International Business, University of Leeds, United Kingdom.

**Mark Casson is Professor of Economics, University of Reading, United Kingdom.
the firm’s environment. By identifying the key characteristics of this environment, the firm’s behaviour can be modelled in a very parsimonious way. The predictions of the model emerge jointly from the profit maximisation hypothesis and the restrictions imposed by the modeller on the structure of revenues and costs. Predictive failure of the model is addressed by reexamining these restrictions and not by discarding the maximisation principle that is at the core of the theory [Buckley 1988].

This methodology may be contrasted with the more usual approach in international business studies of leaving the assumptions implicit and deriving propositions from a discursive literature review [Parkhe 1993]. This dispenses with formal analysis and relies instead on synthesis. But a synthesis is no better than the analytical components from which it is built. This point is particularly salient to the study of IJVs. For the more complex the synthesis, the more important it is that each component is sound. The economic logic of rational action provides just the kind of check on analytical consistency that is required.

A further implication of this method is that the variables entering into the theory do not have to be of a strictly economic nature. The criterion for inclusion is that they are analysed from a rational action point of view. The modelling of IJVs illustrates this very well. A wide range of factors impact upon IJVs [Geringer and Hébert 1989]: not just traditional economic factors, such as market size, but also technological, legal, cultural and psychological factors. Variables of all these kinds appear in the model developed below.

A final point about economic models is that they permit judgements about efficiency to be made. While IJVs may be commended on social and political grounds, they could be criticised as inefficient for, say, large firms that are leaders in their industries. An economic model can address this issue head on. Since no firm, however large, can be completely self-sufficient, it is readily shown that participation in IJVs is efficient provided that the conditions are right. The main objective of this paper is to set out these conditions in full. It is because these conditions are now more widely satisfied than they were in the past that IJVs have become such an important aspect of international business.

**THE TYPOLOGY OF IJVs**

IJVs can take many forms. This paper focuses on a representative equity-based joint venture between two private firms. Its rationale is to combine complementary resources. These resources comprise firm-specific knowledge, and the combination is effected by each firm sharing its knowledge with the other. The knowledge provided by a firm may relate to technology, or to market conditions, or both. The firm does not normally share all its knowledge through an IJV, but only a subset of it.

The geographical scope with which technology is exploited is normally wider than that of marketing expertise, which tends to be of a more localised nature.