

# **International Joint Ventures in China - The Risks Analysis Perspective**

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## **Abstract**

Since the implementation of its 'Open-Door' policy in 1978, China has made significant progresses in terms of economic growth, technology development, institutional changes, and globalization process, etc. Foreign Direct Investment (FDI) is generally believed to have a significant contribution towards these achievements. One of the most important FDI modes, international joint venture (IJV), has consequently attracted considerable attention from both Chinese and overseas scholars.

Prior studies identify IJV is a 'hybrid' form that increases difficulties for management.

This situation is exacerbated if it operates in a transitional or so-called emerging economy, e.g. China. In such environment, foreign investors have to confront innumerable risks in host country. These may include a possibly inefficient institutional environment, imperfect market system, political sensitiveness, and other intractable issues. A variety of studies have identified four types of risks in IJV, namely, the agency risk; the financial risk; the resource deficiency risk; and the market risk.

This study aims to empirically investigate these four types of risks faced by international joint ventures under contemporary Chinese business environment. The methodology of this research employs a qualitative approach, i.e. face-to-face, in-depth interviews and a subsequent case study. Through extensively analyzing the risks involved in IJVs, this paper makes some contributions to extend our current knowledge about IJVs in China.

## **1. Introduction and Literature Review**

The People's Republic of China (P.R.C) has recently entered into a new stage of development as a global economic power. This dramatic development in China has enhanced its economic influence both in Asian countries and on the world stage. By measuring on the purchasing power parity (PPP), China has already become the world's second largest economic power in terms of GDP, which is equal to US\$ 7.262 trillion (Agency, 2006). Since the turn of the century, China has encountered a variety of new opportunities for strengthening its economic transition. These include China's accession to the World Trade Organization (WTO) and Beijing being elected to host the 2008 Olympic games.

As it is a prominent component of China's economic reform, foreign direct investment (FDI) has played a significant role in terms of accelerating national economic growth, developing the emerging market economy, and propelling China into the processes of globalization within the last twenty-eight years. Statistical data reveals that the People's Republic of China has already surpassed the US to become the world's largest recipient of FDI (The Economist 2nd October 2004, pp. 3-24). In addition, China's foreign exchange reserve has reached US \$403 billion, which is the second largest reserve in the world after Japan (The Economist 28 February 2004, p.72). All of these achievements allow China to regard the future with confidence.

For the last three decades, China has gradually liberalized its FDI policy regime, reduced restrictions and barriers to FDI, and improved the overall investment environment. With

its potentially huge and fast-growing domestic markets, relatively well-educated population and low-cost labor resources, China has become one of the most attractive destinations for FDI in the world (OECD, 2002). The long-term commitments of the Chinese government in terms of improving its macro environment for foreign direct investment and strengthening its national competitiveness has proved to be a vital factor in contributing to the sustainable and rapid growth of its foreign investment absorption.

International joint ventures (IJVs), being one of the most important FDI modes in China, have received increasing attention from academics and practitioners. Many studies in international joint ventures have identified IJV as a difficult organizational form to manage because it involves shared ownership and control and cross-cultural effects among other difficulties (Beamish, 1988, Hennart, Roehl, & Zietlow, 1999, Inkpen & Beamish, 1997, Parkhe, 1993a). In addition, differences with respect to national and cultural background, language, long-distance organizational culture, and management style accentuate the inherent conflicts of interest between IJV partners; between the parent companies with IJV managers; and between host country nationals and expatriates, etc (Child, Lu, & Yan, 1997, Child & Yan, 2001, Huang, 2003, Wang, Zhu, & Tan, 2000, Yan & Warner, 2001).

From this standpoint, researching into Sino-foreign joint ventures will provide the following significance: first, Sino-foreign joint venture may represent a different way of expanding our knowledge of managing conventional organizations in China; second, the possibility of applying research findings that are generated from international joint

ventures located in Western countries into the Chinese setting needs to be empirically studied. In addition, contemporary literature reveals that in-depth field investigation of the managing Sino-foreign joint ventures in China is still in the preliminary stages although it is being accorded with increasing attention from worldwide scholars.

Through reviewing the literatures in the areas of foreign market entry strategy and international management, plenty of risks involving in the operation of IJVs are identified by prior scholars. Such external and internal risks are particularly important in the operation of international joint ventures because the success of a cross-national arrangement, such as IJVs, could not solely depend on its internal management. It has to be taken into account about the external/macro context in the host country (Bailey, Janakiramanan, & Lamba, 2000, Blackman & Wu, 1999, Broll, Marjit, & Mukherjee, 2003, Child & Rodrigues, 2003b, Daniels, Krug, & Nigh, 1985, Pan, 2003, Phillips-Patrick, 1991, Shenkar, 1990). Therefore, a successful operation of Sino-foreign joint ventures will heavily rely on effectively and efficiently minimizing all risks internally and externally. As categorized by some scholars, such as Child and Rodrigues (2003a, 2003b), the risks in a host country can be generally attributed to four classes, namely, the agency risk (internal), the financial risk (external), the resource deficiency risk (external), and the market risk (external) (Child and Rodrigues, 2003a, 2003b).

### **1.1 Agency risk**

Agency risk refers to the possibility of moral, legal and managerial failures within an agent-principal relationship. According to agency theory, the modern governance system

in an organization inevitably involves ubiquitous agency relationship, which refers one party (the principal) delegates responsibilities and power to another (the agent), then the agent have to performs the tasks in compliance with the principal's interest (Band, 1992, Child & Rodrigues, 2003b, Eisenhardt, 1989b, Fama & Jensen, 1983a, Jensen & Meckling, 1976, Strahan, 1998, Zhou & Wang, 2000).

The agency risks are inherently existed within all kind of organizations. The first instance that agency risk incurs when the desires or goals between the principal and its agent are conflict. Since it would be very difficult and expensive for the principal to monitor the actual activities done by the agent, the first type of agency problem is difficult to be avoided. The second situation of agency problem may due to the difference of risk sharing when the principal and agent have divarication in terms of the attitudes toward risks in relation to the agent's responsibilities (Eisenhardt, 1989b).

In the context of international joint ventures, the agency relationship become more complicated as multi-level principals and agents exist. First, at the inter-organizational level, the principal in IJVs refers to the parent companies; and the agent is regarded as their delegates in IJVs, i.e. the board of directors in IJVs. Second, at the intra-organizational level, the principal is transferred to the board of directors in IJV and the agent is the management team in IJV. Third, at the following level within IJVs, the principal can be the top management and the agent is the subordinate in IJV (Child & Rodrigues, 2000). Thus, the complex agency relationships in IJV are supposed to increase the agency risks for the owner (herein is the parent companies) than they are in

conventional organization.

The partners of an international joint venture are generally assumed to have different self-interests and objectives, the governing function of multiple level agency relationship should avoid one of the partners being able to acquire better information from the management of the joint venture than the other (Child & Rodrigues, 2003b, Child & Rodrigues, 2003a, Child & Rodrigues, 2000). Such kind situation would become more complex if two general managers exist with direct appointment by different partners and have separate managerial responsibility (Child & Rodrigues, 2000). When the partners disagree with the objectives and have different risk preference, the agency risk will believe as very high (Buckley & Casson, 1998, Child & Rodrigues, 2003b, Child & Rodrigues, 2003a, Child & Rodrigues, 2000).

Borys and Jemison (1989) also identified that the agency risk may increase between partners when there is an imbalanced equity ownership in IJV, especially in the situation that the government policies in host country do not protect minority equity owners (Borys & Jemison, 1989). Therefore, because the agency theory assumes that agent cannot always be trustful given its self-serving behavior (Eisenhardt, 1989b, Jensen & Meckling, 1976), the principals, herein refers to the partners, have to adopt various governing mechanism and incentives to protect their equity investments.

## **1.2 Financial Risk**

In the context of international joint ventures, financial risk always refers that the foreign

investors may face to the possibility of their investment being eroded by specific administrative factors in the host country, and accordingly reduce the level of return on the investment. Given the characteristics of the institutional environment in China, foreign investment in such country is usually considered with higher financial risk than in developed countries. China has several distinct features. Firstly, China has a mixed economic system through combining the market economy and centrally planned economy. The centrally planned economy has always been characterized with a weak capital market structure, poorly specified property rights, and institutional instability, etc (Li, 1998, Xin & Pearce, 1996).

Secondly, there is an unbalanced industrial structure; some of the Chinese state-owned enterprises (SOEs) are still protected by the state, especially for the enterprises in ‘Pillar Industries’, such as energy, communication, etc. Although the literature in the area of strategic alliances has repeatedly emphasized the importance of legal enforcement of contracts in resolving opportunistic behavior (Parkhe, 1993), but such approach might not be applicable in China. Thirdly, China is a politically sensitive country, and economic activities are likely to be politicized, which means the managers in state-owned enterprises usually make their decision on the basis of certain political consideration, but not economic judgment (Li, 1998). All of such phenomena are extremely important for the operation of international joint ventures in China.

In the meantime, the financial risk that is faced by the foreign partners in the operation of Sino-foreign joint ventures also relates to the possibility of dramatic changes of interest

rate or exchange rate by the host country's government. The dramatic changes of interest rate or exchange rate will significantly affect the availability of capital or desired profits. For instance, the change of foreign exchange rate in a host country might not only influence the profits on international trade, but also possibly decrease foreign partner's deserved return on capital. Therefore, the unstable economic environment in host country increases the financial/investment risk of foreign investors.

### **1.3 Resource Deficiency Risk**

Resource deficiency risk normally exists if the resources available to an IJV in host country are insufficient for its operation (Child & Rodrigues, 2000). A plenty of foreign investors are willing to engage in forming international joint ventures with the local firm because the IJVs could provide them with the facilitation of accessing local resources. If the host countries were lack of supplying necessary resources for the operation of IJVs, the foreign investors would face significant risk on their investment since the lack of fundamental resources would lead the IJVs to be terminate.

Although according to geographical statistics, the natural resources in China include coal, iron ore, petroleum, natural gas, mercury, tin, tungsten, antimony, manganese, molybdenum, vanadium, magnetite, aluminum, lead, zinc, uranium, and hydropower potential (world's largest), etc are considerably plentiful (Agency, 2006). Nevertheless, the underdeveloped regulations on the mining of natural resources in China and the continuous under-planned exploitation and squandering, as well as the well-reported smuggling cross-boundary made the natural resources supply in Chinese market falls

short of demand. Therefore, international joint ventures in China might have to face comparatively higher resource deficiency risk.

#### **1.4 Market Risk**

From the foreign investor's perspective, the market risk involved in the management of international joint ventures might exist in several circumstances. Firstly, high market risk would incur if foreign investors enter into new markets with over estimated market opportunities, consequently, the actual operation of IJVs proves that this market could not provide an acceptable return on their investment. The second situation might result from the imperfect market competition system, such as asymmetry information, government interfere, or political stress, etc within host country.

Prior literatures identified that market risk in a transitional economy would subject to higher than in an industrial economy as the transitional country has an underdeveloped market system. The market risk is particularly strong in the People's Republic of China since it has a combined economic system. The traditional centrally-planned economic system and the contemporary market-driven economic system would increase the complexity of the business environment, and hence increase the market risk. In the meantime, since China is always believed as a country with political sensitiveness historically, its market system might not solely depend on the driven of demand and supply; a political influence on particular activities may also need to be considered. .

## **2. Research Questions and Design**

This research is aimed at investigating four types of risks that are faced by the international joint ventures in contemporary business environment of China. In particular, the special attention should be given to the changes of our current perception on how risky of investing in China. Because although the literatures identify that investing in transitional economy, such as China, will subject to higher risks, the continuous growth of FDI in China has presented a different accent. Therefore, our current understandings might not sufficiently reflect the changes of China's business environment. In this regard, this research tries to reveal the risks faced by international joint ventures based on an empirical investigation.

To justify appropriate research methodology, contemporary literatures suggest that two research methods can be applied in investigating such research topic, i.e. the questionnaire survey or case study (Yin, 1994). However, the questionnaire survey would be comparatively disadvantageous to deeply investigate the underlying reasons on specific phenomenon. The case study approach will be particularly applicable when the research attempts to cover the contextual conditions that are highly complicated to the phenomenon under investigation (Daft, 1983; Gummesson, 1991; Yin, 1994). The risk issue in IJVs seems to be in this regard. Therefore, this research employs a qualitative research method, i.e. face-to-face interview, field observation, and subsequent cross-cases study.

### **3. Research Validity and Reliability Justifications**

Prior scholars have proposed a plenty of techniques of ensuring the quality of conducting

case study research and enhancing the validity and reliability of empirical findings (Eisenhardt, 1989a, Yin, 1994). These techniques have been incorporated in this research for satisfying the scientific test of high-quality empirical research.

### **3.1 Theoretical Sampling:**

Theoretical sampling means that the research samples should be collected on the basis of having theoretical conjunction with emerging theory. The significance of using theoretical sampling is the data can be repeatedly present when comparing the event by event. In this research, cases were chosen for replication and extension of the emergent theory instead of statistical randomization purposes (Eisenhardt, 1989a).

### **3.2 Construct Validity:**

Generally, construct validity focuses on testing whether the indicators utilized can sufficiently measure the question being studied. In this research, the author adopts three ways to ensure the concrete evidence can reflect the real situation of the research focus. Firstly, the multiple sources of data collection strategy tends to reveal the facts of each case, especially when triangulate them (Parkhe, 1993b). In this regard, the case study method used in this research can possibly achieve higher level of construct validity than those research methods that solely rely on unique source data collection.

Secondly, to safeguard construct validity of this research, the author employs a chain of evidence throughout the whole study. The chain of evidence refers the stress of research question from data analyses to the conclusion. Using such strategy is to make sure the unfamiliar readers can understand the evidence obtained has addressed the research focus

and support the conclusion reached. This approach has been met through showing how fieldwork has been actually implemented and sufficiently cited the conversations from interview in case reports.

Finally, in order to provide more construct validity of this case study, the author allows the informants to review the case report. If the informants disagree with the interpretation of the evidence, the necessary modification would be made. Such process is to ensure sufficient information regarding the international joint ventures being investigated and accurate evidence being recorded.

### **3.3 Internal Validity**

Internal validity concerns the value of the findings and the legitimacy of causal relationship between variables. In the other word, internal validity stresses the procedure of inference. Literatures identify two approaches for inference, namely statistical inference and causal/logical inference. The statistical inference normally presents the frequency of observed variables in the sample of selected population. However, this approach could not explicitly explain the relationships or correlations between variables.

In some circumstances, especially in the research of exploring 'how' and 'why' research questions, statistical inference approach might not be appropriate because this kind research need think more creatively about the underlying relationship between the observed variables. Therefore, the characteristic of this research implies the application of causal or logical inference approach in this study.

### **3.4 External Validity**

The external validity of empirical research refers to the generalisability of the findings of this study. There is a misleading concept that the generalization of findings in the study of qualitative research, in particular the case study method, is not as good as the quantitative method because the quantitative approach usually involves a plenty of samples collection. This misunderstanding is not reasonable since it mixes up the purpose of different research methods. The aim of qualitative research, such as case study, is to expand our understanding and theories rather than manipulating statistical frequency on observed variables. As indicated by some qualitative researchers, the generalization of findings from qualitative research, i.e. case study, is not solely relied on the representation of case, but because the analysis is unassailable (Gummesson, 1991, Patton, 1990).

From this point of view, this research has been aimed at providing unassailable analysis based on linking the observed phenomenon with comprehensive review of theoretical foundations and making appropriate propositions. In addition, comparatively plentiful case collection will also enrich the applicability of the empirical findings.

### **3.5 Reliability**

The reliability of empirical research is centered on minimizing the errors and inherent biases in a study (Yin, 1994). To satisfy the reliability target of a qualitative research, the researcher needs to make explicit procedures for collecting the data that the later researchers could follow the procedure or 'audit trail' repeat the same case and obtain

the same results. In this research, the author explicitly designs question checklist for conducting interview and carefully recorded by scripts and audio record instrument. Furthermore, the details of each case are illustrated in chapter ten.

#### **4. Research Results**

The data collection consists of two stages. During the first stage, which was conducted during September to November of 2004, the author employed a pilot study through telephone interview with five Sino-foreign joint ventures' senior executives. The primary purpose of this phase is to extend the understanding of the research context and refine the interview framework. The second stage of the fieldwork, an in-depth interview and field observation has been implemented during the period of January, February, and March of 2005. In this three-month data collection stage, more focused semi-open and open-ended questions were adopted to investigate the research focus.

In order to collect the first-hand data, the author personally visited fourteen international joint ventures that were located in Tianjin Economic Development Area (TEDA), China. The following table summarizes the foreign partners' national origin of the fourteen investigated IJVs. The foreign partners included the multinational corporations (MNCs) in US, France, Germany, Australia, Japan, and Korea. To investigate IJVs with comparatively broad foreign partners' national origins would facilitate us to understand the different perspectives by different foreign investors on the risk estimation; and also it would provide us with more reliable results through cross-cases triangulation.

**Table 1: Foreign Partners' National Origins**

Country of Origin	No.	%	Foreign Partner's Nationality	No.	%
Eastern Countries	9	64.29	Japanese	6	42.86
			Korean	2	14.29
			Japanese & Korean	1	7.14
Western Countries	5	35.71	American	2	14.29
			French	1	7.14
			German	1	7.14
			Australian	1	7.14

No.: number of IJVs; %: percentage within total number of participant IJVs.

### **3.1 Agency Risk**

In terms of agency risk, the empirical evidence of this study identifies two kinds of agency risks that are existed in the operation of international joint ventures in China.

Such unique presentation extends our understanding of agency problems that exist in normative organization forms.

#### **3.1.1 Normative Agency Risk in IJVs**

The first instance of agency risk identified from this study is the normative agency problem that also exists in common organizational formats, i.e. the agency problem between the owners/partners and their delegates (the managers of IJVs). As stated in

literature, such kind agency risk results from the agent's self-servicing or autonomous behavior, which will increase the principal's cost in relation to monitoring such activities. In IJV's context, such normative agency risk incurs when the managers in IJVs want to pursue autonomous power and hence they may not making appropriate decision on behalf of the owners/partners and lead to the control loss by the partners. Under such circumstance, how could the principal (i.e. partners) utilize an effective way to minimize such risk, especially given the difficulty of remoteness of control?

Through my investigation, I found most of the Sino-foreign joint ventures have used an unofficial mode to minimize such risk. Both of the Chinese partners and foreign partners are voluntarily to replace their delegates (appointees) after certain period of time. For instance, the changes of foreign expatriates in IJVs do not necessarily mean the failure of expatriates' performance, sometimes, even the expatriates have very good performance; they still have to be replaced. Most of IJVs reported that they had a policy that the general manager or deputy general manager would be replaced on schedule, whatever the actual performance during their period. Such mechanism is quite different with the other organizations, such as listed companies. The replacement of CEO (herein is general manager or deputy general manager in IJVs) or middle-level managers in international joint ventures does not necessarily imply the owners (partners)' unsatisfactory opinion with their performance. The replacement of those positions may result in the promotion in their parent companies if they could perform well on their position in Sino-foreign joint ventures, which is satisfied by the partners during such period.

By analyzing the reason, long-term servicing in IJV might increase the expatriates' desire of seeking autonomy. This is particularly the case in international joint ventures because the long geographical distance increases the foreign partner's difficulties in exerting governing/monitoring power. Therefore, to avoid 'control loss' by the partners, regularly changing the appointment can ensure the management loyalty of expatriates. Meanwhile, such agency risk is not only encountered by the foreign partner, the local partner also have to face this potential risk. However, the regular changes of executive positions in IJVs might increase the difficulties of management of IJVs in terms of consistency and familiarity.

### 3.1.2 Unique Agency Risk in IJVs

In IJV's context, the agency risk is supposed to be higher than normal organization format due to its 'hybrid' nature (Child & Rodrigues, 2003b, Child & Rodrigues, 2003a). In international joint ventures, the partners can directly appoint the senior executives, such as general manager or deputy general manager, or even some functional managers. Therefore, these appointees (i.e. the managers in IJV) are normally believed as having direct loyalty to their appointer (i.e. their belonging partner), which will cause the increase of agency risk by the counter partner.

The evidence obtained from this study proved that such unique agency risk commonly existed in Sino-foreign joint ventures, but more often happened in the early stage of IJV's operation or new managers being appointed. Normally, new foreign expatriates that come to a Sino-foreign joint venture always consider that they should be responsible and

on behalf of the foreign partners. Similarly, the new appointed Chinese managers normally are loyal to the Chinese partners. Nevertheless, the evidence also shows that following the successful operation and increasingly improvement of their mutual trust between those managers, their loyalties to individual partners may be replaced by the joint venture that they belong to.

Followed with the mutual trust increase between the Chinese managers and expatriates, especially when those managers feel that they actually should be loyal to the joint venture itself instead of the partners, such agency risk is reduced. Then their decision-making would change from partners' perspective to joint ventures' perspective, which might be regarded as somewhat 'autonomy'. Therefore, although such kind 'belonging' perspective decreases and hence reduces the agency risk between the partner and the counter partner appointed managers, the normative agency risks in terms of the management of IJV to achieve 'autonomy' will arise. From this point of view, in international joint ventures, the normative agency risk and IJV's specific agency risk co-exist and are correlated.

### **3.2 Financial Risk**

Existing literatures refer to financial risk as the possibility that the investors could not get their expected return on their investment. This situation might be serious for transnational investment because the uncertainty would be higher in a new, unfamiliar environment. Moreover, this kind of risk will be heightened by investing into a country with a transitional economy or a highly political-intensive one. Unfortunately, the People's Republic of China has always been believed to be in such a circumstance.

However, in contrast to prior studies, the financial risk in this study has not been reported as high as the literatures. Most interviewees said the institutional stability in China was comparatively lower than they expected and the government policies and legislations were becoming increasingly favorable for the foreign investors. The economic and political uncertainty in China is competitively lower than other developing countries. Especially, some Sino-foreign joint ventures founded before the Asian Financial Crisis indicated that comparing their Sino-foreign joint ventures, their invested enterprises in other Asian developing countries, such as Thailand, Malaysia, etc has encountered more financial risk than in China.

Also no evidence indicates the administrative department in China had eroded or reduced the level of the foreign partner's deserved return. Most of the invested Sino-foreign joint ventures have very good return on their investment. For instance, the accumulated profits of a Sino-Korean joint venture equals to ten times of its initial investment. Similarly, the accumulated profits of a Sino-Japanese joint venture had exceeded RMB one billion, which equals to 20 times of its initial investment.

With the confidence on future financial return, most Sino-foreign joint ventures voluntarily used distributed profits to reinvested into their joint ventures. This also implies the foreign investors' anticipation of financial risk in China is low. Meanwhile, the macro factors, such as inflation rate, interest rate and foreign exchange rate are comparatively stable for the last three decades with satisfactory. This is especially helpful for those export-oriented joint ventures since the lower value of RMB propels their

export activities.

### **3.3 Resource Deficiency Risk**

The resource deficiency risk in China has been identified as comparatively high in this study, which is consistent with author's perception. Many international joint ventures encountered the resource deficiency problems when acquiring production resource. For instance, some interviewees indicated that the resource deficiency problem is critical for their operation.

A marketing department manager in a Sino-French joint venture indicated that the difficulties of obtaining reasonable-valued essential materials are crucial for the profitability of this joint venture. This joint venture is a hydropower generator manufacturer. The production of hydropower generator requires mess natural resources, such as iron, steel, and copper. But continuous unplanned exploitation and mining in China, as well as squandering and smuggling made the supply market of those natural resources falls short of market demand. However, the long-term contract characteristic on the production of hydropower generator subjects to higher risk on the materials' price instability. Therefore, the profit or loss on fulfilling the contract partially depends on the contemporary market price of such fundamental materials.

This deficiency of the market supply on those materials and market speculation accelerates the extensively increase of their market prices. This situation severely affects this joint venture's development. As the marketing department manager indicated, "... We

*signed a contract in 2003. Then the market prices of iron, steel, and copper were much cheaper than current prices. Consequently, our contract price is lower. Now when we fulfill this contract, those raw materials' price has increased more than 30 percent. So our fulfillment of contract would imply the operating loss... ”*

The similar situation also exists in a Sino-Australian joint venture, which is specialized in the production of construction materials. The marketing manager of this joint venture said “...*In China, construction materials are always sellers' market. It means the lack of concrete manufacturing materials in Chinese market...we have undergone a lot of experience on manufacturing shutdown due to without materials supply....”*

### **3.4 Market Risk**

The market risk has been reported as a complicated situation in this study. On one hand, most investigated Sino-foreign joint ventures agree that the market potential in China is huge, and sometimes it even exceeds their initial anticipation when forming their joint ventures. For instance, the sales manager in a Sino-American joint venture mentioned, “...*At the beginning, we were not sure whether our product could be accepted in Chinese market as we had to compete with Chinese traditional medicine. Chinese traditional medicine has already possessed large portion of market share in this specific treatment area. Meanwhile, we had scarce knowledge of China's regulations, local market experience and sales channel, etc...but later we were surprised by this joint venture's performance. The market share of our product was increased yearly, which highly exceeded our expectation...hence, our current production capacity could not meet the*

*market demand, our parent companies wish to increase their investment to expand the production...*”

The similar situation was also found in the case of a Sino-Korean joint venture. The foreign partner of this joint venture is worldly remarkable manufacturer in the production of electronic instruments and house appliances. It has developed very fast in Chinese market, In accordance with the domestic market share; currently this joint venture is the largest video-player manufacturer in China. As the sales manager in this joint venture has proudly indicated, “...if you randomly choose any four in-used video player, our product must be one of them...” From this point of view, higher market performance implies lower market risk. Another example has been found in a Sino-Japanese joint venture. This joint venture was established in December 1995 with initial investment of US \$ 20.19 million. In the first year, their sales revenue was only RMB 20 million. But in the following years, this joint venture quickly developed with an annual growth of 30%. After 10 years operation, in 2005, its sales revenue achieved RMB 2 billion, which equals to 100 times of the sales in 1996.

Meanwhile, empirical evidence also highlights that the increasing market liberation in China also significantly reduces the market risk faced by international joint ventures. Such point was disclosed from the conversation with a market department manager in a Sino-Japanese joint venture. This joint venture is engaged in manufacturing automobile spare part for Japanese brand automobiles. He indicated that the Japanese partner’s interest of putting more investment into this joint venture is attributed to the increased

liberation in Chinese automobile market. China's WTO accession has accelerated the market liberation and reduced the import tariffs. Originally, this joint venture's main production had been focused on supplying overseas market and only very small percentage of its production was used to Chinese local market. It was caused by the lack of demand on Japanese automobile spare parts from Chinese service market since imported car is still too expensive for local consumers.

Under the WTO accession terms, China is required to reduce the tariffs of motor vehicles from 80 per cent in 2002 to 25 per cent by 2006. This new situation not only implies the huge Chinese market potential for imported motor vehicles, such as Japanese cars in the future; but also suggests the increased market desire on the spare parts associated with those vehicles. So to take advantages of this opportunity, this Japanese partner has decided to expand the production capacity in this joint venture by adding two additional production lines.

Although high market potentials in China minimize the market risk confronted by international joint ventures, evidence also suggests an existing risk in relation to the transitional market in China. Some interviewees have mentioned that the imperfect market in China has resulted in a high credit risk, which means some local customers could not pay their credited payment on schedule. Such situation is particularly serious in some local state-owned enterprises, collective enterprises, or individual organizations. Therefore, although the market potential is very high in China, underdeveloped market and legislative system limited the development of IJVs in China

To deeply analyzing the reason of such phenomenon, it could be seen that the fast economic growth in China is a 'two blade sword'. On the one hand, it creates enormous business opportunities for companies; on the other hand, it impels the capital demands by the firms. In the meantime, the local firms are very difficult to obtain necessary finance from China's underdeveloped financial market. Hence, consequently most Chinese enterprises always encounter the lack of capital. In return, the macro effects of lack of finance by Chinese domestic enterprises would inevitably affects those international joint ventures that they are doing business with.

The sales manager in the Sino-Australian joint venture indicated that they were facing a high credit risk in the joint venture's operation. He said, "*...A big problem existed in Chinese construction industry is the difficulties of payment collection. Many construction companies were bankrupted not due to their bad performance or loss market share, but because of the uncollectible payments from the customers...although this situation is not very severe in our joint venture as we adopt some strict policies to avoid such problems, it still heavily influences our performance by losing some potential customers....*"

## **5. Conclusion**

This research has empirically investigated the risks faced by international joint ventures that are operated in contemporary business environment of China. Based on the empirical evidence, the author has made a contribution to the literature by adding some new propositions, which would deepen our understanding of what kinds of risk the foreign investors have to face and how they currently handle such risks within the changing

business environment of China. However, as suggested by prior scholars, any empirical research has inevitable limitations. The limitation of this research might be due to small sampling and the constraint of geographical setting. Therefore, such limitation will result in the future research opportunities by proving the findings in a comparatively larger sampling with broader geographical settings.

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