

# Why do international joint ventures fail?

## A strategic mismatch explanation

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A STRATEGIC MISMATCH EXPLANATION**

*Submitted to Academy of Management Review\**

**BO BERNHARD NIELSEN**

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# **WHY DO INTERNATIONAL JOINT VENTURES FAIL?**

## **A STRATEGIC MISMATCH EXPLANATION**

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### **Abstract**

Why do so many international joint ventures fail? This paper aims at answering this question and contribute to the research concerning alliance dynamics by combining elements from research considering alliance formation and alliance outcomes. This paper draws on the widely accepted exploitation/exploration dichotomy, suggesting the existence of a continuum of choices related to strategic motivation for alliance formation. However, by integrating the exploitation/exploration arguments into a set of knowledge-related strategic motives for IJV formation, the main arguments focus on the relationship between initial strategic motivation for alliance formation and outcome in terms of knowledge. Essentially, it is argued that IJVs fail due to mismatches between strategic motives and rationales among the partners. Ultimately, a series of testable propositions are derived to guide future empirical investigation. Finally, the paper provides suggestions for future theoretical development and empirical exploration.

### **Keywords:**

International Joint Ventures, Knowledge Management, Strategic Mismatch, Exploration/Exploitation.

## **Introduction**

The dramatic growth of international joint ventures between firms is fundamentally reshaping the nature of international business. As market complexity is growing, inter-firm collaboration has become a crucial component of the pursuit of international competitive advantage. Yet such international collaborative arrangements are very complex to manage successfully, partly because of the difficulty of matching the goals and aspirations of autonomous organizations, headquartered in two or more countries. Often the good intentions and rational motives behind these alliances are not congruent with the strategic direction of either firm on its own, let alone the strategic direction of both in unison. Consequently, IJVs are frequently plagued with high degrees of instability and poor performance (Parkhe, 1993; Kogut, 1989). More often than not synergistic gains and positive spillover effects in terms of knowledge creation and learning for the parents never materialize. But why do these joint ventures fail? More importantly, is it possible to promote higher alliance performance through a better match between strategic motives? This article addresses these questions by identifying a set of strategic motives for international joint venture formation from a knowledge perspective and examining the implications for outcome according to the exploitation/exploration dichotomy (March, 1991). The purpose is to shed light on mismatches between underlying strategic motives for alliance formation and desired outcomes in order to advance the understanding of why IJVs fail.

Lately, we have experienced a paradigm shift from focusing on understanding and managing physical goods to focusing on corporate intangible assets such as knowledge. Hence, knowledge is recognized as a principal source of economic rent and the effective management of organizational knowledge has increasingly been linked to competitive advantage and thus considered critical to the success of the business firm (Grant, 1996; Spender, 1996). Given that research on strategic collaboration between firms has received increasing attention in the literature recently, reflecting the increasing frequency and importance of strategic alliances in business practice, it is surprising that very few attempts have been made to link effective knowledge management to the development of international joint ventures. Although still embryonic, the existing theoretical paradigms within strategic management seem inadequate at explaining the dynamic and highly complex

nature of knowledge as it relates to these hybrid combinations (e.g. license agreements, joint ventures, strategic alliances etc.). Hence, this article explicitly assumes knowledge creation and learning to be key to IJV performance and takes on a knowledge perspective of international joint venture formation and outcome in explaining why so many IJVs fail.

### **International Joint Venture<sup>1</sup> Stability**

International joint venture research rests on its ability to suggest managerial actions that address instability rather than simply documenting frequency of already terminated or unsuccessful ventures. The nature of joint venture development has received little attention in the extant literature, representing a critical omission in the development of a more complete theory of international joint venture development. A core area of research on strategic alliances is concerned with their influence on various aspects of firm performance (Gulati, 1998). Within the domain of firm performance, alliances are often considered to be the wellspring of firm innovation and a source of new capabilities (Bada-racco, 1991, Hamel, 1991; Leonard-Barton, 1995). Empirical evidence suggests that strategic alliances have a positive impact on firm learning and innovation (Deeds & Hill, 1996; Hagedoorn & Schakenraad, 1994; Mowery, Oxley & Silverman, 1996; Nakamura, Shaver & Yeung, 1996).

The influence of alliances on firm performance, one of five broad foci of the strategic alliance literature (Gulati, 1998),<sup>2</sup> has received relatively little empirical attention (Smith, Carrol, & Ashford, 1995), although the potential benefits to firms from alliance participation are quite broad and have been discussed extensively (see Gulati, 1998;

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<sup>1</sup> Building on existing definitions of JVs and international strategic alliances (Geringer, 1988; Geringer & Hebert, 1989) a joint venture (JV), in this article, is defined as involving two or more legally distinct organizations (the parents), each of which *actively* participates, beyond a mere investment role, in the decision-making activities of the joint venture. Furthermore, it is considered to be an international joint venture (IJV) if at least one partner is headquartered outside the venture's country of operation or where the venture has a significant level of operation in more than one country. Hence, an IJV can be defined as: 'Inter-firm collaboration over a given (international) economic space and time for the attainment of mutually defined goals'. This definition excludes a number of integrative relationships that are not considered IJVs in this context. Specifically, it excludes mergers and acquisitions (where ownership changes), subcontracting agreements, licensing and franchising. On the other hand, joint ventures, strategic networks, strategic alliances, and other strategic agreements fulfilling the conditions of the definition qualify.

Hagedoorn, 1993; and Contractor & Lorange, 1988 for reviews). This area of research is most germane to this study, particularly the empirical evidence that seeks to validate the growing conceptualization of alliances as mechanisms that enable firms to acquire certain types of knowledge and learn new skills from their partners.

Existing research that examines the effect of alliances on firm performance has operationalized performance in a number of ways, including organizational survival (Baum & Oliver, 1992; Singh & Mitchell, 1996; Uzzi, 1996), changes in stock prices (e.g., Koh & Venkataraman, 1991; Das, Sen, & Sengupta, 1998), market share changes (Park & Cho, 1997), and accounting-based measures such as sales growth (Powell et al., 1996) and return-on-sales (Hagedoorn & Schakenraad, 1994). While alliances are often found to have a positive impact on these various measures of firm performance, the empirical evidence remains mixed and often inconsistent (Gulati, 1998: 309).

Recently, researchers have pursued a much narrower domain of firm performance and have sought to understand the influence of a firm's strategic technology alliances on its technological outcomes. These efforts have been motivated, in part, by the difficulties in establishing a link between alliances and broader measures of firm performance (Gulati, 1998) and the growing insistence in the academic and practitioner literatures that alliances facilitate knowledge transfer and enhance organizational learning and the development of new capabilities (e.g., Badaracco, 1991; Hamel, 1991; Leonard-Barton, 1995). Empirical research in this area has examined the characteristics of alliances and alliance networks that enhance knowledge transfer and firm innovation.

Research has also emphasized that effective alliance governance can significantly enhance firms' joint learning and knowledge creation (e.g., Dutta & Weiss, 1997; Kogut, 1988; Larsson et al., 1998; Nagarajan & Mitchell, 1998). From a learning perspective, equity joint ventures are considered to be better suited than alternative governance mechanisms to the transfer and learning of tacit and embedded know-how because they align incentives for cooperation, permit a replication of the organizations themselves and provide prolonged and intense social interaction that facilitates the replication of organizational routines (Dutta & Weiss, 1997; Kogut, 1988; Nagarajan & Mitchell, 1998). Em-

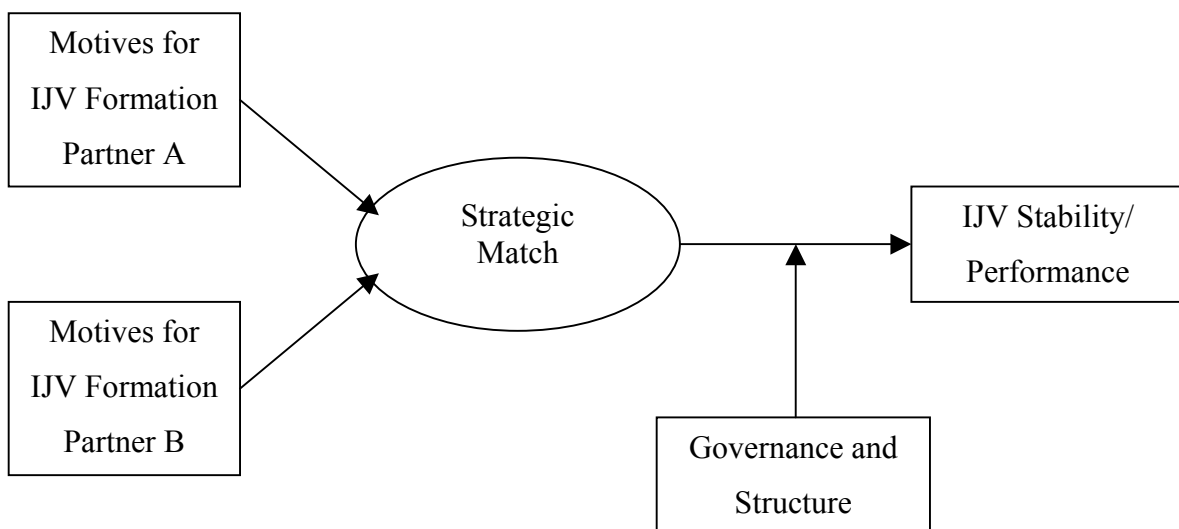
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<sup>2</sup> The remaining four areas of the research literature on strategic alliances identified by Gulati (1998) include: alliance formation, alliance governance, the evolution of alliances and alliance networks.

empirical evidence supports these arguments (e.g., Mowery et al., 1996; Sampson, 2000). Taken together, this research indicates that acquiring knowledge from alliance partners is often problematic and identifies various factors that moderate this process.

While promising, research in this area has not sufficiently demonstrated that alliances influence the development of new knowledge-related resources nor has it identified the conditions under which such development occurs (Hagedoorn, Link & Vonortas, 2000). Prior research has articulated a linkage between inter-partner “fit” and venture performance, however, “fit” has been postulated using different notions such as strategic symmetry (Harrigan, 1988), inter-firm diversity (Parkhe, 1991), match of partner characteristics (Geringer, 1988), or inter-partner compatibility/complementarity (Beamish, 1988; Hill and Hellriegel, 1994). The result of this operational confusion has led to a lack of consistency in empirical findings. Building on prior research, this paper attempts to reconcile these differences and proposes a theoretical framework, linking motives for alliance formation to IJV stability and performance. This strategic fit or “match” is moderated by the governance structure (level of integration and degree of control). Figure 1 below depicts this framework.

**Figure 1: Strategic Match Framework**



## Strategic Integration and Governance Mode

The literature on alliance formation is rich and fragmented. One main theoretical explanation for why firms collaborate is offered by the transaction cost perspective. According to Williamson, intermediate asset specificity and low uncertainty are conditions that may lead to a preference for hybrid forms of governance structure over both arm's length transactions and internalization (Williamson, 1991). Hence, the network perspective has been advanced - from a traditional Williamson-like transaction cost standpoint – as an intermediate form between market and hierarchy, in order to explain the existence and economic justification of these networks, suggesting the existence of a continuum of organizational forms ranging from market through network to vertically integrated firms (Williamson, 1985; Powell, 1990).

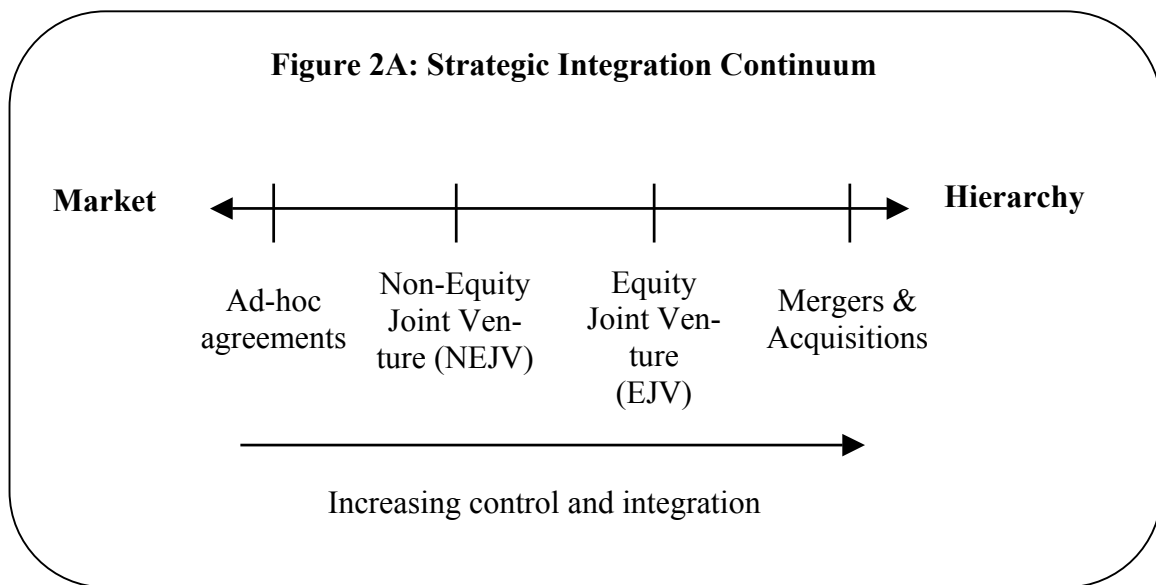


Figure 2A indicates some of the different organizational forms in the strategic integration continuum<sup>3</sup>. The figure also suggests a positive correlation between level of integration and degree of control. Hence, the higher the level of integration (moving from left

<sup>3</sup> For an overview of forms of interorganizational relationships most often discussed in the literature see: Barringer and Harrison, 2000: 382-395.



to right in the continuum) the higher the degree of control. The distinction between a non-equity joint venture (NEJV) and an equity joint venture (EJV) is made in order to emphasize the difference in level of integration and degree of control, which may have an impact on the relationship between motivation for alliance formation and outcome. A non-equity joint venture (NEJV) is an agreement between partners to cooperate in some way without creating a new, joined entity. In contrast, an equity joint venture (EJV) involves the establishment of a newly incorporated entity in which each of the partners has an equity position. Partners involved in an EJV normally expect representation on the board of directors and a proportional share of dividends as compensation (Contractor and Lorange, 1988). A second interpretation of a network defines it as a distinct, highly differentiated, heterogeneous organizational form (Powell, 1990). This view emphasizes the cooperative elements of alliances and suggests that networks evolve into multiple webs of technical, financial and social interactions (Kogut *et al.*, 1992; Gulati, 1995). Others argue that alliance formation may allow firms to reduce the level of uncertainty that stems from some transactions (Kogut, 1988; Hennart, 1988). The literature has produced an impressive list of reasons for why organizations enter into an alliance, including categorizations such as “learning alliances”, where the objective is to learn and acquire from each other products, skills, and knowledge (Lei & Slocum, 1992) and “business alliances”, intending to maximize the utilization of complementary assets (Harrigan, 1985). In terms of strategic choice of the firm, this is consistent with the widely accepted dichotomy in terms of the choice between **exploiting** existing resources and capabilities or **exploring** new opportunities (March, 1991; Koza & Lewin, 1998). Exploitation is concerned with increasing the productivity and efficiency of employed capital and assets through standardization, systematic cost reductions, and improvement of existing technologies, skills, and capabilities (Koza & Lewin, 1998). Exploration, on the other hand, is associated with discovering new opportunities for wealth creation and above average returns via innovation, invention, building new capabilities, and investment in the firm’s absorptive capacity (Cohen & Levinthal, 1990). Although conceptually a clear distinction, in practice this dichotomy reflects a continuum of choices between these two extremes, as firms are likely to seek both exploiting and exploring benefits from their involvement in collaborative ventures; too much emphasis on exploitation may lead to the adoption of suboptimal routines,

while too much emphasis on exploration may lead to incurring the high costs of experimentation without realizing its benefits.

**Figure 2B: Strategic Choice Continuum**

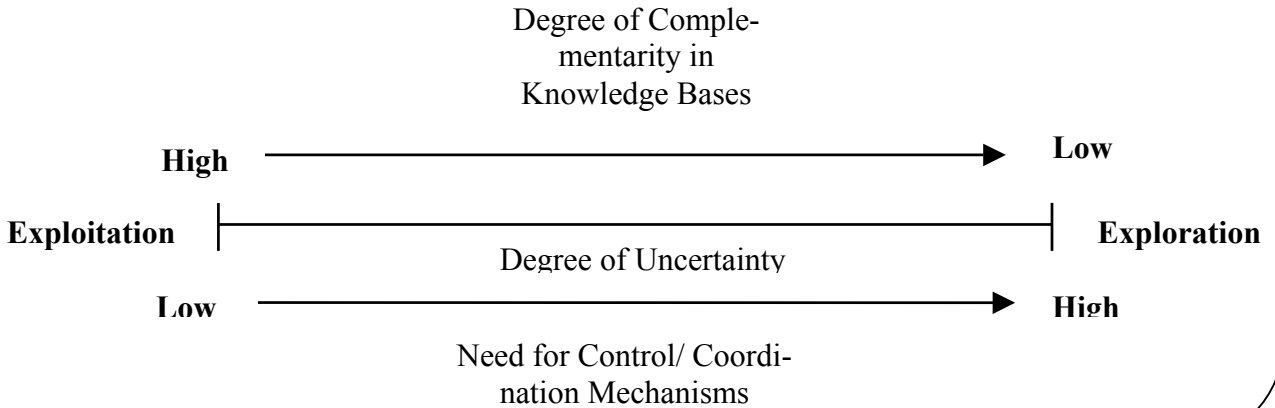


Figure 2B above depicts the dichotomy between exploitation and exploration and how it relates to degree of complementarity (related distinctiveness) in knowledge bases and need for control/coordination in order to reduce the level of uncertainty. As indicated in figure 2B, the higher the degree of complementarity in knowledge bases the more likely is the outcome to be exploitation rather than exploration. This is due to the relatedness of knowledge bases stemming from the inherent homogeneous nature of complementarity<sup>4</sup>. As the collaboration moves toward exploration on the continuum, the degree of uncertainty increases, as does the need for control/coordination mechanisms. As indicated above, there are tradeoffs to both extremes, however, how does a firm position itself along this continuum? Moreover, given different strategic motives among partners in an alliance, what are the effects on outcome in terms of knowledge creation and learning? In order to answer these questions, we need to look at strategic motives for alliance formation from a knowledge perspective, seeking to identify a connection between the stra-

tegic motives identified in the extant literature and the effects on outcome in terms of knowledge creation and learning.

### **Strategic Motives for Alliance Formation: A Knowledge Perspective**

Several authors have approached alliance formation from a strategic perspective, providing a host of motives for forming these strategic collaborations (Harrigan, 1985; Porter & Fuller, 1986; Contractor & Lorange, 1988). In relation to knowledge some authors argue that an alternative to the firm specific view of strategic renewal is to acquire new knowledge-related capabilities through strategic integration and mobilize it vis-à-vis the existing knowledge developing activities (Jemison, 1988). A review of this literature shows a strong similarity in the motives identified. The following section offers a brief description of the strategic motives identified in this literature. Table 1 categorizes the identified motives for alliance formation according to their implied strategic motives and their theoretical roots. The implied motives are classified according to the exploitation/exploration dichotomy depicted in figure 2B on the next page.

#### Risk/Cost Sharing

According to Porter and Fuller (1986) strategic alliances can be viewed as a mechanism for hedging risk because neither partner bears the full risk and cost of the joint activity. Many alliances are shaped around the sharing of risk and cost in that one partner mainly contributes capital and absorbs some of the risk of failure in return for a certain amount of the prospective profit, whereas the other partner provides for the actual activity of the joint venture. Reduction of risk and cost through a joint venture can emerge in different ways (Contractor and Lorange, 1988):

- Reducing total (asset) risk and (investment) cost of a large project over more than one firm
- Reducing cost through product rationalization and economies of scale

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<sup>4</sup> The traditional view of absorptive capacity argues that some level of prior experience with (or overlap of) the knowledge domain is necessary in order for effective collaboration to take place (Cohen & Levinthal, 1990).

**Table 1: Strategic Motivation for Alliance Formation**

STRATEGIC MOTIVE	EXPLOITATION	EXPLORATION
Risk/Cost Sharing (TCE)	<ul style="list-style-type: none"> <li>- Reducing total (asset) risk and (investment) cost</li> <li>- Product rationalization and thus reducing costs through economies of scale, while avoiding risks of full-scale merger</li> </ul>	<ul style="list-style-type: none"> <li>- Enabling faster market entry and exploration</li> <li>- Enabling product diversification into attractive yet unfamiliar business areas and thus reducing market risks</li> </ul>
Transfer of Knowledge Related Capabilities (TCE and OL)	<ul style="list-style-type: none"> <li>- Focus on matching existing (explicit) skills and resources (compatibility)</li> <li>- Focus on needed (explicit) skills and resources (complementarity)</li> </ul>	<ul style="list-style-type: none"> <li>- Focus on collaborative utilization of (explicit and tacit) skills and resources</li> <li>- Focus on creating new capabilities through <i>fusing</i> of skills and resources</li> </ul>
Shaping Competition (SP)	<ul style="list-style-type: none"> <li>- Defensive ploy aimed at reducing competition</li> <li>- Offensive strategy aimed at increasing competition</li> </ul>	- Co-opetition (combining cooperation and competition) aimed at generating new value (change in value chain design)
Access to Market (SP)	<ul style="list-style-type: none"> <li>- Conform to host government policies and regulations</li> <li>- Exploit local market knowledge</li> <li>- Exploit distribution channels</li> </ul>	- Redesign and integrate all relevant aspects of value chain in order to maximize strategic flexibility
Facilitate Internationalization (OL and SP)	<ul style="list-style-type: none"> <li>- Increase international experience</li> <li>- Speed up international market entry</li> </ul>	<ul style="list-style-type: none"> <li>- Develop global strategy</li> <li>- Develop global organization</li> <li>- Internationalize value chain</li> </ul>
Strategic Linkages (TCE and RD)	- Vertical quasi-integration (as means of control of inputs) with each partner contributing one or more different elements in the production and distribution chain	- Total integration (as means of generating added value) of relevant knowledge related capabilities and resources throughout the value chain
Gaining Legitimacy (PE and IT)	- Homogenization through competitive and institutional isomorphism	- Heterogenization and autonomy through isolation and independence

Note: TCE = Transaction Cost Economics; OL = Organizational Learning; SP = Strategic Positioning; RD = Resource Dependency; PE = Population Ecology; IT = Institutional Theory

- Avoiding risks of full-scale merger or acquisition
- Enabling faster market entry leading to faster return on investment
- Reducing market risks through product diversification into attractive new business areas

Although primarily focusing on economies of scale and cost/risk reduction from an economic rationale, the motivation for IJV formation may also be grounded in more behavioral principles, seeking to gain new knowledge and learning as partners enter new markets or explore new processes for product and technology utilization. Hence, depending on the initial motivation (exploitative or explorative), the outcome of the alliance in terms of synergies and learning may be quite different.

#### Transfer of knowledge related capabilities

The traditional view of joint ventures holds that they provide benefits from the exploitation of synergies, technology or other skills transfer (Harrigan, 1985). Most firms approach collaboration from a complementary view and focus on matching knowledge related capabilities that can be transferred and incorporated in the parent firm. The objective is (implicitly or explicitly) to produce economies of scale for those activities carried out in collaboration (Dussauge et al., 2000). Thus, from a motivational perspective, the *focus* of the alliance becomes the central issue in terms of transfer of knowledge related capabilities. If focus is on matching existing skills and resources the collaboration can be viewed as compatibility in terms of transfer of knowledge related capabilities. Explicitly focusing on skills and resources that are needed but not possessed by the firm can be regarded as complementarity in terms of transfer of knowledge related capabilities (Geringer, 1988). Both of these foci are consistent with the exploitation motive. Synergies of knowledge related capabilities, on the other hand, emerge from a focus on creating new capabilities through a collaborative utilization and fusing of skills and resources. This focus enables organizational – and inter-organizational - learning as the main motive is exploration. Hence, the rapid growth in the number of international alliances over the last 10 years has been explained, by process-oriented researchers, as a vehicle for organiza-

tional learning, giving partner firms access to each other's knowledge (Kogut, 1988; Hamel, 1991; Grant, 1996).

### Shaping competition

The basis of competition is greatly influenced by collaborative arrangements since it potentially affects strategic positioning within an industry or across industries (Porter & Fuller, 1986). In an attempt to reduce competition, joining resources might help defend current strategic positioning against more powerful competitors. In addition, binding existing or potential competitors to the firm as allies may serve to limit their strategic flexibility. Alternatively, strategic integration could be used as an offensive strategy aimed at increasing competition, for instance by joining forces with a rival in order to put pressure on a common competitor or by vertically integrating into a new market (Contractor & Lorange, 1988). Both of these strategies are internally focused and inherently static in their pursuit of short-term advantages, which is consistent with the exploitation motive. Conversely, the collaborative dynamic of networks, partnerships, and joint ventures, combining cooperation and competition (co-opetition) in an attempt to create new value through a redesign of the value chain, is a main organizing principle in what Peter Drucker calls the New Economy. According to Peter Drucker, and others, social capital (synergies, networks, shared norms, and trust), as fostered in collaboration and alliances, may be as important as physical capital (plant, equipment, and technology) and human capital (intellect, character, education, and training) in driving innovation and growth. Hence, from an exploratory perspective, collaboration can be motivated by a desire to shape competition and develop sustainable competitive advantage through long-term focus on social capital and knowledge creation.

### Access to market

Traditionally, multinational companies used strategic alliances as a vehicle to enter the markets of developing countries that enforced restrictive conditions on foreign direct investments (Hood & Young, 1979). Although some of these protectionist policies have evaporated, access to some local markets, for example in the former Soviet block and China, are still in many cases contingent upon the foreign company collaborating with a

local partner (Beamish, 1988; Yan & Luo, 2001). In developed market economies, however, we also find ample examples of protectionist policies, some of which have even been escalated by the forming of trading blocks, such as the NAFTA, the EU and the APEC. Additionally, certain industries or products are often subject to specific host government requirements. Hence, firms operating in for example the defense industry, telecommunications and biotechnology find strategic alliances the most practical way of conducting business in these markets (Contractor & Lorange, 1988). In terms of knowledge related capabilities, collaboration may be instigated based on a perceived need to access and exploit local knowledge (i.e. market knowledge, distribution channels or more complex government relationships). Alternatively, some firms approach collaboration from an explorative perspective, redesigning their entire value chain and seeking to adapt and learn from local partners in an attempt to maximize strategic flexibility.

#### Facilitate internationalization

Strategic alliances may, as mentioned above, play a crucial role in facilitating and speeding up entry into foreign markets. For companies in the early stages of the internationalization process, who are lacking resources to expand internationally and who have little or no international experience, collaborating with a local partner might provide valuable access to both international capabilities and specific market knowledge (Beamish, 1988; Geringer, 1988). The development of a (successful) global strategy and the establishment of a global organization is in general a difficult, expensive, time-consuming and high-risk business (Contractor & Lorange, 1988). Forming an IJV may help speed up the internationalization process, which may lead to first mover or early entrants advantage (Gannon, 1993). Again, there seems to be a difference in motivation according to the exploitation/exploration continuum, since some firms approach internationalization from a more or less pure economic rationale, focusing on the most cost-efficient way of increasing international operations, whereas other firms take a more long-term learning-based approach to internationalization, focusing on the entire value chain as a system.

#### Strategic linkages

Drawing on transaction cost economics, Hennart (1988) distinguishes between scale and link alliances depending on the position and contribution of each partner in the relationship. Essentially, this distinction reflects different objectives that firms assign to alliances. Thus, scale alliances, where partners contribute similar resources pertaining to the same stage or stages in the value-creation process, are likely to be formed based on exploitative motives as firms seek to control input and reduce excess capacity (Dussauge *et al.*, 2000). In contrast, link alliances can be viewed as a form of vertical quasi-integration with each partner sharing dissimilar resources, contributing to one or more different stages in the value chain, which may in fact lead to the development of a form of customer-supplier relationship (Hennart, 1988). Thus, firms, forming link alliances, are more likely to seek partners with heterogeneous capabilities (Sakakibara, 1997) as the main motivation for strategic linkage is centered around learning and skill-enhancement.

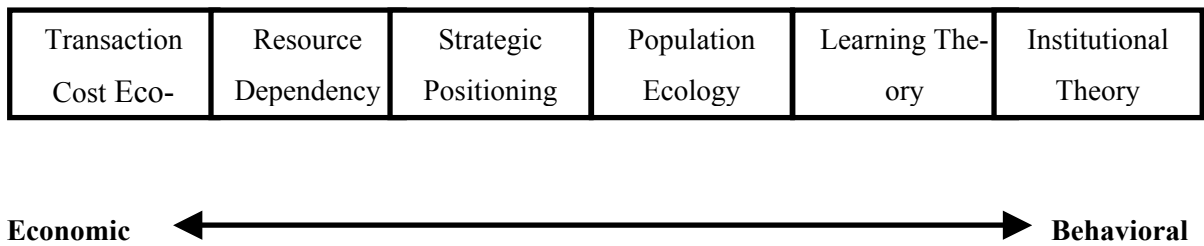
### Gaining Legitimacy

Institutional theory (DiMaggio and Powell, 1983) suggests that institutional environments impose pressures on organizations to appear legitimate and conform to prevailing social norms. Hence, from an institutional perspective, strategic integration can be viewed as a result of a quest of firms to attain legitimacy within their larger environment (DiMaggio and Powell, 1983; Meyer and Rowan, 1977). From an exploitation perspective this is likely to lead to structural and social homogenization over time as organizations give in to the institutional pressures in order to exploit this legitimacy. DiMaggio and Powell adopted the ecological concept of isomorphism to describe this process and went on to identify two distinct types of isomorphism, competitive and institutional (DiMaggio and Powell, 1983). Competitive isomorphism refers to pressures toward similarity resulting from market competition, consistent with population ecology (cf. Hannan and Freeman, 1977). Institutional isomorphism involves organizational competition for political and institutional legitimacy as well as market position. On the other hand, forming strategic alliances in order to gain legitimacy can also be approached from an exploration perspective, where the main objective is to obtain heterogeneity and autonomy through independence and isolation from the institutional environment. For instance, by partnering with a local partner or a local government agency, organizations can gain le-



gitimacy that offers potential for exploration of new strategic avenues. In this sense, the inter-organizational constraints imposed by other actors or the environment, termed coercive isomorphism by DiMaggio and Powell (1983), potentially becomes inter-organizational freedom or opportunity.

**Figure 3: Theoretical Foundations of Alliance Formation**



Source: Adapted and modified from Barringer and Harrison 2000

As indicated in figure 3, the six theoretical foundations for alliance formation fall along a continuum according to reliance on either an economic rationale for integration or reliance on a behavioral rationale. Allowing only limited behavioral influence, transaction cost economics and resource dependence clearly represent economic explanations for alliance formation, while learning theory and institutional theory falls on the behavioral end of the continuum. Although organizational learning theory is predominantly a behavioral discipline, it does have certain economic implications stemming from the ability of an organization to utilize acquired knowledge to reduce costs or in other ways enhance revenues and profitability (Barringer and Harrison, 2000). The other intermediary theoretical foundations all build on a combination of economic and behavioral disciplines in order to explain formation of strategic collaborative arrangements. Although these six theoretical paradigms seem inherently different and offer seemingly unique perspectives on alliance formation, they share a common dichotomous nature in relation to strategic

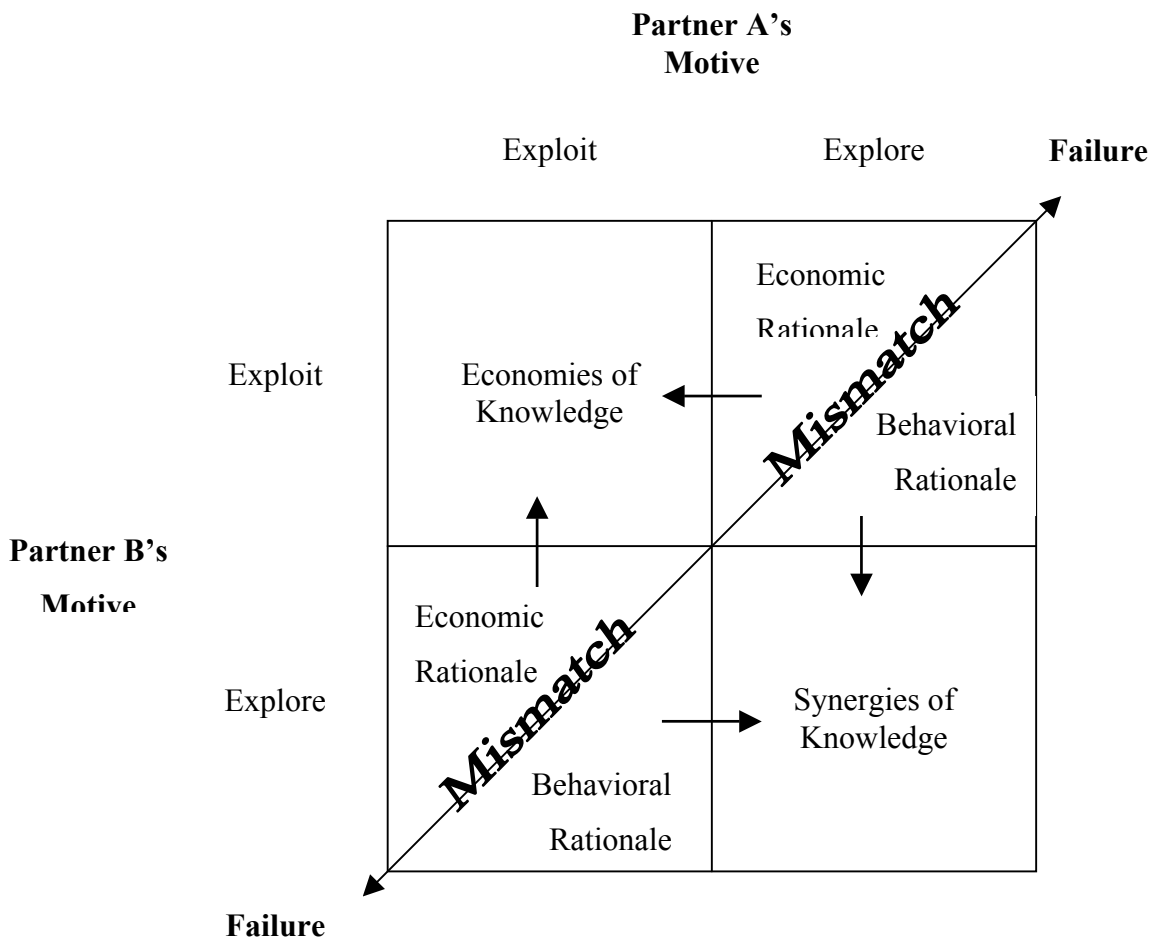
choice between exploitation and exploration. As indicated in table 1 and discussed above, the distinction between economic and behavioral explanations for alliance formation does not predict the strategic choice between exploitation and exploration as all six theoretical explanations can be conceptualized at both ends of this continuum. It seems that explaining formation of inter-organizational relationships is a complex process involving a mix of economic and behavioral paradigms, depending in part on the desired outcome and potential mismatches between the two.

### **The Relationship Between Partner Motives and Outcome**

The extant literature, as presented above, mostly approach motives for alliance formation from a static perspective, addressing the question of why firms form alliances as an independent, firm-specific event. As stated earlier, this literature is fragmented and there seems to be a general disagreement about the impact of various motives on performance. Moreover, most of this literature fails to look at the dynamic interaction between the firms involved in the alliance and the dynamic relationship between the motives of both partners and the potential and desired outcome in terms of knowledge and learning. Rather than examining separately why firms enter these agreements, a more fruitful approach involves looking at different knowledge related outcomes determined by *matches* and *mismatches* between partner motives and aspirations, as shown in figure 4 on the next page.

If both firms enter the partnership strategically motivated by exploitative considerations (for instance risk/cost sharing or access to local knowledge), there is little or no learning intended and the objective is to create *economies of knowledge* in order to enhance competitive advantage. These alliances are motivated by complementarity in knowledge bases and tend to facilitate transfer of predominantly explicit (formal) knowledge (most likely in the form of carefully drafted agreements) in relation to a specific project. The emphasis is on refining an existing innovation or process by gathering specific information that will provide deeper knowledge in that particular area. The objective is (implicitly or explicitly) to produce economies of scale for those

**Figure 4: The relationship between partner motives and outcome**



This model is a simplification and rests on a series of assumptions. First, the model assumes that firms are aware of - and can make conscious choices based on - the actual motivation of own and partner firm. Second, the model is based on joint ventures with only two firms involved (dyads) and performance is assessed at the dyadic level. Needless to say that joint ventures involving more firms significantly increase the complexity of the model. Third, the model implies a clear differentiation between exploitation and exploration, however, in reality mixed motives are possible and highly relevant. Finally, this model is based on an assumption about the positive relationship between learning and performance for both partners in the dyad. Whether or not learning can be assessed at the dyadic level and the difference in impact on each firm is not considered.

activities carried out in collaboration (Dussauge et al., 2000). The focus is on solving problems in the present without examining the appropriateness of current learning behav-

iors. This type of integration is furthermore characterized by the fact that success of the parent companies is of main concern to the members of the joint venture. Since both organizations are introducing only selected complementary, company-specific knowledge to the relationship, the main outcome will be transfer of complementary knowledge related capabilities (*economies of knowledge*). Examples of this kind of integrative relationship is abundant in the literature on vertical alliances, where firms are looking for similarities and complementarities among upstream and downstream partners with the explicit goal of creating competitive advantage. In terms of the strategic integration, a focus on exploitation implies little need for coordination and control in terms of knowledge transfer, since the knowledge exchanged is complementary and driven by a need to automate processes to reap the benefits of scale. Hence, consistent with the discussion above on governance mode, one would expect to find relationships based on matching motives of exploitation on the left of the strategic integration continuum (see figure 2A), for instance organized as loosely drafted license agreements or non-equity joint ventures:

*Proposition 1: International joint ventures based on matching motives of exploitation are likely to involve a low level of integration.*

Alternatively, when both partners approach the collaboration from an explorative perspective (for instance joint product or market development), learning and knowledge creation is at the forefront of the relationship and the outcome is measured as *synergies of knowledge* in an attempt to develop new capabilities. In the evolutionary economics literature (e.g. Nelson & Winter, 1982), the capabilities view of the firm serves primarily as a micro-foundation for population level analysis of industry and technology evolution. Thus, the capabilities perspective helps rationalize the variety of behaviors – including innovative behavior – that are necessary in any evolutionary account of industry and technology evolution (Metcalf, 1989). I label the outcome of these innovative knowledge-driven behaviors stemming from learning processes *synergies of knowledge*, as they involve a simultaneous focus on internal, firm specific competencies and external, collaborative synergies, which plays an important role in creating new knowledge-related capabilities and thereby enhancing competitive performance. According to this perspec-

tive knowledge is viewed as a complex, dynamic and subjective set of assets, which is inherently indeterminate and continually reconfiguring. Hence, new knowledge can be created *among* the participants in a strategic aggregate arrangement as a synergy (and not simply the sum) of the knowledge-related capabilities brought into the collaboration by each member. Consequently, the focus is on gathering new information on many different alternatives. This information is relatively broad and general in nature, because the emphasis is on identifying viable alternatives rather than seeking to automate any one innovation or process. These joint ventures (learning alliances) are managed like an independent business, thereby giving its personnel strong incentives to work for the success of the venture, as opposed to the parents (Badaracco, 1991). In terms of control and integration, this implies a need for increased control and coordination as safeguard against knowledge spillover and opportunism as these types of collaborative relationships focus extensively on deep knowledge exchange and learning over time. Thus, these alliances are more likely to be found to the right on the strategic integration continuum (see figure 2A), for instance organized as equity joint ventures, as firms seek to minimize the uncertainty and transaction costs of knowledge exchange and learning:

*Proposition 2: International joint ventures based on matching motives of exploration are likely to involve a high level of integration.*

Examples of this type of relationship are scarcer in contemporary business reflecting the difficulty of matching asymmetrical knowledge bases and the intrinsic risk and uncertainty involved in this type of venture. However, examples like Toyota and its extended enterprise illustrate the potential gains of synergies and spillover effects from this type of matching, explorative integration. Toyota relies on suppliers for more than 70 percent of the value of its vehicles (Dyer, 2000) and thus management of vertical relationships is critical to the success of Toyota. Realizing the importance of the supplier network and the learning potential, Toyota has created knowledge-sharing supplier networks in both the United States and Japan. The main goal of these networks is to create new knowledge through interorganizational learning and knowledge sharing. In terms of integration and control, Toyota often takes minority ownership positions in their suppliers

in order to create a sense of mutual destiny and secure goal congruence and trust (credible commitment) – important ingredients in the pursuit of synergies of knowledge. Dyer (2000) reports that Toyota, on average, owns 22 percent of the shares of its major supplier partners. Results suggest that part of Toyota’s success stems from its ability to “out-learn” the networks of its competitors (Dyer, 2000: pp. 61). More prevalent in international business, however, are relationships based on mismatches between partner motives and desired outcome. This paper suggests that mismatches between partner motives differ according to the underlying rationale and that these states are transitional, since they create tension between partners.

As indicated in figure 4, mismatches may lead to *failure*<sup>5</sup> in terms of performance or ultimately to termination of the alliance. If one partner is seeking to exploit knowledge related capabilities of its partner, who in turn is strategically motivated by an explorative incentive, the relationship may turn into a game of opportunistic behavior where one partner seeks to exploit (or even cheat) the other partner. This scenario is likely to breed distrust as the *mismatch* between strategic motives becomes apparent to both partners. Over time, the level of knowledge transfer and learning becomes very low as both partners seek to protect their knowledge bases against exploitation. Ultimately, this leads to poor performance and/or premature termination<sup>6</sup>.

Mismatches between strategic motives for alliance formation may, however, be resolved in other ways. If the mismatch stems from *economic rationales*, where both firms initially are motivated by considerations grounded in transaction costs economics or resource dependency (see table 1 and figure 3), such as risk/cost sharing, shaping of competition, or access to market, it will likely resolve itself into the economies of knowledge quadrant. Even though one firm is approaching the collaboration from an explorative per-

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<sup>5</sup> Failure in this article is defined as sub-optimal long-term performance for the joint venture as a result of reduced knowledge exchange. The underlying assumption is that firms will benefit more from effective knowledge sharing in the long run compared to ineffective focus on short-term benefits. The possibility that firms may experience differential returns to a joint venture is relevant, particularly when considering low levels of integration such as licensing agreements. However, for the purpose of this article, it is assumed that long-term performance of both parties to a joint venture from a knowledge perspective is closely related to the overall outcome of the relationship. Hence, a strategic mismatch is assumed to lower the long-term benefits of the collaboration.

<sup>6</sup> Termination is not necessarily equal to failure as alliances can be terminated for a variety of reasons, one of which is the meeting of its objectives. Premature termination, however, refers to the situation where the alliance is terminated before it has met its objectives due to some kind of conflict among the partners.

spective, the overarching rationale behind the alliance is short-term economic returns and hence the alliance is likely to be structured and managed in relation to this rationale, thereby eliminating the possibility of creating synergies of knowledge. As both partners recognize this fact, goals and aspirations will change to reflect this reality. Conversely, if the rationale behind the partnership is based on institutional and learning theory, grounded in *behavioral rationales* (see table 1 and figure 3), there may then be a shift into the synergies of knowledge quadrant. For instance, some firms collaborate in order to gain legitimacy and increase international experience. Their partner may be approaching the relationship from a different perspective, for instance seeking to access new markets and exploit their partner's superior production technology. However, as time passes the relationship changes and both firms realize the importance of integrating value chains and gaining from each other not only production technology and international experience but also more diverse techniques like human resource management and marketing practices. As each partner modifies its objectives, this relationship will eventually lead to spillover effects to other projects and synergistic gains throughout the value chain. Hence, the relationship will shift toward the *synergies of knowledge* quadrant.

The debate in the literature on alliance outcome has predominantly been focusing on outcome as a result of either (1) conditions surrounding the formation (e.g. Kogut, 1988; Park & Ungson, 1997) or (2) collaborative processes and partner interaction (e.g. Ring and Van de Ven, 1994; Larsson et al., 1998). In terms of learning, Dussauge *et al.* (2000) use alliance outcomes as indicators of inter-partner learning, arguing that different types of alliances offer different potential for learning. Similarly, other authors distinguish between cost-sharing and skill-sharing alliances (e.g. Sakakibara, 1997), which essentially resemble the *economies of knowledge* and *synergies of knowledge* quadrants, respectively, in figure 4. Assuming that both firms are consciously following a given strategic motive *and* that these motives are congruent, these studies do not concern themselves with the potential mismatch between partner motives and the likely implications for outcome. Given the added complexity of cultural distance and dissonance involved in cross-boarder partnerships, this paper suggests that such strategic mismatches in motives for international alliance formation are more prevalent than are matches, which may account for a large proportion of the observed failures in international joint ventures:

*Proposition 3: Mismatches in partner motives for international joint venture formation lead to a higher predisposition to failure than do matches in partner motives.*

Research on inter-organizational learning and knowledge creation agrees that firms are more likely to derive significant private benefits from the acquisition of new knowledge related capabilities (Khanna et al., 1998; Dussauge et al., 2000). Similarly, I suggest that this type of *synergies of knowledge* will be a source of competitive advantage for organizations and therefore should be viewed as an ideal state for partners engaging in international joint ventures. However, as indicated above, alliances based on purely economic rationales from an exploitation perspective can also be very successful depending on the goals and objectives of the partnership. The key is to avoid mismatches in strategic motives by explicitly communicating the objectives of the alliance. This entails, among other things, that both firms need to be consciously aware of the exact nature of the relationship and structure the joint venture accordingly. As indicated in figure 4, strategic mismatches do not necessarily lead to failure as they occupy a transitional stage, which may resolve itself into either the *economies of knowledge* or the *synergies of knowledge* quadrant, depending upon the underlying rationale of the relationship. Although these types of joint venture relationships eventually will move toward one of the matching quadrants (*economies of knowledge* or *synergies of knowledge*) – assuming they are not resolved through failure and/or termination - there will be a time-lag before the two partners realize the incongruity and make the necessary adjustments. This time-lag will, other things being equal, lead to a disadvantage in terms of competitive advantage, suggesting the following relationship:

*Proposition 4: International joint ventures based on matching strategic motives between the partners will perform better than international joint ventures based on mismatching strategic motives.*



In terms of learning, the extent to which partner firms learn from each other is likely to vary systematically with motives for alliance formation. This is consistent with Hamel's (1991) inductively derived model of inter-partner learning, where one of the main determining concepts of learning is intent:

*Proposition 5: International joint ventures based on matching, explorative strategic motives between the partners (synergies of knowledge quadrant) will lead to more dyadic learning than international joint ventures based on matching, exploitative strategic motives (economies of knowledge quadrant).*

Additionally, although firms may attempt to strike a balance between exploitation and exploration, in reality, achieving this balance seems elusive. The sure short-run rewards of exploitation distract organizations from pursuing exploration, where returns are far less certain and the risks far greater. Even if the expected value of exploration is greater than that of exploitation, risk and loss aversion still tend to lead to a preference for exploitation. This bias toward exploitation will, however, result in short-lived gains if success criteria (i.e. in a dynamic environment) change after the firm has routinized complementary knowledge transfer. In such an environment, the firm's past investment in routines is rendered obsolete, and the lack of exploration that results from a focus on exploitation can inhibit adaptation and may lead to failure. Indeed, in a hypercompetitive and dynamic environment, even doing extremely well what it learned in the past may result in poor firm performance or failure in the future; it may suffer from the so-called *competency trap* (Levitt & March, 1988). Hence:

*Proposition 6: In dynamic environments, international joint ventures based on matching, explorative strategic motives will perform better than international joint ventures based on matching, exploitative motives.*

## **Conclusion and Directions for Future Research**

As hybrid organizational forms become increasingly prevalent in the business environment the need to understand the dynamics of these emerging organizational forms increase, as managers and researchers struggle to find patterns and indications of how to

effectively manage these complex collaborative arrangements. This paper focused on the relationship between conditions for alliance formation and outcome and the moderating impact of governance mode. Strategic mismatches were defined and their roots traced.

This article has made a conceptual case for the predicted relationships between strategic motives for international joint venture formation and outcome in terms of knowledge and learning. Based on the widely accepted exploitation/exploration dichotomy and suggesting the existence of a continuum of choices related to strategic motivation for alliance formation, the proposed model explores the relationship between strategic matches and mismatches in interfirm formation motives among partners and predicts likely outcomes. Although the important impact of individual formation motives on alliance outcome has long been recognized in the extant literature, few attempts have been made to systematically examine the impact of both firm's motives on outcome simultaneously. Moreover, extant empirical support for these relationships is minimal. Thus, the next logical step is to empirically test the proposed model. Most of the strategic motives for alliance formation have been identified and studied independently and acceptable scales have been developed. Adopting (and modifying) these scales would allow for the testing of the research propositions in order to establish the fit of the proposed theoretical model. It is important, however, to keep in mind the larger context of each partner of an IJV as this may impose significant variation on the companies' ability and motivation to enter IJVs. Hence, the industry structure and institutions, government laws and regulations, and level of technological sophistication, surrounding a firm in its home country, is likely to vary greatly across countries. Such aspects of national culture, in concert with corporate culture variables, must be controlled for in any study involving cross-border interfirm collaboration.

Whereas relatively good scales exist regarding motives for alliance formation, more disagreement exists in the literature on a valid measure of performance, and the disagreement is likely to persist for some time. Several influential scholars (e.g. Parkhe, 1993; Venkatraman & Ramanujam, 1986) recommend employing a multidimensional operationalization, which may overcome some of the drawbacks of prior measures of performance that relied heavily on survival and duration of the alliance (cf. Harrigan, 1988). Thus, for the purpose of this study, performance should be operationalized as a combina-

tion of financial, operational, and effectiveness measures in order to capture the value-added in terms of knowledge exploitation (*economies of knowledge*) versus knowledge exploration (*synergies of knowledge*). A more fruitful avenue may be to adopt a multiple case-study approach. For instance, identifying a set of extreme cases, one for each quadrant in the model, and following them over time may provide evidence of the transitional nature of these relationships over time as goal congruency and motivational intent become aligned. A study of this nature would require access to both partners in these alliances before alliance formation (or at a very early stage) and the tracking of these relationships over time in order to identify possible matches/mismatches and their impact on performance.

The proposed model (figure 4) has obvious limitations and additional theorizing is needed. First, it is important to restate that the model is a simplification and hence rests on a series of assumptions. Relaxing these assumption, for instance by challenging the notion of inter-partner learning and the relevance of dyadic learning as outcome, may change the implications of the model. Second, building on a certain understanding of the exploitation/exploration dichotomy and applying it to a broad definition of IJVs makes the boundary conditions of the theory somewhat loose. For instance, one could imagine types of IJVs where the model would not apply or have different (opposite) implications for performance. Hence, a better understanding of different types of IJVs (in terms of governance and structural design) and their dynamic development over time is needed. Although the model does allow for some dynamism regarding transitional stages of motives and the relationship between initial motivation and outcome over time, it is important to recognize that it is the *rate* of knowledge transfer, absorption, and learning and not just the learning itself that is important. Hence, when the complexity associated with the rate of knowledge transfer, absorption, and learning is added to the equation, an array of issues suited for future research appears, since many firms may have difficulties recognizing mismatches in motives and learning opportunities, let alone explore and exploit them. Thus, future research should seek to establish a better understanding of the complexity of learning as it relates to inter-organizational relationships, for instance by investigating the potential relationships between matches and mismatches in cognitive and behavioral processes and performance. Fundamental questions like (1) how firms learn

from each other, (2) whether learning refers to content or process, (3) whether a relationship between learning and performance exists, and (4) whether firms learn individually or in collaboration need to be addressed in order to answer the essential question of why so many IJVs fail.

### **Managerial Implications**

Although theoretical in nature, this article offers key insights for managers of IJVs as well. First of all, this article stresses the importance of goal congruency and motivational match and offers a framework for analyzing motivational fit. Second, the paper proposes that the relationship between motivational intent and outcome is moderated by governance structure and offers predictions regarding the moderating effects of different levels of integration. Finally, this article has implications for partner selection in IJVs, since the paper explicitly suggests collaborating with a partner, who matches in terms of motivational intent and who possesses knowledge, which is compatible with the objectives of the collaboration, whether it is to reap the benefits of *economies of knowledge* or create *synergies of knowledge*.

In conclusion, the key claim is that employing the exploration/exploitation dichotomy to the motivational intent of partners in international joint ventures and linking this directly to performance adds considerable value to the IJV literature by explicitly modeling strategic mismatches from a knowledge perspective. The strategic mismatch view espoused here is expected not only to help reduce the operational confusion pertaining to inter-partner fit and its effect on performance but also to respond to calls for studying alliance dynamics from a knowledge perspective.

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