

JOINT VENTURES: MYTH AND REALITY

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Introduction

In a simple economic model, an investment will be attractive to the investor if the prospective yield to him exceeds his cost of capital and is the highest of the available alternatives; and it will be attractive to the host country if the prospective payment to the investor is lower than the social yield and the lowest of all possible alternatives. The effect of foreign investment on the economies of developing countries has long been a subject of debate. The question as to whether a policy of accepting certain foreign investment brings more benefits than does some alternative policy generates sufficient debate among economists. But the question must be made more complicated by asking under what terms the foreign investment is to be made. If the government has the option of insisting that the foreigner take in a local partner, does this improve the outcome for the host country? This raises the question of the struggle between foreign business and local government over control of any proposed investment.

The resulting conflicts lead to a consideration of many different arrangements, infinite in their variety and detail. As a way of describing the field, Vernon suggests four types, in tough descending order of "foreign control": (1)

1) The wholly-owned subsidiary — a corporate entity created under the local law of the host country, wholly owned and wholly managed by the foreign investor;

2) The joint-venture — a corporate entity created under local law, partially owned by local private or public interests, and managed

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according to policies responsive in part to those local interests.

3) The co-production agreement — an agreement between a foreigner and an entity that is owned and managed by public authorities in the host country, under which (a) the entity acquires specified machinery and technology from the foreigner; (b) the entity is committed to producing specified products; and (c) the entity, over a number of years, "pays" the foreigner for the machinery and technology in kind, i.e., in specified products.

4) The technical assistance agreement — an agreement between a foreigner and an entity created under local law and owned by local public or private interest, in which the foreigner provides management services, technical information, or both, and receives payment in money.

Which of these approaches is the better "bargain", is thoroughly indeterminate; all depends on the value of what the host country forgoes by reason of not acquiring resources, measured against what is achieved by reducing the foreigner's control. To reduce the foreigner control, host countries are prepared to accept less in the way of valuable resources.

This is not, however, a rule. The ownership data compiled by Wells for 187 American enterprises, show that even the countries whose governments are frequently cited as insisting on joint ventures have retreated frequently from their insistence, and that complete foreign ownership is not rare, even during recent years. (2) Wells suggests that the more a country advances, the more it needs foreign investment from particular firms, some of which are the ones that resist pressures to form joint ventures. The easy opportunities for import substitution have been filled; the need has shifted from products that require only widely available technology to more advanced products for which only a few firms have the know-how. Again some of these firms are likely to oppose local participation. Similarly, efforts on the part of the government to increase manufactured exports may require marketing or technological inputs that only certain firms can supply. As the need for particular investors is increasing, the attractiveness of the country may also be improving. The larger internal market provided to the foreign investor leads some firms to be willing to relax their insistence on control to have access to the market.

The permissible pattern for foreign investment differs from country to country, but, undoubtedly, a country's policies with respect to foreign investment have considerable impact on the form of technology acquisition. In foreign branches or wholly owned subsidiaries, the flow of technology is often treated as an integral part of the investment. In many cases, a substantial degree of foreign capital ownership is a prerequisite for technology transfer; certain highly technical processes and techniques may not be available to developing countries unless the owner is permitted to have full or at least controlling capital ownership of the enterprise.

Joint ventures, it is claimed, offer advantages to both parties. Although certain major multinational corporations are unwilling to enter into a joint venture as a minority partner, the number of joint ventures with minority foreign holdings is growing fairly rapidly. This trend can be attributed to various factors, for example, the desire of foreign companies to get around quantitative import restrictions developing countries place on products that are being manufactured domestically. Depending on the over-all investment climate in a developing country and on the size and profitability of the market and its future projections, foreign investors are increasingly willing to participate in equity capital on a minority basis, if majority foreign ownership is not permitted. (3) Though policymakers in most of the developing countries may prefer joint ventures over wholly owned subsidiaries as a general rule, joint ventures may not represent a real alternative in the individual case.

Areas of Conflict

1) Supply of Capital

One potential source of conflict between the foreign investor and the host country arises out of the fact that most foreign enterprises are not eager to export more capital than necessary in establishing or in acquiring any subsidiary abroad. Although economists sometimes think of such investments as being induced by a surplus of capital in the investing country, foreign investors ordinarily prefer to use little of their own capital and to mobilize a considerable part from local sources. Nonetheless, experience indicates that foreigners will mobilize more capital for the establishment or acquisition of a wholly owned subsidiary than of a joint venture; and, of course, more for a joint venture than

for a licensing agreement. When foreigners raise their capital from local sources, there is always the possibility that it will consist of funds which would not otherwise have been used productively in the local economy; but there is also the opposite possibility, namely, that the funds preempted for the foreign-owned subsidiary may be diverted from competing uses of higher social value in the economy.

The risk that some new undertaking may divert local savings to an activity of relatively low social value exists, of course, not only with respect to foreign wholly-owned subsidiaries but also with respect to joint ventures or licensing agreements. Indeed, to the extent that joint ventures and local licensed enterprises use more local capital the risk is enhanced. Accordingly, from the limited viewpoint of national capital supply there is a presumption that for a given economic activity, subsidiaries which are wholly owned by foreigners may prove more advantageous to the host country at the very outset than the other two arrangements.

Of course, some of the problem could be tackled through measuring the social yield of the project. Though the theory of such calculations is fairly well developed, the application of the theory is something else, involving problems both of conceptualization and of measurement. Particularly difficult are the problems of shadow pricing and of projecting productivity. (4)

2) Technical Skills

One common hope on the part of policymakers in developing countries is that joint ventures may prove a useful form of undertaking because a local partner will be exposed to special information and training. The local partner, it is sometimes thought, may be in a position to use the acquired information and training in ways that are of greater benefit to the economy than if the subsidiary had been wholly owned by foreigners. The empirical basis for that assumption, however, is very thin. In many cases, local partners make no effort to master the informational flow; or if they do master it, make no effort to exercise their mastery outside of the enterprise itself. On the other hand, the parent firms seem able to withhold certain information from joint venture partners. (5)

Evidence for Australia suggests that wholly-owned subsidiaries are more likely than joint ventures to send local employees to the United States for management training. (6) However, local employees are likely to hold more responsible positions in joint ventures. These employees may receive some training from their holding of responsible jobs; on the other hand, they probably would have held equally responsible jobs in locally owned businesses had they not been employed by the foreign subsidiary. On the present evidence, however, it is dangerous to assume that joint ventures do any more to capture a flow of information and training for the benefit of developing economies than wholly-owned subsidiaries would do.

3) Access to Markets

Multinational corporation with manufacturing subsidiaries scattered throughout the world are anxious to avoid any competition between the products made or sold by their affiliated companies. Because of this, many joint venture agreements in the past contained a clause that restricted the exports of the joint venture so as to avoid any competitive conflict. Consequently, foreign groups sometimes consider majority participation the means necessary to obtain the restrictive clause, at which they are aiming, and to enable them to subsequently oppose any sudden and far-reaching modification of the clause. (7)

The existence of formal restrictions, however, is not to be taken as a reliable indicator of whether actual restraints exist. Such a yardstick can err in two respects: by suggesting the existence of a restriction that actually is non-operative; and by failing to flush up restraints that exist even without a formal restriction.

Where foreign parents are in real control of a subsidiary, the existence of formal restrictions is a redundancy. If it were in the parent's interests to use the subsidiary as a major export point, an existing restriction would presumably be disregarded. If it were in the parent's interests not to use the subsidiary in that way, no formal restriction would be needed.

Conversely, in the case of joint venture or mere licensing agreements, it cannot be assumed that the absence of an overt restriction means the existence of access. Even if a local licensee is not explicitly excluded from exporting beyond its licensed area, a prohibition may

nevertheless exist; if the foreign licensor intends to enforce his patents or trademarks against the licensee who strays outside his licensed area, this may be as effective as an explicit restriction. (8)

Other factors may also act to push the parent toward exporting from a wholly-owned subsidiary. The parent may know that if expansion is required in the future the partner may not be able to supply his share of new investment, even though the joint venture arrangements frequently require that the original proportion of ownership be retained. Thus expansion may be delayed, or the parent may have to lend the partner money so that the partner can retain his share in the equity of the new investment. Since the parent can charge only something close to the external market rate, generally below the incremental return, he prefers to use his funds in another subsidiary.

The data indicate that any enterprise develops a number of techniques to control exports. About 45 percent of 1051 collaboration arrangements in effect in 1964 in India had explicit restrictions on exports. The frequency of restrictions was higher for minority foreign participation than for the cases where the foreigner held a majority of the stock.

Still another technique used by the multinational enterprise to control exports within the system is to limit in the joint venture agreement the size of the plant to a capacity that is adequate only for the local market.

Cases of exports from joint ventures are, however, not infrequent. International Computer and Tabulators, for example, agreed to export 30 percent of its production from its Indian venture (9) It did insist on, and received, a majority of the equity in return, in spite of India's position that the foreigners should hold a minority share.

The several studies that have analyzed the written record as a way of trying to determine the extent to which market limitations have been imposed on local units, suggest that there may be a somewhat greater propensity on the part of multinational enterprises to use their wholly owned subsidiaries for export activities from developing countries than to use their joint ventures, though the difference is not very strong. (10) Where export potential is very great, countries have generally relaxed their insistence on joint venture, as in the Andean Group

(Bolivia, Chile, Colombia, Ecuador, Peru). The benefits from exports have usually been considered to outweigh the other economic and the political benefit of minority joint ventures.

4) Transfer Pricing and Royalties

The transfer pricing of imports and exports is one of the more widely discussed of the practices of the multinational enterprises. An import-substituting foreign company operating in a well protected market can reduce its value added in the host country and its commitment to its profits tax, by over-invoicing the intermediate goods it imports from its parent enterprise. The over-invoicing of imports can have a particularly marked effect on an economy of a host country especially where imported intermediates comprise a very large part of gross output in the manufacturing economy. It requires only very small over-pricing ratios to bring about transfers of resources which can, since they are untaxed, constitute a very large proportionate addition to the resources transferred through the repatriation of profits. In Kenya, for example, it has been found that over-invoicing of intermediate goods probably more than doubles the real outflow of surplus from the manufacturing sector as compared with the outflow of profits and dividends (11) The suggestion has been made that a sufficient rise in import duties on intermediates could eliminate the incentive to fix excessive transfer prices. But the substantial increase in such indirect taxation that might be required could have undesirable side effects on industrial structure and tax incidence and on prices within the country. (12)

In the case of a joint venture, the multinational firm acting as an "economic man" has of course an incentive to remove profits from the subsidiary in ways that eliminate the need to share them with the local partner. Direct payments to the parents for services and higher prices on purchases from affiliates reduce the profits that have to be shared. In the absence of a local partner, who is interested in maximizing profits in the subsidiary, the foreign firm might use transfer prices, royalties, technical fees, etc., to shift profits to lower tax jurisdictions, to avoid exchange controls, or to reduce the recorded profitability of the subsidiary so that accusations of exploitation are less likely.

What evidence exists comes out slightly on the side of those who claim that the local partner is effective in defending his interests. Vaitsos (13) has reached the conclusion that joint ventures in Colombia

have a slightly lower "over-price" than do wholly owned subsidiaries. Findings for New Zealand also support the contention that the presence of a local partner tends to lower the cost of purchases. Deane (14) found that joint ventures were more likely than wholly-owned subsidiaries to be free to purchase from non-affiliated suppliers.

Wells suggests that savings to the economy through more favorable transfer pricing may not be, however, a net gain for the host country. There is considerable evidence that the foreigner shifts some of the remittance obtained from transfer pricing in the wholly-owned subsidiaries to other techniques for the joint ventures. Charges for the provision of know-how, tradenames, and management appear to be higher for joint ventures than for wholly-owned subsidiaries. Two studies of foreign investment in Australia found that joint ventures were charged more than wholly-owned subsidiaries for services. (15) The interviews conducted by Wells with some chemical companies indicated more frequent payment of fees for technical services from joint ventures than from wholly-owned subsidiaries. (16)

In addition, host governments are more willing to allow payments for technology in the case of joint ventures than in cases where all the equity is owned by foreigners. In India, for example, royalty payments to foreign parents were generally not allowed for wholly-foreign subsidiaries, but were allowed for joint ventures. (17)

5) Rate of Reinvestment

To measure the rate of reinvestment of reported earnings, the only survey that purports to provide comprehensive figures on this point is the United States Department of Commerce census of foreign direct investment for 1966. Some salient figures from that census are presented in the next table, which shows the reported earnings, remittances to parents and reinvestments of manufacturing subsidiaries located in specified development areas.

Reported earnings, remittances and reinvestments of foreign manufacturing subsidiaries of United States — based enterprises in developing countries, 1966 (Millions of dollars)

By percentage of U.S. parent's ownership	Subsidiaries in Latin America	Subsidiaries in Africa & Middle East	Total
95% — 100%			
— Reported earnings	222	38	260
— Reinvested in subsidiaries	143	17	160
— Ratio (%)	64.4	44.7	61.5
50% — 94%			
— Reported earnings	60	5	65
— Reinvested in subsidiaries	42	3	45
— Ratio (%)	70.0	60.0	69.2
25% — 49%			
— Reported earnings	26	1	28
— Reinvested in subsidiaries	18	2	20
— Ratio (%)	69.2	100.0	71.4

Source: United States Department of Commerce, U.S. Direct Investments Abroad, 1966, Part I: Balance of Payments Data (Washington D.C. 1970).

If the figures in this table could be taken at face value, they would suggest that, in one limited respect, wholly-owned ventures had performed worse from the view point of the developing countries than had joint ventures. The rate of reinvestment of reported earnings is seen in the table as higher for the joint ventures than for the wholly-owned subsidiaries. Unfortunately, however, the figures are too weak to draw any such conclusion. One problem is that "reported earnings" only covers a part of the benefits derived by United States parents from subsidiaries. Added sums, roughly estimated at about 35 percent of reported earnings, are reported as royalties, fees and administrative charges from subsidiary to parent; but these are not available on a basis that breaks them down according to degree of ownership. If such charges are less common for wholly-owned subsidiaries than for joint ventures, then the more complete figures could well reverse the tendency shown by the aforementioned table. (18)

Joint ventures, however, may be interesting as a transfer vehicle only in the case where the foreign firm is willing to transfer technology in exchange for an equity position in the venture. This has the effect, perhaps, of heightening the incentive to the foreign firm since it now shares in the good (or bad) fortunes of the recipient firm. Nevertheless, it would seem that joint ventures can be used as an incentive to acquire technology from small and medium sized firms which might not otherwise participate in the technology transfer process.

The In-Flow of Technology in Combination with Joint Ventures

Depending on the over-all investment climate in a developing country and on the size and profitability of the market and its future projections, foreign investors are increasingly willing to participate in equity capital on a minority basis, if majority foreign ownership is not permitted.

When foreign capital participation in joint ventures is below 51 percent technology license agreements assume considerable significance. Though a foreign partner with a minority equity holding of 30 to 40 percent can strongly influence decision making, majority capital ownership by local nationals ensures that various commercial aspects of acquisition of technology will be adequately considered from the licensee enterprise's viewpoint. At the same time, foreign participation in an enterprise ensures, up to a point, that the foreign partner will make technological expertise available. To avoid possible conflicts, it is desirable for both partners to enter into a formal agreement for the transfer of technology. The agreement should of course prescribe the responsibilities, rights and liabilities of each party, the details of the technology to be transferred and the terms and conditions of the transfer.

The extent of foreign equity participation in a proposed joint venture will depend on the amount of technical assistance that may be required from the foreign licensor in production, management and marketing, including exports. The extent of the foreign investment should be reflected in the terms on which the technology is to be transferred. These terms will, of course, depend on the relative keenness of the licensor and licensee for the former's participation in capital investment by the licensor and payments for technology should be viewed independently, as one related to risk capital while the other represents payments for specific know-how. (19)

There is a crucially important distinction, however, between (a) a transfer of "intangibles" leading to acquisition by the supplying firm of an ownership interest in the receiving enterprise — the supplier's perceived incentive being vitally linked to such ownership — and (b) such a resource transfer taking place on its own merits, with the expected and actual compensation of the supplying firm deriving directly or indirectly from the transfer itself.

Under assumption (b), the foreign know-how is supplied on terms acceptable to the receiving enterprise (and country). From the standpoint of know-how supplier, there exists an acceptable framework within which terms can be negotiated that are sufficiently attractive to bring forth deployment of the skills and techniques being demanded.

In the context of assumption (a) above, the advantages of a joint venture are many. If we assume, for example, a situation in which a foreign proprietor is permitted to own 49% of the equity of the enterprise receiving the technology in a developing country, and also that a given percentage of the proprietor's capital contribution (e.g., 50%) can consist of the licensed technology, under these circumstances the proprietor will supply a portion of the monetary capital needs of the joint venture enterprise, and by virtue of this commitment may be expected to select the most appropriate technology for initial input to the enterprise. The continuing participation and commitment by the proprietor increases also the probability that it will devote serious efforts towards keeping the technology up-to-date and also regularly devoting attention to the welfare of the enterprises. In addition to that, profits realized from the joint venture by the proprietor result in fact from actual earnings, and are not merely calculated on the basis of sales, without regard to profits, as is usually the case in determining royalties; thus the interests of the parties to promote efficiency are identical.

The intimacy and long term relationships fostered by well-structured joint ventures thus provide excellent vehicles for technology transfers to developing countries in the present day context. If proprietors recognize that these arrangements are the "most" they will be able to achieve, they may be expected to participate with a positive attitude. This is particularly true if they realize that their competitors will grasp any serious opportunity they tend to ignore. (20)

The Bargaining Power Towards Industrial Oligopolies

To the individual developing country, the problem of dealing with Western industrial oligopolies may look like this: A few large firms control the technology or bundle of skills it needs. As a result of oligopolistic interdependence, these firms have reached a commonly held conclusion about the international value of their technology or skills; and until the products that have resulted from these technologies reach the later stages of product life cycles, they are likely to have oligopolistically determined market prices. The oligopolists will regard the value of their technology as directly related to these prices.

Although in the eyes of a developing country the value that the oligopolists have placed on their technology may seem far too excessive, it undoubtedly realizes that if it shops around for "fire sales" of technology, it is unlikely to be successful. Should one oligopolist underprice the technology, it could anticipate retaliation from its rivals.

In that situation the developing countries need to become sensitive to what motivates oligopolists to be able to deal with them effectively. The following suggestions were taken from a report presented by Professor Raymond Vernon to the government of Indonesia in 1970. (21)

First, as soon as a developing country allows one member of a foreign oligopoly to set up a local manufacturing facility, it may expect that the other members will want "in" as well. Then the balance of bargaining power has shifted to the side of the developing country. If it is dealing with a concentrated oligopoly, it will have more bargaining power still because of the tendency of firms in such industries to interact intensively. When one member of the club makes a move the others want to follow; and by realizing this, the developing country is in a position to demand a high entrance fee, what a developing country can do is to attract one leader in each industry by means of fairly strong enducements and then plan on hard bargaining with any of the others that wish to follow.

The preceding suggestion may not work if the developing country is negotiating with the member firms of a highly concentrated, stable oligopoly. Yet it need not be powerless in this situation for the evidence suggests that there is nothing like a new rival to bring to life oligopolistic reaction. If the developing country can entice a firm that is not a member of an oligopoly to invest within its borders for the purpose of manu-

facturing the oligopoly's products, its bargaining position vis-a-vis the traditional oligopoly members is likely to improve. The established oligopolists may then be eager to bargain over terms of entry.

However, in its desire to encourage competition among oligopolists, a developing country may regard it wise to attract direct investments by three or four firms in an oligopoly. But it is questionable whether such a policy will produce the desired results. The evidence shows that when the industry leaders in tight oligopolies rapidly counter one another's investments, they may emphasize the modes of competitive conduct that have proved profitable for them all; and these are not likely to include price competition.

If, therefore, the developing country hopes to narrow the gap between the private and social returns on the investments, it should keep in mind that an open door policy to investment by foreign oligopolists is not necessarily the road to this objective. (22)

FOOTNOTES

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16. Wells, *Foreign Investment in Joint Ventures* ... *op. cit.*, p. 24.
17. Kurian, K., Mathew, *Impact of Foreign Capital on Indian Economy*, New Delhi, 1966, p. 303, quoted by Wells, *op. cit.* p. 24.
18. Vernon, *Restrictive business practices, The operations of multinational United States enterprises in developing countries, Their role in trade and development*, UNCTAD, United Nations, New York, 1972, pp. 24.25.

19. Guidelines for the Acquisition of Foreign Technology in Developing Countries, with special reference to technology license agreements, *UNIDO*, United Nations, New York 1973, pp. 7-8.
20. Goldscheider, R., *Assessment and Contractual Arrangements for the Acquisition of Foreign Technology by Developing Countries*, in Finnegan, M., & Goldscheider, R., "Current Trends in Domestic and International Licensing, Practising Law Institute, New York City, 1976, pp. 506-508.
21. See Knickerbocker, F.T., *Oligopolistix Reaction and Multinational Enterprise*, Division of Research, Graduate School of Business Administration, Harvard University, Boston 1973, pp. 196-200.
22. *Ibid.*, p. 199.

المشروعات المشتركة : الاسطورة والحقيقة

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كان ولا يزال موضوع آثار الاستثمار الاجنبي على اقتصاديات الدول النامية موضوع نقاش بين العديد من الباحثين . فهل يؤدي الاستثمار الاجنبي الى تحسين اوضاع البلد المضيف ؟ وان كان الجواب بالاجاب المشروط ، فما هي تلك الشروط ؟.

ومثل هذه الاسئلة مرتبطة بسؤال أساسي وهام مؤداه :

ما هي علاقة المؤسسات التجارية الاجنبية بحكومة البلد النامي المعنية ، ولن تكون السيطرة على المشاريع التي يجري تنفيذها ؟

هذا ويتحدث البحث عن أربعة ترتيبات معروفة « للسيطرة الاجنبية » :
(١) فرع مملوك تماما للشركة الاجنبية (٢) المشاريع المشتركة (٣) اتفاقيات الانتاج المشترك (٤) واتفاقيات المساعدة الفنية .

اما مواضيع النزاع بين الشركات الاجنبية والدول المضيضة ، فهي التالية : (١) توريد رأس المال (٢) المهارات الفنية (٣) قدرة الوصول الى الاسواق (٤) التحويل والتسعير والعوائد (٥) وسرعة اعادة الاستثمار .

كذلك فان الدراسة تتحدث عن العلاقة بين البلد النامي والمؤسسات الصناعية الكبيرة ، علاوة على تقديم مقترحات تتعلق بتنمية قدرات البلد المضيف النامي على المساومة مع الاحتكارات والمؤسسات التجارية العالمية .