Joint Ventures as an Internationalisation Strategy for SMEs

David A. Kirby
Stefan Kaiser

ABSTRACT. For some time believed to be inferior to Wholly Foreign-Owned Enterprises, Joint Ventures have become a popular vehicle for foreign market servicing. Although there are various proponents of the joint venture strategy as a means of enabling SMEs with limited productive resources and/or market knowledge to enter international markets, relatively few have focused on the actual joint venturing activities of SMEs. This article examines the activities of 9 U.K. and 12 German SMEs that have joint ventures in China. Based on a questionnaire survey and in-depth case interviews, it reveals that the initiatives appear to have been successful but that they are not without their problems and in many ways the experiences of the firms involved seem similar to those of the large multi-national enterprises. It argues that the key to success appears to be the choice of the joint venture partner and concludes that, given the limited resources of small firms, assistance is required to help them locate and select appropriate partners.

1. Introduction

Globalisation has been a major trend of the 1990s and firms that felt secure within national boundaries are now facing both increasing international competition and market opportunities. Whereas in the early 19th century only about 1 per cent of all manufactured goods were traded internationally, in the 1990s this increased to approximately 15 per cent and in the mid 1990s world trade was growing in excess of 8 per cent per annum, compared with a 3.7 per cent annual growth in economic output. As a consequence, firms have become more international in outlook and committed to global markets. However, research demonstrates (Barkema et al., 1996) that this applies in the main to large firms (defined here as those with 500 or more employees) rather than to small and medium-sized enterprises (SMEs). While some SMEs are "born global", often SMEs lack the resources necessary to internationalise and traditionally they have appeared reluctant to engage in global business activities. When they have, exporting has been the predominant activity (Cavusgil, 1980; OECD, 1981; Stratos, 1990; Mulhearn, 1994; Vatne, 1995) and commitment to Foreign Direct Investment (FDI) has been somewhat limited (Buckley, 1983; Dunning, 1993; Acs and Preston, 1997), when compared with both large firm FDI and the export activities of SMEs (Albaum et al., 1992).

Between 1986 and 1993, worldwide FDI grew at 14.6 per cent and it continues to be a driving force in the globalisation process (UNCTAD, 1997). Even so, it is the large firms that have been the main drivers (Fujita, 1995; Buckley, 1997; Eden et al., 1997) though there is evidence suggesting increased FDI activity by SMEs (Mulhearn, 1994; Fujita, 1995; Kohn, 1997; Reynolds, 1997). Not surprisingly, perhaps, research into such activities has been somewhat limited. Traditionally, students of international business have believed that success in foreign markets is dependent on size (Gomes-Casseres, 1997) and according to Campbell (1997), the concept of the global small firm is an inherent contradiction since the main driver of globalisation (scale economies) does not apply to SMEs. As a consequence, researchers such as Rugman et

Final version accepted on October 22, 2001

David A. Kirby
Surrey European Management School
University of Surrey
Guildford
Surrey, GU2 5XH
United Kingdom
and
University of South Australia

al. (1985); Robock and Simmonds (1989) and Young et al., (1989) have argued that SMEs cannot be multinational enterprises (MNEs) and that an MNE is a large firm. While there is no uniformly accepted definition of an MNE, most definitions stress that a MNE must possess and control assests in a foreign country (Buckley and Casson, 1976; Teece, 1981) and must engage in either overseas production (Caves, 1971; Buckley and Casson, 1976; Hood and Young, 1979; Teece, 1981, 1985; Rugman et al., 1985; Robock and Simmonds, 1989; Dunning, 1993) or overseas marketing (Young et al., 1989). Thus, in theory at least, there is no reason why a SME cannot engage in foreign direct investment and be a multi-national enterprise.

It would seem, though, that SMEs do face considerable barriers when attempting to engage in FDI and are more likely to fail than large firms (Buckley et al., 1988; Acs et al., 1997; Eden et al., 1997). This stems from their limited resources, in particular their limited financial, managerial and information resources and their attitude to risk. Such limitations can be overcome, however, as Buckley (1979) has demonstrated and many initially unsuccessful firms subsequently go on to undertake successful foreign investments (Buckley et al., 1988). In such circumstances, the Joint Venture (JV) appears to be particularly important. As Hennart and Reddy (1997) discovered in their study of a sample of Japanese investments in the United states, the JV can be seen primarily as a device to gain access to resources embedded in other organisations and, according to Gomes-Casseres (1989), as a means of acquiring local management expertise and connections in order to facilitate fast entry into new markets. Although there are various proponents of the JV strategy as a means of enabling SMEs with limited productive resources and/or market knowledge to enter international markets (Harrigan, 1985; Contractor and Lorange, 1988; Osland and Cavusgil, 1996; Buckley, 1997; Gomes-Casseres, 1997), relatively few have focused on the actual joint venturing activities of SMEs (Connolly, 1984; Kaufmann, 1995; Donckels and Lambrecht, 1995).

2. Aims and methodology

Against this background, the article examines the proposition that the joint venture strategy is a means of overcoming the traditional restrictions facing SMEs that wish to internationalise. Thus the overall aim of the study is to investigate whether, and to what extent, the joint venture supports the internationalisation efforts of SMEs. The specific objectives of the article are to:

(i) identify the characteristics of SMEs adopting the joint venture strategy by applying the frameworks of Beamish and Wang (1989) and Beamish (1993);
(ii) determine the experiences of SMEs that have entered into joint ventures, following a framework developed from the works of Harrigan (1984), Datta (1988) and Fan (1996).

To meet these aims and objectives, the article examines the experiences of U.K. and German SMEs that have developed joint ventures in the People's Republic of China. The selection of China as the case region is based upon the fact that since the introduction of its "open door" policy in 1974, the Chinese authorities have determined that to achieve the country's modernisation, Foreign Direct Investment is required to provide the missing capital, technology and management skills (Tai, 1988; Grub and Lin, 1991) and to facilitate access to international markets (Child, 1994). Accordingly, in July, 1979 the equity Joint Venture Law was passed. This permitted the formation of joint ventures and since then, China has become one of the major importers of technology . By the end of 1996, the Government had approved something in the order of 283,793 foreign-funded ventures with a contractual investment of some US$469.3bn (£300.8bn). Clearly, most of these have been undertaken by large multinational enterprises and most studies have investigated the China investment undertaken by such organisations (Kaiser et al., 1996), despite the fact that SMEs are seen to be of increasing importance to the development of the Chinese economy (Anyansi-Archibong, 1989; Danenburg and Tan, 1989). However, Wu (1993), in his study of European foreign direct investment in China, has drawn attention to the fact that less experienced firms are more likely to enter China through joint ventures, while Au and Enderwick (1994) have examined the Chinese joint ventures of New Zealand SMEs and Leung and Yeung (1995) have investigated the negotiation strategies of 168

SMEs from Hong Kong, Asia, North America and Europe.

The study reported here is based on a questionnaire survey of German and U.K. SMEs with a joint venture in China. The identification of a sampling frame was difficult, as Fujita (1995) has recognised, since neither country has a complete or comprehensive database from which a sample could be drawn. Using a variety of sources, a population of 26 U.K. and 31 German SMEs was identified, each of which was believed to have a joint venture project in China and fewer than 500 employees. After further screening, the number of U.K. firms that met the criteria and were prepared to participate in the study was reduced to 15. Although it was recognised that the survey population was not large, because of the dispersed locations of the identified firms, it was decided to undertake a postal survey and to adopt Dillman's (1978) "total design" method in order to increase the response rate. The questionnaires, which contained 25 multi-choice questions, were designed following a review of the existing literature, interviews with owner-managers involved in international business, academics in the field of international business and a survey of SMEs in the Northeast of England (Kaiser and Kirby, 1996). Before distribution in September, 1996, the questionnaires were pre-tested, translated into German and back translated into English. They elicited responses from nine U.K. and twelve German SMEs, giving a response rate of 60 per cent and 39 per cent, respectively, for the two samples. The results were processed using SPSS.

3. Survey findings

3.1. *Characteristics of sample SMEs*

All of the 21 firms (43 per cent U.K. and 57 per cent German) in the survey had fewer than 500 employees and it was possible to identify two groupings – those with fewer than 200 employees (Size One) and those with between 200 and 500 (Size Two). In total, 10 firms had fewer than 200 employees, 60 per cent of which were from the German cohort. Nine firms had more than 200 employees, fifty five per cent being German. On average, the U.K. firms were larger than their German counterparts with 237 and 217 employees, respectively.

Three quarters (9) of the German SMEs and 89 per cent of the U.K. were limited liability companies (GmbH). The remainder were either limited partnerships (KG) in the case of the German firms or public limited companies in the U.K. case. All of the U.K. firms and 10 of the German operate in the manufacturing sector, mainly in mechanical engineering and electronics. The two German firms not in manufacturing were in the service sector.

For three (33 per cent) of the U.K. firms, the joint venture in China was their sole foreign operation. This compared with 6 (50 per cent) of the German firms. The remaining U.K. firms (6) had a second JV, a representative office or a wholly foreign-owned enterprise (WFOE), in addition to their China-based JV. The other German firms (3) had a representative office, another JV or a WFOE. As might be expected from the literature, the smaller (Size One) SMEs had fewer foreign-owned operations compared with the larger firms.

All but two of the German firms had previous experience of doing business in China in the form of exporting (4), exporting and licensing (3), licensing (1), joint venturing (1) and buying (1). In contrast, three U.K. firms had no prior experience with China, though one of the sample had been doing business with China for 17 years before engaging in its JV, while others had ten, eight and five years, respectively, and one had been "exporting machinery for several years".

3.2. *Characteristics of Chinese partners*

The majority of the sample had only one joint venture partner in China, though two U.K. firms had partners from Singapore and Taiwan. While the German SMEs tended not to joint venture with Chinese firms smaller (in terms of turnover) than themselves, this was not the case with the U.K. SMEs which joint ventured with firms both larger and smaller. Generally it was the larger (Size Two) firms that partnered firms larger than themselves.

Partners were drawn from either the private or the public (state-owned) sectors. Three of the nine U.K. firms reported that they had partnered a private sector SME and four a state-owned enterprise, whereas eight of the German firms reported that their joint venture partner was from the public sector. Only two German firms claimed to be partnering a local private firm. Analysis of the findings by size suggests that the larger (Size Two) firms seemed to show a distinct preference for state owned enterprises as their joint venture partner.

3.3. *Characteristics of joint venture*

All of the ventures were established after 1987 and prior to 1996 in the case of the U.K. firms, and 1990 for the German Joint Ventures. Investment ranged from £0.25m (US$0.39m) to £9.0m (US$14.0m) for the U.K. firms and £0.36m (US$0.56m) to £6.9m (US$10.8m) for the German SMEs, with the smallest firms having the smallest investment, as might be expected. On average, the U.K. joint ventures employed 102 staff, while the German joint ventures engaged an average of 56 staff. Once again, the smaller the parent SME, the smaller the joint venture operation.

The most popular area for joint venture formation appears to be East China, with 8 operations (5 from the U.K.) being located there. This was followed by the Northeast (4) and the South (3) with the Southeast and the remoter areas of the West receiving one operation each. Thus it would seem that both the U.K. and the German SMEs had sought investment opportunities in the more privileged areas of the country, rather than the under-developed West. However, the two firms that did locate in the West were two of the larger (Size Two) SMEs, which tend to be found in the North and East of China, rather than the South. Possibly this suggests that several of the smaller (Size One) firms were attempting to minimise the risk associated with joint venture creation by locating in the more favoured areas of the country. As Table I reveals, however, it would seem that for both U.K. and German firms, the most important factor affecting the location decision was the availability of trained labour, followed by the availability of cheap labour for the U.K. firms and the quality of the infrastructure for the German enterprises. Possibly factors such as these influenced the initial search for the joint venture partner, however. Interestingly 5 of the U.K. firms and 7 of the German SMEs took over the existing production facilities of their Chinese partners.

3.4. *Motivations for joint venture formation*

As Table II reveals, the greatest motivation, for both the U.K. and the German firms, for engaging in a FDI project in China was to gain access to the market. This gained a "very important" rating from both cohorts and was ranked first by them. However, the German cohort rated access to "cheap labour" as being of equal importance, while for the U.K firms the second most important motivator was the establishment of a strategic position in the Asia Pacific Region, followed by access to "cheap labour". Overall the findings suggest that the two primary motivations for SMEs being interested in a FDI project in China are the size of the market and the availability of cheap labour.

The reasons why the U.K. and German SMEs

TABLE I
Reason for choice of location

Reason for choice of location	U.K. SMEs		German SMEs	
	Importance	Rank	Importance	Rank
Availability of trained labour	1.3	1	1.5	1
Location of partner	2.0	2	2.7	6
Availability of cheap labour	2.0	2	2.2	3
Infrastructure	2.3	4	2.0	2
Proximity to target market	2.7	5	2.5	4
Sources of raw material	2.7	5	3.0	7
Investment incentives	2.7	5	2.6	5

Rsp (0.05) = 0.6786; Rsp (0.01) = 0.8571.

TABLE II
Motivations for engaging in an FDI project in China

Motivations	U.K. SMEs		German SMEs		All Sample	
	Importance	Rank	Importance	Rank	Importance	Rank
Potential market	1.3	1	1.8	1	1.5	1
Srategic Asia Pacific position	1.8	2	2.2	4	2.02	3
Cheap labour	2.2	3	1.8	1	1.97	2
Faster market entry	2.4	4	2.3	5	2.34	5
Necessary to be there	2.9	5	1.9	3	2.84	4
Overcome import duty	2.9	5	3.4	7	3.18	7
Following customes	3.0	7	5.0	9	4.12	9
Raw materials	3.1	8	2.5	6	2.75	6
Approached by PRC	3.1	8	3.8	8	4.00	8

Rsp (0.05) = 0.5833; Rsp (0.01) = 0.7667.

exploited the Chinese market potential and cheap labour resource through a joint venture were substantially different (Table III). From the responses, it would seem that the U.K. SMEs decided to joint venture because of the Chinese partner's business knowledge, its ability to smooth the way through the Chinese bureaucracy and its knowledge of customers. Apparently, the U.K. SMEs were seeking the attributes of their potential Chinese partners, believing that they would bring something to the venture that the SMEs could not provide. In contrast, the German SMEs appeared to enter into a joint venture to save financial and managerial resources as the literature on SME internationalisation suggests. Thus, the two national cohorts appear to have different motivations for entering into a joint venture in China and one, the U.K. SMEs, seem to contradict the existing body of understanding. However, the two groups appear to be in agreement with respect to the low emphasis they place on the Chinese partner's technology, trade union relations or company skills. Similarly, they do not appear to be convinced that having a Chinese partner would provide political insurance.

3.5. *Joint venture ownership and management*

On average the U.K. SMEs owned 46.4 per cent, and the German SMEs 47 per cent, of their joint venture operations in China, though it is noticeable that whereas the average equity shareholding of the smaller (Size One) enterprises was only 43 per cent, the larger (Size Two) firms had 51 per cent of the ownership on average.

Although only 17 of the 21 respondents were prepared to answer questions about their boards of directors, it would seem that in seven cases the control was shared equally between the partners in the Joint Venture and that in 8 cases the Chinese partner had one director more than its SME partner. In only three cases did the directors from the western SME outnumber those of its Chinese partner, but in eleven cases the western partner (usually the German SME) nominated the chair of the Board.

Rarely, it would seem, were the western SMEs prepared to give away responsibility for Research and Development (Table IV). In only two (U.K.) joint ventures did the Chinese partner have responsibility for R&D. Perhaps this is to be expected as was the western partner's tendency to control the production function, also. In contrast, responsibility for marketing tended to lie with the Chinese partner, and though this might appear logical given the local partner's contacts and knowledge of the market, it would seem to result, largely, from the delegation of responsibility by the German partner. Responsibility for the personnel and finance functions was split more evenly.

3.6. *Joint venture performance and problems*

Overall, the SMEs seemed satisfied with their joint venture experiences, though the U.K. firms

TABLE III
Motivations for forming a joint venture

Motivations	U.K. SMEs		German SMEs	
	Importance	Rank	Importance	Rank
Partner's China business knowledge	1.8	1	2.8	12
Required by PRC	2.0	2	2.7	10
Smooth way through bureaucracy	2.2	3	2.2	4
Partner's knowledge of customer	2.3	4	2.1	3
Less financial input required	2.4	5	1.7	1
Strategic action to pre-empt competition	2.4	5	3.0	15
Favourable government treatment	2.6	7	2.6	9
Limitation of risk	2.6	7	2.4	5
Less management input required	2.8	9	2.0	2
Overcoming national prejudice	3.0	10	2.4	5
Access to raw materials	3.1	11	2.5	7
Political insurance	3.2	12	2.8	12
Sharing of distribution channels	3.3	13	2.5	7
Access to partner's skills	3.7	14	2.7	10
Trade union relationship	4.1	15	4.2	16
Access to partner's technology	4.2	16	2.9	14

Rsp (0.05) = 0.4265; Rsp (0.01) = 0.5824.

TABLE IV
Director responsibilities

Responsibility	U.K. SMEs		German SMEs		All Sample	
	U.K.	Chinese	German	Chinese	U.K./German	Chinese
Production	4	3	6	2	10	5
Marketing	4	4	4*	9*	8	13
Finance	4	3	4	3	6	6
Personnel	5	3	4	6	9	9
R&D	6	2	8	0	14	2

* Shared responsibility in two joint ventures.

appeared to be more satisfied than their German counterparts. On a scale of 1 to 5, where 1 is "very satisfied" and 5 is "not at all satisfied", the U.K. firms rated their satisfaction level at 2.4, compared with a German rating of 2.9. However, the ventures were not without their problems (Table V). The most significant, ranked first by the U.K. firms and second by the German, was the Chinese partner's concept of quality, followed closely by the repatriation of profits (ranked first by the German firms and joint third by their U.K. counterparts). Apart from this broad agreement on the most significant problems facing them, the U.K. and German cohorts showed no statistically significant correlation between the types and importance of the problems experienced. For example, the two national groups responded differently with respect to the transfer of technology and the ability of the Chinese engineers to transform theory into practice. Whereas the German SMEs saw this as an important problem and ranked it second (with a rating of 1.7 – "very important"), the U.K. firms ranked it ninth (with a rating of 2.3 – "important"). Conversely, for U.K. firms, it was the recruitment of personnel that was of greater significance. They ranked it second (with a rating of 1.6 – "very important") compared with tenth by the German SMEs (who gave it a rating of 2.4 – "important").

TABLE V
Joint venture problems

Problem	U.K. SMEs		German SMEs		All Sample	
	Importance	Rank	Importance	Rank	Importance	Rank
Concept of quality	1.5	1	1.7	2	1.6	1
Recruiting personnel	1.6	2	2.4	10	2.1	5
Personnel motivation	1.9	3	2.0	6	1.9	3
Repatriation of profits	1.9	3	1.4	1	1.6	1
Local sourcing	2.0	5	2.8	12	2.5	12
Insufficient training of Chinese managers	2.0	5	2.4	10	2.2	7
Low labour productivity	2.1	7	3.0	21	2.6	15
Communication with local staf	2.1	7	2.3	8	2.2	7
Technology transfer	2.3	9	1.7	2	2.0	4
Loss of control	2.3	9	2.3	8	2.3	10
Mismatch in management styles	2.3	9	2.4	10	2.3	10
Dividend policy	2.3	9	2.9	19	2.7	19
Damaging reputation	2.4	13	2.0	6	2.2	7
Bureaucracy	2.4	13	2.6	16	2.9	21
Chinese commercial practices	2.4	13	3.0	21	2.7	19
Corruption	2.4	13	1.9	4	2.1	5
Foreign exchange restrictions	2.6	17	2.5	15	2.5	13
Transfer pricing	2.6	17	2.4	10	2.5	13
Infrastructure	2.7	19	2.4	10	2.6	16
Restrictions on sales and imports	2.7	19	2.6	16	2.6	16
Unfair competition	2.7	19	1.9	4	2.3	10
Political risk	2.9	22	3.8	24	3.4	23
Absence of detailed investment law	3.0	23	2.9	19	2.9	21
Creating a new competitor	3.1	24	3.5	12	3.4	23

Rsp (0.05) = 0.3435; Rsp (0.01) = 0.4748.

3.7. *Factors contributing to success*

Sincerity and patience were considered the most important requirements for success by both the U.K. and the German SMEs (Table VI). Ranked first by the German enterprises and second by the U.K., "sincerity" was given an overall rating of 1.38 ("very important") by the two cohorts, compared with 1.4 for "patience", which was ranked first by the U.K. firms and second by the German. Although the two national groups differed significantly, otherwise, in their views of the factors contributing to success, both groups regarded "adapting to the Chinese market" (rated 1.8 and 1.7) and "good business connections" (rated 1.5 and 2.0) as "very important" with overall ratings of 1.76 and 1.78, respectively. Interestingly, the factors regarded as being of least significance, by both cohorts, were "familiarity with PRC business practices" and "relationships with PRC officials", which seem to deny the importance of the Chinese partner to the joint venture.

4. Case findings

Case 1 is a limited partnership located in South Germany. For over a 100 years it has been manufacturing high technology mechanical components for the chemical and petrochemical, crude oil, machine building, coal refining, power generation, shipping and marine engineering, pulp, sugar production, etc., industries. It claims to be the second most important manufacturer of mechanical components worldwide with a market share of 13 per cent. In the financial year 1995, the firm generated 57 per cent of its turnover overseas and had subsidiaries on all continents except Africa. It established its Chinese Joint Venture in 1995 as the first step in establishing itself as the leading supplier of high-quality mechanical components in China. Prior to so

TABLE VI
Joint venture success factors

Success factor	U.K. SMEs		German SMEs		All sample	
	Importance	Rank	Importance	Rank	Importance	Rank
Patience	1.3	1	1.5	2	1.4	1
Sincerity	1.5	2	1.3	1	1.4	1
Good business connections	1.5	2	2.0	6	1.8	4
Good product	1.6	4	1.9	5	1.8	4
Adapting to Chinese market	1.8	5	1.7	3	1.7	3
Relationships with Chinese officials	1.9	6	2.1	7	2.0	7
Familiarity with Chinese business practices	2.0	7	1.8	4	1.9	6

Rsp (0.05) = 0.6786; Rsp (0.01) = 0.8571.

doing, however, *Case 1* had established in 1982 a "know-how" transfer agreement with a Chinese customer, a State Owned Enterprise based in North East China. For a payment of £0.6 million (US$0.95 million) the Chinese enterprise had received the right to produce three different types of mechanical components, together with training. The agreement was due to expire in 1992 and *Case 1* was not very keen to continue, largely because the German managers who had to visit China did not enjoy the local living conditions. However, by the early 1990s these were improving and the firm began to explore opportunities for contracting with a local partner. At the same time, one of its German customers (a leading manufacturer of Engineering Products) was involved in negotiations with a Chinese state Owned Enterprise in East China to establish a Joint Venture to manufacture engineering products. The prospective Chinese partner had a mechanical components division in which the German partner had no interest. Accordingly, it alerted *Case 1* to the opportunity and proposed that the Chinese enterprise should be split to form two Joint Ventures manufacturing Engineering Products and Mechanical Components, respectively. Following a detailed, month-long investigation of the firm and the market opportunities, *Case 1* decided to proceed.

Its primary reason for establishing a plant in China was to gain access to the potential market that China afforded. However, *Case 1*'s goal was to become not only the best but also the biggest manufacturer of mechanical components. It saw China, therefore, as a strategic opportunity to develop and penetrate other markets, enabling it to develop its operations on a worldwide scale. Its decision to establish a joint venture with a local Chinese company, instead of a wholly foreign owned enterprise, was influenced by one of its major German customers. *Case 1*, as it indicated in its Newsletter of January 1996, believed it important to follow its international customers as, by so doing, its market would be created automatically. The firm saw this as a means of minimising the risk involved in entering the Chinese market as secured volumes would be sought by its German client, which would help it develop a cost-effective means of producing high quality components to develop further the Chinese market.

The Joint Venture partner was a large, integrated state owned enterprise with in excess of 2,000 employees of which 200 worked in its mechanical components division. When the Equity Joint Venture was created it took the form of a limited liability company, according to Chinese Law and employed 95 staff. With its formation the Chinese enterprise ceased to exist as a manufacturer of engineering products and mechanical components, but in September 1996 the municipal government decided to revive it in order to provide alternative employment for staff not taken on by the joint ventures. In October 1996, therefore, it sold its shares in the two joint ventures to a holding company, closely linked to the municipal government, comprising a conglomerate of three dozen firms, both Chinese and Sino-foreign, engaging some 60,000 staff. Although the official documentation states that *Case 1* agreed to the acquisition as it could provide access to new customers and markets, in reality it had no choice and only heard about the transfer of shares after it had happened. Subsequently the original joint venture partner became a service provider, catering for the workforce of the two joint ventures and operating a fleet of buses that transport the workforce to and from the factories. Additionally it has an operational division that takes on contract manufacturing and acts as a sub-contractor to the joint venture.

When it commenced operation in January 1995, the Joint Venture was housed in an old building owned by the Chinese partner, but from June 1996 it moved into new purpose-built accommodation funded largely by *Case 1*, which holds a 51 per cent share in the venture. Initially offered a 60 per cent share by the Chinese partner, *Case 1* rejected this because it wanted a strong, active partner not one that regarded the joint venture as a portfolio investment. Its strategy was to minimise its risk but to maximise its control. Although *Case 1* held a 51 per cent share in the venture, it insisted that the General Manager should be a Chinese and that, initially at least, he should have responsibility for sales. The General Manager reports to a Board of 4 Directors (2 German and 2 Chinese) chaired by *Case 1*'s Director of Overseas Affairs. The Vice Chairman is Chinese, which is not uncommon in Sino-foreign joint ventures with approximately equal ownership. In addition to the four directors, the meetings of the Board, which take place every six months and last for one or two days, are attended by all of the other managers. In these meetings everything is discussed openly, including the policy of the venture for the next six months. The whole point of involving the managers is to ensure information is shared and to obtain their input into the decision-making of the general manager. Although *Case 1* holds a majority interest in the venture, consensus decisions are sought and according to the Production and Quality Assurance Manager they had not had a major crisis in decision-making. Day-to-day decisions are made by the individual line managers. Every Monday morning all departmental managers meet with the managers in the General Manager's office to consider any problems facing the joint venture. In addition, the individual departments meet separately to discuss department-specific issues.

The role of the expatriot German Production and Quality Assurance Manager was fundamental to the success of the venture. Since the General Manager did not speak English, he became the intermediary between the Chairman of the Board, proposing to the General Manager what the Chairman would like to happen. However, as a second tier manager he had no decision-making power and could not issue directives. He could only propose actions to the General Manager and although he "nearly always decided the way I wanted it", *Case 1* considered this to be a weakness and created a new position for the Production and Quality Assurance Manager. Early in 1997 he became Assistant General Manager with the authority to issue directives to other managers. This way, the problem was resolved and the Chinese managers could accept his authority "without losing face".

According to *Case 1*'s Director for Overseas Affairs, the Joint Venture "is a good success". He had planned for two loss-making years with profits generated in year three on. While the Joint Venture did make losses in the first two years of operation, they were lower than had been anticipated and sales volumes were, in fact, 25 per cent higher than predicted. Even so, the Joint Venture was facing numerous difficulties including problems with production and quality, with the quality of local sourcing, with low productivity standards, with foreign exchange restrictions, with communication, with sales and marketing, with pricing and with security (concern about copyright and patent infringement). Interestingly, none of these appeared to have been foreseen in the negotiation process. Here the main issue had been agreeing the product programme. However, other issues included the planning of operations in subsequent years, the business plan, the distribution of equity share and, particularly, the valuation of both partners' contributions, such as drawings (the German partner) and machinery (the Chinese partner). Initially this was a major problem for both parties but eventually agreement was reached and the German partner was offered, and accepted, a sixty per cent equity share in the venture. As the Director for Overseas Affairs pointed out, he had a clear idea of what would be acceptable as the outcome of the negotiations and he "was prepared to withdraw from the proposal if I had not felt comfortable with an issue". Even so, the German partner had to accept certain compromises. For example, *Case 1* normally commits itself to project durations of 10 to 15 years. In this case it agreed to a 50-year commitment since the Chinese party "liked such long durations". Again, although the German partner had entered China "in order to serve the Chinese market", it had agreed to purchase a certain quantity of the Joint Venture's output for export markets and to the condition that by the end of the fifth year of operation, the venture would export 30 per cent of its annual production. Despite this, the negotiations proceeded quickly. On 14th July 1994, a Chinese delegation visited Germany for talks. This was followed, on 25–29th July, 1994, by a delegation to China from the prospective German partner. During this visit, a "letter of intent" was signed. In August 1994, the German Director of Overseas Affairs went to China to sign the contract and the Joint Venture started operation on 2nd January, 1995. The speed with which the negotiations were concluded stemmed in part from the professionalism and determination of the German partner and the close links which the Chinese partner had with the municipal government. However, it seems likely that the negotiations were not protracted, also, because the Chinese partner wanted the deal, not least because it did not wish to lose the complementary deal to create an engineering products joint venture.

Case 2 is an U.K. limited liability company with 10 employees, four of whom work in production and the rest in research and development, sales and administration. It is located in the North East of England and was founded in 1986 to manufacture electronic devices for corporate clients. It exports its products to more than 60 countries throughout the world and has been carrying out development work in Australia, Canada and Germany. At the time of the interview, the company was not active in the U.S. market, as it was under-capitalised. However, the Managing Director, who holds 86 per cent of the equity, recognises that the company "needs to be there" as business would be good. Prior to establishing a Joint Venture in China, *Case 2* had no experience of either the Chinese Market or the Asia Pacific Region, other than Australia. It had been looking to develop in a low cost production area and initially its Managing Director had been keen to produce in Korea, since the quality of the labour force was perceived to be better than in China.

The Chinese partner in the Joint Venture is a privately-owned firm located in East China. It was founded over thirty years ago and comprises five companies, three of which are joint ventures with foreign partners. Two of these are from the U.K. and one from Thailand. It operates in a variety of industry sectors, including knitting, yarn-feeding and textile appliances, and is the largest producer of yarn feeders in Asia. In total it employs some 500 staff and in 1995 had a turnover of £3.0 million (US$4.7 million), of which more than 90 per cent was generated by the Chinese market. The remaining 10 per cent were earned through exports, mainly to America, Europe and neighbouring Asian countries. Its objective in entering into a Joint Venture with *Case 2* was to help it achieve its mission of "creating a world-famous brand and striving for a first class enterprise". This drive and desire was articulated in huge Chinese characters in the entrance hall of the firm's head office building.

The resultant Joint Venture, which came into existence in 1994, is an Equity Joint Venture, established as a limited liability company according to Chinese law. The total investment in the business, which employs 20 staff, accounts for some £111,000 (US$174,000). It occupies premises owned by the Chinese partner, previously used by its textile appliance business. These buildings are no more than eight years old and provide the quality environment required by the U.K. partner. The Joint Venture manufactures eight types of electronic devices. These comprise some 50,000 units a year and only a small fraction of *Case 2*'s product range. Expansion of the product lines is planned but no timescale has been set for this. Approximately 30 per cent of its components are sourced in China and all of the end product is exported to the U.K., though there are plans to exploit the Chinese and other South East Asian markets

Although labour costs in the Joint Venture account for approximately 1 per cent of sales, compared with 5 per cent in the U.K., the decision to locate in China rather than Korea was made "not because it was cheap, but because it was cheap and had skilled labour that was available". However, *Case 2* would not have selected China if it had not been for the opportunity to joint venture. Its sole interest in China was as a resource seeker – to manufacture high quality electronic devices at a low cost. This could have been done on a contract basis, but the preferred Chinese partner was exclusively interested in establishing a Joint Venture. There were a variety of reasons for this, but primarily the Joint Venture was seen by the Chinese partner as a means of helping it acquire advanced technology and contacts in other world markets. In return, it offered *Case 2* access to cheap, quality labour and the Chinese Government's support for peasant enterprises, including the right to import/export and the ability to import machinery free of duty. However, *Case 2* had no intention of serving the Chinese market, only of using it as a means of low-cost quality production.

Ownership of the Joint Venture is split 67:33 in favour of the Chinese partner. This suits *Case 2* as it had not intended entering into such a partnership. Contractually, however, it can increase its share in the venture by sending an extra person to China. For the present, though, the equity distribution clearly depicts who has control of the Joint Venture. Three of the five members of the Board come from the Chinese partner company and its Chairman is Chairman of the Joint Venture. While the Chinese partner takes responsibility for production, technology and management of the entire venture, *Case 2* takes responsibility for marketing and new product development. For any major decisions to be made on investment, managerial appointments, etc., the Managing Director of *Case 2* has to be consulted and in agreement.

Initially monthly accounts were prepared and sent to the U.K. Since they did not reveal any problems, their frequency was reduced so that currently the Managing Director of *Case 2* receives only the annual statement of accounts (sales, profit and loss and balance sheet) and the Board meets once a year, either in the U.K. or China, to consider it and the future performance of the Joint Venture. The accounts are prepared by the Joint venture's accountant and checked annually by the "Accountant Commission CITY [East China]". More frequent communication between the two partners takes place by fax with the U.K. partner paying for the translation services of the Chinese partner's interpreter. According to the Managing Director of *Case 2* "Mr (name of Chinese partner) and I get on well. We know our business very well. We have been in business for a lot of years now. We agree on numbers, exchange faxes and try very hard to have an idea of what the business will be like"

The General Manager of the Joint Venture is an engineering graduate from a Chinese University who had been working for six years prior to his appointment as equipment manager in one of the Chinese partner's companies. At the time of the interview *Case 2* had not expatriated personnel to the Joint Venture and had no plans for so doing. Hence the appointment of the Chinese General Manager had been welcomed by *Case 2*.

At the time of the interview there appeared to be no serious problems with the joint Venture and according to both parties, it had been successful. While not being prepared to release turnover figures, they indicated that sales for 1996 showed a 10 per cent increase over the previous year and the Chinese partner referred repeatedly to the profitability of the Joint Venture. At the same time, the Chinese Directors stressed that as a result of the Joint Venture they had "made a lot of friends and friendship between the two countries". Indeed, it would seem that the relationship between the two partners went beyond the purely business. The senior management got on socially as well as professionally. As a consequence, and because the interests of the two parties coincided so precisely, the Joint Venture appears to have been free of the inter-personal problems that so frequently exist in such initiatives.

5. Conclusion

For some time Joint Ventures were believed to be inferior to Wholly Foreign-Owned Enterprises (Kindleberger, 1979; Caves, 1982; Killing, 1983; Rugman, 1983; Harrigan, 1985; Poynter, 1985; and Rugman et al., 1985) as they were long seen as failing to maximise a firm's returns on its Specific Advantages (FSAs), and a potential source of conflict, given the difficulties partners experience appreciating each other's contribution (Kindleberger, 1979). Accordingly, such co-operative, partnership arrangements were seen as only the second or third best option for supplying foreign markets, used only when government regulations precluded exporting, licensing or the establishment of WFOEs (Wells, 1973; Beamish, 1985; Root, 1987; Contractor and Lorange, 1988; Hamill and Hunt, 1993). However, as this research has demonstrated, Joint Ventures can be a successful market entry strategy, particularly for small and medium-sized enterprises with limited resources and knowledge of the local market. From the findings presented here, it would seem that, as Hennart and Reddy (1997) have suggested, the joint venture is primarily a device to gain access to resources embedded in other organisations and is particularly favoured in situations, such as China, where national governments are attempting to restrict foreign ownership and where local expertise and connections are seen to be important in facilitating market entry (Gomes-Casseres, 1989). As a result, Joint Ventures have become a popular vehicle for foreign market servicing and, when compared with wholly foreign-owned enterprises, have for long been the dominant FDI strategy (Herzfeld, 1983). They are not without their problems, however, as the research has demonstrated. Even so, they do seem to have been largely successful in the eyes of the small firms that have entered into them and it would appear that a major influence has been the congruity or complementarity of the partners' motivations as suggested by Killing (1983), Connolly (1984), Harrigan (1985), Datta (1988), Schaan (1988) and Gomes-Casseres (1989). This is not always the case, however, and according to Lane and Beamish (1990) the central challenge for firms, whether large or small, in establishing a Joint Venture is to identify an appropriate partner.

For a small or medium-sized firm with limited resources and market knowledge, such a task might be expected to be particularly difficult. Clearly this has important implications for both research and policy. From a research perspective it would seem important to understand more clearly how western small firms that joint venture successfully identify their joint venture partners, especially in countries like China that are geographically and culturally remote. Preliminary research with the small and medium-sized firms investigated here suggests that relatively scant attention is paid to planning the Joint Venture, to partner selection or to agreeing, in advance, the contribution of the partners (Kaiser and Kirby, 2000). Given that western Governments increasingly appear to be concerned to encourage small and medium-sized enterprises to enter into joint venture arrangements, the findings of this research would suggest that if scarce resources are not to be wasted, relationships are not to be soured and the benefits to all parties are to be optimised, partner selection can not be left to chance. As has been argued elsewhere (Kaiser and Kirby, 1996) potential joint venture partners appear to require assistance in locating and selecting each other. If suitable partners can be identified, there appears to be little reason why small and medium sized enterprises cannot form joint ventures as a means of entering international markets. Indeed, on the evidence presented here, it would seem that the joint venture experiences of SMEs are not that dissimilar to those of the large, multi-national counterparts and that success factors revolve around the inherent and complementary strengths of the partners.

Providing these difficulties can be overcome, it seems likely that joint ventures will increase in importance as an internationalisation strategy for SMEs. This is not to say that they will necessarily replace other types of international activity but that they will complement them and contribute to the greater involvement of SMEs in international activity. Under such circumstances, an interesting and valuable piece of future research might be to identify the circumstances whereby joint venturing might be the preferred internationalisation strategy for SMEs and the relationship between joint venturing and other SME ternationalisation strategies.

References

Acs, Z. J. and L. Preston, 1997, 'Small and Medium-Sized Enterprises, Technology, and Globalisation: Introduction to a Special Issue on Small and Medium-Sized Enterprises in the global economy', *Small Business Economics* **9**(1),1–6.

Acs, Z. J., R. Morck, J. M. Shaver and B. Yeung, 1997, 'The Internationalisation of Small and Medium-Sized Enterprises: A Policy Perspective', Small Business Economics **9**(1), 7–20.

Albaum, G., J. Strandskov, E. Duerr and L. Dowd, 1992, *International Marketing and Export Management*, Wokingham: Addison-Wesley Publishing.

Anyansi-Archibong, C. B., 1989, 'Small Business in China's

Special Economic Zones', *Journal of Small Business Management* **27**(2), 56–58.

Au, A. K. M. and P. Enderwick, 1994, 'Small Firms in International Joint Ventures in China: the New Zealand Experience', *Journal of Small Business Management* **32**(2), 88–94.

Barkema, H. G., J. H. J. Bell and J. M. Pennings, 1996, 'Foreign Entry, Cultural Barriers and Learning', *Strategic Management Journal* **17**(2), 151–166.

Beamish, P. W., 1985, 'The Characteristics of Joint Ventures in Developed and Developing Countries', *Columbia Journal of World Business* **20**(3), 13–19.

Beamish, P. W., 1993, 'The Characteristics of Joint Ventures in the People's Republic of China', *Journal of International Marketing* **1**(2), 29–48.

Beamish, P. W. and Y. Wang, 1989, 'Investing in China via Joint Ventures', *Management International Review* **29**(1), 57–64.

Buckley, P. J., 1983, 'New Theories of International Business; Some Unresolved Issues', in M. Casson (ed.), *The Growth of International Business*, London: George Allen and Unwin, pp. 34–50.

Buckley, P. J., 1997, 'International Technology Transfer by Small and Medium Sized Enterprises', *Small Business Economics* **9**(1), 67–78.

Buckley, P. J. and M. Casson, 1976, *The Future of Multinational Enterprise*, London and Basingstoke: Macmillan.

Buckley, P. J., G. D. Newbould and J. C. Thurwell, 1988, Foreign Direct Investment by Smaller U.K. Firms; The Success and Failure of First-time Investors Abroad, London: Macmillan

Campbell, K., 1997, 'The Minnows' Fight against the Sharks', *Financial Times* (24 October), 16.

Caves, R. E., 1971, 'International Corporations; The Industrial Economics of Foreign Investment', *Economica* **38** (February), 1–27.

Caves, R. E., 1982, *Multinational Enterprise and Economic Analysis*, New York: Cambridge University Press.

Cavusgil, S. T., 1980, 'On the Internationalisation Process of Firms', *European Research* **8** (November), 273–281.

Child, J., 1994, *Management in China During the Age of Reform*, Cambridge: Cambridge University Press.

Connolly, S. G., 1984, 'Joint Ventures with Third World Multinationals: A New Form of Entry to International Markets', *Columbia Journal of World Business* **19**(2), 18–22.

Contractor, F. J. and P. Lorange, 1988, 'Competition vs. Co-Operation: A Cost/Benefit Framework for Choosing between Fully-Owned Investments and Co-Operative Relationships', *Management International Review* (Special Issue), 5–18.

Danenburg, W. P. and Z. Y. Tan, 1989, 'The "Sparking Program" and Its Effects on Small Business in the People's Republic of China', *Journal of Small Business Management* **27**(2), 60–62.

Datta, D. K., 1988, 'International Joint Ventures: A Framework for Analysis', *Journal of General Management* **14**(2), 78–91.

Dillman, D. A., 1978, *Mail and Telephone Surveys*, New York: Wiley.

Donckels, R. and J. Lambrecht, 1995, 'Joint Ventures; No Longer a Mysterious World for Smes from Developed and Developing Countries', *International Small Business Journal* **13**(2), 10–26.

Dunning, J. H., 1993, *The Globalisation of Business*, London: Routledge.

Eden, L., E. Levitas and R. J. Martinez, 1997, 'The Production, Transfer and Spill-Over of Technology: Comparing Large and Small Multinationals as Technology Producers', *Small Business Economics* **9**(1), 53–66.

Fan, Y., 1996, 'Research on Joint Ventures in China: Progress and Prognosis', in R.Baran, Y. Pan and E. Kaynak (eds.), *International Joint Ventures in East Asia*, New York: International Business Press, pp. 71–88.

Fujita, M., 1995, 'Small and Medium Sized Transnational Corporations: Trends and Patterns of Foreign Direct Investment', *Small Business Economics* **17**(3), 183–204.

Gomes-Casseres, B., 1989, 'Joint Ventures in the Face of Global Competition', *Sloan Management Review* **30**(3), 17–26.

Gomes-Casseres, B., 1997, 'Alliance Strategies of Small Firms', *Small Business Economics* **9**(1), 33–44.

Grub, P. D. and J. H. Lin, 1991, *Foreign direct investment in China*, New York: Quorum Books

Hamill, J. and G. Hunt, 1993, 'Joint Ventures in Hungary: Key Success Factors', *European Management Journal* **11**(2), 238–247.

Harrigan, K. R., 1984, 'Joint Ventures and Global Strategies', *Columbia Journal of World Business* **29**(2), 67–69.

Harrigan, K. R., 1985, *Strategies for Joint Ventures*, Lexington, MA: Lexington Books.

Hennart, J. F. and S. Reddy, 1997, 'The Choice between Merger/Acquisitions and Joint Venture; The Case of Japanese Investors in the United States', *Strategic Management Journal* **18**(1), 1–12.

Herzfeld, E., 1983, *Joint Ventures*, Bristol: Jordans.

Hood, N. and S. Young, 1979, *The Economics of Multinational Enterprise*, London: Longman.

Kaiser, S. H. and D. A. Kirby, 1996, *China in Focus*. Paper presented at the international conference on development strategies for SME's, Changzhou, China.

Kaiser, S. and D. A. Kirby, 2000, *The Joint Venture Experiences of Small and Medium Sized Enterprises (Smes) in China: An Examination of German and U.K. Small and Medium sized Firms*. Paper presented at the International Conference on Business Transformation and Social Change in East Asia. Tunghai University, Taiwan.

Kaiser, S., D. A. Kirby and Y. Fan, 1996, 'Foreign Direct Investment in China; An Examination of the Literature', *Asia Pacific Business Review* 2(3), 44–65.

Kaufmann, F., 1995, 'Internationalisation via Co-Operation – Strategies of Sme', *International Small Business Journal* **13**(2), 27–33.

Killing, P. J., 1983, *Strategies for Joint Venture Success*, New York: Praeger.

Kindleberger, C. P., 1979, 'The Theory of Direct Investment', in D. R. Lessard (ed.), *International Financial Management*, Boston: Warren, Gorman and Lamont.

Kohn, T. O., 1997, 'Small Firms as International Players', *Small Business Economics* **9**(1), 45–51.

Lane, H. W. and P. W. Beamish, 1990, 'Cross-Cultural Cooperative Behaviour in Joint Ventures in LDCs', *Management International Review* **30**, 87–102.

Leung, T. and L. L. Yeung, 1995, 'Negotiations in the People's Republic of China: Results of a Survey of Small Businesses in Hong Kong', *Journal of Small Business Management* **3**(1), 70–77.

Mulhearn, A., 1994, 'The European SME Sector: Definitional Problems and the Policies of the European Commission', *Journal of European Business Education* **4**(1), 46–60.

OECD Observer, 1981, *International Direct Investment: A Change in Pattern*, Part 112, September, 9–13.

Osland, G. E. and S. T. Cavusgil, 1996, 'Performance Issues in U.S.-China Joint Ventures', *California Management Review* **38**(2), 106–130.

Poynter, T. A., 1985, *Multinational Enterprise and Government Intervention*, New York: St. Martin's Press.

Reynolds, J. T., 1997, 'New and Small Firms in Expanding Markets', *Small Business Economics* **9**(1), 79–84.

Robock, S. H. and K. Simmonds, 1989, *International Business and Multinational Enterprise*, Irwin: Homewood.

Root, F. R., 1987, *Entry Strategies for International Markets*, Lexington, MA: D.C. Heath.

Rugman, A. M., 1983, 'The Comparative Performance of U.S. and European Multinational Enterprises, 1970–79', *Management International Review* **23**(2), 4–14.

Rugman, A. M., D. J. Lecraw and L. D. Booth, 1985, *International Business – Firm and Environment*, New York: McGraw-Hill.

Schaan, J-L., 1988, 'How to Control and Joint Venture Success Even as a Minority Partner', *Journal of General Management* **14**(1), 4–17.

Stratos, 1990, *Strategic Orientations of Small European Businesses*, Aldershot: Gower Publishing Company Limited.

Tai, L. S. T., 1988, 'Doing Business in the People's Republic of China: Some Keys to Success', *Management International Review* **28**(1), 5–9.

Teece, D. J., 1981, 'The Multi-national Enterprise; Market Failure and Market Power Considerations', *Sloan Management Review* 22(3), 3–17.

Teece, D. J., 1985, 'Multinational Enterprise, Internal Governance and Industrial Organisation', *American Economic Review* **75** (May), 233–238.

UNCTAD, 1997, *World Investment Report*, New York.

Vatne, W., 1995, 'Local Resource Mobilisation and Internationalisation Strategies in Small and Medium Sized Enterprises', *Environment and Planning* **27**(1), 63–80.

Wells, L. T., 1973, 'Effects of Policies Encouraging Foreign Joint Ventures in Developing Countries', in E. B. Ayal (ed.), *Micro Aspects of Development*, New York: Praeger, pp. 149–177.

Wu, W., 1993, *A study of the Determinants of EC Firms' Entry Mode Choice into the Chinese Market: Licensing or Joint Venture*. Paper presented at the U.K. Annual Conference, Pontybridge.

Young, S., J. Hamill, C. Wheeler and J. R. Davies, 1989, *International Market Entry and Development*, Engelwoods Cliff, NJ: Prentice Hall.