Chapter 2

LITERATURE REVIEW

This chapter on literature review is divided into four sections. The first section covers the review of theories of Foreign Direct Investment and Joint Ventures. The purpose of this section is to help us in understanding the process of why firms invest abroad, what strategies of investments are used in different conditions and what are the advantages and disadvantages of foreign direct investment and Joint Ventures.

The second section reviews the process of industrialization in Malaysia. This will help in understanding the policies of the Malaysian government for attracting foreign investment either directly or through Joint Ventures. The third section sets forth the theoretical basis used for evaluating the role of partners in JVs. This theory is used for developing the research methodology for evaluating the role of domestic partners in Chapter 3. The last section reviews the findings of research study conducted by International Finance Corporation (IFC), World Bank in 1996 on Joint Ventures in developing countries and findings of a study on International business ventures in Malaysia by Abdul Razak's (1979).

2.1 REVIEW OF THEORIES OF FOREIGN DIRECT INVESTMENT & JOINT VENTURES

2.1.1 Why Firms Invest Abroad

There are many reasons why a firm may want to produce in another country, and not necessarily in the country that is cheapest for production or the country where the product is sold. There are many factors that influence a firm's decision to export or invest directly in a foreign country. The subject of international investment arises from one basic idea, the mobility of capital. Although many of the traditional trade theories assumed the immobility of the factors of production, it is the movement of capital that has allowed foreign direct investment across the globe (Czinkota et al 1996). This is based on the simple premise that if there is competitive advantage to be gained, capital will get there, provided accessibility is not hindered.

2.1.1.1 Decision Sequence to Invest Abroad

After the initial success of a firm, its corporate growth strategy may be influenced by **diversification** or **specialization** strategies. The decision faced by the firm is to go for either economies of scope or diversification, within the country of operation, or to go for economies of scale or specialization (Kay 1991), by exporting or producing in other markets or both. The decision is influenced heavily by the core competencies possessed by the firm. To illustrate this, if the corporate growth strategy of a firm, whose core competency is research and development, they may extend their business by diversifying into other business forms such as production or marketing. Whereas a firm specializing in production of consumer goods, may have to adopt the strategy of specialization to achieve economies of scale. These economies of scales can be achieved by producing for world markets in either home country or investing abroad to exploit the synergies and competitive advantages of host countries. The diversification strategy is tantamount to changing the firms competitive advantage, whereas specialization leads to exploiting existing competitive advantage abroad.

A firm that wants to exploit its competitive advantage by accessing foreign markets can do so by either producing at home or producing abroad. Customarily the firm will choose the path that allows it advantage on the following dimensions:

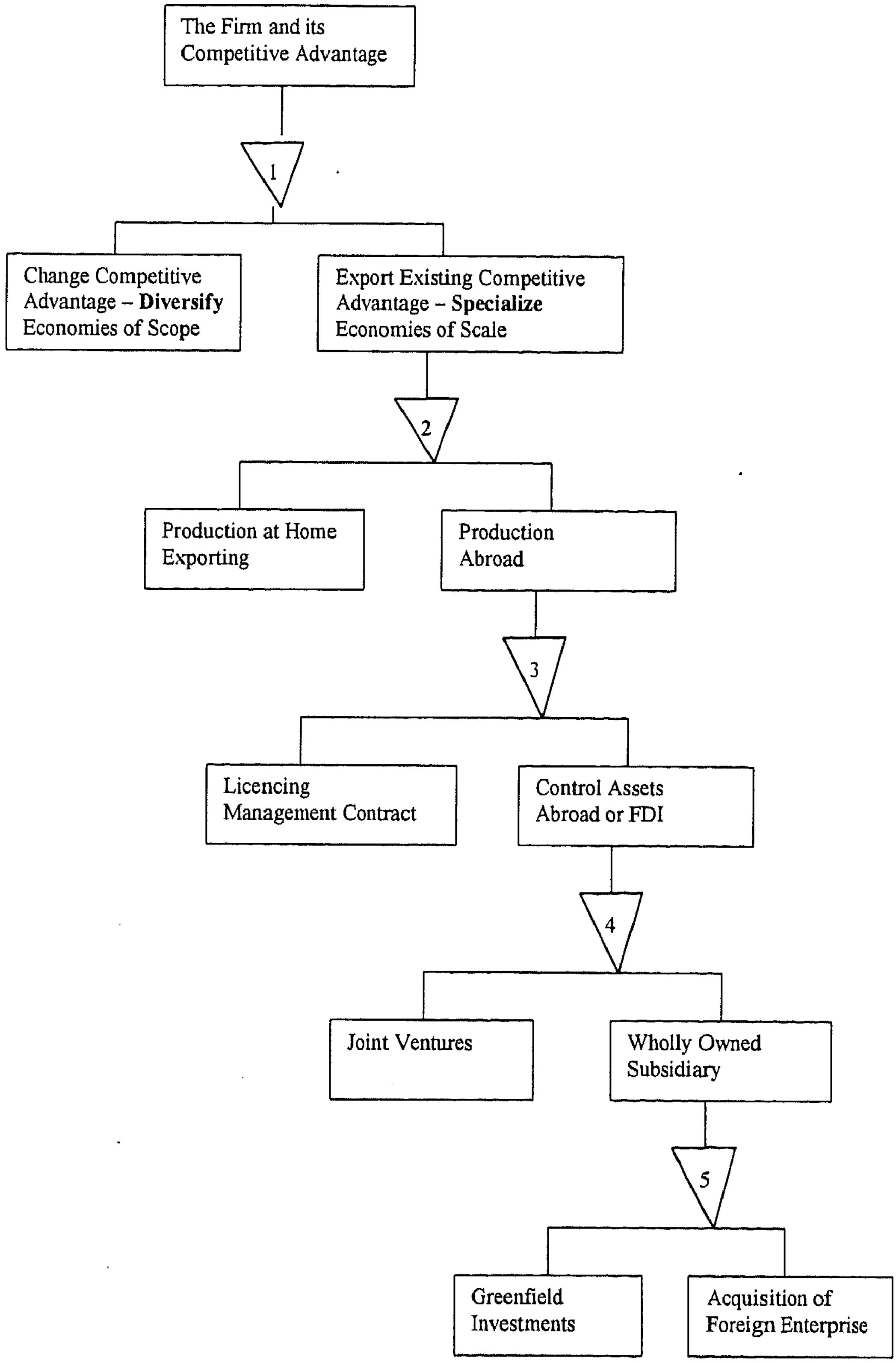
1. access resources and markets it needs to exploit existing competitive advantage
2. degree of control over assets, technology, information and operations
3. the magnitude of capital, the firm must put to risk

The higher the degree of control required, more would be the outlay for capital required to be allocated for expansion overseas. This can be best explained by the decision sequence tree shown in figure 2.1 – the direct foreign investment decision sequence (Gunter and Mirus 1995). The firm has two options of producing abroad. It can be done at minimum risk in the form of licensing or contract management, which obviously does not provide long-term profits and control over assets, technology and operations, but minimizes the risk of investment. It is the simplest and cheapest way of production abroad, as compared to a firm is producing using the parent firms technology and know-how.

The real question for the firm to answer is whether it wants to reduce capital investment risk or to maintain control over the product and technology, which is more often found in food & beverage industries. The other option available to the firm is to control assets abroad by way of foreign direct investment or Joint Ventures, in that order of preference. The firm that wants direct control over the foreign production process next determines the degree of equity control by either owning the firm outright or shared equity participation, often through Joint Ventures. Trade-off with shared ownership continues the debate on control of assets or other sources of firm's original competitive advantage.

Many countries require the foreign firms to operate jointly with local firms, as they want to protect and ensure growth of local firms and investors. Joint Ventures, not wholly owned subsidiaries, are the dominant form of business organization for multinational corporations (MNCs) in less developed countries (LDCs) (Vaupel and Curhan, 1973) and are frequently used by Fortune 500 companies in the developed countries (Harrigan, 1985). In fact for US-based firms, all co-operative arrangements (Joint Ventures, licensing or contract management agreements) outnumber wholly owned subsidiaries by a ratio of four is to one (Contractor and Lorange, 1987). This is due to lower capital risk exposure of the investing firms and ease of operation in many developing countries.

Fig 2.1 : **The Direct Foreign Investment Decision Sequence**



Source : Adapted from Gunter Dufey and R. Mirus, "Foreign Direct Investment: Theory and Strategic Considerations", Unpublished, University of Michigan, May 1995

The final decision branch between a Greenfield investment – building from the ground up and the purchase of an existing foreign enterprise as a form of foreign direct investment is a question of cost. The acquisition of an existing foreign firm may be lower initially, but it also contains a number of customizing and adjustment cost, which are not apparent initially (Czinkota et al 1996). Acquisition of existing firm has inherent benefits if the business possesses substantial customer and supplier relationship or other advantages like distribution network or established brand names, which can help the new owner in the pursuit of its own business line.

2.1.2 Theories of Foreign Direct Investment

The forces making for direct investment abroad are many and varied. According to Dunning (1970) it is reasonable to assume that the firm will invest abroad as long as the marginal rate of return is greater than could be earned elsewhere (allowing for differences in risk). In context to contemporary business world it means that firms will produce in other countries if there are inherent benefits in terms of cost or market access, else they will export from there own country.

There are inherent benefits for either the MNCs (or TNCs) and host countries to be derived from flow of foreign direct investment. The remarkable expansion of foreign direct investment is having a very substantial impact both on patterns of economic growth of individual business enterprises and on national economies of investing and recipient countries (Dunning 1970). From the point of view of MNCs and investing countries, they get higher returns for their investments resulting in improved revenue generation, whereas for local enterprises and recipient countries it brings access to new technology, management know-how, employment generation and overall economic development.

From the host countries point of view, the real issue is whether foreign direct investment or other forms of investments like Joint Ventures, licensing etc.

results in sustainable economic development or not. Like in case of Malaysia, Nazari's (1993) research on TNCs concludes :

"That the operations of electronics TNCs in the Malaysian economy has contributed significantly towards Malaysian economic development. This has occurred through the fostering of linkages between foreign firms and local suppliers, through transfer of technology in forms of upgrading of local employees, the transfer of functions such as design, development and marketing to Malaysia, the skill upgrading of the level of sophistication of the manufacturing process and finally through the transfer of the production of more sophisticated products to Malaysia."

There are many theoretical approaches for explaining FDI four major ones are discussed in brief in the next section. These can be classified as follows[1]

1. Neo-Classical
2. Neo – Marxist
3. World Systems Theory
4. Internationalization of Capital

2.1.2.1 Neo-Classical

Foreign Direct Investments by MNCs serves as an efficient allocator of resources internationally as to maximize world welfare. The underlying reasons for FDI are to be analyzed from the perspective of host countries and home countries. In the context of this paper, we will be focussing our analysis on the effects of FDI on host country, this is necessitated especially in the wake of Malaysian economies heavy dependence on FDI. The Neo-Classical Approach is divided into three major models – the **Capital Flow model**, the **Product Life Cycle model** and **Internalization model**.

The **Capital Flow Model** stresses the benefit of host nations as a result of FDI, i.e. inflow of capital from external sources. Foreign capital will supplement

[1] These clasifications are based on Nazari (1993) research on Transnational Corporations and draws from theoretical literature on TNCs, including Dunning (1981), Hood and Young (1979), Jenkins (1987) and Sklair (1991).

domestic savings and provide additional foreign exchange required for growth, besides increasing technological and managerial know-how for the host country (Meier 1972, Rueber, 1973).

Contrary to Capital Flow model which focuses on benefits for host nation, the Product Life Cycle and the Internalization models focuses on the underlying reasons for why firms tend to internalize production, rather than merely exporting their products.

The **Product Life Cycle** theory (Vermon 1966; Wells 1973) argues that changing patterns of trade and investment can be explained by tracing the movement of products along the different stages of life cycles. The new and maturing products are usually manufactured in developed countries due to high technological know-how and need for protecting patents and technical knowledge. Whereas, the matured products are efficiently produced in less developing countries (LDCs), due to availability of cheap labor. For host countries among LDCs, the implication is that they are able to acquire technology on favorable terms, whereas the TNCs are able to gain market access for their products. This trend is also obvious in high technology industries like semiconductors, where the production was largely in developed countries during the initial phases of PLC and subsequently as the technology matured firms invested in LDCs to gain advantage of cheap labor conditions prevailing in the markets.

The **Internalization** approach (Dunning 1981, Casson 1976, Rugman 1981) is currently the most dominant approach within the Neo-Classical Tradition. The eclectic paradigm suggested by Dunning (1981), proposes that FDI is undertaken by firms possessing specific advantages like technological, marketing, production or R&D skills, which are not possessed by other firms. Dunning argues that firms tend to take advantage of the market by exploiting imperfections in the external markets themselves rather than sell or lease them. This implies that the firms internalize the use of their specific advantages, which may lead to overseas production or FDI. Both the host nations and the firms tend to gain from this internalization. Host nations gain as they acquire technology, know-how and assets and firms gain by getting access to cheap labor, market and other forms of investment incentives.

The major criticism against the neo-classical theory is that it tends to ignore in there analysis, the possible role of number of economic and social factors to limit the contributions that can be made by foreign capital in terms of development of a nation's level of industrialization. These economic and social factors are unique to a nations political and historical circumstance (Nazari 1993) such as political scenario, racial structure.

The theory is also unable to explain the proposition that maximum benefit from FDI can be gained only if there is minimum interference from the government forces. The proposition has been proven wrong in case of the economic development and industrialization of East Asia NICs (like Korea, Taiwan and Singapore), where benefits from FDI were maximized despite of active interference by the local governments. This has been amply proved by the work of many writers like Wade (1990), Amsden (1989) and Lall (1993).

2.1.2.2 Neo-Marxist

This approach derives from traditional Marxist theory to analyze the underdeveloped economies of Asia, Africa and Latin America. There are three major schools of thoughts propounded by Baran (1957), Frank (1969) and Emmanuel (1969). Baran's theory propounds the development of centre and periphery countries. His theory postulates that the capital flows from centre (developed economies) to periphery (underdeveloped economies). Capital is chiefly for investment purposes and does not benefit the host economy (Baran 1973). Frank has tried to explain the key features of capitalism that constitute the cause of underdevelopment in the Third World Countries. These are expropriation of surplus by many and appropriation by few, polarization of capital into metropolitan centres and peripheral satellites. A major observation by Frank was that foreign capital far from supplying the basic needs of the masses tends instead to concentrate on the production of luxuries for a small elite (Frank 1969; 168).

Emanuel proposed that under certain conditions peripheral countries might indeed become net losers when they engage in international trade with the centre. It implies that the periphery will be drained of its wealth by the center as long as it remains part of the international capitalist system. The neo-Marxist generally condemns use of FDI as a method for development in the developing world.

The main criticism of the neo-Marxist approach is its blocked development and static view of the world. The center – periphery relationship is a manifestation of imperialistic system of exploitation rather then manifestation of tendency for capital to internationalize (Marcussen and Thorp 1982). The theory falls short of explaining the impressive industrialization taken place in East Asian NICs, as it does not allow possibility that significant differences in internal characteristics may occur between third world countries and that economies can and do move from periphery to centre and vice versa.

2.1.2.3 World Systems Theory

Propounded by Immanuel Wallerstein (1974), the theory regards capitalism as a global system for organizing economic activities. The world capitalist system builds on the neo-marxist theory. The theory proposes that the world capitalist system can be divided in three economic zones-core, peripheral and semi - peripheral. As propounded by the neo-Marxist, the economic relationship between core and periphery is fundamentally exploitative. The periphery receives less from the core for it's economic activities and hence it is not in a position to accumulate capital necessary for successful economic modernization.

The semi- periphery functions as the intermediary between core and periphery. Their role can be regarded as regional and financial centre, as centre for collection of surplus and the administration of the core investment in periphery. Countries like Hong Kong and Singapore qualify as semi - peripheral economies. The theory also suggests that the nation states are continuously locked in an intense competition to maximize their power in relation to each other.

Most significant development in the World Systems theory is the New International Division of Labor (NIDL) thesis of Frobel (1980). His thesis proposes that the global reorganization of industrial production takes place for three reasons :

1. Breakdown and allocation of production process on a world wide basis
2. Differences in wage structures of developed and developing nations
3. Development of efficient transport and telecom technology has led to relative independence in the choice of production process on a geographical basis.

The theory proposes that very limited technology transfer and very rudimentary forward and backward linkages occur (Frobel 1980). This further reinforces the neo- Marxist theory that the third world countries will never be able to achieve genuine autonomous development, so long as they remain part of it.

This theory has the two major drawbacks, first it over emphasizes that cheap labor is the primary motivating factor for foreign capital to be attracted to peripheral countries and second the development possibilities differ from region to region.

2.1.2.4 Internationalization of Capital (IOC) Theory

IOC approach is focussed on impact of foreign capital on third world countries. The theory builds on the concept of "self expansion of capital" and in it's quest for accumulation, capital is said to move through the circuits of capital in two spheres of activities, namely production and circulation.

The IOC approach recognizes the possibility that the competitive nature of capital will result in positive outcome for the third world countries, through changes in labor process or modernization of local firms linked to foreign firms (Henderson 1989).

The strong point of this theory is that it considers the effects of internal factors of a nation, namely - social, historical and political, referred as locational advantages by Dunning. Secondly IOC occurs in both the spheres of circulation and production (Jenkin 1987), whereas the neo classical and neo Marxist approaches are largely focussed on the spheres of circulation.

The focus of the Neo-Classical, Neo-Marxist, approaches is largely in the sphere of circulation by concentrating on respectively, the efficiencies of markets, the relations of exchange, and, market power of the TNCs. The IOC approach recognizes both the spheres of production and circulation, the IOC theory points out that the capital goes to the periphery in search for both new areas of investments and new markets (Marcussen and Thorp, 1982). The IOC approach does help in explaining the flow of capital to NICs in East and South East Asia.

2.1.3 Advantages And Disadvantages of FDI

Foreign investments can be a powerful force for development and growth in developing countries, but it can also disrupt the development process unless if not managed carefully. The various advantages and disadvantages of FDI as mentioned in the above theories can be best summarized by The World Bank's study on Managing Capital Flows in East Asia (1995), which outlines the following benefits and dangers of foreign investments[2].

2.1.3.1 Benefits of Foreign Direct Investments

- Additional resources available for productive investment

[2] World Bank, "Managing Capital Flows in East Asia", 1995

- Risk sharing with the rest of the world (equity)
- Greater external market discipline on macroeconomic policy
- Enhanced access to technology and management skills
- Broader access to export markets through foreign partners
- Training and broader exposure of national staff

2.1.3.2 Dangers of Foreign Investment

- Currency Appreciation
- Reduced scope for independent macroeconomic policy actions
- Greater exposure to external shocks
- Demand for protection in local markets
- Some loss of control of foreign – owned domestic industry

The recent economic turmoil in the monetary and capital markets of various South East Asian economies like Thailand, Malaysia, Indonesia and South Korea can be well explained by the dangers of foreign investments as outlined by the World Bank report. Malaysia's over-dependence on foreign direct investment in the manufacturing sector and recent liberalization of the capital markets has resulted in surge of flow of foreign investments. The cost of an open foreign investment policy has manifested in the current currency and stock market crash which has lowered the per capita income of Malaysia from US$ 4200 to US$ 2770, a drop of almost 34 per cent.

The more important issue now is whether dependence on foreign Investment should be reduced or a more prudent macro and micro economic policies must be pursued to ensure long-term economic sovereignty of the nation. Obviously countries can still obtain the benefits and face the dangers with little or no foreign investment, but the risks are greater when levels of foreign investments are high. According to the World Bank report (1995) astute policy can enhance the benefits, and various dangers posed by foreign investment can be managed through a clear policy direction and prudential regulations from the authorities.

2.1.4 Joint Ventures–An Alternate Mode Of Foreign Investment

Joint Ventures offer another form of attracting Foreign Direct Investments through equity participation with foreign partners. From the host country's, point of view the level of ownership and control of the foreign partners is lesser in Joint Ventures as compared to a Foreign Wholly Owned Subsidiary (WOS). Dunning's (1980) eclectic paradigm of Foreign Direct Investment clearly highlights that capital will move to country, which offers more comparative advantage. The increased scale of liberalization in newly emerging economies like Vietnam, China and India will eventually offer better returns for MNCs, which in the long run may relocate to these countries. Although it is yet to be substantially established, Nazari's (1993) research on TNCs on Malaysia's electronics sector indicated that capital tends to accumulate, which is well supported by the Internationalization of Capital Theory of FDI. This does help in explaining that many MNCs tend to expand locally in Malaysia, to further exploit the linkages with local suppliers and availability of well trained human resources, necessary for running the operations.

This may be true for semiconductor industry, however recently companies like Thomson Electronics and other Taiwanese companies divested from Malaysia and moved to Vietnam and China, in order to maintain their competitive advantage, as the cost of production rises in Malaysia. The same is true for Malaysia's ability to attract the Hard Disk Drive Manufacturers from Singapore in the early 1990's.

The point is that today Malaysia is an attractive destination for FDI in the electronics sector, but in today's tumultuous business world the advantages can dither. Hence it is imperative for the Malaysian economy to explore alternative ways of investment in order to alleviate the negative impact of FDI. This will ensure reduced dependence on FDI especially in the electronics sector. This can be achieved by enhancing the technological, managerial and market access skills of the local industry. Theoretically, one of the best and quickest ways of doing the same is through Joint Venture participation.

Next section discusses some of theories of Joint Ventures to understand the motives, benefits and disadvantages of Joint Ventures from the perspective of both the TNCs - Investing countries and local firms - host countries.

2.1.4.1 Defining Joint Ventures

An analysis of the literature on international management, business law, political science, and accounting indicates that there is no consensus regarding the definition of Joint Ventures. At times they are defined very broadly, including all types of cooperation between companies, such as "pooled research and development, or joint purchasing or marketing or a whole host of cartel activities", in other words "all situations in which two or more persons or independent firms join forces to achieve some common goal" (Hibner 1982). Bivens and Lovell 1966 and Spinks 1978 (Shenkar and Zeira 1991) made similar definitions. Beamish (1992) defines Joint Venture as :

"*The shared – equity undertakings between two or more parties, each of which holds at least five percent of the equity.*"

Harrigan (1984) offers a more general definition for Joint Ventures as "the participation of two or more companies in an enterprise in which each party contributes assets, owns the entity to some degree and shares risk (Harrigan et al, 1984). Freidmann's and Kalmanoff's (1961) definition's add that the venture is also considered long term. Other definitions emphasize parent firm[3] (Young and Bradford, 1977, p 11), joint control over the venture (Liebman, 1975; Zaphiriou, 1978), economically independent parents (Bernstien, 1965;, Berne 1978; Spinks, 1978) and which emphasize separate legal and organizational entity (Boyle, 1968; Dobkin, Burt, Spooner, & Krupsky, 1986;

[3] Different terms are used to describe parties who own and control JVs: "Co-owners", "Co-venturers", "Partners", and "Parents" (Young and Bradford, 1977)

Joelson & Griffin, 1975; King, 1969;, Pfeffer & Nowak, 1976). (Shenkar & Ziera, 1991)

For our purpose we will treat Joint Venture definitions as propounded by Shenkar and Zeira (1987) :

A Joint Venture is a separate legal organizational entity representing the partial holdings of two or more parent firms, in which the headquarters of at least one is located outside the country of operation of the Joint Venture. The equity is subject to the joint control of operation of the Joint Venture. This entity is subject to the joint control of its parent firms, each of which is economically and legally independent of the other.

Further the Joint Ventures in Malaysia are officially categorized by Ministry of International Trade and Industry (MITI) as follows :

a. **Joint Venture Malaysian Owned (JVM) : Malaysian equity greater than 51 percent**

b. **Joint Venture Foreign Owned (JVF) : Foreign equity greater than 51 percent**

c. **Joint Venture 50 –50: Equal Ownership of equity.**

2.1.5 Theories of Joint Venture

Joint Ventures in developing countries have often been considered as a result of investment codes restricting foreign ownership of productive assets. It implies that JVs are forced down upon the foreign investors and hence are the second best options, perhaps officially framing fictitious partnership with silent local investors. (Navarett, 1991). On the contrary many research has shown there are many circumstances under which firms investing in LDCs prefer a JV to a WOS (Buckley and Casson, 1989; Oman 1984; Beamish 1989). Killing (1983) divides the reasons for creating a Joint Venture into three groups: a) government suasion or legislation, b) partners needs for other partners skills, and c) partners needs for other partners attributes or assets such as cash or patents, while attributes are the use of manufacturing of certain products.

A literature survey on theories of Joint Venture shows that many theories can explain the existence of JVs. Three major theories of Joint Ventures are discussed in this paper:

1. Internalization Theory
2. Transaction Cost Theory
3. New Forms of Investments

2.1.5.1 Joint Ventures and Internalization Theory

The research and writings of Peter Buckley and Mark Casson (1976), Dunning (1981), and Rugman (1981) have attempted to answer the question why firms push themselves down the investment tree by producing abroad. The theory propounds that due to involvement of transaction costs, which must be borne as a result of conducting business in imperfect markets, it is more efficient or less expensive for the firm to internalize rather than use market intermediaries to serve a foreign market. Williamsons (1975) argues the cost of writing, executing and enforcing arm's length contracts with market intermediaries are greater that the costs of internalizing the market. This argument is valid under two environmental conditions – uncertainty and a small number of market agents coexist with human factors of opportunism and bounded rationality.

This implies that firms prefer to internalize if it faces complex, unpredictable business environment with few potential channel members, who will tend to make profit from the lack of complete knowledge possessed by the firm. The theory focuses on the non-transferable resources of competitive advantage – proprietary information possessed by the firm and its people.

Joint Venture participation is another form of Internalization strategy used by firms. Instead of using arm's length investments like licensing and contract management, which do not allow effective transmission of knowledge or represent too serious a threat to the loss of the knowledge to allow the firm to achieve the benefits of international investments.

According to Beamish (1992) "In order to justify the utilization of international JVs within the framework of internalization, two necessary conditions must exist. The firm possesses a rent-yielding asset which would allow it to be competitive in foreign market; and Joint Venture arrangements are superior to other means for appropriating rents from the sale of asset in foreign market (Teece 1983)" (Beamish, et al 1992). It could be argued that the attractiveness of Joint Ventures is a function of both - revenue enhancing and cost reducing opportunities they provide to MNCs.

However the major drawback of the theory is, that in its present form, the firms would have a strong economic incentive always to avoid Joint Venture arrangements, since these are regarded as being inferior to WOSs in allowing the firm to maximize the returns available on its ownership-specific advantages (Caves 1982, Rugman 1983, Killing 1983, Poynter 1985 and Harrigan 1985)

2.1.5.2 Joint Ventures and Transaction Cost Theory

Transaction cost theory focuses on the structures by which economic exchange is governed. The approach is based on Commons (1934) view of the transaction as the basic unit of analysis and Coase's (1937) concept that organizations and markets are alternative means of organizing economic activity. Williamson (1975), who developed a model specifying the conditions under which transaction is efficiently governed by different structures, elaborated these powerful models. His model accounted for the importance of two important human behavior – opportunism and "bounded rationality" (Simon 1947: 1957). Bounded rationality and opportunism combine to create problems in economic exchange. Information incompleteness and asymmetries make transactions costly. Transaction cost theory argues that lowering these cost is the main problem (but not the only problem) of organizing economic activity. Williamson (1975,1985) argues that organizations and other structures of governance arise as efficient structural solutions to these problems of economic governance. Under certain conditions hierarchical organization are more efficient structural forms than markets for governing exchange.

Researchers in international business have been very successful in providing an economic rationale for the establishment of an MNC as a response to imperfect markets utilizing transactional cost logic (Buckley and Casson, 1976; Caves 1982; Dunning, 1981; Hennart, 1982; Rugman, 1981; Teece, 1981, 1983). In extending this logic to international markets they have found it useful to distinguishing between strategies of vertical integration and horizontal diversification since the nature is different in each situation.

Joint Ventures can be viewed from the alluring perspective of transaction cost theory. The question of which activities to be pursued jointly with a partner depends on the transaction cost of accessing the market as the lowest cost of entry. Firms pursuing vertical integration strategies have to look far beyond the basic strengths of their core businesses (Harrigan 1986). Joint Ventures typically involve three major costs – costs of negotiating and policing agreements, dual system of parental control involving duplication of monitoring and appropriation costs involved in intellectual property and other intangible assets (Kay 1991). This makes Joint Ventures as most costly form of expansion strategy, as compared to full ownership. Although the initial cost of full ownership is low, but the long-term cost of building up a specific knowledge base to gain competitive advantage in foreign markets may be a major deterrent. Joint Ventures will be chosen only when blocks or barriers to single ownership solutions impede the adoption of the diversification strategy.

The obvious impediments are government restrictions to multinational expansion, such as Third World requirements to the effect that a local partner is a prerequisite for market entry (Kay 1991). Alternatively in case local entrepreneurial firms are not willing to sacrifice sovereignty, than Joint Ventures will be the only strategic solution. Williamson (1985) argues that if any three conditions are not met in a given transactional situation, then the market mechanism can relocate resources effectively. These conditions are denied as bounded rationality (cognitive and language limits on individuals ability to process and act on information) asset specificity (specialization of assets with respect to use or user) and opportunism (self-interest seeking with guile) as central issues of transactional cost.

The major criticism of the transactional cost theory comes from Beamish (1989) and Kay (1991) who argue that the theory fails to explain Joint Ventures existing out of trust and goodwill (Casson 1987) and forbearance from cheating (Buckley 1988). Kay (1991) argues that Joint Ventures can be pursued as a strategy even in case where partners are opportunistic, self interested and deceitful and downright untrustworthy – if there is no reasonable alternative. Beamish (1989) also suggests that in situations where Joint Venture is established in a spirit of mutual trust and commitment to its long-term commercial success, opportunistic behavior is unlikely to occur.

2.1.5.3 New Forms of Foreign Investment

Charles Oman (1986) tried to explain the theory of Joint Venture from the perspective of the host country and the home country. According to him among the new forms of investments (NFI) which cover a broad, heterogeneous range of international operations, are Joint Ventures in which foreign equity does not exceed 50 percent. Whether Joint Ventures can be considered investments varies from one project to another and also from one party to another. From the host country's view it is invariably an investment but from the perspective of the foreign firm supplying technology, equipment or access to foreign markets, it depends on the nature of the venture (Oman 1993).

In the last decade, many developing countries have actively promoted new forms of investment (NFI) over traditional FDI to enhance local control over industry and to circumvent the rent extracting powers of the MNCs. The developing countries continued their interest in NFI's as they could acquire only those components of the traditional FDI package such as: technology, management, marketing, finance that could not be obtained locally. Many industrialized and indebted countries see such form of industrialization as a way to minimize foreign exchange cost of obtaining assets necessary for industrial restructuring and sustaining local industry.

It is mainly production from traditional FDI's in developing countries, that is incorporated into the global networks of the major MNC's. Therefore the ultimate importance of NFI over FDI is determined more by the inter -firm competition and by their interaction with the host government policy rather than unilaterally by the developing country's government decision to attract traditional FDI or emphasize selectively on NFI.

Multinational firms tend to concentrate their efforts in industry segments where barriers to entry (hence value added and profitability ratios) are high, while at the same time they seek to maintain and increase their flexibility. MNC's may become intermediaries for both the input (technology and management) and output (international markets) sides of any industry in a developing country and at the same time shift a large share of investment risk onto the international lenders and their host country partners.

Host country elite in both the public and private sectors may increasingly retain the legal ownership of the investment projects in their countries. Also they may assume or prefer to be delegated certain managerial responsibilities in return for the increased risks they share.

2.1.6 Advantages and Disadvantages of Joint Ventures

Joint Ventures are often resorted to as a last form of foreign direct investment. But it offers advantages to both the foreign partner and it's home country as well as to the domestic partner and the host country. The next section briefly covers the underlying reasons, which prompts the two partners to enter into a joint venture. These are also some of the apparent advantages of JV over FDI.

2.1.6.1 Advantages to Foreign Partner and Its Home country

When the foreign company participates as an investor it shares with the host country partner an interest in maximizing the difference between costs of producing the projects output on one hand and the value of output on the other. The two parties have a common interest in the project's success as an investment and it's future ability to generate surplus.

In case of Joint Ventures, some MNCs feel that they can earn attractive returns from certain tangible or intangible assets that they supply without necessarily having to finance or own the project. In some cases they can gain increased leverage on assets they have supplied via the JV, because the local partner absorbs start up costs and provides working capital. JV also offers reduced exposure to risks, both commercial and political that are usually high in traditional FDI.

Newcomer MNC also use JVs to compete with the established giants. Their strategies are both offensive and defensive. Behaving offensively, new comer MNC's tend to offer host countries or partners, shared ownership or greater access to technology in return for exclusive access to local markets.

In other cases, JVs can be used defensively by the newcomers, when their managerial and financial resources are stretched thin in the context of globalized oligopolistic rivalry. In such a scenario, by sharing technology, control and profits, the newcomers can benefit from the local partner's knowledge of local markets, access to local finance and willingness to share the risks.

In present information era, as technologies diffuse and products mature to become increasingly competitive, the major MNC's resort to NFI as part of their strategy of divestment. If a company feels that their control over a particular technology is waning, they may use NFI's to license their technology and obtain higher marginal returns, which they can use to finance movement into higher growth activities in home country or other industrial countries.

It is observed that industry leaders resort to NFI only in fairly isolated or protected markets - countries where production by Joint Ventures stands little chance of competing internationally with the company's main core activities. The reason for such selectivity may be that (a) companies do not supply their most advanced technology to the JV and (b) relatively high production costs in the host country.

2.1.6.2 Advantages to Domestic Partner and Host Country

From the perspective of the domestic partner they get access to the desired technology, know-how, managerial, technical skills of the foreign partner. Joint ventures offer following benefits to the domestic partner and host country

Access to foreign partners finance is a motivation that is common to nearly all developing country companies. Access to process and product technologies from the foreign partner Continued availability of technical expertise and support is the reason why local partners enter into Joint Ventures.

Joint Ventures are vehicle for importing knowledge pertaining to organization, strategy formulation and implementation, marketing manufacturing and other management functions. Local companies enter into Joint Ventures primarily with a hope that the knowledge they gain from the venture will be transferred to their other local operations and will be beneficiary in the long run.

JV, also offers the local partner a convenient way to access the export markets. Although in most of the cases JV's are formed explicitly to do business in the local market, local partners do tend to attach importance to the international reputation of the foreign partner.

The chances for the home countries local industry to adopt and assimilate the knowledge is much higher in a Joint Venture compared to a WOS. The country gains with higher level of local ownership and control in the JV, which helps in promoting local industry and saving valuable foreign exchange which is normally repatriated by foreign owned WOS.

Lastly the home country gains in terms of employment generation, technology spin-off effects, knowledge about foreign markets in some cases, besides it helps in reducing imports of the products manufactured by the Joint Venture.

2.1.6.3 Limitations of Joint Ventures for the Host Country

Many of the countries now realize that they have achieved only limited success through Joint Ventures due to multiple reasons :

1. Domestic partners continue to depend on foreign firms for access to international markets and competitive technology.
2. The firms supplying assets through Joint Ventures, often approach these projects as sales operations rather than investment operations, thereby giving rise to conflicts in the interest of both the parties.
3. The rates of failure of Joint Ventures due to inter-partner conflicts are very high. According to a study conducted by Killing (1983) almost 39 per cent of JVs fail within first five years of formation.
4. Often the technology available to the local partner and host country is not the latest technology of the foreign partner.

It can be concluded that Joint Ventures do offer some inherent advantages over foreign direct investment. Most significant of all is that Joint Ventures offer an effective platform for the local entrepreneurs to launch themselves into the world markets by assimilating product, process and managerial knowledge. From the host countries' perspective the loss of economic sovereignty is not complete as compared to FDI, because eventually the local industry has a fair chance of becoming independent. In the case of Malaysia, there is a need to make a concerted effort to develop local electronic industry and Joint Ventures can play a significant role in doing the same.

2.2 MALAYSIAN INDUSTRIALIZATION AND JOINT VENTURES : A HISTORICAL PERSPECTIVE

This section is an overview of the Malaysian industrialization and highlights the policies of the Malaysian government towards Joint Ventures. It is important to mention here that despite of active promotion of JVs by the government, not much empirical data is available. A detailed survey of the literature shows that are very few studies that have been done related to this field in Malaysia.

The industrialization process in Malaysia can be divided into four distinct phases (Jomo and Edwards 1993) :

1. Phase 1 : Import Substitution Industrialization [ISI] (1950's-1960's)
2. Phase 2 : Export -Oriented Industrialization [EOI] (1960's-Early 1980's)
3. Phase 3: Heavy Industrialization-Second Phase of ISI (Early1980's–Late 1980s)
4. Phase 4 : Renewed Commitment to EOI (Late 1980's onwards)

2.2.1 Phase 1 : Import Substitution Industrialization [ISI] (1950's-1960's)

British colonial policy favored foreign investment in the primary sector (Nazari 1993). Post colonization, in the 1950's, the Malaysian government actively sought industrialization which favored import substitution. The strategy sought to encourage TNC's to set up production assembly and packaging plants for supply of finished goods. Import substitution industries were encouraged by providing import duties and quotas(Edward 1975).

The initial period of import substitution policy obviously favored joint ventures instead of wholly owned subsidiaries. According to Choo Koon Meng in his thesis on joint ventures in Malaysia (1968), a large number of MNC's (Esso, Dunlop, Shell , Matsushita) formed JV's during this period. Out of a total of 142 pioneering ventures 52 were JV's whereas 21 were WOS. In the manufacturing - electrical sector some of the major Joint Ventures were - Malayan Cables, Matshushita Electric, Union Carbide Electrical and Allied

Industries (Choo 1969). Although Choo's thesis is based on general foreign equity aspect of Joint Venture's it does mention that the management and control of most Joint Ventures was in the hands of the foreign partners.

It can be concluded from the above that most JV's were formed initially to fulfill the government's legislative requirements for equity participation. Moreover for MNC's it was the best way to get access to the market without losing control and management of business and technology.

2.2.2 Phase 2: Export Oriented Industrialization [EOI] (Late 1960's- Early 1980's)

The racial tensions and post election riots in 1969 were largely due to unequal distribution of income effects of the ISI (Jomo and Ishak, 1986). The declaration of the New Economic Policy (NEP) in 1970, with two major objectives of eradicating poverty irrespective of the race and to eliminate the identification of occupation with race, coincided with the new phase of : Export Oriented Industrialization (EOI).

The EOI was focussed on modernizing Malaysia's open capitalist economy (Jomo & Edward, 1989). The new focus of the government was to attract foreign export oriented investment which was well augmented by the setting up of export processing zones (EPZ's) and licensed manufacturing warehouses (LMW's) in the early 1970's. This was consistent with the emerging new trends in international division of labor which prompted the TNC'S to relocate manufacturing facilities at locations offering lower production costs. The success of the EPZs in Malaysia was unprecedented (Warr 1987) and has contributed significantly to the development of Electrical and Electronic Sector in Malaysia (Nazari, 1993) as these accounted for more than half of the manufacturing exports since mid - 1980's.

Jomo & Edwards (1989) highlighted that during the EOI phase the import content of products manufactured for export was nearly 70 per cent. Moreover 90 per cent of the companies operating in the EPZ's were foreign owned

(Arif & Senduram, 1987), which meant that a large amount of profits were repatriated to the home countries. The net foreign exchange earnings were a little over 10 per cent of the gross sales for the period 1972 –82. There was little technological transfer or development of skills in the industries established in the EPZ's, with a few limited linkages between the FTZ's and other firms in the economy.

During the early 70s, the government was insisting on formation of Joint Ventures. According to Abdul Razak (1979) the government policy did not state explicitly the maximum percentage of ownership for the foreigners to acquire equity in Joint Ventures. The equity acquired by the foreigner was generally acquired either in respect of the participation in profits and assets or in appointment of directors responsible for management. This was an era where government actively pursued foreign direct investment, most of which came in form of setting up of foreign WOS in the FTZs and LMWs.

2.2.3 Phase 3 : Heavy Industrialization- Second Phase of ISI (Early 1980s–Late 1980s)

By beginning of 1980, the export-oriented industries had developed substantially alongside the import-substitution industries. The second phase of ISI was modeled around the success of South Korea's import substituting industrialization and was consistent with the Prime Minister , Dr. Mahathir Mohammed's "look east policy" (Jomo 1985). Heavy Industries Corporation of Malaysia (HICOM) was formed to initiate the heavy industrialization program. These were epitomized by setting up of iron & steel, cement, automobile and small engine industries. The initial failure of these projects to take off under stiff international competition resulted in heavy protection of these industries and massive external borrowings by the government to make these projects successful.

These projects survived because of continued government support, which was partly because of negative political consequences that might have resulted from abandonment of these projects. (Nazari, 1993). The recession accompanied by outflow of capital, resulted in at least 20 per cent depreciation of the effective exchange rate of Ringgit (IMF, 1986).

In brief, the heavy industrialization policy proved to be a heavy burden on the government's finances. (Chee, 1992, Jomo, 1990). During this phase also there was more importance given to FDI although formation of JVs was encouraged. But due to an open investment policy, major chunk of investment in electronics sector was through FDI.

2.2.4 Phase 4 : Renewed Commitment to EOI (Late 1980's onwards)

The government launched the Industrial Master Plan (IMP) in 1986, which had a planning horizon of a decade, as it's response to the deteriorating economic situation, after the factors affecting the economy were highlighted in a study conducted jointly by UNIDO & MIDA . The report highlighted the following major drawbacks that plagued the Malaysian Economy : (MIDA – UNIDO, 1986)

1. Dependence of manufacturing on a narrow base of labor intensive and resource based industries.
2. Very weak inter-industry linkages.
3. Heavy reliance of the manufacturing sector on FDI, which was dominated by large firms retaining control over technology, marketing and component supply.

The major recommendations of the study were in the areas of :

1. Improvement in indigenous technological capabilities
2. Further liberalization of the foreign investments

The findings of UNIDO – MIDA study (1986) led to the relaxation of the Investment Coordination Act, 1975 and Promotion of Investments Act, 1986. This resulted in the relaxation of the foreign equity ownership. Under the Promotion of Investments Act, 1986 foreign investors are permitted to hold 100 per cent of equity if they export 50 per cent or more of the production or employ more than 350 full - time Malaysians employees. They are allowed to employ up to five expatriates for various posts. The IMP I (1986–1995) also specified a shift towards the development of Electronics & Electrical Industry.

Malaysia is a favorite location for foreign investments especially in export oriented sectors (Nazari, 1993) and there has been increased inflow of foreign investment towards the end of 1980 due to relaxation of some stringent rules of NEP.

Despite of the phenomenal success of Malaysia's Industrialization process especially in the manufacturing, it is plagued with some structural problems. These are a) excessive concentration of exports in electrical and electronic goods, b) exports are not well diversified and are mainly directed to Singapore, Japan and USA. c) the electrical, electronic and textile industry are dominated by foreign MNCs

These structural weaknesses have been addressed by the IMP II especially in terms of inter-industry and inter-sectoral linkages and on low-skilled low-wages labor. The Second Outline Perspective Plan, the Sixth Malaysia Plan (1991–1996), the National Development Policy (NDP), desire to promote and protect indigenous manufacturing technology. These plans also attempt to diversify, restructure and mordernise the industrial base. The Sixth Malaysia Plan (1991–1996) continues to seek foreign investment but the shift is more towards capital-intensive and technologically sophisticated industries, which are in line with the new emphasis on upgrading of quality and technical sophistication of the labor force.

According to Edwards (1983), the Malaysian government's policies has been too supportive of the private sector without counterbalancing the discipline imposed on them. NEP does impose limited controls on equity structure, transfer of technology.

2.2.5 Malaysian Government's Present Policies Towards Joint Ventures

The Malaysian government welcomes foreign investment in the manufacturing sector. To meet the government's objective of increasing Malaysian participation the government encourages projects to be undertaken on a Joint Venture basis between Malaysian and foreign entrepreneurs[i]. Although government imposes no restriction on foreign equity ownership in case the project is for exports of more than 80 per cent of production. For projects exporting 51–79 per cent of production, foreign equity of up to 79 per cent is allowed. The government promotes Joint Ventures with foreign equity limited to 30 – 51 per cent in case the project exports 20 –50 per cent of its production. In case exports are less than 20 per cent then the foreign equity is limited to 30 per cent. However foreign ownership requirements can be relaxed provided the project employs high level of technology, spin-off effects, size of investments location and value added and raw material utilization policies. In such cases Joint Ventures aimed at domestic market can be approved with 100 per cent foreign equity.

From the above section it can be summarized that the Malaysian governments policy of attracting investment still continues to favour foreign direct investment as these are meant primarily for the export-oriented industry. The government actively promoted Joint Ventures for import-substituting industries like the industrial electronics sector. The open door policy of the government has brought significant returns, but at the same time the local industry continues to depend heavily on foreign MNCs. A more focussed policy to promote local electronics industry might result in bringing long-term benefits for the Malaysia.

2.3 BASIS FOR EVALUATING ROLES OF PARTNERS

In order to evaluate the role of domestic partner in a Joint Venture a comprehensive literature review was conducted and it was found that the roles of domestic partner could be defined by the needs of the foreign partner to enter into a JV. With context to our research paper the theory of need and commitment by Paul Beamish (1989) is taken as a basis for developing the research methodology. The same is briefly discussed in the next section.

2.3.1 Need And Commitment In Joint Ventures

The need and commitment of domestic and foreign partners can assess the long-term survival and success of any Joint Venture. These themes can be traced to the work of Freidman and Beguin (1971), Franko (1972), Robock and Simmonds (1973), Stopford and Wells (1972), Raveen and Renforth (1983), Killing (1983), Beamish (1989). Beamish (1989) in his study on Multinational Joint Ventures in developing countries had identified that the success of JVs depends on the needs and commitments of partners.

Virtually all the research done by the above academicians, stressed the difficulty of choosing partners when the social political and economic environment was rapidly changing. They noticed that Joint Ventures were formed as a result of uncertainty concerning the new market: apparent learning of the new market followed, then the need for the partner waned.

In context to our study on the roles of domestic partners, we can study their contributions from the context of the foreign partner's needs for forming the Joint Venture in the first place. The degree of success and the benefits accrued for the domestic partners by formation of the Joint Venture can be estimated form the commitment of the foreign partners in making the venture successful. Since the scope of the research is limited to domestic partner roles, we will not cover the commitment under our literature review.

According to Beamish (1989) the partners' needs are categorized as follows

1. Items readily capitalized
2. Human Resources needs
3. Market –access needs
4. Government / Political needs
5. Knowledge needs

These partner needs can be classified into five groups with three items each (except for four in the case of government and political needs). The same are give in detail in Table 2.1 and summarized below:

1. **Items readily Capitalized :** Capital is one of the only two reasons for which partners need each other, (the other being expertise) (Roulac, 1980). But the second need identified by Beamish is the assurance of raw material supply followed by technology and equipment. Local partners are needed by firms of developed countries as a means of spreading their technology to new markets.

2. **Human Resource Needs:** The need for technical, production, R&D experts, general managers, marketing personnel, make up for the human resource needs of the local partners. (Stoppard & Wells, 1972). Beamish classified the general managers in a separate category from rest of the "functional managers ". It is observed that the local partners may be more readily able to provide , the third human resource need i.e. access to low cost labor force than the multinational could if operating a wholly owned subsidiary.

3. **Market Access Needs :** In this category, the possibility of local partner needing a foreign partner to gain better access to the export markets for goods produced locally was pointed out Janger (1980). The second need included better access to any market : domestic or foreign. Part of this second need includes a partner need as mentioned by Killings (1978) : channels of distribution. Lastly the speed of entry into either the local or the foreign market is also an important need of both the partners.

4. **Government and Political Needs :** Beamish suggested three items of government / political needs reflecting three differing concerns of existing requirements, possible requirements, and potential advantages. Beamish included the 'need to meet government requirements' & the 'need to meet government import substitution

Table 2.1 : **Needs of Foreign Partner in a Joint Venture**

Domestic Partner Needs	Foreign Partner Needs
1. Items Readily Capitalized	
Capital Raw Material Technology / Equipment	Capital Raw Material
2. Human Resources Needs	
Functional Managers Marketing Production R&D / Technical Development	General Managers Low Cost Labour
3. Market Access Needs	
Access to Foreign Markets Foreign Channels Development Speed of Access o Foreign Market	Access to Domestic Markets Domestic Channels of Distribution Speed of Access to Local Markets
4. Government / Political Needs	
	To meet equity ownership requirement Gain Political Access Gain Political Advantage
5. Knowledge Needs	
Knowledge of Foreign Economies Transfer of Technological Know-how	Knowledge of Domestic Economies Operating Laws Labour Laws Factory regulation Customers Marketing Methods

Source : Adopted form Beamish Need & Commitment Theory policy' as suggested by Hill (1978), as the first concern. The next partner need included by him was "to satisfy forecasted government requirements for local ownership". Using Joint Ventures as a means of reducing political risk of intervention represents a logical decision for many companies operating in strategic sectors of the economy. The domestication / localization tendencies of LDC governments was highlighted by Poynter (1982). The last partner need in this section is local political advantages which includes better political access.

5. **Knowledge Needs:** General Knowledge encompasses operating conditions, labor laws, factory regulations, customer, and marketing methods (Newbould,1978). Therefore general knowledge of local economy, politics and customs is the first item of this category. The second item - general knowledge of the foreign economy, politics and customs reflects the perspective of the LDC partner. The third item was the knowledge of current business practices.

2.4 REVIEW OF STUDIES ON JOINT VENTURES

This section briefly reviews two studies that related our study on Joint Ventures. One of the studies is recent and was undertaken by World Bank. The other was conducted in Malaysia in 1979. The findings of these studies will throw further light on issues to be examined by our research. Besides there findings be used as a reference to compare the results of our research survey.

2.4.1 IFC Study On Joint Ventures In Developing Countries

In a recent study conducted by International Finance Corporation (IFC) in 1996 of 70 Joint Ventures operating in 6 developing countries (Philippines, India, Turkey, Brazil, Argentina and Mexico) the following needs and motivations of the foreign partners were found to be major cause for setting up Joint Ventures. The study highlighted the following motivations of the foreign partner for formation of Joint Venture.

2.4.1.1 Meet Government Regulations

Government policies and restrictions are a strong motivating factor in persuading companies to utilize JV structure in their market developing strategies. Still several companies tie up with local companies mainly to meet the government's regulation to have a link with a local firm. In certain countries, like India regulations restrict the foreign companies participation to a minority status. It is therefore easier to operate as a minority partner through JV rather than import over substantial trade barriers. JV's are also seen as an intermediate step in a long term strategy of MNC's to exploit the market through it's own wholly owned subsidiary, if and when the restrictions are relaxed.

2.4.1.2 Cost And Risk Sharing

It is observed that corporate managers with extensive international experience often see developing country markets as inherently more risky than operations elsewhere in the world. JV provides a mechanism whereby, the foreign companies can limit the financial exposure while at the same time gain experience in the new market. Provision of financing is the one of the most important and sought after contribution of the local partner.

2.4.1.3 Lack of Familiarity with the New Country

The JV provides a shorter and easier route to understanding the local conditions in a country . Lack of knowledge has several dimensions in all of which the local partner is expected to make a contribution such as local product adaptation, market & distribution channel familiarity, labor conditions, legal system, local customs and business ethics are a few to point out. Most of the foreign companies are ill equipped to handle the bureaucracy in developing countries, therefore companies look at JV partners to navigate expeditiously through government bureaucracies and local business circles to enable the success of their investment in the market.

2.4.1.4 Existing Facilities of Partners

In some cases local companies may have existing production and distribution facilities which can be readily used by the JV. It would be rather difficult , uncertain and cost - ineffective for the foreign company to produce and sell locally if these facilities were not existing.

2.4.1.5 Effective Technology Use

MNC's are valued for the technology they provide to the venture. But combining with the JV partner also provides the MNC with an opportunity to earn higher additional returns from it's R&D over and above the anticipated returns from alternative forms of technology exploitation such as licensing or export sales.

Table 2.2 provides a summary of frequency of mentions for important contributions made by the local partner in descending order of frequency and includes frequencies above 50 per cent.

Table 2.2 : **Major Contributions of Local Partners**

Knowledge of Local Politics	70 per cent
Knowledge of Government Regulation	68 per cent
Knowledge of Local Customs	68 per cent
Knowledge of Local Markets	65 per cent
Knowledge of Financing	58 per cent
Local Reputation	58 per cent
Access to local Markets	54 per cent
* Percent of JVs in sample where category was specified. Respondents could specify more than one category	

Source : IFC Discussion paper no. 29, World Bank, Washington, 1996

2.4.2 JVs Between Malaysian Public Corporations And Foreign Enterprises: An Evaluation

Abdul Razak's (1979) study deals with Joint Ventures between Malaysian Public Corporation and Foreign enterprises in the manufacturing sector. The study is based on the work of Freidman (1971), Stopford and Wells (1972) and tries to analyze the benefits to public corporations and international firms from the contributions of foreign partners and public corporations respectively. The research was conducted on 34 Joint International Venture firms with public enterprises in Malaysia. The subsequent section summarizes some of the key findings of his research survey.

2.4.2.1 Investment Strategy in Malaysia

The most important reason cited for going in for Joint Ventures was the preferential treatment accorded by the Malaysian government mainly to attract foreign investors. Even the state governments bestowed special privileges to attract the foreign investors. Secondly, the need and convenience of their associates' complementary resources and facilities was another important reason This reason coincided perfectly with the government's intention to acquire not only inflow of capital but also technical and industrial know - how.

2.4.2.2 Motivations for Joint Venture

The need of the state corporations to make use of the foreign partner's established channels of distribution , control of supply, and knowledge of international business practices to expand their activities abroad was a key reason. For the foreign partners the principle motive to go in for a joint venture was the desire to sell technology and industrial know - how in response to government subsidies of one form to another.

2.4.2.3 Financing

The Joint Ventures attached unquestionable significance to the local sources of funds. A greater dependence on local financing was experienced by those firms classified by low degree of foreign ownership and relatively smaller companies. The findings tend to support the view that the foreign partners came with insufficient capital investment.

2.4.2.4 Management Control

The results revealed that the foreign partner had considerable degree of decision making power in key areas of research, manufacturing methods and production planning. Although majority of the firms produced goods for Malaysian market and utilized local inputs, even the decision-making regarding marketing and purchasing was not free of foreign partner's dominance. Another significant finding of the study revealed that virtually all the minority foreign owners sought and often acquired representation on the management greater than the proportion of their ownership, instead of ideal representation in proportion of ownership of partners. Foreign associates had an effective say in the nomination of top executive officer of the joint company. The chairman, though was a local. Foreign Managing Directors were employed in medium - sized or export oriented firms. The foreign partners also exerted control by creating executive committees (which composed of foreign personnel employed in the sales and plant divisions) that had overriding authority in certain circumstances.

2.4.2.5 Transfer of Technology

Research and development was only conducted by 10 per cent of the firms mainly limited to improvement in present products or processes and this was coordinated by the foreign partners. Cost considerations and absence of qualified research personnel were the main reasons cited. It was also easier to access results of R & D from foreign associates' firms abroad. In case of tangible assets, the Joint Venture imported machinery and materials either from the foreign partner or from any other source the latter may choose. There was a high dependence on imports especially by firms involved in higher level of production process, mainly due to either absence of locally made components, inferior quality of local products or uncompetitive local prices. Apart from the loss of external linkages to the local suppliers and contractors, the pricing of components supplied by the foreign partner was another problem associated with transfer of tangible assets. Most of the local executives assumed that the possibility that higher prices were charged. For transfer of intangible assets, in all the firms, although the foreigners had supplied the venture with complete blue prints of design and technology. Locals lacked the capabilities of understanding the technical details. Training was provided by the foreign partner, either by transferring sufficient personnel to and from associated firms or by providing on–the job training.

2.4.2.6 Market Access for Exports

In many cases there were arrangements for the JV to enjoy the advantages of the foreign affiliates world wide marketing organization. Export activities were mainly the responsibility of the foreign partner. There was evidence of widespread incidence of restrictive business practices, particularly in export and marketing arrangements. While exports to South East Asian markets was allowed, gaining access to other markets was restricted.

2.5 CONCLUSIONS

MNCs will continue to seek opportunities for marketing their product and technology abroad. The form of market entry strategy is primarily guided by the local investment policy of the country they plan to venture into. From the perspective of developing countries like Malaysia, Joint Venture investment must be promoted aggressively by the government in order to upgrade the manpower skill and manufacturing level of local electronics industry. From the literature review covered earlier we can summarize that the domestic partners' major role in a JV is a) to provide political support b) knowledge of local regulation, customs and c) to provide market access.

Whether these role change over time is the topic of our research. It depends mainly on the domestic partners ability to assimilate knowledge and technical know-how, which was lacking during the late 1970s as pointed out by Abdul Razak (1979). His research raises some new issues like lack of transfer of technology, low research and development activity, inaccessibility to foreign markets amongst others. The domestic partners dependence on their foreign counterparts continues to remain high.

This serves as a starting point for us to come up with our research methodology, which is discussed in the next chapter.