Influence of Parent Company's Organizational Dimensions on Its JV Performances – Opportunism Occurrence and Control Efficacy

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Abstract

How does a parent company organizational dimension affect its joint ventures' performance in a transitional economy? We explored that question through an analytical inductive case study. Our findings indicate that the confluence of a function-oriented matrix form and lack of formal procedures at the strategic level led to a fief-like organization in which its functional departments hold high power and low accountability while its JVs' management team hold low power but high accountability. Such a fief-like organizational parent makes a negative contribution to its JV performance by adding difficulty to its JV formal control, introducing department-driven opportunism through imposing inside hierarchical goals upon its JV, leading to a low opportunism control efficacy as the result of the separation of opportunism beneficiary from the costs. The negative contribution from the fief-like organization is due to its organizational injustice and a reverse arrangement between authority power and accountability.

Keywords: Parent organizational dimensions, Joint ventures performance, Opportunism, Control efficacy

1. Introduction

Despite inter-firm collaboration as joint ventures (JVs) has become a critical part of corporate strategy and firm growth in the worldwide market (Luo & Park, 2004), the failing rate in JVs, especially in international joint ventures remains high, varying from 30% to 70% (Hennart & Zeng, 2002; Parkhe 1993). This warrants a great of attentions from both scholars and practitioners on what make a JV succeed or fail.

The nature of any joint venture is a loosely coupled system in which investing parties interdependently share existing resources or jointly develop new resources while maintaining their respective parental identities and resource control (Luo & Park, 2004). To some degree all JVs inevitably involve opportunistic behaviors by individual parties or fiduciary risks of interdependence between parties (Das & Teng, 1998; Parkhe, 1993). Opportunistic behaviors not only hurdle the establishment of a trustful relationship between parties by hampering interparty confidence, commitment and synergy creation, but also add a great deal of uncertainties to the success of JVs (Luo & Park, 2004).

A wealth of research has addressed opportunism from different perspectives such as economic environment (Luo, 2007), reprioritization, and over-commitment (Verbeke & Greidanus, 2009). The extant literature lacks of a research that addresses how parent company's organizational dimensions contribute to JV opportunism through parent control channels. Organizational factors are significant determinants of firm performance (Hansen & Wernerfelt, 1989) because organizational structure is an essential element for strategic implementation (Okumus, 2003). Previous research indicates that controls exercised by parents over their JVs have been one of critical determinants on JV performance and success (Geringer & Hebert, 1989). A study of a paradigm of parent organizational dimensions, parent control and its JVs, and JV performance would help us understand the complexity of JV performance and influencing factors.

The objective of this article is to examine how parent organizational dimensions influence its JV performance through the lens of opportunism. We use an equity joint venture established by two multi-national oil companies as a context for our theoretical development and empirical verification. The contribution of this analytical inductive study is four-folds. It elucidates that a function-oriented matrix company in transition economies leads to the formation of a fief-like organization unintentionally when it lacks of control function at the corporate strategic level. Such fief-like organizations facilitate JV opportunism through parent function-directed inside control. Thirdly this study shows incapability of the micro-defined deterrence mechanism in controlling parent department-driven opportunism as a result of the separation of opportunism beneficiary from the opportunism costs. We also discovered that such a separation is a consequence of reverse arrangement between authority power and accountability and organizational injustice when a JV is embedded in a fief-like parent company hierarchy. Using those findings we developed a theoretical framework to illustrate the paradigm of parent organizational dimensions, parent control – JV relation, and JV performances.

2. Background

2.1 Parent organizational dimensions: matrix structure and organizational justice

There are a variety of organizational structures for determining the number of levels and the set of activities that are grouped together. This study is focused on a matrix-form structure of parent companies in which a JV is embedded. People and resources in a matrix structure are grouped simultaneously by function and by product/project (Qian, Gerard & Xu, 2006). Vertical controls exerted by functional lines are kneaded with horizontal controls from project lines forming a complex controlling and reporting relationship. Employees in a project (as an example of a JV) are subject to dual controls from both function bosses and the project leader (Jennergren, 1981) that may affect employee behaviors when they face conflicting loyalties. Consequently project's performance will be affected as its employees tend to bend toward their function leaders who control their purse strings (Kerzner, 2006).

A JV formed by at least two parent companies with two distinct organizational structures will no doubt face a more complex control than a fully-owned project does. Each of the parent companies tries to exert its influences and control by embedding the JV into its own hierarchy (Geringer, 1988) in order to maximize its gains (Kogut & Zander, 1996).

Another factor that may have impact on JV's performance is parent company organizational justice that deals with how decision making procedure affects those who have a stake in, but limited control over the outcome of the decision (Johnson, Korsgaard & Sapienza, 2002). In the past, organizational justice has been used to explain employee theft, social conflict and hindering of cooperation (Greenberg & Scoot, 1996; Lind, 1995). Kim and Mauborgne (1991) found that there is a strong positive correlation between organizational justice and the commitment of a management team. Here we extend this concept to investigate how parent organizational injustice affects its JV performance.

2.2 Opportunism in JVs: driving forces and curbing mechanism

In transaction cost theory, opportunism is defined as "self-interest seeking with guile" (Williamson 1975, p 6). Guile is described as "lying, stealing, cheating, and calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse" (Williamson, 1985, p47). In a JV setting, opportunism is defined as "an act or behavior performed by a party to seek its own unilateral gains at the substantial expense of another party and/or the joint venture entity by breaching the contract or agreement, exercising private control, withholding or distorting information, withdrawing commitment, shirking obligation, or grafting joint earnings" (Luo, 2007).

Besides the self-interest seeking nature of human beings, the driving forces of opportunism in a JV are easily influenced by its context (Luo, 2007), such as asset specificity, environmental uncertainty, and relational norms (Ashwin & Rodney 1999), reprioritization and over-commitment (Verbeke & Greidanus, 2009). Current literature has not paid attention to parent company's organizational dimension influences on its JV performance, especially on opportunistic behaviors and control. A parent company is an immediate operational context of JVs. Its organizational structure presumably has some impact on its JV performance through parent control channels.

Furthermore, there is scant research on the efficacy of opportunism control in JVs (Brown, Dev, & Lee, 2000) that deserves a great attention because it has dramatic effect on JV's performances and relationships among all the stakeholders. According to Kramer (1990) and Luo (2002), each of the partners in JVs is economically rational being and acts calculative. Opportunism can be controlled through a calculative process such as imposing high costs to the opportunistic party who would refrain from opportunistic behaviors if cost of opportunism is higher than its benefits (Doney, Cannon & Mullen, 1998). However, such micro-defined calculative process may be limited when several groups of a parent company with different interests are involved in opportunistic behaviors (Das & Dahman, 2002; McEvily, Perrone & Zaheer, 2003; Winter, Smith, Morris, & Cicmil, 2006). Multiple group involvement in an opportunistic behavior adds high complexity to effectively deterring opportunism. Absence of an analysis of its complexity would lead to a low control efficacy and ultimately contributes to poor JV performance.

3. Research Method and Data Collection

3.1 Research Method

The traditional single case study method was selected for the purpose of this research due to high complexity of the JV itself, inter-wired networks with each of the parent companies, and involvement of multiple groups that have different interests from the same parent company. The single case study method enables us to gain a deep understanding of JV setting through getting as close as possible to the real-life context of managers (Dyer & Wilkins 1991) and thus recovering and preserving the actual meanings that actors ascribe to those actions and settings (Gephart, 2004, p455). Such a research method is especially useful for "developing theoretical insights when research focuses on areas that extant theory does not address well and when the research question is a process one" (Ozcan & Eisenhardt, 2009, p249) such as ours.

3.2 Case Selection

The JV under the study was jointly formed between two of the world major oil companies in the Middle East: one parent company is a Chinese state-owned company named as CHINOIL while the other parent is also a state-owned company named as MIDOIL that is based in the Middle East. The name of the JV is coded as CM. The goal of CM was to explore, appraise, and develop non-associated gas reservoirs and natural gas liquids in the Middle East.

CM was formed in 2004 with MIDOIL holding a 20% of participation interest and CHINOIL holding 80%. All the Chinese secondees were directly deployed from CHINOIL functional departments. MIDOIL's employees were assigned through the MIDOIL Project Management Office (PMO). Officially CM is a distinct entity separated from its founders' architectures per the Shareholder Agreement.

3.3 Data Collection

We relied on three primary data sources: first-hand knowledge, archives, and informal discussions. The author was the contracting manager of CM during 2004-2008 and thus developed first-hand in-depth knowledge of CM, including the parent companies' organizational dimensions and controls, and opportunistic behaviors observed in CM. The archival data include emails, Board meeting minutes, internal reports, official agreements, and documented communications between CM and its parent companies.

To ensure the accuracy of the data and improve the robustness of the resulting theory, we triangulated the data in various ways (Anand, Gardner & Morris, 2007). We studied and compared different archival data and then compared that data with our first-hand knowledge. When an inconsistency emerged, we contacted the senior managers in CM and the parent companies for clarifications. This rigorous comparison and analysis not only allowed us to avoid any potential biases but also ensured data validity.

3.4 Data Analysis Method

Following Santo and Eisenhardt (2009) and Yan and Gray (1994), we used an analytical inductive method, which is appropriate for this case study. We began with an in-depth case analysis through the lens of a research question (Eisenhardt, 1989): *How do parent organizational dimensions affect its JV performances?* We started our analyses with CHINOIL organizational structure to identify its organizational form, power construct, and the major players. A further analysis was made to extract relationships between CHINOIL organizational dimensions and CM performance. Through multiple events analysis and comparison, insights about the influence of parent organizational dimensions on JV performances merged based on consistent patterns and themes (Santo & Eisenhardt, 2009). We followed an iterative process of cycling among prepositions, data, and literature to refine our findings, relate them to existing theories, and clarify our contributions' (Santo & Eisenhardt, 2009: 648).

4. Results

4.1 Features of CHINOIL organizational structure

CHINOIL as a state-owned company in transitional economies was run as a functional-oriented matrix form in which authority power is mainly distributed in functional areas. Each of the functional lines is led by individual vice president (VP) who is authorized for both strategic and operational control over particular functional area. At the same time, CHINOIL has a dozen of oversea projects in the form of JVs, such as CM, across the functional lines forming a matrix structure. The official rank and delegated authority of project leaders who have no direct staff and control over resources are junior to the functional line managers.

Vertically a VP in function areas is devoted to controlling everything in very detail from function strategic planning to operational control. At the corporate strategic level, CHINOIL lacks of a control procedure in place to monitor, coordinate, and integrate functional areas and their interests toward the corporate strategic objectives and goals. The VPs tend to consider their designated functional areas as their own territories pursuing their own interests and won't allow others to intervene with their businesses. Such features are similar to that of fiefs. We named such organizations as fief-like organizational structures.

Consequently the functional bosses have superior positions over those JV leaders. Such power distribution creates some problems to the JV operations, which is the focus of this study.

Preposition 1: The confluence of the functional-oriented matrix-form structure of a transitional company and lack of monitoring and coordinating functions at the corporate-level tends to develop absolute powers in functional areas, forming a fief-like organization.

4.2 Dual Control

CM is one of CHINOIL oversea JVs and was treated to some extent as a fully-owned project by being embedded in the CHINOIL function-oriented matrix organizational structure. It experiences dual controls from the functional areas of CHINOIL as well as from CM Board and Management Team (MT). The latter represent parents' overall interests.

The control from CHINOIL functional areas is considered as an inside control within the CHINOIL hierarchy. It is excised through functional department appointing and directly supervising CHINOIL MT members and directors in CM. Although the inside control is not formal and obvious to the CM MIDOIL members, to the CHINOIL managers it has higher status than the CM formal control – the Board and CM MT, due to CHINOIL fief-like hierarchical organizational structure and the nature of CM as a temporary project.

Proposition 2: Parent function – directed inside control adds some difficulty to the JV formal control.

4.3 Functional department-driven opportunism

In 2005 the Engineering Department of CHINOIL established a service center to provide services and products to CHINOIL JVs for profits. The prices of all the services were pre-determined and not negotiable. Under the pressure of the CHINOIL Engineering Department who directly commanded the drilling department of CM to purchase the drilling supervision services at a pre-determined rate exclusively from CHINOIL, CM drilling department manager who was seconded from CHINOIL Engineering Department politically didn't have any choice but accepted the order.

There are several aspects associated with the purchase of the drilling supervision service that are not consistent with the Shareholder Agreement or the industry practice. First the purchasing rate of the related –party transaction service was much higher than the market price. Second, the Engineering Department of CHINOIL ordered CM not to contract any other sources for similar services even if the rate may be more favorable. Third, drilling supervision service is not considered to be urgent and confidential (otherwise such services have to come from the parent companies) and was available in the host country market. According to the Shareholder Agreement the competitive bidding procurement procedure should be used for purchasing such services, instead of sole source as required by the CHINOIL functional department. As the result of the inconsistencies between the Shareholder Agreement and the drilling supervision service purchase, MIDOIL questioned such transactions and considered the CM's Chinese management team having performed opportunism.

Proposition 3: A fief-like parent company most likely makes a negative contribution to its JV performances by function department pursuing its own interests.

4.4 Efficacy of deterrence mechanism

Per the Shareholder Agreement all the related – party transactions are subject to the board monitoring and require an approval of non-related-party directors if the amount of a transaction exceeds the threshold specified in the Shareholder Agreement. Non-related-party directors are defined in the Shareholder Agreement as those who are nominated by shareholders other than the related party.

Once perceiving their partner perform opportunism, MIDOIL increased its opportunism control level by imposing a more restrictive approval procedure for all type related–party transactions with CHINOIL. Besides its project management office, MIDOIL added its Legal Department as an additional checkpoint before a request for a related – party transaction with CHINOIL reaches the non-related party director for his approval.

With addition of the new checkpoints, the approval procedure for related – party transactions between CM and CHINOIL became more constrained and time consuming. The time frame needed to receive a final approval is three-fold more than before. For example, it took 83 days to extend the CHINOIL drilling supervision service contract, 63 days more than before. The new approval procedure dramatically slowed down all the operations and subsequently increased the operational costs such as crashing projects in order to meet project schedules. Based on the percentage of the shared interests, CHINOIL who holds 80% bore more costs than MIDOIL did. Furthermore, the costs of the opportunism had far exceeded the benefits. Ironically such costs were never added to CHINOIL Engineering Department, a real opportunism driver and beneficiary. This is a result of the fact that the functional departments in the fief-like parent company don't hold accountable upward to the CHINOIL strategic level and downward to CM. And opportunism beneficiary and cost bearer were unintentionally separated in CHINOIL fief-like organizational dimensions.

As a consequence of the separation of opportunism beneficiary from the costs, CHINOIL Engineering Departments continued selling their services to CM even the associated costs to CM and CHINOIL had exceeded the benefits.

Proposition 4: Micro-defined deterrence mechanism derived from the transaction cost theory doesn't apply to the situations in which opportunism benefit is separated from the associated costs.

4.5 Organization injustice - reverse arrangement between accountability and power

As mentioned before, the control exerted by the functional departments of CHINOIL was considered as an inside control within the CHINOIL hierarchy. It is not shown in CM controlling and reporting system. So, functional leaders are not held accountable for their decisions because they are not visible in the CM system. Instead, it was the CM Management Team, (especially CHINOIL Management Team) have to justify all the decisions made by CHINOIL functional bosses in front of the CM Board and MIDEOIL.

Within CHINOIL organizational structure, functional departments have higher authority power than CHINOIL CM management team does. The latter is subject to the control from their functional departments. Within the CM hierarchical system, CHINOIL management team holds high accountability to the CM and the Board. And the Board holds accountability to the two parent companies. Obviously CHINOIL functional departments don't hold accountability upward to CHINOIL (they don't need to report CM performance to CHINOIL) and downward to CM (they are not present in the CM system). But they hold authority power.

According to the Board meeting minutes from 2004 to 2008, none of CHINOIL functional department heads who had attended the Board meeting has ever claimed the ownership of and defended their decisions they made on the related-party transactions. It is always CM CHINOIL management team who had to stand in front of the Board to answer their questions and accepted their criticism. Such twisted relationship between accountability and power leads to organizational injustice which in turn contributes to opportunism occurrence and low control efficacy in CM as illustrated before. It is worthy to mention that the problems with the opportunism were not solved until 2008.

Proposition 5: Organizational injustice of a parent company as the result of a reverse arrangement between accountability and power contributes to its JVs' continuous poor performance.

5. Toward a theoretical model of the influence of parent organizational dimensions on its JV performance

In the prior section, we sketched the organizational dimensions of a JV parent company, relationship with its JV in terms of authority and accountability, and parent organizational influence on the JV performance. We derived five prepositions as depicted in Figure 1. These findings are organized around three areas – parent company's problematic organizational dimensions; relationship between the parent company and its JVs; and Its JVs' performance.

In a typical transitional company in transition economies, previous formal constraints have been weakened and the new formal processes have not been established to fit market-based economy (Peng & Heath, 1996). CHINOIL split its previous centralized control among its functional departments and at the same time not only lacked the formal control procedures in place cross the departments, but also lacked a control function at the corporate strategic level to monitor and coordinate departmental behaviors and integrate their interests toward the corporate strategic objectives. As a result, a functional-oriented matrix organization situates itself in a fief-like organizational structure forming absolute authority power in functional areas (proposition 1).

Fiefs, such as CHINOIL, are characterized by very restricted information diffusion; personalized economic relationship; hierarchically imposed goals; hierarchical coordination; and high uncertainties (Biosot & Child, 1996). At the same time, CHINOIL has been trying to expand its business by forming oversea JVs. CHINOIL JV MT heads hold a lower official rank than and are subject to the control of function leaders . Consequently the JVs experience dual controls – a formal control from its JV board and MT and a hierarchical inside control from CHINOIL functional lines. As suggested by the features of fiefs, the formal control of the JV would face difficulty when hierarchical goals are imposed by CHINOIL functional lines (proposition 2). Such hierarchical goals make a negative contribution to its JV performance when the purpose of function lines is to pursue their own interests at the expense of its JV partner (Proposition 3).

Micro-defined control mechanism employed by MIDEOIL over CHINOIL function-driven opportunism is based on the rationality of the transaction cost theory. That is all the partners in JVs are economically rational beings and act calculative (Child, 2001; Kramer, 1999; Luo, 2002). It suggests that a party would refrain from opportunistic behaviors if the associated cost of such behaviors being caught is higher than its benefit or reward (Doney, Cannon & Mullen, 1998). Such rationality is based on an assumption that a partner and its subdivisions and departments all act together as one economic unit. Such an assumption is not valid in this study. Table 1 presents the economic analysis for all the players related to the function-driven opportunistic behaviors in CM. Both CM and CHINOIL bore the opportunism costs while CHINOIL Engineering Department, the major beneficiary of the opportunism, bore no costs due to its separation from the CM's accountability.

Our findings indicate that the transaction cost theory derived control mechanism appears in principle not capable of solving opportunism problem due to the separation of opportunism benefit from the associated cost (proposition 4). In another word, the partner, its function departments, and JVs are separated economic units and they don't act together as the result of lack of controlling functions at the corporate level to monitor departmental behaviors, coordinate departmental interests, and integrate different interests at different levels toward a common strategic objective in the company. Such organizational dimensions also lead to the reverse arrangement of authority power and accountability between functional departments and JVs and ultimately organizational injustice. As stated by proposition 5, organizational injustice of a parent company contributes to the poor performance of its JVs by adding its hierarchical control over the JV's board control and imposing hierarchical interests upon the JV.

In summary, this article began by describing a high dissatisfactory rate of JVs and lack of an important study of the influence of a parent organizational structure dimensions on its JV performance. The findings here suggest that a parent organizational structure has unintended but notable impacts on its JV performance through people's psychological, sociological and physical interactions (Hensen & Wernefelt, 1989) between parent functional areas and its JVs. This explains the JV acceptance of the CHINOIL departmental hierarchical imposed order, un-resistable parent inside control, unavoidable department-driven opportunism, and difficulty for controlling such opportunism. Overall, a fief-like parent makes a negative contribution to its JV performance.

6. Managerial implication

The managerial implications of the influence of parent organizational dimensions discussed above are important for improving JV performances from the perspective of JV parent companies. Parent companies in transitional economy shall examine its organizational dimensions to avoid unintentionally formed fief-like organizational structure, reversal arrangement between power and accountability, and department imposed goals upon its JVs that conflict with corporate long –term strategy.

JV joint partners that share similar organizational culture contribute high success rate of JVs (Fey and Beamish, 2001). But with economy globalization, business between different companies with different organizational dimensions and between different countries with different cultures is inevitable. Our findings of low efficacy of opportunism control as a confluence of separation of opportunism beneficiary from cost and assumption made by MIDOIL that CHINOIL, its functional departments, and its JV management team acted cohesively as one interest entity suggest that it is necessary and essential for a parent company to know and understand its partner's organizational dimensions. Such knowledge and understanding would help pinpoint problems occurring at the JV and address them efficiently and effectively.

7. Conclusion and future research

This study suggests that a perspective of parent organizational dimensional influence on its JV performance provides insights on JV management and performances. The relationship between a JV and its parent companies appears to be contingent on parent organizational dimensions, which at least applies to the context of transition economies.

In today's global environment, with expanding markets in transitional and developing economies, JVs' performances to some extent determine success or failure of their parent companies. Taken together, our findings contribute JV literature through our understanding of how parent company's organizational dimensions influence its JV performances and offer insight view of how to improve JV performance from the lens of parent organizational perspectives.

This study has several limitations that merit further investigation in future research. First, the conclusions are subject to the limitations that are attached to a single case study, and the conceptual model presented was not tested in a quantitative sense. Second, our study is geographically limited to Chinese transitional company. The explanatory value of our findings needs to be replicated and confirmed in future studies.

Besides the limitations of this paper that need to be addressed, future studies need to qualitatively and quantitatively determine how of knowledge and understanding of partner's organizational dimensions including organizational culture help a parent company to improve its control over its JVs and thus enhance its JV performances.

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Table 1. Cost and benefit analysis of functional department-driven opportunism for CHINOIL players.

Elements	CHINOIL Players		
	CM	CHINOIL Engineering Dept.	CHINOIL Corporate
Cost	1. Bad relationship with MIDOIL; 2. And CM poor performance	None	1. High operational costs, 2. Loss of partner's trust 3. Loss of further cooperation opportunities with the partner 4. Loss of international reputation
Benefit	None	Departmental income	Departmental income
Cost vs. benefits	Cost > benefits	Cost < benefits	Cost > benefits

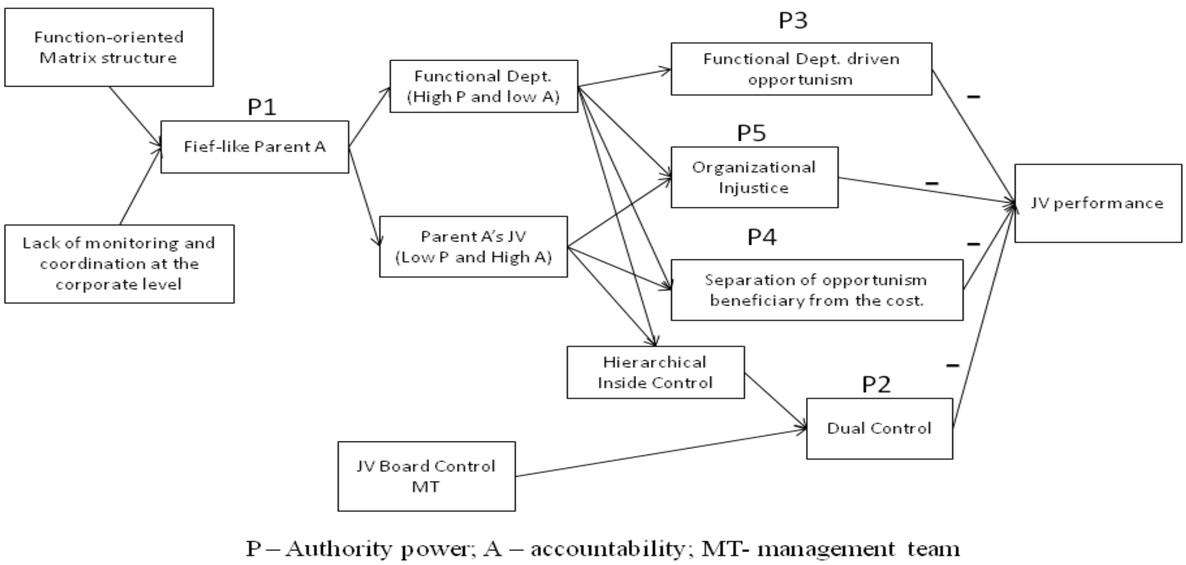

Figure 1. Theoretical framework for the influence of parent organizational structure on its JV performance