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Internalization of IJVs and Institutions

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Introduction

Joint ventures (JVs) can be temporary organizational forms (Franko, 1971; Peng & Shenkar, 2002; Serapio & Cascio, 1996). Upon termination, a JV can be sold off by its present parent firms to a third party; one of the parent firms can buy the remaining controlling shares from the other parent(s), or the firm may be liquidated. In case of insolvency, or when both the parents decide to exit the business because of changes in their corporate strategies, they are likely to choose sell-off or liquidation. When only one of the firms

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considers the JV unfit for its current strategy, it may choose to terminate the venture (Raghunath, 1998). In such cases, the other partner(s) may choose to acquire the shares of the exiting partner or have a third-party firm buy those shares and become a new partner in the JV.

When all of the parent firms are interested in continuing to do business in the same sector as that of the JV, and not pursuing more market-oriented (vs. hierarchy-oriented) mode choices, such as licensing, the mode change choice should lead to a wholly owned subsidiary (WOS) (Makino, Chan, Isobe, & Beamish, 2007). In such cases, the JV is a good acquisition candidate for its parent firms, upon termination. With full knowledge of its operations, the scope of due diligence required is lower, and the JV may be more readily integrated into the partner firm, as the JV's culture is likely to have some imprint from that of its parent firms. The JV can add immediately to resources of the parent acquiring it, giving scale and/or scope advantages to the acquirer. At the same time, the other (former) partners lose these advantages. While they can make up for it by either acquiring another firm with similar operations or undertaking a greenfield investment, these actions will incur additional costs associated with search, due diligence, and integration, in case the other partner(s) choose(s) to acquire another firm from the market. A greenfield investment will require time to attain the scale of the JV. Such transaction costs, however, may not be covered by the price at which the selling partner(s) release(s) the JV stake(s) to the acquiring partner. Hence, if a partner wishes to continue operating in the JV's business segment, there is logic in their competing strongly with the other partner(s) to acquire the JV. Because of these advantages, the JV should be a more appealing acquisition target for the parent firms, rather than for others. Moreover, the parent firms have deeper knowledge about the JV, relative to other firms in the market. Hence, the costs should be higher for third-party firms, because of the increased costs associated with due diligence and integration. Thus, JVs, upon termination, are highly likely to be internalized by one of the parent firms (Steensma, Barden, Dhanaraj, Lyles, & Tihanyi, 2008).

"Internalization" is an often-used term in the international business literature (Dunning, 2003). As used in the context of internalization theory, it discusses the boundaries of the firm's decision making, building

on transaction cost theory; intermediate products and services for which markets are imperfect can be internalized, such that they are owned and controlled within the firm. These theories are used to help identify mode choice when firms internationalize. When discussing internalization in the context of JVs, we use the term more generally, compared to the way it is used in internalization theory. Consistent with Meschi (2009), we use "JV internalization" to refer to the acquisition of the JV by a partner firm, who turns it into a WOS.

This scenario is important for strategy scholars, as it provides a micro-analytic view of competition and mode change. Several constructs, derived from different theoretical perspectives, can be studied and tested for how they relate to internalization at this level. To this, we add the constraint that the JVs are international (i.e., firms from different home countries partner to form the JV), and apply an institution-based view (Peng, 2002; Peng, Sun, Pinkham, & Chen, 2009; Peng, Wang, & Jiang, 2008) to study how institutions shape the internalization. Regulative, normative, and cultural-cognitive systems are considered the three pillars of institutions (Scott, 2008b). The impacts of national culture, representing the third pillar, on mode choice, performance, and switching are well-researched (Barkema & Vermeulen, 1997; Brouthers & Bamossy, 2006; Hennart & Zeng, 2002; Kogut & Singh, 1988; Pothukuchi, Damanpour, Choi, Chen, & Park, 2002). Considering regulatory pillar, the nature of governmental regulations, especially their complexity, will be a major factor (Dikova & van Witteloostuijn, 2007). However, public choice theory suggests that more regulations can breed corruption (Djankov, La Porta, Lopez-De-Silanes, & Shleifer, 2002). Because corruption can be a strong norm to follow, it can act as an institution under the normative pillar, and it serves to change the effectiveness of the regulations (Weitzel & Berns, 2006). These institutional factors can create friction in terms of one partner's trying to acquire the JV, whereas they may act as sources of competitive advantage for another. We study this issue in this chapter, and try to find out how each aspect is likely to affect whether foreign or local partners internalize the international JV (IJV).

India represents a good context for this study. Since liberalization in 1991, regulations have been reduced in many industries, and the JV is no longer a government-mandated mode of entry in most industries.

We study India after a decade of liberalization, so that the firms of interest are confident of a stable regulatory regime. Few scholars have considered India for such research (Kozhikode & Li, 2012), with more choosing to study China as a representative of developing or emerging economies. However, unlike China's communist capitalist economy, India has a democratic capitalist economy, which gives it institutional environment that is more prevalent in many other countries. Hence, the outcomes of this study may offer enhanced generalizability.

Literature Review

Considerable research has been done on JVs (Beamish & Lupton, 2009; Christoffersen, 2013). According to Parkhe (1993), most of the literature on IJVs has focused on the motives for IJV formation, partner characteristics and selection, control and conflict, and IJV stability and performance. When Parkhe (2006) reviewed the field again, the results were very similar. Knowing that the termination rate of JVs is as high as 30–70 % in various samples (Buckley & Casson, 1988; Kogut, 1989; Park & Russo, 1996), many researchers have studied JV termination, aiming to understand causal factors (Ren, Gray, & Kim, 2009; Yan & Zeng, 1999). Still, there have been very few studies exploring aspects beyond the factors leading to JV termination. One understudied aspect is the evolution/transformation of a JV into a WOS of one of the partners (Hennart, Kim, & Zeng, 1998; Kogut, 1991; Reuer & Miller, 1997; Steensma et al., 2008). Instead of branding JV termination as "failure", it can be considered as an option for growth and expansion (Kogut, 1991), with acquisition of the JV by one partner treated as the exercise of such an option (Barkema, Shenkar, Vermeulen, & Bell, 1997; Bleeke & Ernst, 1991; Dussauge, Garrette, & Mitchell, 2000; Gomes-Casseres, 1987; Hennart et al., 1998).

Uncertainties increase the costs of maintaining the JV (White & Lui, 2005), which means that a partner may acquire it in order to reduce transaction costs (Chi & Seth, 2009). Also, when the risk associated with further investment is low, the cost of acquisition is lower than benefits of the JV, and it is comparable to similar assets in the market; a partner

firm may acquire the JV to completely appropriate the benefits rather than sharing them (Folta & Miller, 2002; Kogut, 1991). Acquiring the JV offers advantages over other acquisitions, because of the easier integration; effective integration is what enables acquisition success (Haspeslagh & Jemison, 1991). Because termination of a JV through acquisition by one of the parent firms means that the venture tips toward one side or the other, we study the impact of the institutional environment to understand to which side the venture is likely to lean. Therefore, we review the literature on JV termination and internalization, followed by the literature on institutions and regulations. In addition, a brief history of the institutional environment for firms in India is presented, to develop an understanding of the context of the empirical study.

JV Termination and Internalization

Theorizing on inter-organizational relationships has been based on many perspectives (Barringer & Harrison, 2000; Faulkner & De Rond, 2000). One of the most prominently used perspectives in the JV literature has been transaction cost economics (Tsang, 2000), which looks at JVs as a hybrid form of organization, between market and WOS, on the basis of the level of uncertainties prevalent (Williamson, 1991). Under the transaction costs framework, as the uncertainty resulting from market inefficiencies goes up, the preferred mode to organize the transaction changes from market to a hybrid option, and then to a WOS. However, another key theoretical perspective, based on real options, suggests that a firm would do well to invest in a JV under such circumstances, and wait for a better opportunity when the uncertainty is lower; that is, under high uncertainty, limit risk by committing less, and increase the investment when the risk is reduced (Ahsan & Musteen, 2011; Chi & Seth, 2009). This apparent conflict between the real options and transaction costs approaches is resolved with an understanding of the distinction between the uncertainties being considered. In the transaction cost approach, the uncertainty is viewed as endogenous, the type of uncertainty that the firm can reduce with investment. In the real options approach, the key uncertainty is exogenous, which cannot be affected by a firm (Folta, 1998; Folta & Miller, 2002).

Neither the transaction cost nor the real options perspective considers aspects such as trust and reciprocity in relations. The transaction cost view is based on an underlying assumption of opportunistic behavior. Game theory, however, suggests that partners benefit in the presence of mutual trust, which enriches relational capital. The typical use of transaction cost theory does not account for repeated transactions, which can be treated as an iterative prisoners' dilemma; to understand that, in a one-off game, one may act opportunistically but, in repeated games, benefits are maintained by trust and reciprocity (Axelrod, 1984; Faulkner & De Rond, 2000; Gulati, 1995). Moreover, from both the knowledge and resource-based views, trust and reciprocity are required for the firms to be able to share tacit resources, on top of the contract- mandated sharing of explicit resources between partners (Osborn & Baughn, 1990). The resource-based view suggests that, instead of considering cooperation as a middle path, it can be viewed as a way to improve sustainable competitive advantage by gaining from resource combination (Das & Teng, 2000b; Kimber & Raghunath, 2001; Tsang, 2000). In fact, the relationship itself can be considered as a resource that contributes to competitive advantage (Madhok, 2000; Madhok & Tallman, 1998). The organization learning perspective suggests that JV destabilization may be the result of one partner's having won the "learning race" and gained its desired level of knowledge from the relationship (Hamel, 1991). Considering property rights, the formation of the JV entailed partners' each investing less than what would have been required for complete ownership (Ramanathan, Seth, & Thomas, 1997). Once the value that can be appropriated by acquiring full ownership property rights exceeds their cost, for one partner, internalization is the logical strategy.

JV termination stems from instability. Research in this area has often considered stability as representing performance (Parkhe, 1993; Ren et al., 2009). Studies on termination have tended to focus on longevity, specifically JV duration (Dussauge et al., 2000; Hennart et al., 1998). Upon termination, JVs are necessarily either dissolved or acquired (Das & Teng, 2000a; Park & Ungson, 1997). From studies related to JV termination, some prominent factors considered are bargaining power, commitment, control, trust, justice, conflict, cooperation, cultural differences,

goal congruity, external environment, and parent characteristics (Ren et al., 2009; Yan & Zeng, 1999).

Yan and Gray (1994, p. 1480) define bargaining power as “a bargainer’s ability to favorably change the bargaining set, to win accommodations from the other party, and to influence the outcome of a negotiation”. Firms engaging in JVs have different strategic objectives and strengths (Harrigan & Newman, 1990). In an operational JV, partner firms depend on each other’s resource contributions; if one partner contributes some “irreplaceable” resource, this creates a strong dependency on the part of the other partner(s), and the contributor of that key resource gains power (Inkpen & Beamish, 1997; Yan & Gray, 1994). The factors influencing the bargaining power of JV parents include government suasion, technology, local knowledge and marketing skills, and the distribution of outputs and financial capital (Blodgett, 1991). Foreign partner bargaining power may be curtailed by host country laws (Gomes-Casseres, 1990; Nakamura, 2005; Patibandla, 2006; Puck, Holtbrügge, & Mohr, 2009). Based on examples from Abegglen and Stalk (1985), Nakamura (2005) suggested that the nature of changes in bargaining power, for local or foreign parents, may provide insights into the eventual acquirer of the JV. A firm will logically acquire the JV only if the associated integration, negotiation, and switching costs are lower than for alternative firms in the local market. When both of the parties do not share the interest in terminating the JV, the initiator will have to bear heavier switching costs, since the other partner is not ready to leave the partnership and hence is motivated to demand more for its share (Chi, 2000; Chi & Seth, 2009; Franko, 1971).

Puck et al. (2009) studied the factors behind the foreign partner’s acquiring IJVs in China, using transaction cost theory (including the knowledge perspective) and institutional theory and considering asset specificity, external uncertainty, and cultural distance. Building on the Steensma and Lyles (2000) consideration of JV stability, Steensma et al., (2008) used the social exchange and organization learning perspectives, and identified power imbalance, learning from the foreign parent, and conflict between parents as the main contributors to both JV’s turning into WoSs and also to whether the WOS becomes foreign or local.

Institutions

Apart from the way people casually converse about institutions, scholars in the field of sociology, economics, and political science use specific definitions. According to North (1990, p. 3), "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction". These rules can be either formal (e.g., regulations, laws, constitutions, property rights) or informal (e.g., customs, norms, traditions). According to Scott (2008a, p. 48) "Institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life". According to Schotter (1981, p. 11) "A social institution is a regularity in social behavior that is agreed to by all members of society, specifies behavior in specific recurrent situations, and is either self-policed or policed by some external authority".

While many other scholars have provided defined institutions, most definitions are in line with these three. The common notion underlying the definitions is that they seek to make the behaviors of individuals and organizations predictable (Crawford & Ostrom, 1995; Greif, 2006), through formal rules or informal norms that groups of individuals or organizations practice and expect others to follow. Enforcement may be implicit, through the mechanisms of reputation, coordination, or control of other social benefits, or there may be formal enforcement agencies. According to Dowling and Pfeffer (1975, p. 122) "Organizations seek to establish congruence between the social values associated with or implied by their activities and the norms of acceptable behavior in the larger social system of which they are a part". That is, organizations try to follow the appropriate institutions, which control the strategy domain, including both strategies that can be used and the outcomes obtained using these strategies. Thus, institutions also control organizational opportunities.

Choice based on minimizing transaction costs represents a fundamental tenet of neo-institutional economics. Building on the Coase (1937) discussion of markets and hierarchies as alternate forms of governance, Williamson (1991) argued that transaction costs can be used to guide choices among firm-level "institutions of governance" (Williamson, 1991, p. 269; Williamson, 1998, p. 75). Davis, North, and Smorodin (1971, p. 6)

defined an institutional environment as "The set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution". Any change in the institutional environment changes the comparative costs among the institutions of governance of markets, hierarchies, and hybrid modes (Williamson, 1991); this notion is key in international business research, and represents the foundation of much of the entry mode literature (Anderson & Gatignon, 1986; Brouthers, 2002; Brouthers & Hennart, 2007; Chang & Rosenzweig, 2001; Contractor & Kundu, 1998; Delios & Beamish, 1999; Delios & Henisz, 2003; Erramilli & Rao, 1993; Luo, 2001; Makino & Neupert, 2000).

Regulation

The nature of the market incentivizes firm behavior. A competitive product market pressures a firm to improve its efficiency and quality, while an inefficient labor market may facilitate the use of poor practices pertaining to employee safety. Similarly, without market pressure, firms may be lax in terms of their impact on the environment. While a competitive product market may improve the labor market over time, it may not affect environment-related concerns. Society may thus demand that governments use regulation to increase social welfare more rapidly, rather than relying on slower acting market forces (Aghion, Algan, Cahuc, & Shleifer, 2010; Mulligan & Shleifer, 2005). The state is also likely to set regulations pertaining to monopoly, collusion, and anti-trust law, in order to curtail unfair competitive practices (Posner, 1969). Along with these examples of market failure, there can be other reasons to regulate (Patibandla, 2013) with the aim of improving the nation's resources. For example, mandated domestic partnership arrangements for foreign entrants may facilitate technology transfer to domestic firms and improve the nation's foreign exchange.

Institutional Environment for Firms in India

Immediately after independence, Indians had a sense of mistrust toward businesses, especially foreign ones (Basu, 2004; Roy, 2002), especially

in light of the fact that a foreign firm first came to India to trade and then conquered it, which paved the way for the country to be colonized (Dalrymple, 2015). The newly formed government favored a large bureaucracy to plan and control economic activities, rather than depending on market mechanisms. A small number of business families were dominant, and they captured the state (Bardhan, 1984; Patibandla, 2006), gaining the bulk of the available licenses for various industries. Public financial institutions provided loans, held equities without active managerial control, and also took over poorly performing units, covering the loss. The anti-foreign business sentiment in India strengthened from the 1960s until the reforms in 1991 (Bardhan, 1984; Chari & Gupta, 2008). In 1973, the Foreign Exchange Regulation Act was implemented, which allowed the government to impose strict control over foreign exchange and investments by foreign firms. Facing strong limitations, firms such as Coca Cola and IBM left India. Domestic firms had protection from foreign competition, and the dynamics of local entrepreneurship were frail, except for few pockets of the country (Patibandla, 2006). The business groups created the alternative, to compensate for the resulting institutional voids (Khanna & Palepu, 2005; Khanna & Rivkin, 2001).

These business groups opposed the advent of reforms relaxing regulations governing foreign direct investment (FDI), arguing that they lacked the technology to compete against foreign players and hence should be protected. Chari and Gupta (2008) found that influence worked in favor of domestic firms in many industries during liberalization, such that the inward FDI allowed during 1991 was selective, and was successfully prevented in highly concentrated industries. State-owned firms were particularly effective in this effort, and opposition parties argued against such liberalization as a populist ploy (Bardhan, 2005).

Following the liberalization of 1991, the capitalist market mechanism was at work in India. The liberalization was phased, with regulations relaxed in different industries over time. Previously, regulations had mandated the use of JVs to enter India in many industries (Contractor, 1990). With liberalization, the institutional environment changed, and many foreign firms altered their operation modes. Industries in which state-owned or traditional private firms were concentrated before liberalization continued to be incumbent-dominated (Alfaro & Chari, 2009).

In particular, post-reform, substantial changes appeared in the rising service sector. Industries such as telecommunications and IT experienced tremendous growth, and industries that had previously been unregulated have grown especially rapidly. The growth of the service sector is attributed to the availability of high-quality tools, because of liberalization and the expansion of the manufacturing sector (Dehejia & Panagariya, 2014).

India's political environment affected the regulatory changes. The alternating between political parties in power creates differences in patterns of public expenditure (Gerring, Kingstone, Lange, & Sinha, 2011; Sáez & Sinha, 2010). Obtaining buy-in from most parties, both supporting and opposing, to get regulations passed is difficult, and even when parties are convinced, the public may not be. This led to the defeat of last Bharatiya Janata Party (BJP) government in 2004. The United Progressive Alliance (UPA-I, the first term of the two consecutive terms for which they were elected) government understood the mandate more clearly, and invested in public expenditure accordingly. It also had pressure to do this from its allies, the leftist parties (Bhattacharyya, 2013). Arguably, the corrective steps taken led to winning a second term mandate for UPA, such that Congress, the leading party in the alliance, no longer required the left-wing support, and the policy formulations changed accordingly. However, during this second term, their supporters also opposed the reforms, fearing loss of support among their primary voter; this led to the controversy around FDI in retail, where political parties like members of the ruling alliance All India Trinamool Congress also opposed it fiercely and even threatened to withdraw support for the government (Bhattacharyya, 2013). UPA-II also appeared to lose focus on monitoring, allowing rampant corruption to continue, including scams in the 2G spectrum auction, coal block allocation, and the 2010 Commonwealth Games. These issues contributed to the poor performance of Congress and UPA in the 2014 national elections, allowing BJP to come back into power as the single largest party.

Competitors in markets use their resources to beat their rivals (Lahiri, Kedia, Raghunath, & Agrawal, 2009). Similarly, during exposés of corruption scam, it became clear that firms also used their political resources toward these ends (Heston & Kumar, 2008). Differential regulations applying to foreign and domestic competitors mean that local firms

should be advantaged; it also seems that they may also have advantages in terms of political influence.

Theory

Motivating Through New Institutional Economics

Calculated choices are based on cost-benefit analysis (Ghemawat, 1991; Ghemawat & Costa, 1993). As (Milgrom & Roberts, 1990, p. 88) argued, "capitalist economic institutions are organized so as to minimize the sum of the costs of resources used in production and the costs of managing the necessary transactions". This explains the importance of transaction cost economics in the international business literature (Williamson, 2010). The work of Coase (1937) led to the establishment of the idea that the firm is a mode of governance. This led to the transaction cost theory pertaining to the boundary of the firm, which states that, if the costs of transacting in the market are high, and can be reduced by internalizing the transaction within a firm, then the firm should be the form for organizing the transaction.

This relates to *raison d'être* of markets. Markets facilitate exchange at lower cost by reducing the costs of search and information, and evolve with economies of specialization (Patibandla, 2006; Smith, 1904). Larger markets create uncertainty with regard to the enforcement of contracts, and so most are regulated, such that contracts are honored (Patibandla, 2006). Still there are costs associated with transacting in a market, including bargaining, contracting, policing, and enforcement (Dahlman, 1979). Sometimes, these costs can be reduced by bringing the transaction into the firm. Moreover, entrepreneurs often prefer to exert more control and absorb some risks, in order to invest in transaction-specific assets.

The costs of transacting are not always lower within a firm, and some transactions should be carried out in the market (Coase, 1937, 1960). Moreover, firms and markets are not the only two modes of economic organization. There are many ways in which a transaction can be organized, including long-term contracts, JVs, alliances, franchising, and

licensing. Modes of economic organization are chosen based on where the transaction cost is expected to be the lowest (Williamson, 1989, 1991). This concept has also been applied to study the termination of JVs (Makino et al., 2007; Park & Russo, 1996; Pearce, 1997). It is important to note that the transaction costs that lead to mode change need not be the same as those determining the mode chosen as outcome of the change. This is reflected in the literature by two strands of research in this area: one addressing IJV instability or termination and the other looking at IJV acquisition (Puck et al., 2009; Steensma et al., 2008). We focus on the latter in this chapter.

The transaction costs involved in acquiring the JV may differ for each parent, which can affect which parent executes the acquisition. While industry-level factors will be similar, differences exist at the firm level, in terms of resources and capabilities. A key difference is associated with the firm's country of origin, and foreign and domestic firms will be affected differently by institutions. The foreign firm will be less familiar with the host country culture, and the regulations surrounding a foreign firm are different from that of a local firm. Generally, foreign firms must abide by both industry-level and foreign investment policies of the host countries, while local firms are affected only by the former. If corruption is a norm in the host country and the foreign firm's home country has anti-corruption policies extending jurisdiction over foreign subsidiaries, or the firm is from a country where corruption is not a pervasive norm, then it will be at a disadvantage.

Impact of Regulations

Institutions are "constraints that shape human interaction" (North, 1990, p. 3), and "a constraint on one person is opportunity for another" (Schmid, 2004, p. 1). Regulations about foreign investment and operations are constraints that shape the behavior of the foreign firms in a country, affecting their strategies.

Governments generally welcome FDI, in order to increase investment and bring new resources and technologies into the country. However, along with the benefits, FDI brings some potentially negative outcomes,

such as harm to local firms that are unable to compete effectively against the foreign players. Over time, this can lead to foreign firms' becoming extremely powerful, raising concerns about national security and sovereignty, leading governments to create restrictions in terms of FDI regulations that include ownership restrictions such as the requirement to have a local partner (Chen, Paik, & Park, 2010). In such a situation, the foreign partner will be prevented from internalizing a JV, but will need to either find another local partner or else go public. Such constraints benefit the local partner. Even though the resources of the foreign firm may be superior, the local partner has an advantage in terms of acquiring the JV.

Local laws that are complex and strongly regulatory encourage foreign firms to choose IJV as an entry mode (Yiu & Makino, 2002). In highly regulated environments, the foreign partner is likely to prefer not to change the JV into a WOS, and may seek another JV partner (Puck et al., 2009), to maintain legitimacy and lower transaction costs associated with handling the regulatory environment (Xu & Shenkar, 2002).

Strongly nationalist sentiment among the public may affect the host country government's attitude toward regulation, giving it enhanced bargaining power that the local partner can use to its advantage (Gomes-Casseres, 1990; Yiu & Makino, 2002). As discussed earlier, regulatory protection has long been available to Indian firms in many industries, and nationalist sentiments regularly nudge the government to continue this stance. During the liberalization of FDI, the most regulated industries were among the last to be opened to foreign competition (Chari & Gupta, 2008). Even after almost 15 years of liberalization, the situation has not changed in many industries, especially those in which state-owned enterprises and business groups dominated before the reforms; this is despite the increased participation of foreign firms (Alfaro & Chari, 2009). In terms of regulations and lobbying power, foreign firms remain disadvantaged, giving them incentive to find other partners in the event of the termination of a JV. Thus, we hypothesize:

Hypothesis 1 In industries with higher regulation, the likelihood of the local partner's acquiring the IJV upon termination is higher.

Impact of International Trade Relationships

In 2012, India experienced a large scandal related to the distribution of 2G licenses. As a remedial step, the government canceled the licenses of operators that had obtained their licenses in that distribution round. Among those affected was a JV between a local company and Telenor, a Norwegian company. Telenor took legal action, and also arranged for the Norwegian IT minister to come to India, and meet with Indian counterparts to negotiate.

We expect the home countries of foreign partners to help them to negotiate in the host country, especially for firms in which the home country has some ownership. Such negotiations are arguably more likely to be effective work if the host country views itself as dependent, in terms of trade, on the foreign firm's home country, conferring stronger bargaining power.

Hypothesis 2 If the host country is dependent on the home country of the foreign partner in terms of trade relations, then the likelihood of the foreign partner's acquiring the IJV is higher.

Impact of Corruption

Corruption is generally viewed as having a negative impact on inward FDI (Smarzynsk & Wei, 2002). It also affects the entry mode choices of foreign firms (Uhlenbruck, Rodriguez, Doh, & Eden, 2006) and the partnership criteria used for IJVs (Roy & Oliver, 2009). Institutional theory supports the notion that a foreign firm can gain legitimacy by partnering with a local firm (Chan & Makino, 2007), which will help the foreign firm to gain the local knowledge necessary to, among other issues, find alternatives to circumventing the constraints posed by corruption. On the other hand, highly pervasive corruption may lead a foreign firm to avoid equity partnerships, in order to reduce the bargaining power of local partners (Uhlenbruck et al., 2006). Relatedly, Delios and Henisz (2000) found that the equity ownership held by foreign firms is dependent on expropriation hazards, both public and private.

In highly regulated environments, political strategies assume greater importance (Djankov et al., 2002). As the foreign partner has already entered the host country through the IJV, it can be assumed to have some understanding of the practices pertaining to corruption in that environment, and may not want to exit the country following the break-up. Still, local firms have advantages, in terms of their networks with bureaucrats and politicians (Hiatt & Park, 2013). More specifically, it is logical to assume that foreign firms from countries with levels of corruption similar to India's will cope more easily and thus be more comfortable with internalizing the JV. The difference in corruption level between the host and home countries will affect the amount of expertise the foreign firm will have to gain with respect to corruption in the host environment (Spencer & Gomez, 2011). Faced with a large difference, the foreign firm may find it more unattractive to deal with corruption (Cuervo-Cazurra, 2006), and opt to ally with a local partner. For example, in the 2G spectrum auction scandal, the direct participants in the act of corruption were local firms. Though the foreign partners lost those licenses upon investigation and ruling by the court of law, the risk of prosecution due to the corrupt actions was completely assumed by the local partner. Based on this, we hypothesize:

Hypothesis 3 The higher the corruption levels in the host country, relative to the home country of the foreign partner, the greater the likelihood of the local partner's internalizing the IJV.

Methodology

Sample

Data for applicable IJVs in India were obtained from the Thomson SDC (Securities Data Corporation) Platinum database, supplemented by other sources such as the Thomson One banker and Prowess databases and company websites. The JVs considered have at least one Indian parent firm. JV data for the period of 2002 through 2012 were examined, and yielded 174 JV acquisitions, of which 40 were fully domestic JVs.

To avoid the confounding effect of the strategic exit of one partner's leading to acquisition of the JV by the other partner, we checked to see if both of the parents had continued in the same industry in India, after the acquisition, using registration details, company annual reports, and corporate websites, along with news articles included in Lexis-Nexis. A lack of evidence that a firm had continued its operation in the same industry in India was taken as indicative of a strategic exit from the industry having driven the acquisition of the IJV by the other partner; such cases were not included in the analysis. Finally, in 62 of the 134 terminated IJVs, both parents continued in the same industry in India after the acquisition. These 62 firms comprise our sample.

Of the 62 events in the sample, the Indian partner acquired the JV upon termination in 23 cases. For these cases, we also verified that the foreign partners did not have any foreign investment-related regulation prohibiting them from acquiring the JV.

The dependent variable is binary, taking the value of 1 if the local partner internalized the IJV upon termination, and 0 otherwise. As the dependent variable is binary, we use conditional logistic regression, with fixed effects for the year of IJV termination.

The explanatory variable used to test Hypothesis 1 is binary, with a value of 1 for highly regulated industries and 0 for others, based on data from Department of Industrial Policy and Promotion of the Government of India. A similar classification is available for US firms, and is in wide use (Grier, Munger, & Roberts, 1994; Hadani & Schuler, 2013). The categorization was done by creating an index that aggregated eight ordering schemes: Pittman's (1977) seminal work on classifying regulated industries in the USA, the Chakraborty and Nunnenkamp (2008) analysis of FDI intensity in India, the Das (2003) results on effective rate of protection in the manufacturing sector in India, *The Economist* (2014) classification for crony capitalism, trade policy data on restrictions on export/import, the presence of an industry regulatory body, the presence of the government as a major buyer or supplier, and whether industry belongs to the natural resource or infrastructure sector. The cataloging was based on two-digit NIC code, and the use of Indian data revealed several differences from the US coding.

For Hypotheses 2 and 3, country-level variables pertaining to India and the home country of the foreign partner are included. The amount of trade (as a percentage of total trade in India in the year of the internalization) between the two countries, per UNCTAD, is used to test Hypothesis 2. As this measure is a proportion, a logit transformation ($ln(x/(1–x))$) is used before including it in the regression, for improved interpretation of the results. For Hypothesis 3, the difference in corruption levels is measured based on Transparency International's corruption perception index.

Several control variables are included in the regression modeling. At the inter-country relationship level, we control for diplomatic affinity of nations (Voeten, Strezhnev, & Bailey, 2015), operationalized using an index that shows the similarity in voting positions of two countries in the United Nations General Assembly, reflecting diplomatic closeness. Cultural distance is operationalized using data from the GLOBE study (Waldman et al., 2006) and the approach of Kogut and Singh (1988). Three cases involving foreign firms from countries for which GLOBE data were not available were dropped from the sample. At the firm level, we control for the India-specific experience of the foreign firm, based on annual reports, company websites, news articles from Lexis-Nexis and Google, and, if necessary, the registrar of companies website. We also controlled for the owner business group (if any) of the Indian partner and the group size, using a composite variable from the Centre for Monitoring Indian Economy Pvt. Ltd. (CMIE) Prowess database. The owner groups are classified by CMIE as private Indian standalone firms, government-owned firms, top 50 business houses, large business houses (120 business groups that are smaller than the top 50, in terms of revenue) and other business houses. Data were unavailable for nine local firms, through the Prowess database; these firms were dropped from the analysis. Two additional observations were dropped because of duplicate entries.

Results

The descriptive statistics of all the variables are provided in Table 5.1, and the correlations between pairs of the non-categorical explanatory variables are provided in Table 5.2. Since there are some strong correlations detected, we present the variance inflation factor (VIF) statistics for the

Table 5.1 Descriptive statistics

Variable	Mean	Std. Dev.	Min	Max
Acquirer	0.42	0.50	0	1
Experience of the foreign firm	23.50	29.50	3	150
Trade (logit transformation)	−3.47	1.54	−11.52	−1.86
CPI score difference	4.03	1.36	0	6.20
Affinity of Nations index	−0.02	0.46	−0.64	0.81
Cultural distance (GLOBE)	1.77	0.78	0	3.79
Highly regulated industries	0.40	0.50	0	1
Owner groups				
Top 50 business houses	0.40	0.505	0	1
Large business houses	0.15	0.36	0	1
Other business houses	0.29	0.46	0	1
Private (Indian) firms	0.12	0.32	0	1

Table 5.2 Correlations among non-categorical variables

	Experience of the foreign firm	Trade (logit transformation)	CPI score difference	Affinity of Nations index
Trade (logit transformation)	0.09			
CPI score difference	0.10	0.26*		
Affinity of Nations index	−0.11	−0.52**	0.12	
Cultural distance (GLOBE)	0.02	0.06	0.58**	0.29*

*p<0.05, **p<0.01

explanatory variables in Table 5.3, which shows that there are no issues of problem multicollinearity present in the model. The results of the regression modeling are presented in Table 5.4.

Among the control variables, the foreign firm's experience in India is found to add significant (p<0.10) explanatory power, suggesting that foreign firms with greater experience in India are more likely to concede their shares in the IJV to the local parent. Hypothesis 1 finds support from the finding that the likelihood of the local parent's acquiring the IJV is significantly (p<0.10) higher within highly regulated industries. Hypotheses 2 and 3 are not supported, as the coefficients associated with the difference in corruption levels between India and the home country of the foreign parent and the trade relationship.

Table 5.3 VIF values

Variable	VIF	Tolerance	R^2
Experience of the foreign firm	1.10	0.91	0.09
Trade (logit transformation)	1.86	0.54	0.47
CPI score difference	1.57	0.64	0.37
Affinity of Nations index	1.74	0.57	0.43
Cultural distance (GLOBE)	1.49	0.67	0.33
Highly regulated industries	1.12	0.89	0.11
Owner groups	1.15	0.87	0.13

Table 5.4 Conditional logistic regression with fixed effects for the year of IJV termination

DV: Partner internalizing the IJV	
Experience of the foreign firm	0.05$^+$
	(1.66)
Trade (logit transformation)	−0.86
	(−1.23)
CPI score difference	0.20
	(0.46)
Affinity of Nations index	−2.73
	(−1.60)
Cultural distance (GLOBE)	0.42
	(0.56)
Highly regulated industries	1.45$^+$
	(1.70)
Large business houses	17.07
	(0.01)
Other business houses	17.39
	(0.01)
Private (Indian)	18.89
	(0.01)
Top 50 business houses	17.01
	(0.01)
Pseudo R^2	0.36
AIC	48.90
BIC	68.02
Log-likelihood	−14.45
χ^2	16.02$^+$

$^+p<0.10$, $n = 50$, t statistics in parentheses

Discussion

Studying impact of corruption on acquisitions made by foreign firms, Weitzel and Berns (2006) argued that corruption reduces the premium paid by reducing synergy. Meschi (2009) found that, with reduced corruption, foreign firms are more likely to try to internalize an IJV. However, these findings were observed only when corruption was operationalized using the Political Risk Services (PRS) International Country Risk Guide corruption index, and not for the Transparency International ratings.

In this study, we add to the literature by shifting the focus to regulation at the industry level in the IJV's host country, while filtering out the situation in which a partner left the IJV willingly as part of change in corporate strategy by checking to see if the selling parent continued in the same industry during the year after the dissolution of the IJV. While the difference in corruption levels between India and the foreign partner's home country did not offer significant explanatory power in our model, this should not be interpreted as implying that corruption does not affect the internalization decision. As the odds of an IJV in a highly regulated industry being acquired by the local parent are significantly higher, we can infer that corruption does play a role. According to the public choice perspective, higher regulation indicates higher scope for rent-seeking behavior (Buchanan, 1980; Krueger, 1974; Mudambi, Navarra, & Delios, 2013; Tollison, 1982; Tullock, 1967) and thus presents higher likelihood for the public office to be captured for rent-seeking (Dal Bó, 2006; Stigler, 1971). Hence, we can expect that highly regulated industries in India are more likely to be administered by public offices that are subject to corrupt practices. In such a case, the local firm will have an advantage over the foreign firm, being more familiar with the process of capturing these offices. Third-party political and public affairs consultants can provide such know-how to foreign firms, and might also offer their services to complete the process of capture as an outsourcing solution, as was done by Vaishnavi Communications in the case of the 2G spectrum auction scam discussed above. Still, local firms can be expected to have longer term and stronger ties with the politicians and bureaucrats at key public offices. If the corruption in such offices is arbitrary (Lee, Oh, & Eden,

2010; Rodriguez, Uhlenbruck, & Eden, 2005; Uhlenbruck et al., 2006), then the third-party solutions may work for foreign firms. Otherwise, the historical and strong relationships should be of more value to local firms. Hence, our results provide a hint that highly regulated industries in India might be corrupt and, if so, the corruption is not arbitrary in nature.

In the relatively small dataset used for this study, there are no firms from countries with corruption scores lower than that of India, according to Transparency International. In light of those scores, the above inference about the possibility of highly regulated industries in India's being corrupt seems plausible. However, the small dataset limited the scope to estimate the impact of the difference in corruption levels between countries. Future work, using a larger sample with a variety of host countries will be useful, and may allow effects of other country-level variables, such as trade and diplomatic affinity between nations, to be investigated in more depth.

Our model has addressed only the impact on competition between foreign and local firms. As noted earlier, the strength of political ties may also affect competition, especially between local firms, and should be studied in scenarios of such close competition for resources. For managers working in India, corporate political strategies are important. Our results reinforce the notion that political strategies need to be fine-tuned, according to the nature of the industry in which the firm operates. In less regulated industries, the importance of political ties should be reduced. Firms should always act with caution and proper due diligence.

Measuring the level of industry regulation can be complex. There are multiple dimensions, such as ownership limitations, reporting requirements, and copyright protection strength, along which the level of regulation across industries differs. Our rather simplistic use of a binary categorization to represent the industry's level of regulation represents a limitation of this study and gives scope for further research to create a detailed index of regulation across industries and study its impact.

We have also made some strong assumptions regarding the limited effectiveness of lobbying by foreign firms. In practice, the scenario may be different. Foreign firms do have some room to lobby, based on the technology they bring and the new jobs they create. However, following Alfaro and Chari (2009), state-owned enterprises and traditional private

firms still dominate industries in India. Hence, lobbying by foreign firms can be expected to fall short in comparison to the efforts of the incumbents (Alfaro & Chari, 2009; , 2008). More direct studies that test this assumption will be useful.

Broadly, this chapter has focused on the competition between foreign and local firms. However, competition is looked at in chapter paper at the micro level between only the foreign and local firm that were erstwhile IJV partners, with respect to internalizing the IJV upon its termination. In this way, we concentrate on competition upon mode change, and provide insights about the impact of the institutional environment on the outcome of that competition.

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