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SUSAN FREEMAN

**Department of Marketing
Monash University
Clayton Campus, Wellington Parade
Clayton 3168 Victoria, Australia
Tel: + 61 (3) 9905 8195 and Fax: + 61 (3) 9905 9232
email: susan.freeman@buseco.monash.edu.au**

and

CHELSEA FREER

**Department of Marketing
Monash University
Clayton Campus, Wellington Parade
Clayton 3168 Victoria, Australia
Tel: + 61 (3) 9905 8195 and Fax: + 61 (3) 9905 9232
email: chelsea.freer@buseco.monash.edu.au**

Use of Formal and Informal Control Mechanisms in International Joint Ventures: Australian and Indian Joint Venture Partnerships

***Keywords:** International Joint Ventures (IJVs); Business Relationships; Control Mechanisms; Extent of Control; Strategically Important Activities; Case Studies*

Abstract

How can Australian international marketers and managers ensure control over their joint venture operations in emerging markets? Does control evolve? What are some of the implications of alternate control mechanisms? These are some of the questions that the current study addresses. This study investigates the area of international joint venture (IJV) control in the developed Australian and the emerging Indian market place. In doing so, it replicates and refines previous researchers' conceptualisation of IJV control and extends their framework to include an examination of the dynamic nature and interaction of control between local and foreign partner firms. A qualitative, cross-case research methodology was employed to analyse the mechanisms through which control is exerted.

Two in-depth case studies were conducted with flourishing Australian and Indian joint venture partner firms in order to provide a deeper understanding of how control

operates within dissimilar business and cultural environments. The case study results indicated the use of multiple control mechanisms within the joint ventures and provided detail as to how each mechanism exerted control. Further, the results illustrate the evolving nature of international joint venture control and identified two types of international joint ventures, Technology-based (Type 1) and Market knowledge, Distribution-based (Type 2) IJV's. From the cross-case study results it can be inferred that international marketers operating within IJV's need to employ control mechanisms that have a value-adding, future orientation in order to enhance mutual benefits.

Introduction

Due to the internationalisation of many industries, international joint ventures (IJV's) have become an important element of many firm's internationalisation strategies. Yet, effective control over IJV's represents difficulties for the parent because they are often unable to rely solely on their ownership position to determine the IJV's behaviour and management, instead requiring recourse to other modes of influence (Lecraw 1984). *Control* refers to the process by which one entity influences, to varying degrees, the behaviour and output of another entity through the use of power, authority and a wide range of bureaucratic, cultural and informal mechanisms (Ouchi 1977). Control plays an important role in the capacity of a firm to achieve its goals. Typically, as organisations expand in size, there are concurrent increases in the complexity and differentiation of their structures as well as their risks of conflicts, opportunistic behaviour and competing goals between units (Geringer & Herbert 1989). As a result, top management are confronted by the increasingly crucial need to monitor, coordinate and integrate the activities of the organisation's business units, including IJV's (Ramaswamy Gomes & Veliyath 1998).

The purpose of this study is to focus on *strategically important activities* identified by the Australian-Indian (international joint venture) IJV firms and how these critical activities have changed over the duration of the relationship. The following research objectives are established to fulfil the purpose of this study. First, describe the nature of the IJV relationship between the actors IJV firms from commencement to the present; second, analyse and describe the various control mechanisms (positive and negative utilised by IJV's; third, describe how the nature of the IJV relationship has

changed over the duration of the relationships. Finally, to describe the extent to which the IJV partners have achieved their strategic objectives.

International Joint Venture Control

The importance of the issue of control explains why, scholars have devoted attention to this concept's role in the management of organisations (Ouchi 1977; Vancil 1979; Ramswamy et al. 1998). In particular, they have examined the different degrees of control multinationals exercise over their subsidiaries (Cray 1984), as well as mechanisms, systems and procedures used and the variables influencing the recourse to them (Egelhoff 1984). The issue of control of IJV's has received relatively less attention. West (1959) recognised the potential inter-partner conflicts, which could result from this form of organisation. According to West (1959), without effective control efforts, firms were likely to experience great difficulty in managing IJV's. Yet despite this early observation regarding its importance, the issue of JV control has received only fragmented attention (Geringer & Herbert 1989). Subsequent research efforts have largely examined very different dimensions of IJV, and no explicit attempts have been made to provide an integrative approach to the issue (Lecraw 1984). Geringer and Herbert (1989) have reviewed and synthesised prior studies addressing the conceptualisation of control mechanisms within IJV's, as well as the IJV control performance relationship.

Mechanisms for Achieving Control

Initial studies have shown that firms frequently rely on majority ownership to achieve management control of an IJV's activities (Stopford & Wells 1972). Although these studies showed that a majority position in equity could ensure some degree of control over the venture, the same argument might not be valid for IJV's where the equity was equally divided between parents or where a firm had only a minority participation role. This latter situation especially concerned firms that, over time, were unable to demand full or dominant ownership positions. The continued diffusion of technology, increased scale of risk accompanying new projects, increased globalisation of many industries and host government policies promoting local equity participation in order to obtain resources, have often constrained the option of implementing wholly-owned ventures (Yan & Gray 1992).

In addressing such concerns, Friedman and Beguin (1971) suggested that control was not a strict and automatic consequence of ownership. Schaan (1983) demonstrated the breadth of mechanisms available to parent firms for exercising control over their IJV's.

Many researchers have proposed mechanisms through which control can be exerted. These include majority ownership, reporting requirements, managerial representation, technological dominance, the official IJV agreement, the Board of Directors and informal mechanisms. In essence, each of these control mechanisms have been demonstrated or have been proposed to influence the IJV's partners behaviours through various requirement in term of processes or procedures, the assignment of responsibilities and legal accountabilities. Fundamentally, these mechanism promotive or prevent the joint venture from engaging in certain activities.

Schaan (1983) categorised control mechanisms into two main types - *positive* control mechanisms, which parent firms employed in order to promote certain behaviours, and *negative* control mechanisms, which were used by a parent to stop or prevent the IJV from implementing certain activities.

However, most of these alternate control mechanisms have not been empirically investigated. Both Geringer and Herbert (1989) and Schaan's (1983) papers were conceptual in nature and did not investigate whether these mechanisms did in fact operate within IJV's. Other than the large amount of research investigating the relationship between ownership and performance, these alternative control mechanisms have received minimal attention.

International Joint Venture Performance

Consensus on the appropriate definition of IJV performance has yet to emerge. Objective measures for IJV performance have been used, ranging from financial indicators (Tomlinson 1970) to the survival or liquidation of the venture (Killing 1983), its duration (Harrigan 1988), and instability of its ownership (Franko 1971). However, these objectives measures do not adequately reflect the extent an IJV has achieved its objectives. Despite poor financial performance, an IJV may have achieved attained the objectives of its parents - for example, of transferring technology - and thus be considered *successful* (Ramaswamy et al. 1998). Likewise, IJV's may be viewed as *unsuccessful*, despite achieving good financial results or continued stability in ownership, because of their stated objectives. Killing (1983),

Beamish (1984) and Ramswamy et al (1998) used a perceptual measure based on a single-item scale measuring parent's satisfaction of the performance of the IJV. The main advantage of this type of measure is its ability to provide objective and subjective data regarding the extent to which the IJV has achieved its objectives. Thus, the present study measures performance using Killing's (1983) measure of the extent to which the IJV has achieved its strategic objectives.

Regulatory Environment

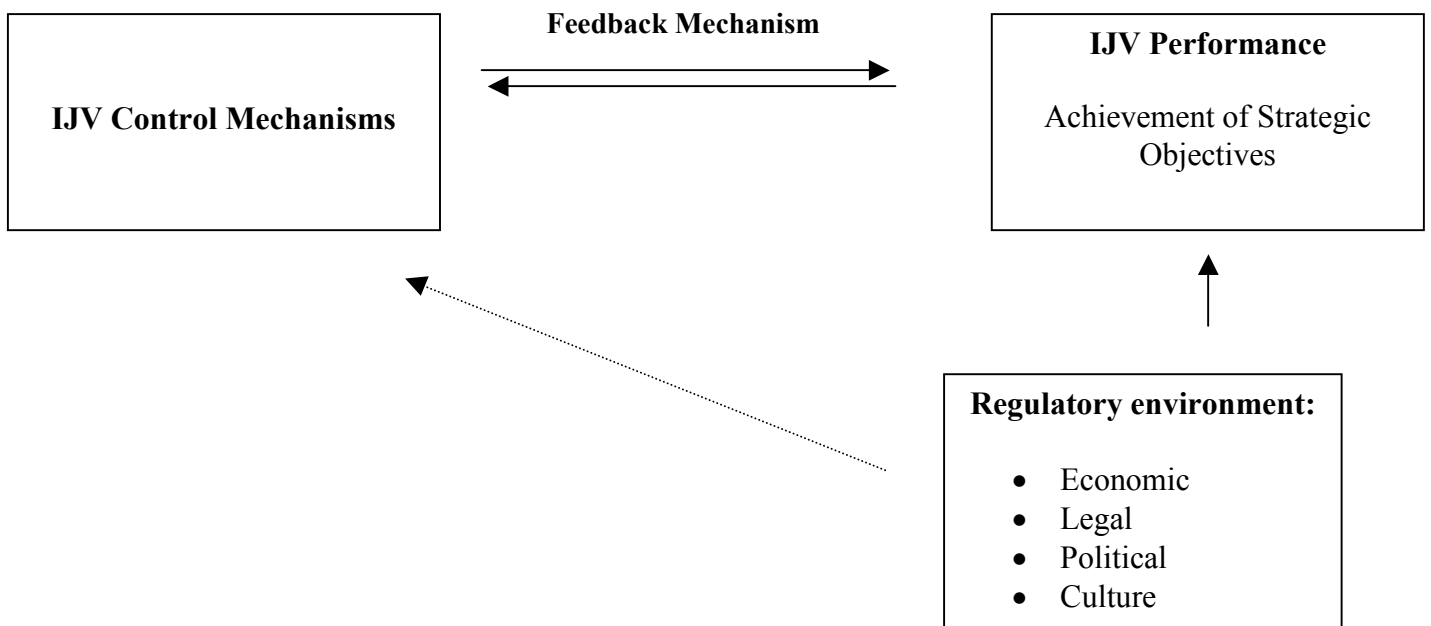
The regulatory environment will be examined for its impact upon the achievement of the IJV's objectives. The general economic conditions that have had a significant impact upon the IJV will be investigated, for example, growth rates, unemployment, current account deficits and inflation rates. India's foreign investment regime has been very tightly controlled prior to 1991 (Ramaswamy et al. 1998; Lal & West 1997) but now continues to deregulate. The impact of the Indian business culture will be measured according to the varying sources of culture (Indian) and how they have affected the achievement of the IJV's strategic objectives. Issues concerning language, nationality, education, ethnicity, religion, family, sex, social class and corporate culture will be analysed.

Development of the Conceptual Model

In view of previous research by Geringer and Herbert (1989) and Schaan (1983), the present study will utilise a case study approach to investigate the *strategically important activities* identified by Australian firms with their Indian partnerships and how these critical activities have changed over time. Thus, the study will focus on the mechanisms that each IJV partnership used to exercise control; the extent or degree of control; and how the focus of control has changed over the duration of the relationship. Figure 1, the *conceptual model*, indicates how the three dynamics of control impact on the achievement of strategic objectives and how each of these dimensions are mediated by the *strategically important issues* facing the firm. This feedback process is further influenced by the economic, political, legal and cultural environment, which regulates the amount and type of control that can be exercised and has an impact upon the business environment under which the IJV operates.

Figure 1 demonstrates a feedback relationship between the three dimensions of control and the achievement of the IJV's strategic objectives. These variables change over time and consequently the model is dynamic in nature. This flow moves from the recognition of important strategic issues to the setting of strategic objectives. These strategic objectives determine the focus of the control (utilising how much and what mechanisms are available) and thus impacts on the achievement of the strategic objectives. This cycle is reversed as the important issues and the regulatory environment change.

Figure 1: Dynamic model of the interaction between the dimensions of IJV control mechanisms and achievement of strategic objectives for Australian/Indian IJV relationships.



Research Design and Methodology

A case study approach is seen as an appropriate research method to explore these questions. Yin (1994) and Lee et al. (1999) suggest that case studies follow a procedure of establishing aims, designing sample, measuring, collecting and managing data and finally analysing and concluding. Selected Australian firms with JV activities in India were chosen on the basis of access and length of history of JV activity.

Informed respondents were sought to gain the most accurate information. Senior managers involved with the Australian/Indian partnership were selected according to

access and experience with IJV. Two case studies were used for the present study to provide depth and richness to the proposed research study. Data collection was obtained via in-depth interviews due to their ability to elicit the interviewee's thoughts, and feelings about a topic. The current study conducted multiple interviews to study the Australian managers' perception of the IJV's processes.

Each of the managers was asked to assess the extent to which the IJV achieved its strategic objectives (deemed most appropriate measure to complement the multiple reasons for IJV formation and continuation) to ensure that the controls employed within the IJV's investigated are not those from deteriorating IJV's and thus those that may be ineffective controls. The background of the two case studies is introduced below.

Case Study IJV Partnerships

The background of the two case studies selected for this study are briefly discussed and this is followed by an individual case analysis for each IJV partnership. A cross-case analysis and typology are provided after the individual case analysis section below.

Case Study One - Phandi

Phandi India comprises of two partners, Hountta Australia and Phandi India. Phandi India produces auto electronics and accessories. The joint venture's existence is based on market knowledge and distribution. It is located in India with a 50/50 equity differential. The informed respondents in this case included the CEO of Hountta Australia and Phandi India (also the IJV GM).

Case Study Two - Azzi India

Azzi India operates in the high-tech lighting and power industry. Again, this joint venture is located in India. However, government restrictions on the amount of foreign investment, limits the Australian partners ownership to 24 percent. Azzi India is majority owned by the Indian partner firm and thus is the major source of capital investment. The Australian partner's contribution stems from its vast resources in research and development, none of which the Indian partner possesses. Therefore, the Australian partner produces a semi-processed product, which is brought by the joint venture and is finished, marketed and distributed in India. Semi produced electronic

product are sold to the IJV by Azzi Australia. The informed respondents in this case were the CEO of Azzi Australia, Azzi Australia's Product Quality Manager and the Indian Partner - Sundergy CEO (who is also the IJVGM).

Case Study Results

The results are presented in terms of the research objectives, which began with identifying the major control mechanisms being utilised in the joint ventures. There were five major control mechanisms found to be operating in one or both of the IJV's.

Control Mechanism – Board of Directors (Majority)

One formal instrument of control in both case studies was the IJV's board of directors. In both the IJV's, partners confirmed the legal requirement in India of holding a board meeting every two months. Both IJV's indicated that this legal requirement ensured that the board was well informed and participated in the strategic direction of the IJV. However, the Indian partner (Sundergy) in the Azzi India IJV possessed a controlling majority of one on the board. The IJV literature discusses the board as being a potentially important source of control. However, the results of the Azzi India case study indicated that this did not occur.

Control Mechanism – Technological Dominance

Azzi Australia was able to overrule the board's decisions, even though they were a minority group on the IJV's board. The importance of the technology in the IJV's functioning gave the Australian partner (Azzi Australia) a powerful overriding control mechanism.

However, whilst the Australian partner controlled the technical input of the IJV, the Indian partner firm (Sundergy) possessed:

- A majority in ownership (76%),
- Managerial and marketing control because they held the position of IJVGM as well, and the,
- Ability to staff the IJV with local Indian employees.

However, the Indian partner's (Sundergy) control over the IJV was limited due to technological dependency that was critical to the IJV's success. This was described by the Indian CEO:

I am at their mercy!

The dependency situation suppressed alternate forms of control such as the IJV's board of directors, the position of the GM, and hindered the informal relationship between the two partners. This would have significant implications for control. It can be inferred that to maintain effective control, the Indian partner needs to have a *future-orientation* in mind that serves as a protective role for them. The Indian partner must be able to provide some significant contribution to the IJV to prevent the Australian partner from simply acquiring the Indian partner's share of the IJV as the Indian market continues to be liberalised and restrictions on foreign investment are lifted all together. Therefore, from these results it can be inferred that time is an important element in this process.

Control Mechanism - Management Representation

The results of this cross-case study analysis suggest that the appointment of the IJV GM and marketing manager was dependant upon the *focus* of the IJV. Given these circumstances, the GM and the appointment of staff reflected the need to have managerial staff that had in-depth knowledge of the local market conditions, culture, and consumer behaviour. Thus, in both cases the GM and marketing manager were representatives from the Indian partner firms. Again, this has implications for bargaining power. The essential Indian contribution of market knowledge and existing distribution systems cannot be understated and was a major mechanism of control, whereas for the foreign partner marketers, this is a limitation of capability. Therefore, it can be inferred that foreign partners need to ensure that they are continually adding value to the IJV to ensure their worth or value to the partnership.

However, the Australian partner in the Phandi IJV did not see the role of the IJV GM and marketing manager as a threat. Due to the informal relationship that existed within the Phandi case, the marketing skills of the Indian partner firm (Phandi India) were seen as a competitive advantage for the IJV and not as a threat:

We [Hountta Australia] don't have a lot of control because we are unaware of the Indian market place. I don't pretend to know anything about their religion or customers or more importantly how to market our products to them. Therefore, he really has control because he knows the market and in our industry, that's what it's all about.

Control Mechanism - Equity

The two IJV's investigated within this study question the validity of previous studies' use of ownership as a proxy for management control in IJV's. It can be inferred from these case studies that equity is only a minor matter in the IJV's overall governance. For example, in the case of the Azzi India IJV, ownership was skewed heavily in favour of the Indian partner firm (76 per cent); however, equity did not play a major role in determining which partner possessed the marketing and managerial control. The majority equity possessed by the Indian partner firm (Sundergy) played a secondary role to the dominant technology supplied by the minority Australian partner firm (Azzi).

The final mechanism of control that existed within the case studies was an informal relationship between the two partners. This was particularly evident in the Phandi case study.

Asia is all about people. The reason this IJV is so successful is because we have both worked on developing an understanding of each other environments. I trust my partner completely. We have more than just a legally binding partnership, we have become mutually respecting friends with mutual benefits resulting from our strong relationship

In contrast, the Azzi case provided an illustration of how relationships can be hindered by a dependency situation. The dependence of the Indian partner firm (Sundergy) on Azzi Australia to provide the IJV with the technological knowledge created a tense situation whereby the Indian partner firm (Sundergy) had little control over their seventy six per cent stake in the IJV, as described by the Indian partner firm:

If I could start over, I would be sure to have the technology, so not to be pushed around.

Categorisation of Control Mechanisms

With the assistance of Schaan (1983) and Geringer and Herbert's (1989) conceptual papers, the results of our study allowed the development of a framework of control mechanisms, illustrating the underlying purpose of employing each mechanism and also how each mechanism exerted control over the IJV. They have been categorized according to their orientation and type, below in Figure 2.

Schaan (1983) distinguished between *positive* and *negative types* of control mechanisms, which promote or prevent certain actions by the IJV. Breaking down the

control mechanism dimension further, Geringer and Herbert (1989) found it valuable to acknowledge the differences in orientations of control mechanisms.

Figure 2 (below) integrates these two categorisations of IJV control mechanisms in order to develop a more complete framework of IJV control mechanisms. The case study results have been applied to this framework and are illustrated in Table 1 (below).

Figure 2: Integration Positive/Negative Control Mechanisms Categorisation and the Orientation of Control Mechanisms

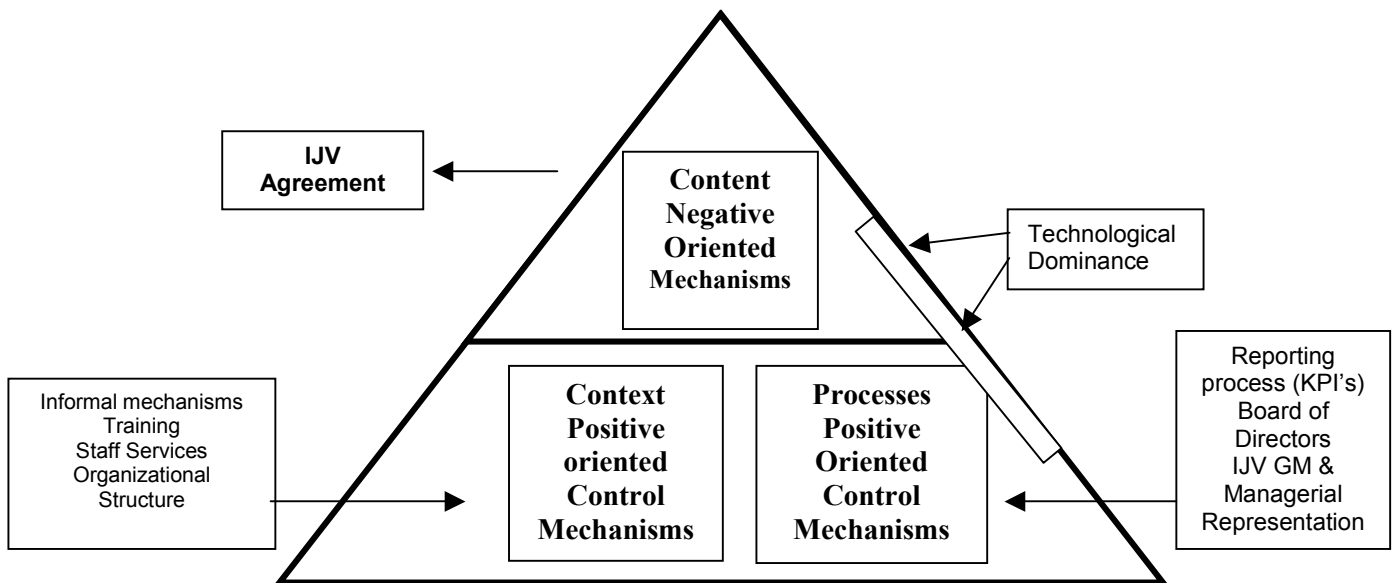


Figure 2 shows that control mechanisms can either promote or prevent the IJV from engaging in particular behaviours (positive or negative control mechanisms). This study examined these *types* and *orientations* of control mechanism and categorised them according to previous studies in this area (Schaan, 1983; Geringer & Herbert, 1989). This can be seen in Table 1 below.

The incorporation of Schaan (1983) and Geringer and Herbert's (1989) control mechanisms' framework was supported in this study. By developing a more comprehensive conceptual framework of the composition of control mechanisms, marketers, academics and managers will be able to gain a deeper understating of *how* they can effectively control their IJV's in pursuit of achieving their own strategic objectives. Further, the dual perspective (both IJV partners) of control mechanisms employed within the two case studies illustrated how these control mechanisms interact, the differing power of alternate control mechanisms, and found that multiple control mechanism are employed simultaneously.

Table 1: Categorisation of Type and Orientation of IJV Control Mechanisms.

Type and Orientation of Control Mechanism	Mechanisms found in Cross-Case Analysis	Function of Mechanisms
Content-Negative oriented mechanisms	<ul style="list-style-type: none"> • The official IJV agreement • Equity differentials 	Both are formal, legally binding control mechanisms that set out the parameters of the IJV's official control. They cannot be altered without legal processing and play a major role in preventing the IJV from engaging in particular activities. Both mechanisms require the IJV to behave in accordance with certain rules and/or regulations (i.e. specifications in the IJV agreement) (Schaan, 1983).
Context-Positive Mechanisms	<ul style="list-style-type: none"> • Informal relations • Staff services • Training 	The results of this cross-case analysis indicated that these mechanisms all assisted in creating an environment for the IJV to achieve its strategic objectives (context oriented control mechanisms). They promoted employees to engage in certain behaviours and create an environment for IJV partners to develop an understanding of the employee's skills (training), partner's motivations and limitations (informal mechanisms). (Schaan, 1983).
Process-Positive Mechanisms	<ul style="list-style-type: none"> • Reporting process • Board of Directors • The managerial and marketing decision-making process 	These three mechanisms have all controlled the IJV in terms of the strategic direction the IJV followed. They promoted the IJV to engage in particular activities, gave partners some strategic control over the IJV's operations. (Schaan, 1983)

However, it can be inferred from the results that technological dominance as a mechanism of control can be both promotive and preventative in its influence over the IJV. In the Azzi case study, the technical expertise of Azzi Australia required the IJV to behave in particular ways (i.e. buy the semi-produced product from Azzi Australia rather than produce the product itself). It also prevented the IJV from engaging in certain activities (i.e. legally binding restrictions on the IJV in the exporting and marketing of its product). It can be inferred from the case results that technology controls the IJV processes (process-oriented) and directly intervenes in the IJV's manufacturing and marketing of its finished product (content-oriented).

In conclusion, whilst the incorporation of the *type* and *orientation* of control mechanism is supported, further research needs to be conducted to explore the conditions under which technology is a positive process-oriented control mechanism or a negative content-oriented control mechanism. This was outside the scope of this study.

External Environment:

The case study results inferred many external influences facing the joint ventures, including government restrictions on foreign equity (Azzi India) and many cultural, legal and economics variables. However, perhaps the major impediment to Australian

business operating in India was the vast cultural differences between the two nations. These cultural differences were evident in both case studies; however, this example from the Phandi case study is typical of the stories told by the managers. This example stems from the Phandi case study when the Australian partner was visiting the IJV's manufacturing plant in India

All of a sudden the lights went off. All production immediately stopped so the General Manager said: The electrician will attend to that, so he shouted and a big chief electrician turned up and said: Oh, yes, begging your pardon, I will be attending to this immediately, and disappears. So five minutes later, no power. Ten minutes later, no power. Quarter of an hour later, no power. So the Chairman, said: This is not good enough. So we walked into the plant where the electricity is supplied, a little generator stands in the corner and there sits the chief electrician in lotus position in front of the door because in front of the door is a table. We said to him: Aren't you going to fix the generator? And he said: begging your pardon, sir, but can you not see there is a table standing in front of the door and I cannot be accessing it. So we said in not very polite terms: well, shift the bloody thing. And he said: Begging your pardon, but I'm the chief electrician I am not a furniture removalist. It was not his caste to do that [he was a Brahman, the highest level in the Indian caste system]. So we got somebody else to shift the table and seconds later we had power. Make somebody understand that. A bit of a problem!

Cross-Case Analysis and Typology

Based on the case study results it was possible to identify two distinct types of IJV's. *Type 1 - Technology based IJV's, and, Type 2 - Distribution and market knowledge based IJV's.*

Type 1: The Azzi IJV was characterised by tensions and conflicts, focused on R & D and product innovation, and commitment was primarily based on mutual achievement of objectives. Technical dominance was the main control mechanism. Type 2: The Phandi IJV was characterised by a commitment based on loyalty and accommodation, transparency of information and relational dynamics played a major role in the control of the joint venture. These two types of IJV's have been categorised based on their descriptors as seen in the Table 1. Two final inferences can be drawn from these results. Firstly, ironically, the IJV with less tension (Type 2) can be seen as more at risk than the Type 1 IJV (Azzi IJV) in possibly not being able to sustain the venture relationship long term. The explanation for this goes back to the very essence of why companies form IJV relationships. As described in the literature review, IJV's serve multiple purposes. However, in order for IJV's to operate long term, the very nature of the IJV must continue to grow. In Azzi's case, this is technology based, and the technology continues to develop at a pace that allows both partners to feel that new knowledge is driving the venture presently and for the foreseeable future. Evidence

for this is seen in their continual focus on research and development and both partners indication of their commitment to a long-term relationship. Based on the results of the cross-case analysis, it can be inferred that IJV's based on technology (Type 1) as opposed to distribution and market knowledge (Type 2), are able to withstand greater levels of tension and potential conflict due to the constant value being added to the IJV by the innovative nature of the IJV.

However, in the Phandi IJV, market knowledge and distribution are the main driving forces behind the IJV's lifecycle. This had been demonstrated in the literature to have a finite lifespan. The literature suggests that unless value can be continually added in Type 2 IJV's, the purpose of the IJV's may be undermined. Thus, despite type two IJV's apparent ease of operation, closeness, transparency and loyalty, the nature of the relationship infers that it is more at risk of sustaining long term survival.

Conclusion

In their review of IJV control, Ramaswamy, Gomes and Veliyath (1998) and Shaan (1983) argue that a majority of the literature on IJV control has tended to emphasis single dimensions of control and have not considered how the dynamic nature of IJV's cause these dimensions to change over time. By examining the interaction and dynamic nature of all three dimensions of control (*extent, focus and mechanisms*), we have developed a comprehensive model of control and its dynamics with respect to IJV's.

Although a wide variety of control mechanisms have been identified, managers have received minimal guidance about when and how to use them, as well as the potential tradeoffs between alternative control options. As a result many firms have chosen to bypass the IJV control option or enter ill prepared. These firms may be missing potentially valuable opportunities. This study attempts to bring into focus a critical variable influencing venture development and performance, and to provide a basis for improved understanding and management of IJV's. Review of the literature leaves little doubt that control is a crucial organisational process. The study may help explain why researchers have used different approaches in the past to study control in IJV's.

The development of a theoretical and practical model for controlling IJV's in a developing market place will benefit managers from developed markets by providing a deeper understanding and conceptualisation of IJV control as it changes over the

duration of the IJV relationship. Finally, it will provide practical lessons, which will assist in the achievement of IJV strategic objectives.

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