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## Joint ventures in the ASEAN countries

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Egyptian promotional laws. One of the objects here was to supply the Middle Eastern OPEC market but nothing of the kind has so far happened.

Great problems are met in the measurement of technology transfers under cooperation arrangements. They can really only be measured by specific field studies although examples in more advanced developing countries show that considerable positive diffusion effects have in fact been induced in this way. That correlative transfer effects must have taken place is demonstrated by the fact that not only the local content of production has been raised relatively quickly but managements of joint ventures have been largely indigenized and further by the increasing supplies of locally produced high-grade goods to the markets of the states concerned. The rate of transfer of industrial research capacities to enterprises in developing countries should be judged with reserve. Attention should however be paid to Ranis' reference to the

importance of development stages and the related transfer of certain technological concepts from the industrialized to the developing countries. Besides, such transfers need not always be spectacular but can take the form of technical means of production developed in other countries being adapted to the utilization of domestic resources, with the result that the share of local inputs is increased.

Under structural aspects it is a disadvantage that all forms of industrial cooperation on a private-enterprise basis are mainly governed by market conditions, so that many countries with less advantageous market opportunities find it difficult to take part in it. It is also a fact that certain instruments of cooperation are often employed only in such a way that they serve the interests of the partners from the industrialized countries which usually have a stronger market position.

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## COOPERATION

# Joint Ventures in the ASEAN Countries

by Doo-Soon Ahn, Bochum\*

**Many developing countries see in joint ventures a convenient means of pursuing their economic development in their own way without forgoing the benefits to be derived from foreign investment capital and know-how. The following article presents some of the findings of an empirical study by the author in the ASEAN countries. He addressed his inquiries on motivation, advantages and drawbacks of enterprises with local participation to 77 joint ventures as well as 29 fully foreign-owned firms.**

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The "indigenization" of their economies has become an important objective of economic policy in many countries of the Third World. Foreign capital is in general heavily involved in these economies, and the participation of foreign capital in new investments is therefore subjected to restrictive regulations while measures are also taken for "fading out" existing foreign investment projects<sup>1</sup>.

The countries in question start from the premise that foreign investments while indispensable for the

achievement of their development objectives may give rise to dangers, actual or implicative, for their economies and societies. The chief pros and cons of foreign investments as discussed in the literature range from their effects on the economic structure, employment, stability and distribution in the host countries to sociocultural questions and issues of national sovereignty and independence<sup>2</sup>.

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<sup>1</sup> Cf., i. a., R. D. Robinson: National Control of Foreign Business Entry. A Survey of Fifteen Countries, New York and elsewhere, 1976; R. Krämer: Zur Investitionspolitik afrikanischer Länder (On the investment policy of African countries), in: Weltwirtschaft, No. 1, 1977, p. 128ff.; C. F. D. Alejandro: Direct Foreign Investment in Latin America, in: Ch. P. Kindleberger (ed.): The International Corporation, Cambridge, Mass. and London 1970, p. 319ff.

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Irrespective of this dispute about the advantages and drawbacks of foreign investments to the host countries the investment authorities in these countries have to face several factors of uncertainty in their national economic policy as a result of the foreign capital activities:

- ☐ Foreign investors are free to choose investment locations irrespective of national frontiers without entering into a binding commitment to the countries concerned;
- ☐ Foreign investors have the possibility of relocating existing production plants in other countries;
- ☐ Foreign investors are at liberty to pursue a policy of their own in the monetary and financial sphere, eluding the economic policies of the states concerned;
- ☐ The national economic authorities are uncertain or ignorant of the possible effects of foreign investments on the national economy;
- ☐ The national economic authorities are uncertain or ignorant of the reaction of foreign investors to directive economic policy measures by the state.

These are the circumstances in which the host countries are searching for a remedy which enables them to eliminate the root cause of the hazards but does not necessarily impel them to forgo the advantages of foreign investments for their economies.

With this end in view the governments of the five ASEAN countries adopted a number of measures for the control of private direct investment<sup>3</sup>. They included a "joint venture policy".

### Joint Venture Obligations

Apart from a few exceptions foreign investors are in all ASEAN countries obligated to carry out all their investment activities through the medium of joint ventures with indigenous partners. Joint ventures of foreign and indigenous entrepreneurs are a special form of foreign investment and may arise from

- ☐ the establishment of a new enterprise in the legal form of a separate entity;
- ☐ the participation of local partners in an existing foreign enterprise;
- ☐ the participation of foreign partners in an existing indigenous enterprise.

The governments of the ASEAN countries do not as a rule welcome the third variant and therefore sanction it only in rare cases.

The joint venture policy must be judged against the background of the suspicion with which foreign economic powers are viewed in the developing countries. This distrust rests on the following surmises<sup>4</sup>:

- ☐ Behind the foreign investments lurk strong political power interests in the countries of the capital donors.
- ☐ Profit-motivated foreign investors pay too little attention to the objectives of the native governments.
- ☐ Direct foreign investments do not infrequently compete with indigenous investments.
- ☐ Foreign investors infringe the interests of the host country, especially in critical situations.
- ☐ Decisions on direct investments are taken in the home country of the investor, with the result that the government of the host country loses control.
- ☐ Foreign staff policies, minimal technology transfers and low training effects of direct investments are against the national interest.

### Motives of the Host Countries

As the ASEAN countries are in principle opposed to authorization of foreign investments in any other form than through joint ventures, the representatives of the indigenous interests were asked which motives were responsible for this insistence on joint ventures.

The answers differed widely, and the arguments offered were not always objective und unemotive. All the interviewees however clearly believe joint ventures to constitute a useful alternative to direct investments without local participation, and it was also evident that joint ventures are held to have positive importance as an instrument of investment policy which may be

<sup>2</sup> Cf. V. Bethke, G. Koopmann: *Multinationale Unternehmen und Entwicklungsländer. Interessenkonflikte und Verhandlungspositionen* (Multinational enterprises and developing countries. Conflicting interests and negotiating positions), Hamburg 1975; J. N. Behrman: *National Interests and the Multinational Enterprise. Tensions Among the North Atlantic Countries*, Englewood Cliffs, N. J. 1970; P. H. A dy: *Private Overseas Investment and the Developing Countries*, in: P. H. A dy (ed.): *Private Foreign Investment and the Developing World*, New York and elsewhere, 1971, p. 3ff.

<sup>3</sup> Cf. R. D. Robinson, op. cit.; Th. W. Allen: *Policies of ASEAN Countries Toward Direct Foreign Investment*, in: A. Kapoor (ed.): *Asian Business and Environment in Transition*, Princeton 1976, p. 57ff.

<sup>4</sup> Similar criticisms are to be found in J. Jegathesan: *Impact of Foreign Investment and Technological Cooperation on Development Problems: The Position of Developing Countries*, in: Friedrich-Ebert-Stiftung (ed.): *One World Only. The Impact of Foreign Investment and Technological Cooperation on Development. An International Forum Report 10*, Singapore 1974, p. 136ff.

hoped to improve the effectiveness of foreign investments.

The arguments presented in reply to the questions may be grouped in four motive categories:

□ *Transfer motives:* Provision through cooperation with foreign firms of locally scarce production factors; improved selective transfers through joint ventures of capital, technology, and management and marketing know-how.

□ *Instruction and mobilization motives:* Mobilizing and channelling of local capital; training in manual and clerical skills; development of local entrepreneurial talent through participation in joint ventures; diffusion of modern technologies and investment methods through interaction processes in joint ventures.

□ *Economic policy motives:* More accurately targeted nationally oriented economic policies aiding through joint ventures, e. g., diversification of the regional and sectoral economic structure, horizontal and vertical integration of the economy, and more equitable income distribution.

□ *National political-strategic motives:* Control and coordination of the economic developments in the country; strengthening of the position of the local economy and society vis-à-vis foreign economic powers; increase of economic self-reliance;

<sup>5</sup> A good survey of this issue is found in H. H e m b e r g e r : Direkte Auslandsinvestitionen – Elemente des Entscheidungsprozesses und Erklärungsansätze (Direct foreign investments – Elements of the decision-making process and attempts at an elucidation), Frankfurt and Zürich 1974, p. 150ff.

safeguarding of the national sovereignty through joint ventures.

To put the developing countries' case in a nutshell, they are hopeful that joint ventures will give them the benefits of foreign investments without disadvantages otherwise connected with them.

### Backing by Investors

The motives which induce foreign investors to participate in joint ventures in developing countries are as a rule not vastly different from those for foreign investments generally. While the motives for foreign investments<sup>5</sup> cannot be followed up here in detail, more consideration may be given in the present context to those which have led to joint ventures but not to other forms of foreign investments. In order to pinpoint the special motives for joint ventures as distinct from general ones for foreign investments, the factors militating against joint ventures have been included in the inquiry.

Asked why joint ventures were chosen as the form of investment, the interviewed foreign investors gave as widely varying answers as the representatives of local interests:

□ "Long-term stabilization of own business activities through joint ventures" was mentioned most often, and

□ "legislative constraints in the host country" and "use of local know-how of the partner" came next.

It is evidently assumed that nationalistic feelings in the developing countries, the extent of which cannot be

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V E R L A G W E L T A R C H I V G M B H - H A M B U R G

judged, may induce the state to keep foreign investments under even stricter control. The local public thinks of a foreign direct investment without indigenous participation *eo ipso* as *foreign* while a joint venture is not infrequently held to be a *national* firm. When it comes to the crunch a joint venture is thus less at risk than a direct investment.

The fact that all the host countries in South-east Asia are – just like other developing countries – pursuing a “fading-out” strategy which involves the successive reduction of the foreign interest in implemented projects is also in favour of foreign investors engaging from the outset in joint ventures.

Utilization of the local know-how of an indigenous partner is an especially important motive for foreign investors without sufficient experience of external markets. Association with a local partner can overcome a foreign newcomer's lack of knowledge of local business practices, consumer buying habits, market situation, legal regulations, dealings with the authorities, and the customs of the population.

Joint ventures also commend themselves to foreign investors because they allow

- ☐ local incentives to be used for joint ventures;
- ☐ financial bottlenecks to be overcome through engagement of local capital;
- ☐ market access to be secured (for instance in regard to public contracts);
- ☐ raw material sources of the local partner to be exploited;
- ☐ the image of the firm as a “partner” of the host country to be enhanced.

### Arguments Against Joint Ventures

The 29 interviewed firms in 100 % foreign ownership were asked why they had abstained from joint ventures in spite of in part restrictive legal regulations. In reply they most often referred to

- ☐ specific project features (e. g. technology-intensive production processes or overwhelming importance of exports), so that there was no need for joint ventures;
- ☐ the wish to ensure autonomous management and quality control and prevent interference by local partners;
- ☐ absence of a need for a local partner, mainly because of long experience with conditions in the host country;

- ☐ absence of financial or other bottlenecks hampering project implementation.

The points raised against joint ventures show in conjunction with the motives for them that coercive motives<sup>6</sup> such as legislative constraints of host countries in regard to the forms of investment play an important role in the formation of joint ventures in developing countries. This does not necessarily mean that the foreign investors in developing countries choose a joint venture only because it is the only available alternative to abstention from investing. His personal inquiries have led the author to the conclusion that voluntary motives are at least as important as the coercive ones.

The mere fact that foreign investments are made with local participation does not tell us much about the actual distribution of power and does not indicate that the factors of uncertainty connected with foreign investments or the unease felt by local governments about them have been removed.

It has to be asked in this context

- ☐ in which proportion the partners are sharing the joint venture;
- ☐ what contributions the partners have made to their joint ventures; and
- ☐ where the actual power lies in these joint ventures.

### Importance of Equity Holdings

The criterion most often used for categorizing joint ventures is the proportion of the equity capital held by the partners. In consequence of the “emancipation of the developing countries” the majority of the enterprises operating on a world-wide scale have waived their former claim to 100 % capital and control rights over their investments in these countries. They are now ready to agree to local participation in their investment projects but still want the decisive directive functions to be left in their hands. This means mainly that the foreign investor should have a majority shareholding in the joint venture. The following arguments are advanced in support of this view:

- ☐ Planning and coordination of world-wide business activities require the retention of the decision-making powers at all operational levels by the foreign partner.

<sup>6</sup> This term has been taken over from D. K e b s c h u l l : Motive für deutsche Direktinvestitionen in Entwicklungsländern (Motives of German direct investments in developing countries), in: Probleme der Arbeitsteilung zwischen Industrie- und Entwicklungsländern (Problems of the division of labour between industrialized and developing countries), Beihefte der Konjunkturpolitik, Nr. 19, 1972, p. 11 ff.

□ Secrecy about technical and organizational know-how, which represent the principal asset of multinational enterprises, could be put in jeopardy if they had only a minority interest in joint ventures.

□ Satisfactory operational performance and quality controls cannot be taken for granted under minority participation conditions.

On the other hand, there are many points against acquiring majority participations in developing countries and thus in favour of minority holdings in joint ventures. Mention may be made of the following:

□ Joint ventures with a foreign minority interest promise better long-term stability in the host country because they are less likely to become the butt of nationalistic movements. Joint ventures with a foreign majority holding are as a rule under constant "indigenization" pressure.

□ The local majority partner has a stronger incentive to support the enterprise actively, with the result that it can operate more efficiently.

□ The public will regard a joint venture with a foreign minority holding as a "national" one and therefore accept the foreign investor as the country's "partner", with positive repercussions on other activities extraneous to the joint venture.

### Opposite Positions

In practice the foreign investors are as a rule aspiring at a majority position while the local governments will permit foreign participations of up to 50 % at most.

Parity participation offers a simple compromise solution between these opposite positions. For the developing countries it is of interest, i. a., because it gives them the feeling that they are accepted as partners of an equal status and obtain the appropriate rights of control. For the foreign partner it can also prove advantageous if, as may be regarded as normal, besides his parity share of the equity he has a technological lead. Parity involves a deadlock risk when decisions are blocked by a stalemate among the management but this danger can in practice be circumvented in various ways<sup>7</sup>.

Historically the trend of foreign investments has been marked by a continuous world-wide decline of 100 % direct investments while the share of foreign minority holdings in joint ventures has been increasing at the expense of the majority participations<sup>8</sup>.

This trend also obtains in the ASEAN countries<sup>9</sup>. The tabulation of the available information (Singapore had to be omitted for lack of statistical data) shows that the fully or mainly foreign-owned enterprises account for a rather modest share of the total foreign investment, except in Indonesia where majority holdings are the predominant form of foreign participation<sup>10</sup>.

### Distribution of Foreign Investments in ASEAN Countries by Degree of Involvement

Country <sup>a</sup>	Projects in full foreign ownership	Projects in foreign majority ownership	Projects in foreign parity ownership	Projects in foreign minority ownership	Total number of projects
	(%)	(%)	(%)	(%)	
Indonesia	97 (18.5)	336 (64.0)	52 (9.9)	40 (7.6)	525
Thailand	25 (5.1)	63 (13.0)	13 (2.7)	385 (79.2)	486
Philippines	20 (8.3)	32 (13.3)	1 (0.4)	188 (78.0)	241
Malaysia		328 (32.5)		682 (67.5)	1010

<sup>a</sup> Excl. Singapore where foreign investment participation is not subject to restrictions.

Source: Calculated from data of national authorities.

All ASEAN countries pursue the "indigenization policy" with great consistency. It can therefore already be predicted that in the future foreign minority holdings will be the rule rather than the exception.

### Pattern of Contributions

What other contributions are made by the partners beside their share of the joint venture capital is an important question. In addition to his equity capital contribution which is predetermined by his shareholding the foreign partner is as a rule expected to provide other services including

- credits or access to sources of finance;
- management know-how;
- technological know-how;
- marketing know-how and marketing facilities.

If the foreign partner supplies all these services for a joint venture, he is understood to provide a "complete package". This kind of complete package-joint venture plays an important role in developing countries. Under

<sup>8</sup> Cf. R. Vernon: Restrictive Business Practices. The Operations of Multinational United States Enterprises in Developing Countries. Their Role in Trade and Development. U. N., New York 1972, p. 23; also J. M. Stopford and L. T. Weil, Jr.: Managing the Multinational Enterprise. Organisation of the Firm and Ownership of the Subsidiaries, London 1972, Table 10-1, p. 144.

<sup>9</sup> For more details cf. D. Ahn: Joint Venture als ein Instrument der Investitionspolitik der Entwicklungsländer. Dargestellt am Beispiel der ASEAN (Joint Venture as an example of the investment policy of the developing countries. Presented by the example of the ASEAN), doctor thesis, Bochum and elsewhere, 7th chapter.

<sup>10</sup> Own calculation from data of the national investment authorities. These comprise only projects which have been registered with the authorities.

<sup>7</sup> Cf. (no indication of author): Joint Venture Corporations: Drafting the Corporate Papers, in: Harvard Law Review, Vol. 78, 1964, p. 393ff.

such circumstances preference will be given to a (potential) foreign investor who is in a position to provide all or an essential part of these factors on favourable terms.

Supplementary contracts on services by the foreign partners have been concluded for 77 joint ventures and six other "foreign" operations in ASEAN countries. They include

- ☐ 24 management contracts,
- ☐ 30 licence and trademark contracts,
- ☐ 33 technical assistance agreements,
- ☐ 23 export agreements (with sales guarantees or export commitments by the foreign partner).

The foreign partners expect the local partners to form a bridge to local political and commercial circles and to the public, to facilitate the access to the market for inputs and outputs in the host country, to look after permits, licences, etc., and to arrange staffing and administrative matters. Commercial and political connections play a role in their choice of local partners. So does local know-how, experience with the local market for inputs and outputs, possession of raw material sources, etc. The local partner's contribution to the capital on the other hand is often relatively unimportant as is indicated for instance by the capital structure of the industrial projects undertaken with foreign participation in Indonesia. Local interests provided in this country no more than 7.8 % of the capital.

#### Distribution of Effective Power

It is clear from the mentioned actual or anticipated contributions of the joint venture partners that the effective distribution of powers in the enterprise depends not only on the equity holdings but on a number of other factors.

Of importance are for instance the relations between the partners as suppliers and customers. The sample check among enterprises in ASEAN countries by the author revealed that the exports of products made by the joint ventures were handled almost exclusively by the foreign partner or his distribution network. The foreign partner also decided in most cases on the supply of components, parts and intermediate products, and this means as a rule that indispensable technical know-how for operational tasks of the joint venture is provided by the foreign partner.

Summing up, it can be said that the distribution of powers in a joint venture depends upon various

internal and external factors among which may be mentioned<sup>11</sup>:

- ☐ size, strength, connections and international experience of the partners;
- ☐ market size, development level, factor endowment of the host country, and the investment strategy of the local government and its legislation;
- ☐ kinds of products, target markets and marketing strategies of the partners;
- ☐ economic structures, competitive situation and cost factors in the host country as well as the home country of the foreign partner;
- ☐ distribution of responsibilities between the joint venture partners.

The distribution of responsibilities puts the foreign partner usually in a position of ascendancy over the local partner. In the joint ventures in ASEAN countries it was observed that the foreign partners provided on average a majority of the members of decision-taking and executive organs. They also filled the more important posts; they supplied for instance the managing directors, the financial directors or the general managers.

#### Prospects

For the host countries of foreign investors the joint venture offers an alternative to two other forms of investment. On the one hand it is an alternative to 100 % direct investment: Local interests are brought in so as to avoid as far as possible the undesirable side-effects of foreign investments. What matters here are not only the *ex post* results but the impression in the host country that the "impotence of the state" in the face of foreign economic powers in its own country<sup>12</sup> has been overcome.

The joint venture offers the host country on the other hand – and foreign investors often fail to see this – an alternative to 100 % local investment and thereby a means of increasing the intensity of competition in the local market. A warning against excessive optimism about the joint ventures is however called for: It must be realized that they are a useful instrument in appropriate cases, but certainly no panacea for all the problems connected with foreign direct investments in developing countries.

<sup>11</sup> Cf. V. Bethke, G. Koopmann, op. cit., p. 188ff.

<sup>12</sup> Cf. R. Hellmann: Kontrolle der Multinationalen Unternehmen (Control of the multinational enterprises), Baden-Baden 1974, p. 117.