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KEEPING OPTONS ALIVE BY REPAIRING DAMAGED RELATIONSHIPS IN INTERNATIONAL JOINT VENTURES

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ABSTRACT

Why are some damaged international joint venture relationships repaired? Under what conditions does such a repair make sense? This article addresses these two questions by drawing on real options theory. Not all troubled relationships are terminated immediately; instead, many are repaired and retained for a prolonged time. Counter-intuitively, we make the case that that repairing and retaining of troubled relationships may be a reflection of their interests in keeping real options alive. They remain in collaboration until a future decision point comes and a "go" or "not go" decision can be made.

Key Words: international joint ventures, damaged relationships, real options perspective

INTRODUCTION

Firms use international joint ventures (IJVs) for the purpose of technology/resource exploitation or exploration, economies of scale or scope, market adaptation, or risk diversification (Cuypers & Martin, 2010; Hennart, 1988; Parkhe, 1991; Hill & Hellriegel, 1994; Hitt, Dacin, Levitas, Arregle & Borza, 2000; Inkpen & Beamish, 1997; Tong, Reuer & Peng, 2008). Alternatively, IJVs carry managerial costs caused by complexities and challenges associated with joint investments, coordination or control, multiple agencies, or competition and conflict (Barden, Steensma & Lyles, 2005; Das & Teng, 2000; Hambrick, Li, Xin & Tsui, 2001; Inkpen & Ross, 2001; Reuer & Leiblein, 2000; Tong & Reuer, 2007).

It is notable that IJVs are commonly characterized by their inherent instability that eventually leads to a high failure rate (Das & Teng, 2000; Dhanaraj & Beamish, 2004; Hennart et al., 1998; Park & Ungson, 1997). Just as few human marriages are truly an ideal picture of two individuals living "happily ever after," conflicts and relationship damages are common in alliance relationships. Relevantly, Eaves, Weiss, and Visioni (2003) analyzed a three-year cross-industry study of alliance relationship management and found that poor or damaged relationships accounted for fifty-two percent of all broken joint ventures (JVs). For this reason, IJV instability or termination is popularly studied (e.g. Das & Teng, 2000; Hennart et al., 1998; Yan & Zeng, 1999).

Just as few individuals would want to divorce their spouses when relationship difficulties initially arise, few managers terminate their alliances right away when relationship damages occur–if they do, they would be regarded as reckless. However, over the long run, we do know that a large percentage of individuals and firms terminate their relationships. Therefore, it is certain that many firms remain in a difficult collaboration for some time, and that some eventually terminate their relationships and presumably others repair their damages and move on with relationships that are more functioning. Repairing damaged relationship in the context of strategic alliances can be defined as significant efforts to save and improve a troubled relationship that has a high likelihood of failure and termination in the absence of serious efforts to save it (Peng & Shenkar, 2002).

Therefore, why do firms choose to remain in a difficult collaboration? While motivations to repair damaged IJV relationships range from an interest in deriving economic value from the collaboration to a desire to protect corporate reputation as a good partner, one potential motivation that has not been discussed before is that partners may be interested in preserving the real option value of their IJV relationships. IJVs have long been conceptualized as real options (Cuypers and Martin 2010, Kogut 1991, Reuer and Leiblen 2000, Tong et al. 2008). Real option perspective sheds new light on how firms deal with IJV termination as well as why firms choose IJVs over other governance modes. Real options view argues that entering into uncertain markets via JVs is like buying call options (Chi and McGuire 1996, Cuypers and Martin 2010, Folta 1998, Kogut 1991, Tong et al. 2008). As a real option investment, IJVs carry the benefits of preserving upside potentials and curtailing downside risks under conditions of high uncertainty (Dixit and Pindyck 1994, Folta and Miller 2002, Kumar 2005, Pindyck 1991, Reuer and Leiblein 2000, Tong et al. 2008).

Consequently, we advance the argument that repairing damaged relationships represents partners' efforts to keep real options alive. This argument builds on a straightforward but somewhat counterintuitive line of reasoning: to the extent that IJVs represent any real option value, prematurely closing or ending any IJV relationships due to relationship conflicts will immediately obliterate any value—present or future—of these real options. In other words, even though divesting an IJV troubled by damaged relationships among collaborating firms might be a better idea than keeping it viable in the short-term, holding onto the IJV can also be a strategic consideration.

Having decided to remain in a difficult collaboration, next, managers confront a challenge: How? The literature is sparse on this issue. Some studies focus on the downward spiral toward eventual demise of the relationship (e.g. Peng and Shenkar 2002), but few scholars have grappled with the challenge that managers in a difficult collaboration confront: they want to make their relationship work but are also prepared to terminate it should it become necessary at a future point in time. This, of course, is the "strategy process" or "implementation" perspective, which is largely missing not only in the alliance literature, but also in the strategy and management literature in general.

Our purpose in this paper is to diagnose managerially the conditions under which inter-organizational relationships are damaged. We intend to examine how JV partners should manage nontrivial downside risks and make their relationships work, and how to repair damaged relationships to obtain their expected real options values. Since almost all real options research focuses on the beginning and ending of real options (establishing and terminating or acquiring JVs in this context), we add to this literature by focusing on how firms may add to, or at a minimum, retain the values of their real options during the lifespan of their inter-organizational relationships.

Overall, by focusing on the "why" and "how to" aspects of the decision and efforts to remain in a difficult collaboration, we address a key question: how to keep the real options "real" when encountering relationship difficulties. While we intend to contribute primarily to the strategic alliance literature, our process and implementation perspective also is an endeavor to contribute to real options management, because existing work suggests that there is a major gap between the theoretically presumed benefits of having real options such as JVs (Kogut 1991) and the actual realization of such benefits (Reuer and Leiblein 2000).

Finally, implications for real options theory, the theory of strategic alliances, and management practice are all addressed.

LITERATURE REVIEW AND PROPOSITIONS

Problems and Termination of International Joint Ventures

It is commonly agreed that JVs are not goals in themselves, but a contractual partnership designed to achieve strategic goals (Inkpen and Ross 2001). Unlike other types of real options investments, JVs have the unique characteristics of doing business jointly with other firms; thus, are inherently embedded with high transaction costs (Gulati and Singh 1998, Reuer and Leiblein 2000, Tong et al. 2008). Cultural adaptation to different customs, languages, or bargaining styles requires time for mutual contacts or learning to occur. It is also necessary to adapt to different organizational policies and practices, requiring additional time and effort. These different cultural and organizational problems have been considered as primary factors contributing to alliance instability and termination (Parkhe 1993, Serapio and Cascio 1996).

Low credibility among IJV partners delays learning and hinders the accomplishment of the alliance goals (Inkpen and Beamish 1997). When two different organizations form an alliance, trust is a basic issue directly related to the conflicts, stability, and outcomes between the two parties (Boersma et al. 2003, Brouthers and Bamossy 2006, Gill and Butler 2003, Madhok 2006, Parkhe 1993, Thuy and Quang 2005). Violating the contract will bring about conflict in the alliance relationship, resulting in decreased alliance credibility since alliance credibility depends on sincerely executing the contract by both parties. There have been cases where an alliance was ended because of a partner's violation of the contract (Parkhe 1993, Serapio and Cascio 1996).

For those aforementioned reasons, JVs have been noted to have inherent instability as is reflected by a high propensity for short life or failure (Das and Teng 2002, Hennart et al. 1998, Hill et al. 1990, Kogut 1989, Park and Ungson 1997). The poor performance and low survival rate of many JVs raise the issues of whether many JVs are high-risk projects and whether they are being managed timely (Reuer and Leiblein 2000). That is, notwithstanding these option value-adding characteristics of JVs under high exogenous uncertainty, downside losses or exchange coordination costs could be nontrivial, or it will be difficult to capture the value latent in these ventures (Gulati and Singh 1998, Lyles and Salks 1996, Peng 2003, Tong et al. 2008, Steensma and Lyles 2000), leading to imperfect claims on emerging opportunities (Reuer and Leiblein 2000).

Traditional Perspectives on IJV Termination

It is commonly agreed that IJVs carry organizational complexity and inherent instability (Chung and Beamish 2010, Hennart et al. 1998, Zaheer and Mosakowski, 1997). Regarding this issue, Yoshino and Rangan (1994) argued that relational conflicts among IJV partners are affected by partner opportunism, asset complementarities, learning, trust between partners, and competitive conditions. Kogut (1989) asserted that an alliance closedown increases as the economic motive gap between partner increases and the agreeability between partner declines. Similarly, Das and Teng (2000) proposed that relational instability in IJVs is generated by an imbalance between competition and cooperation, rigidity and flexibility, or short- and long-term orientation. Conflict within a joint business causes unnecessary costs that negatively affect an IJV's performance and stability.

Diverse perspectives exist in the extant literature to explain this IJV instability or termination. For instance, bargaining power perspective explains that power asymmetry associated with shared ownership or contributing resources leads to IJV instability (Choi and Beamish 2004, Chung and Beamish 2010, Inkpen and Beamish 1997, Pearce 1997, Steensma et al. 2008). Organizational learning perspective says that slow or hindered learning, or asymmetry in the learning race accelerate IJV instability or termination (Kumar and Lti 1998, Inkpen and Beamish 1997, Parkhe 1991, Yan and Zeng 1999). The completion of intended learning or the acquisition of necessary resources or capabilities trigger divestment (Inkpen and Beamish 1997, Makhija and Ganesh 1997). In contrast, slow or poor learning, difficult access to necessary resources, and no gain from partners can be catalysts for divestment (Chi 2000, Parkhe 1991).

The transaction cost perspective suggests that partners' opportunistic behaviors associated with moral hazards or hold-up risks increases transaction costs and relational conflicts, thus, IJV termination (Das 2005, Das and Kumar 2009, Das and Rahman 2010, Das and Rahman 2009, Gulati and Singh 1998, Kale et al. 2000, Parkhe 1991, Pearce 1997, Shan 1991). In an IJV, more than two companies with different nationalities being involved increase the difficulty of controlling partner behaviors (Das and Kumar 2009, Das and Rahman 2010, Kale et al. 2000, Zhang and Li 2001). A firm is concerned about its ability to capture a fair share of the rents from the alliance in which it is engaged. That is a kind of appropriation concern due to uncertainties associated with future specifications, cost uncertainties, and problems in observing partner contributions. If uncertainty becomes higher due to *ex post* opportunism of partners and thus, difficulty in valuation of a partner becomes intense, firms may be exposed to the risk of adverse selection (Jap and Anderson 2004, Kale et al. 2000, Madhok 1995, Parkhe 1993, Serapio and Cascio 1996, Park and Ungson 2001, Zhang and Li 2001).

The bargaining power perspective argues that incomplete claims on joint businesses carry relational instability since partnering firms are not always agreeable; thus, they are in a game situation (Julian 2005, McGinn and Keros 2002, Parkhe 1993, Pearce 1997). Under that situation, IJV partners attempt to exert political or bargaining influence to maximize their own benefits, sometimes at the sacrifice of other firms' interests (Inkpen and Beamish 1997, Parkhe 1991, Pearce 1997). Firms engaged in IJVs make relative contributions to joint businesses based upon their heterogeneous resources including technology, local knowledge, and government connections, leading to asymmetric bargaining power and relational changes including termination (Blodgett 1991, 1992, Chung and Beamish 2010, Gomes-casseress 1988, Inkpen and Beamish 1997). For example, the initial distribution of equity ownership reflects the relative bargaining power among the participating firms, and affects the preferred level of ownership including IJV termination via buyouts or sell offs, with regard to changing bargaining power over time (Blogett 1991, 1992, Chung and Beamish 2010, Hennart et al. 1999, Steensma et al. 2008).

Real Options Perspective on IJV Termination

Real Options Value of JVs

Real options view suggests that entering uncertain markets through JVs is like buying call options because of the benefits of preserving upside potentials and curving downside risks under the conditions of high uncertainty associated with changes in exchange rates, institutional change, technology, or market (Chi 2000, Chi and McGuire 1996, Cuypers and Martin 2010, Dixit and Pindyck 1994, Folta 1998, Kumar 2005, Tong et al. 2008). Under high uncertainty, a firm can make flexible decisions by investing in a relatively lower level than wholly owned subsidiaries (WOSs) or outright acquisition (Folta 1998, Kumar 2005, Reuer and Leiblein 2000). Because initial investment has the characteristic of sunk cost, which is irreversible once made, alliance investment can give firms the advantage of reducing potential downside risks (Cuypers and Martin 2010, Folta 1998, Tong et al. 2008).

Relatively low involvements in an uncertain environment provide firms with the flexibility to make subsequent decisions with a minimum risk. Firms engaged in IJVs retain the real option value by waiting and seeing until uncertainty associated with the initial investment becomes reduced (Cuypers and Martin 2010, Dixit and Pindyck 1994, McDonald and Siegel 1986, Pindyck 1991, Reuer and Leiblein 2000, Tong et al. 2008, Trigeorgis 1996). An IJV is a real options investment that allows firms to take sequential investment processes including waiting, acquiring, or divesting according to the evolution of market conditions (Bowman and Hurry 1993, Folta 1998, Folta and Miller 2002, Kogut 1991, Kogut and Kulatilaka 2001, Kumar 2005).

Firm's Choice to Remain in Troubled Collaborations

It is commonly expected that a once-damaged relationship cannot be repaired easily; the relationship is finally dissolved in most of cases (Peng and Shenkar 2002). The prior literature on IJV instability/termination argued that inherently unstable characteristics of alliances could initiate some relational conflict, which might cause relational damage and eventually lead to relational termination. Slow or poor learning, difficult access to necessary resources, or no gain from partners can be catalysts for divestment (Chi 2000, Parkhe 1991). Additionally, there are also difficulties in actual management of the partnership due to high transaction or management costs (Gomes-Casseress 1987, Hill, Hwang, and Kim 1990). In other cases, firms end their present alliances to seek more direct and full control of their solely owned business and escape impaired alliance relationships.

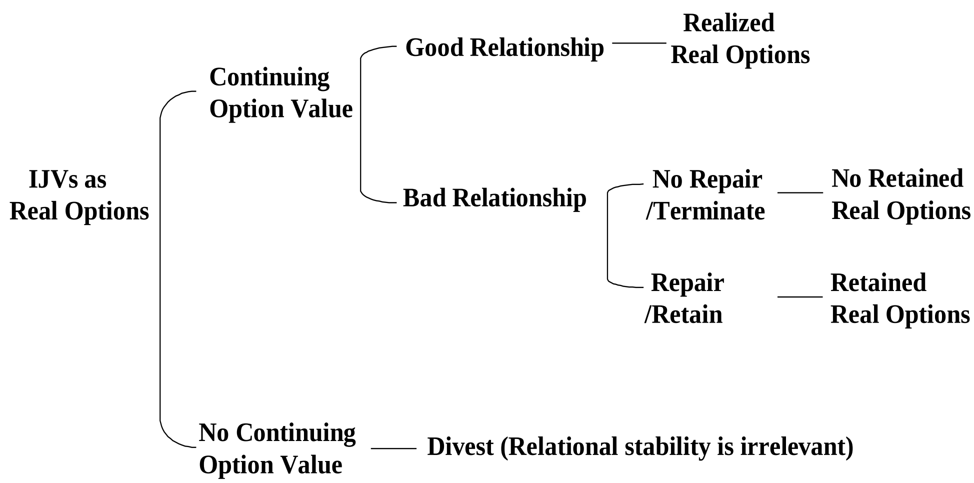
This suggests that valuable real options investments such as IJVs are also costly to create and manage. Although IJVs in highly uncertain situations may have significant potential real option value, if the cost of creating and managing these IJVs is too high, they will not be pursued. Alternatively, if the cost is low, IJVs will be pursued to attain intended objectives. Conflict and the following damaged relationship associated with its unstable characteristics are predicted to affect the destiny of IJVs as a real option investment. To put it another way, even when exogenous uncertainty is not resolved or new opportunities do not arise and thus real options value is still alive, a difficult relationship may set in motion premature or unfavorable termination of the present relationship.

If relational difficulty is serious and termination is at hand, firms can no longer retain this options value. Similarly, Tong et al. (2008) argued that although JVs can provide growth options in theory, their ongoing operations may entail nontrivial transaction costs that make it difficult to capture the value of the growth options latent in these ventures (Lyles and Salk 1996, Peng 2003, Steensma and Lyles 2000).

Proposition 1: The value of option embedded in IJVs will be offset by downside costs associated with relational conflict, behavioral opportunism, or asymmetry in power or learning. This will lead to early/unfavorable termination and eventually undermine potential high payoff embedded in the option to hold.

IJVs are usually expected to undergo some changes in their inter-firm relationship (Arino and Reuer 2004). In each phase of change in Figure 1, managers must consider two critical questions: (1) Is this current situation favorable to ongoing business? (2) How does a new decision affect the value of the firm? Whether managers find positive or negative answers to these questions, they will need to make some optimal decisions. These choices embrace altering its strategic directions, renegotiating its contract such as reconfiguring its ownership and/or management structures, even including alliance termination (Yan and Zeng 1999). Repairing the damaged relationship to retain the present IJV is one of them.

Real Option Value and Relational Changes in IJVs



Keeping Real Options Alive by Repairing Damaged IJV Relationships

However, in reality, not all troubled relationships are terminated. Thus, the question of why firms choose to remain in difficult relationships remains to be answered. To begin with, there must be a continuing need for JVs to make a prolonged relationship sensible for the partners. It means that firms must consider the value of waiting for farsighted purpose; retaining the impaired relationship can be understood in this context. Specifically, firms want to take advantage of flexibility by repairing and retaining their relationships as long as real options values remain positive with exogenous uncertainty unsolved. Following this logic, even in the event of a damaged relationship, firms have incentives to repair and maintain their present relationship pending its full realization in a more favorable situation, rather than terminating it immediately.

This indicates that firms must control other factors influencing alliance longevity and relational instability, if they prefer to retain these real options values. Therefore, firms should make the auxiliary decisions required to protect or enhance these values over time (Kester 1984). Since flexibility is still crucial to focal firms, firms have a motivation to normalize present joint business relationships by repairing the damage until they can exploit their real options fully in a more favorable situation. Relevantly, Kumar (2005) argued that the forgone flexibility due to termination is likely to be more valuable in uncertain target markets than in mature ones.

Likewise, managers with real option thinking are expected to weigh the risk of losing flexibility in a damaged relationship, which is not easy to recover to the pre-damaged condition.

Additional benefits of repairing damaged relationships should be mentioned further. Relational losers are also apt to face problems in managing global strategy. As stated earlier, IJVs are evaluated as an organizational mode for a platform for future investment. That is why firms take advantage of IJVs to learn about partners and the local market to adapt to a new or unfamiliar market. In this way, IJVs can act as important strategic tools for global strategies of the parent firms. If firms untimely or unfavorably lose this strategic relationship, they will have the risk of losing not only the initial investment but also potential opportunities. Put differently, they may lose earlier-invested time and effort, which could have been used in other activities, and some opportunities that the present cooperative business may create in the future. JV partners may want to keep a relationship in good stead to achieve their intended objectives. The objectives could be completing their global strategy by making use of IJVs, or acquiring advanced technology or local knowledge. Firms may need time until their intended objective is accomplished. Therefore, this monitoring and repairing relational damage can give the firms the opportunity of continued learning (Kumar 2005).

It already has been stated that firms in IJVs are commonly expected to face conflicts and subsequent instability. To overcome this difficulty of joint business, firms must learn more about international business, partners, and the market by preserving the present relationship rather than dissolving it during a relationship crisis. It becomes more meaningful when firms expect new opportunities including favorable environmental changes. In China, for example, IJVs with local firms give MNCs an opportunity to successfully exploit the prominent large market specifically at the time of more liberalization or deregulation of foreign investment. In that case, MNCs would enjoy "preemptive advantage" compared to later entrants or earlier terminated firms (Peng 2003).

Damaged but not repaired relationships can be a serious problem in terms of corporate reputation. Corporate reputation is considered one of the most important relational assets that MNCs have to manage (Fombrun, Gardberg, and Barnett, 2000). It can build a platform from which future opportunities may spring and serves as a buffer against loss (Fombrun et al. 2000). Relevantly, investment in a relationship, including repairing a damaged relationship with other firms, can increase the real options available to a company, deriving value from indirectly creating potential for future gain such as R&D investment (Fombrun et al. 2000). Alternatively, an unpleasant or unfavorable ending, and thus damaged reputation, may negatively affect future business with other firms. Therefore, a JV relationship is worthy to be managed carefully considering that improved reputation could be a compound option, in other words, a good asset for subsequent IJVs (Janney and Dess 2004).

Proposition 2: Certain JV partners prefer to remain in a relationship in that a repaired relationship can retain present options and create new options value associated with reputational effect in the future investment opportunities with other firms.

Managing Damaged IJV Relationship

There are several ways firms could use to manage damaged IJV relationships. The first is to structure the inter-organizational relationship. This optimal structuring issue also covers the appropriate safeguarding mechanisms that enlarge the shadow of the future (Jap and Anderson 2003, Parkhe 1993). As in the theoretic game situation (Chi and McGuire 1996, Julian 2005, Parkhe 1993), each partner is likely to be influenced by the behaviors of other partners. In situations where there is high behavioral uncertainty and difficulty in the evaluation of partners, firms in JVs are exposed to appropriation concerns, hold-up risks, and adverse selections (Gulati and Singh 1998); this is a dark side of inter-organizational relationships (Jap and Anderson 2003). These transaction cost factors associated with *ex post* opportunism may diminish the control and flexibility over resources (Pfeffer and Salancik 1978). Setting *ex post* deterrents to the *ex post* opportunism embedded in JVs has managerial meaning in this context, such as contractual safeguards or stipulations in a formal partnership agreement (Parkhe 1993).

Optimally-structuring inter-organizational relationships in JVs is not a one-time issue since JVs are usually experiencing several phases of the relationship, relevantly re-contracting and adjusting according to environmental and relational changes (Arino and Reuer 2004, Chung and Beamish 2010, Ernst and Bamford 2005, Reuer et al. 2002). Contractual alterations, major changes in the joint board or committee overseeing the alliance, or the introduction or formalization of monitoring mechanisms could be taking place (Reuer et al. 2002). By reminding partners to provide direction for the activities and efforts of the dyad, firms in JVs can reduce the risk of shirking and moral hazards, particularly in the event of agency problems (Jap and Anderson 2003).

The second way of repairing a damaged relationship is building intelligent flexibility. IJV partners monitor the behavioral dynamics of the JV and early detection of marital distress. In addition, partners need to be prepared for a “midlife” crisis (Peng and Shenkar 2002). The process does not necessarily have to lead to eventual termination, as there are opportunities for reconciliation during each phase. Yet, the dissolution process itself, once in motion, tends to take on a life of its own, and the chances for reconciliation significantly diminish over time (Peng and Shenkar 2002). It means that the earlier a partner catches a symptom of the deteriorating relationship, the higher probability it will have to recover. In addition, investing in a relationship is necessary in that IJVs require continual nurturing. Like married couples working hard to invigorate their relationships (Gray 1992), alliance partners also need to improve the likelihood of achieving high performance while preserving the relationship. Otherwise, once one party starts to waver and the dissolution process is in motion, it will be very difficult to turn back.

In that sense, building "intelligent flexibility" into the contract and the terminology and phraseology of the contract are also very important. It is imperative to take the steps necessary to ensure that all parties have a common understanding of the agreement (Serapio and Cascio 1997). However, alliance partners should not expect to cover everything in the contract that governs the alliance. For example, although it is impossible to derive a specific economic value for an asset in a future period, both parties may agree on a method to be used in valuing the asset at the appropriate time.

It is important to have a formal specification of rules and guidelines that clarify important issues such as financial procedure and technology sharing for those working within the alliance. However, because the market and environmental conditions may change, partners must be adaptable. Although a contract may legally bind partners, an adherence to a rigid agreement may hamper necessary adaptations (Shenkar and Luo 2002). Preparing an exit provision for the timing and asset allocation in the event of an exit would be a prime example (Das and Teng 1998).

The third way of relationship repairing is investing in relational assets. To promote learning effectively, overcoming cultural difference among partners is urgently necessary. Poor communication is the primary barrier to effective learning. Shenkar and Luo (2004, 331) stated, "because many conflicts stem from unclear or misread signals between partners, it is important to jointly develop a set of operating principles for the alliance and establish effective communication systems." Taking advantage of key personnel contacts, exchange problems, or mediating personnel (e.g. previous partners) would be helpful (Shenkar and Luo 2004). For example, the communications in Fuji Xerox includes a co-destiny task force, presidential summit meetings, functional meetings, resident directors meetings, and personal exchanges (Gomes-casseress 1996). These communication channels bridge the differences between Fuji and Xerox. Regular meetings are an important step in jointly setting principles for alliance operations. These meetings should establish the facts of any matter at issue, and record the discussion and solutions proposed.

JVs require continuous nurturing, similar to married couples working hard to invigorate their relationships (Peng and Shenkar 2002). Partners also must improve the likelihood of achieving high performance while preserving the relationship. Otherwise, once one party begins to waver and the dissolution process is in motion, it will be very difficult to turn back. In this context, investing in relationships can be another real option.

Finally, firms could promote communication and learning in their JVS. To promote learning effectively, overcoming cultural difference among partners is urgently necessary. Bad communication is the main barrier to effective learning. There can be effective ways to enhance effective communication and learning. Sympathetic listening reduces communication noise, develops various communication channels, meta-communication (Dindia and Baxter 1987), and structuring emotional conversations are in effect. Williams (2005) recommends that if the victim (a) is willing to put in the time and energy, (b) perceives the potential value derived from the relationship, and (c) does not have better options, the following steps will help violators repair the trust that they have damaged: (1) acknowledge that a violation of trust has occurred; (2) determine, from the victim's standpoint, the exact nature of the violation and what event caused it; (3) admit that the event destroyed trust; (4) accept responsibility for the violation, debating or denying responsibility impedes repair; and (5) offer to make reparation.

Proposition 3: Damaged IJV relationship will be repaired by promoted learning, enhanced safeguarding, and/or intelligent flexibility. That will allow IJV firms to achieve their intended objectives by retaining flexibility embedded in the option to hold.

One Anecdotal Evidence: GM-Daewoo IJV[1]

In 1984, GM and Daewoo formed a 50:50 JV to produce a consumer vehicle, 'Pontiac Lemans.' GM, the largest American automaker, intended to exploit relatively advanced manufacturing infrastructures and skilled workers of South Korea compared to those of other Asian countries. GM also planned to explore other Asian markets including China based on its platform investments in Korea and with Daewoo. Daewoo, the third largest automaker in Korea at that time intended to learn advanced technologies from GM and moving toward the European market by taking advantage of GM's global network. From their original intent, this IJV was considered an option for the two firms since their joint business carried future decision rights and follow-on claims on tentatively subsequent investments in other countries.

However, this joint business had been seriously challenged by increasing wages of Korean workers, poor quality of the Lemans, and plummeting sales. Each company blamed the other regarding these unexpected and poor outcomes. For instance, Daewoo attributed its struggling JV to GM's poor marketing and blocking Daewoo's sales to Eastern Europe. Daewoo also tried to develop its own model. From the two firm's standpoints, their IJV partner committed appropriation risk (i.e. partner firms intend to take more benefits from joint business than deserved), moral hazard (i.e., partner firms do not do what they are supposed to do), or adverse selection (i.e., partner firms turn out to be a sour lemon). For these reasons, the relationship between the two companies became damaged. What made their IJV relationship worse was that their damaged relationship went public. If problems inside an IJV are known to the outside, the problems might be out of the IJV firms' hands. Eventually, due to these relational conflicts between the two companies, their first IJV was terminated in 1992 when GM withdrew its investment from Korea.

Interestingly enough, in 2001 GM and Daewoo reformed another IJV. The reason was that GM still thought the Korean market and Korean partner were attractive for testing the waters in Asian markets. Daewoo needed GM's financial support and car models to continue its automobile business after its parent firm, Daewoo group, collapsed during the Asian financial crisis in the late 1990s. Since then, the two firms have produced new models and made profits while repairing the damaged relationships they had experienced in their first IJV. In the second IJV, for instance, the two firms made an adjustment in their ownership stake. Specifically, GM has taken the majority ownership and led the joint business for effective learning and management. Referring to relational failures in their first IJV, the two firms have renewed their contractual specifications regarding production, sales, and labor unions. They also facilitated exchange training programs among key personnel to overcome the differences in corporate culture and management practices.

From their efforts, it can be interpreted that the two companies did not want to eliminate potential real options value embedded in their IJVs and thus resumed their joint business with their damaged relationship repaired. Recently, their second IJV is at risk of another damaged relationship after GM's headquarters in the US went bankrupt following the economic downturn in late 2000 and GM laid off two Korean CEOs without prior notice in 2009. GM might shrink its investment in Korea. How the relationships in this second IJV are going to unfold in an uncertain future is again attracting public attention.

DISCUSSION

Contribution and Implication

Overall, this article departs from the existing literature in three significant ways. First, we endeavor to contribute to the IJV literature by articulating a crucial yet unexplored rationale behind the decision to repair damaged relationships. Second, given that almost all real options research focuses on the beginning and ending of real options (that is, establishing and terminating/acquiring IJVs in this context), we add to this literature by focusing on how firms may add to or at least retain values of their real options during the lifespan of their IJVs. Finally, in light of the strong slant toward "strategy formulation" behind much real options research (i.e., formulating an IJV strategy in search of real options values), this article adds a much needed "strategy implementation" perspective by showcasing how real options values are derived and maintained through a series of actions to repair damaged relationships. For instance, some JV contracts contain an explicit option to increase the stake of one of the parents. However, in the case of a partner's contract violation such as purchasing shares of another partner or selling its shares to a third partner, the option value can deteriorate. In that context, JV participants need to repair any relevant damage by renegotiating the contract.

This study also contributes to relevant arguments regarding IJV instability/termination by linking it to the real options argument. Previously, these two research streams existed separately: instability literature focuses on the relational problems associated with a partner or internal uncertainty, and the real options literature focusing on the real options value associated with external uncertainty. However, in JVs, firms must consider both issues at the same time since more than one firm is involved in these joint businesses. This study concerns the effect of an alliance's inherent instability on the flexibility of JVs as real options in generating potential conflict between two contrasting characteristics. Other researchers have concentrated on relational instability and related costs, increasing or reducing commitment to create control or initiate divestment. Meanwhile, real options theorists are interested in maintaining flexibility. Examining the issue of repairing damaged IJV relationships from the real options perspective is one way to integrate or compare these two perspectives. Considering that once a relationship is damaged it cannot be restored easily, this study explored the situations why partners recover from relational crisis and when repair is reasonable by considering other values and costs not discussed a great deal early on in JV relationships. In that it has a rationale of the value of "delaying or waiting," we referred to real options theory to explain the repairing of damaged relationships. Likewise, real options theory is expected to apply to some prolonged situations.

Limitations and Future Directions

Despite these contributions, this article is not free from limitations. Though this study provides some testable propositions, the main arguments and propositions have not been supported fully in empirical works. To overcome this shortcoming, case studies would be supplemented where JV partners actually repaired their damaged relationship and enjoyed intended real options values. Additionally, it would be valuable to track the processes of damaging, repairing, and terminating in some real cases. In the process, it will be helpful to examine relevant real options values, relational difficulties, and any relationship between them. How JV partners can repair relationships once they show signs of decay will be a meaningful research question. Relevantly, it is valuable to draw sources of conflict in damaged relationships that are more specific and then propose some mechanisms to repair these relationships. As for the ways to resolve conflicts, it is also desirable to trace the deteriorating process of the relationship and suggest conflict resolution mechanisms phase by phase as in the article by Peng and Shenkar (2002). These will be a meaningful effort to reveal the way to return to a normal relationship and thus, enjoy successful cooperation in JVs.

CONCLUSIONS

By comparing intended objectives as a real option with actual relationship difficulty as a transitional form, this paper proposed that a JV as a real option should be affected by its inherent instability. Therefore, the actual realization of real options value embedded in JVs may be available under relational stability. This is because the value of the firms in JVs is attributed to options value and relational stability at the same time. Regarding when repair is reasonable, benefits of remaining should enable focal firms to keep present and/or future real options. Finally, this paper suggested how firms manage downside risks to obtain their intended flexibility through JVs. Addressing actual management costs associated with alliance instability would be expected to complement previous literature on the real option theory and alliance management with more consideration.

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ENDNOTES

1 The main information regarding this case is excerpted from Peng's (2009) book, 'Global Business.'

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