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Abstract

This study discusses the formation phase of Chinese-Finnish joint ventures in China. The purpose of this thesis is to create best practices for Finnish software companies in forming a joint venture with a local Chinese company in China. Therefore, the main research question, in *what are the best practices for forming Sino-Finnish joint ventures in China for Finnish software firms*, is examined through four different themes within the joint venture formation phase; the motives, the partner selection, the choice of a joint venture type and joint venture negotiations.

The theoretical background of the study consists of literature relating to the establishment process of Sino-Western joint ventures in China. The empirical research conducted for this study is based on the expert interviews. The empirical data was gathered via nine semi-structured interviews with both Chinese and Finnish experts in software and technology industry, who have experience or knowledge in establishing Sino-Finnish joint ventures in China. Thematic analysis was used to categorize and interpret the interview data. In addition, a thematic network was built to act as a basis of the analysis.

According to the main findings, the main motives for Finnish software companies to establish a joint venture in China are lack of skills or experience, little resources to enter on their own, and China's large market. The main motives for Chinese companies are to gain new technology or managerial skills, and expand internationally. The intellectual property rights (IPR) have recently improved a lot in China, but the Finnish companies' knowledge on IPR is inadequate. The Finnish software companies should conduct a market and industry research in order to understand their position in the market and to find a suitable location and potential joint venture partners. It is essential to define partner selection criteria and partner attributes. In addition, it is important to build the joint venture around complementary motives and a win-win situation between the joint venture partners. The Finnish companies should be prepared that the joint venture negotiations will be challenging and they will take a long time. The challenges can be overcome by gaining understanding about the Chinese culture and business environment.

The findings of this study enhance understanding of the joint venture formation phase in China. This study provides guidelines for Finnish software companies to establish a joint venture in China. In addition, this study brings new insights to the Sino-Western joint venture literature with its software industry context. Future research is, however, necessary in order to gain an understanding of the advantages and disadvantages of a joint venture as an entry mode into China for Finnish software companies.

Key words	China, joint ventures, motives, partner selection, negotiations, best practices
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Tiivistelmä

Tämä tutkimus käsittelee yhteisyrityksen perustamisvaihetta Kiinassa. Tutkimuksen tarkoitus on luoda parhaat käytännöt suomalaisille ohjelmistoalan yrityksille yhteisyrityksen perustamiseen Kiinassa. Tutkimuskysymys on: *Mitkä ovat parhaat käytännöt kiinalais-suomalaisten yhteisyritysten perustamiseen Kiinassa suomalaisille ohjelmisto-alan yrityksille.* Tutkimuskysymystä tutkitaan neljän teeman avulla; motivaatio, yhteistyökumppanin valinta, yhteisyritystyyppin valinta ja yhteisyritysneuvottelut.

Tutkimuksessa käytetty teoria pohjautuu kirjallisuuteen kiinalais-länsimaisten yhteisyritysten perustamisesta Kiinaan. Tutkimuksen empiirinen osa perustuu asiantuntijahaastatteluihin. Empiirinen data kerättiin yhdeksän puolistrukturoidun haastattelun avulla. Haastatteltavat ovat kiinalaisia ja suomalaisia asiantuntijoita. Heillä on kokemusta tai osaamista kiinalais-suomalaisten yhteisyritysten perustamisesta Kiinaan ohjelmisto- ja teknologia-alalla. Haastatteludatan tulkitsemisessa ja analysoimisessa käytettiin temaattista analyysiä.

Tämä tutkimus osoittaa, että suomalaisten ja kiinalaisten yritysten motiivit perustaa yhteisyritys Kiinaan eroavat toisistaan. Suomalaisten ohjelmistoyritysten motiiveihin kuuluu Kiinan markkinaosaamisen tai -kokemuksen puuttuminen, vähäiset resurssit Kiinan markkinoillemenoon ja Kiinan markkinan suuri koko. Kiinalaisyritysten motiiveihin kuuluu uuden teknologian ja johtamistaitojen oppiminen ja kansainvälisen markkinaosaamisen lisääminen. Immateriaalioikeudet ovat kehittyneet lähiaikoina Kiinassa paljon mutta suomalaisyrityksillä on riittämätön tietotaito suojata tuotteitaan. Suomalaisyritysten tulisi tehdä markkina- ja toimialatutkimusta Kiinassa, jotta he pystyisivät määrittämään oman markkina-aseman ja löytämään potentiaalisia yhteistyökumppaneita. Yhteistyökumppanin valinnassa on tärkeää, että suomalaisyritykset muodostavat selkeät valintakriteerit ja pohtivat millaisia ominaisuuksia yhteistyökumppanilla tulisi olla. Yhteisyritys tulisi perustaa jokaisen yhteistyökumppanin menestymisen ympärille. Neuvottelut kiinalaisen osapuolen kanssa ovat haasteellisia ja neuvotteluprosessi kestää yleensä kauan.

Näiden löytöjen pohjalta tietämys lisääntyi yhteisyrityksen perustamisvaiheesta. Tämä tutkimus tarjoaa suuntaviivat suomalaisille ohjelmistoyrityksille jotka suunnittelevat yhteisyrityksen perustamista Kiinaan. Lisäksi tämä tutkimus tuo ohjelmistoalan kontekstillaan uutta tietoa kirjallisuuteen kiinalais-länsimaisista yhteisyrityksistä. Lisää tutkimusta tarvitaan yhteisyritysten perustamisen eduista ja haitoista suomalaisille ohjelmistoyrityksille Kiinaan.

Asiasanat	Kiina, yhteisyritykset, motiivit, yhteistyökumppanin valinta, neuvottelut, parhaat käytännöt
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# **THE BEST PRACTICES IN THE FORMATION PHASE OF SINO-FINNISH JOINT VENTURES IN CHINA**

**For Finnish software companies**

Master's Thesis  
in International Business

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## **ABBREVIATIONS**

CJV	Contractual or cooperative joint venture
EJV	Equity joint venture
FDI	Foreign direct investment
IJV	International joint venture
IPR	Intellectual property rights
JV	Joint venture
WFOE	Wholly foreign-owned enterprise

## **PREFIX**

Sino	Chinese
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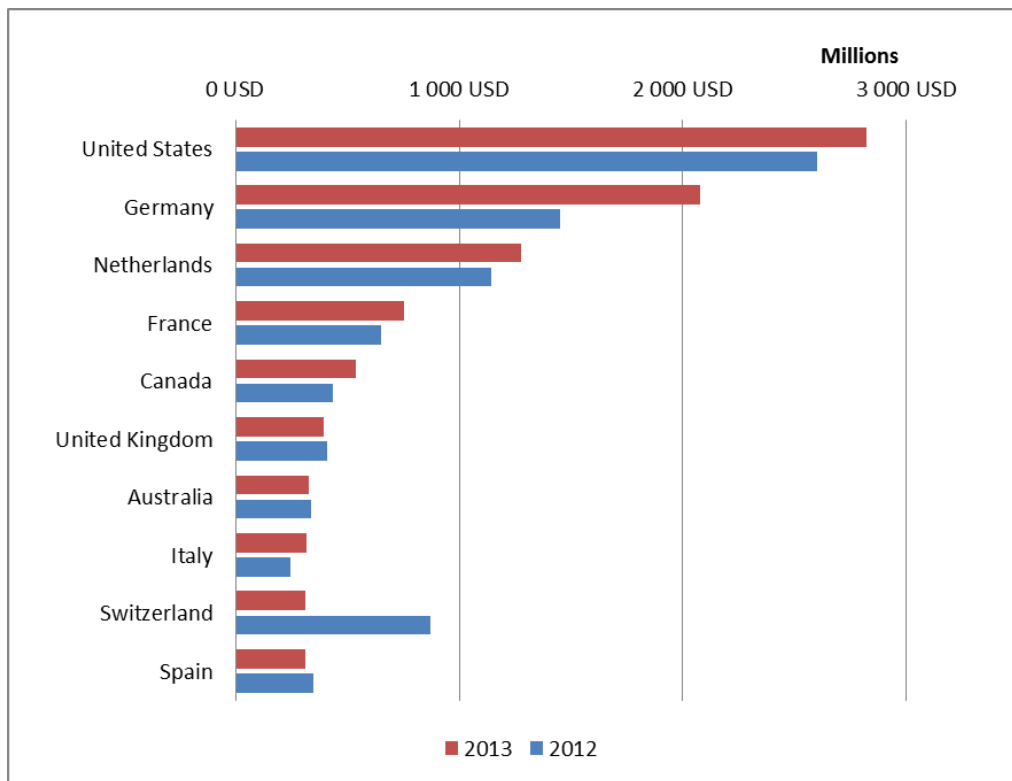


# 1 INTRODUCTION

## 1.1 Background

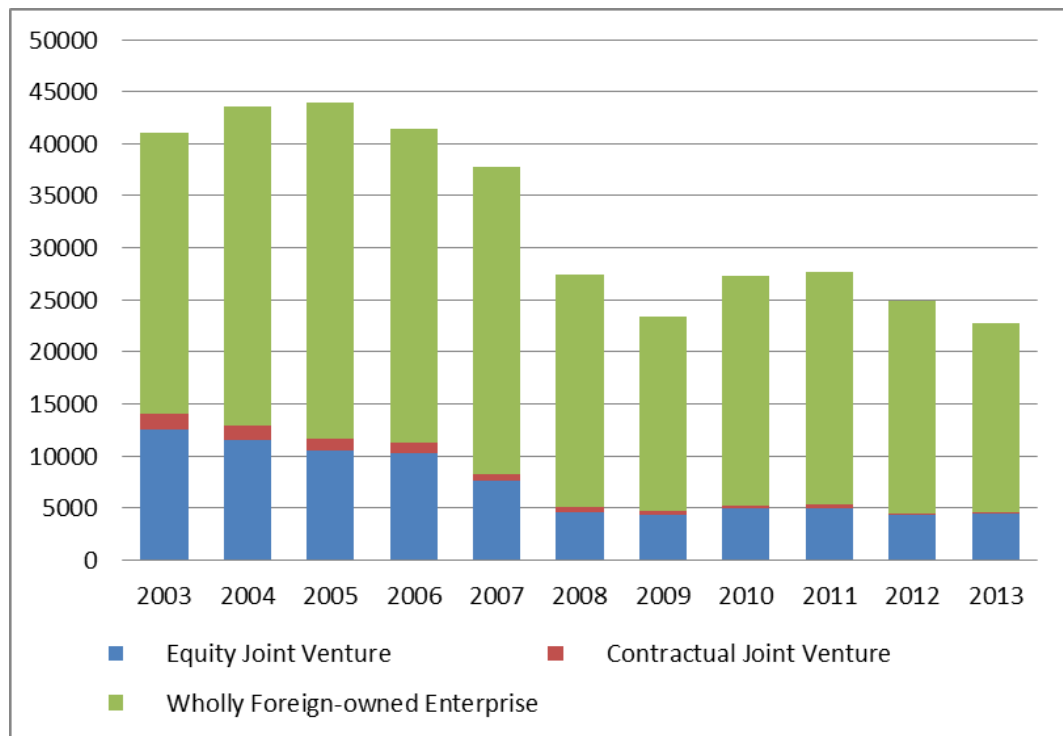
Since 1979, China has been reforming from centrally planned economy to market driven economy. During these 30 years, China's economy has grown tremendously and it has become the second largest economy in the world. The fast and continuous growth has been enabled by, for instance, large population, growing middle class and adequate labor. However, there are challenges that could potentially have an impact on the continuous growth, such as distortion of the economic structure and environmental degradation. (Zhang & Liu 2009, 127, 132-136.) In fact, China's over 10% GDP growth in 2010 has slowed down for the past few years to 7.4% in 2014. The GDP growth is forecasted to stay over 5% for the next five years. (The Economist Intelligence Unit 2015.) Foreign direct investment (FDI) has been one of the drivers of China's fast growth (UNCTAD 2014). China opened its economy for FDI in 1979. However, China became an important host country for FDI only in the beginning of the 1990s due to some changes in the legislation (Kettunen, Lintunen, Lu & Kosonen 2008, 68). The primary objectives in opening China up to foreign investment were to bring in foreign capital, advanced technology, management skills and urban construction, and generally to catch up with the developed countries (Woodward & Liu 1993, 83). Today, China is the second largest host economy of FDI in the world (UNCTAD 2014). FDI into China is now more than US \$80 billion per year. In total, China has received approximately US \$500 billion of FDI since 1978, 10 times more than the FDI that has gone into Japan since the end of World War II in 1945. (Chung & Bruton 2008, 30.) According to A.T. Kearney's FDI Confidence Index China was ranked the most attractive FDI destination in the world between 2002-2012, and for the past two years it has been the second most attractive just behind the U.S. (The 2014 A.T. Kearney Foreign Direct Investment Confidence Index, 1, 2).

Nevertheless China attracts a great amount of FDI; it is not an easy FDI destination for foreign companies. According to the World Bank's rankings on the ease of doing business, China is ranked 96<sup>th</sup> country, but China has been one of the most successful countries to improve its ranking from the previous years (The World Bank 2014). The main challenges in FDI into China are bureaucracy involved in the business operations, diversity of legislation and differences between the different regions (Kettunen, et al. 2008, 1). The overseas ethnic Chinese investors from Hong Kong, Taiwan and Macao have dominated the FDI into China since 1978 (Zhang 2000, 191). The top 10 Western countries investing into China in 2013 and 2012 are shown in figure 1.



**Figure 1 Foreign direct investment in China by the top 10 Western countries (China Statistical Yearbook 2014)**

As illustrated in figure 1, out of the top 10 Western countries the United States is the number one in FDI into China with nearly 3 billion USD. Germany and the Netherlands are the next two largest investors into China. The rest of the Western countries have invested less than 1 billion USD into China in 2012 and 2013. The three most common types of FDI into China are wholly foreign-owned enterprises (WFOEs) and joint ventures (JVs). The JVs are divided into equity joint ventures (EJVs) and contractual joint ventures (CJVs). WFOE is a limited liability company wholly owned by foreign investor(s). WFOE can do almost any type of business in China. JV is a company owned partially by foreign investor(s) and partially by Chinese investor(s). EJV and CJV differ primarily in terms of the way in which profits and losses are distributed. In addition, there exist specific industries in which foreign investment can only be done as part of a JV. (Dezan Shira & Associates 2012, 7-8.) Figure 2 presents the number of FDI projects by type in China. In 2003-2013, WFOE has been the most popular FDI type in China. EJV has been the most popular JV type in China. The number of JVs has remained approximately same for the past six years. The overall number of FDI projects in China has decreased during the past decade.



**Figure 2 Foreign direct investment in China by type in 2003-2013 (China Statistical Yearbook 2004-2014)**

JVs were the first FDI type that was allowed by the Chinese government in 1979. Sino-Western JVs have been extensively studied since the 1990s (e.g. Glaister & Wang 1993; Woodward & Liu 1993; Björkman & Kock 1995; Luo 1998, 2001, 2002; Vihakara 2006; Wang 2007; Ott, Liu & Buck 2014), because of the growing popularity as a FDI type. International joint ventures (IJVs) have significantly high rates of failure and instability (Davidson 1987, 77; Stafford 1994, 64; Medcof 1997, 718; Das & Teng 2000, 77) due to the many challenges they face. JVs are often referred to as a marriage (Ott et al. 2014, 873): it requires commitment, trust and good understanding of the partner(s).

Finland has opportunities in bilateral cooperation with China. Currently, crucial development needs are economic cooperation and sustainable city development in China. Also developing China's welfare services, technology cooperation and improving technological know-how on climate, water, other sustainable green solutions and Cleantech are important in China. (Turkki 2014, 6.) Relations between Finland and China are described by the Ministry of Commerce of the People's Republic of China (MOFCOM) as "given the traditionally sound political relations, complementarities between the two economies, and great passion of the two business communities for cooperation, the bilateral economic and trade cooperation is promising and enjoys enormous potential" (MOFCOM 2008). Finland is not very well-known in China, but generally Finland is regarded as clean, fresh and close to nature. Finland is also known for its high technolo-

gy and innovation and good PISA results. (Kauppapolitiikka 2012.) Chinese companies can help Finnish companies to reach consumers in China by managing less-developed institutional environments, contributing capital, providing product and service adaptation, and supplying low-cost manufacturing resources. Finnish companies can help Chinese companies to gain access to advanced technology, advance their marketing and branding skills in the developed markets, and learn about operating in developed economies with stricter regulations. (Jullens, Suonio & Tang 2013, 8.) The presence of Finnish companies in emerging markets lags behind other open economies such as Holland, Sweden and Switzerland. Large Finnish companies in industries such as forestry, telecommunications, and industrial equipment have made important forays into emerging markets, but most Finnish companies are not prepared for the shift in the world's center of economic gravity from West to East. Emerging market is already proven to be a growth engine for companies all around the world and it has a growing demand especially in the ICT industry. (Jullens et al. 2013, 2.)

## **1.2 Software industry as a context**

One of the key drivers of the ICT industry in China has been the strong support from China's government. The ICT sector is one of the most important sectors in the Chinese national 12<sup>th</sup> Five Year Plan, which sets aims for economic and social development in China until 2015. Central and local governments put emphasis on ICT clusters to provide favorable land/tax policies, enhance local infrastructure, establish industrial parks and trading places, organize trade fairs, support technology upgrade of enterprises and coordinate the link between industry and research. An example of an ICT cluster is Zhonguancun Science Park (Z-Park) in Beijing. It is the first high-tech industrial development zone founded in 1988. Z-Park fosters collaborative R&D activities and international technology transfer that have led to a rapid development of the ICT industry in China. (EU SME Centre 2013a, 3-4.) In 2012, the total revenue of the software industry in China was USD 400 billion with a growth rate of 32.7%. The software market is heavily dominated by domestic companies. Global software companies have an edge in the more high-end software sectors. The domestic companies are now catching up due to accumulation of experience, increasingly skilled talents, and government support. In 2012, there were over 28 thousand software companies, middle or large size, in China. The key software companies in China were Insigma, Neusoft, UFIDA, Beyondsoft, Chinasoft and Hisoft. Moreover, multinational corporations (MNCs) with an established presence in China include Microsoft, Oracle, SAP and IBM. (EU SME 2013a, 6-7.) According to the Catalogue for Guidance of Foreign Investment (2012, III: 21), the development and manufacturing of software products is classified as an encouraged group,



which means that the foreign investment can enjoy preferential policies in the software market.

The software industry has been the fastest growing industry in Finland for the past 30 years (Tekes 2012). Finland's information technology (IT services and software) industry grew 20% per cent from 2013 to 2014 (Economic situation and outlook 1/2015). In the World Economic Forum's (WEF) competitiveness report 2014–2015, Finland ranked number one of the world's top countries in innovation; it was number one in terms of higher education and training as well as the availability of engineers and scientists, and it led the other Nordic countries in patenting. China is ranked only 32 in innovation and 65 in higher education and training; however, it is number two in market size. (World Economic Forum, 154, 181.) China is a remarkable trade and investment destination for Finland. The total amount of investment from Finland into China is over 10 billion euros, which is significant in relation to the size of the Finnish economy. Currently, there are approximately 350 Finnish companies in China that employ approximately 60 000 Chinese people. (Elinkeinoelämän Keskusliitto 2015.) In 2008, the majority of the Finnish companies operating in China were in the field of mechanical engineering, electronics, and information technology. The investment made by Finnish companies has mainly been based in the coastal regions of China. (Kettunen et al. 2008, 1.) Finnish software companies appear to have internationalization problems, such as finding personnel and partners, culture, language, regulations of immaterial property rights and piracy in China (Touru 2009, 4).

### **1.3 Research objectives and research question**

As mentioned earlier, IJVs have a high rate of failure and China is not an easy host country for FDI. The formation phase of a JV is suggested to be an essence of a successful JV in China (Hoffman & Schlosser 2001, 376; Wang 2007, 174). This thesis attempts to find the best practices in the formation phase of a Sino-Finnish JV for Finnish software companies. Wang (2007, 174-176) studied the performance of Sino-Finnish JVs and suggested a framework for the formation and management phase of the JVs. Lasserre (1999, 19-20) interviewed 96 Western managers about JV satisfaction in Asia Pacific region, including China. The manager's responses to the questions "what would you do differently" and "what did you learn" were mainly concerned with the formation phase of a JV, including partner selection and relationships as well as preparation and planning. The formation phase is seen as important and managers feel that they would want to do it differently.

This study will be more specifically put in the context of Finnish software companies. China's software industry grows over 30% yearly. The software industry used to

be dominated by foreign companies, as China lacked talent and skills of its own. The number of domestic companies is growing and in 2012 there were over 28 thousand software companies in China. One of the reasons for the growth of the domestic companies in the industry is strong support from China's government. (EU SME 2013a, 3-4, 6-7.) Besides supporting the domestic companies within the software industry, the Chinese government encourages high technology and software industries for foreign investment too (Provisions 2007, art.5). Due to the fast growth of the software industry and Chinese government's support, there are many opportunities for foreign investors.

The main research question of the thesis is: *What are the best practices for forming Sino-Finnish joint ventures in China for Finnish software firms?* Focusing on the software industry brings new insights to the theoretical study of the JVs. In order to answer the main research question, four sub questions were formed:

1. What are the main motives for forming a Sino-Finnish joint venture in China within the software industry?
2. How do the Finnish software firms select a joint venture partner in China?
3. How do the Finnish software firms choose a joint venture type in China?
4. What are negotiations for a Sino-Finnish joint venture like?

This study aims at creating best practices in forming Sino-Finnish JVs in China for Finnish software firms. Oxford Dictionaries (2015) define a best practice as "*a way of doing something that is seen as a very good example of how it should be done and can be copied by other companies or organizations*". The definition of a best practice by the Oxford dictionaries will be applied in this study. The best practices will be created based on the theoretical and empirical findings. The best practices can act as a guideline for Finnish software companies to enter into the Chinese market via a JV. The sub research questions were formed based on the literature review, which is presented in chapters 2 and 3. The theoretical part of this study focuses on Sino-Western JVs and the empirical part of this study focuses on Sino-Finnish JVs within the software industry. The empirical data of this thesis is collected through expert interviews. Semi-structured interviews are made with Finnish and Chinese experts, who have experience in establishing JVs in China within software or technology industry.

## 2 SINO-WESTERN JOINT VENTURE IN CHINA

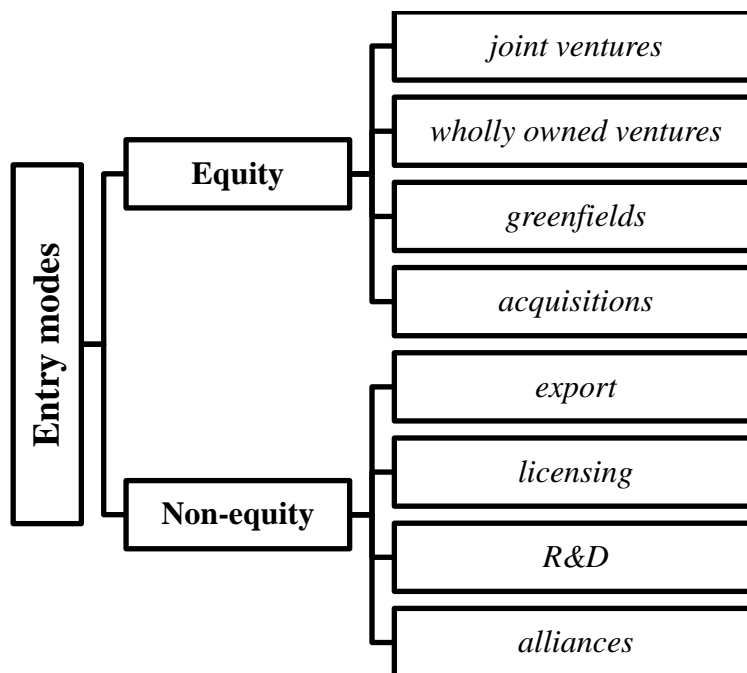
### 2.1 Joint ventures as an entry mode into China

Geringer (1988, 4) defines a JV as “*a discrete entity created by two or more legally distinct organizations (the partners), each of which contributes less than 100 percent of its assets and actively participates, beyond a mere investment role, in the joint venture’s decision making*”. When two or more firms establish a JV, they create a new business, but they continue to operate their existing firms separately (EU SME Centre 2013c, 2). JV is one of the many entry modes. Entry mode choice is the cornerstone of a firm’s market entry strategies (Tse, Pan & Au 1997, 781; Datta, Herrmann & Rasheed 2002, 85). Sharma and Erramilli (2004, 2) describe an entry mode as “*a structural agreement that allows a firm to implement its product market strategy in a host country either by carrying out only the marketing operations (i.e., via export modes), or both production and marketing operations there by itself or in partnership with others (contractual modes, joint ventures, wholly owned operations)*”. According to Sharma and Erramilli’s (2004, 2) perspective there exist two key strategic decisions in entry modes: the location of production and/or marketing activities and ownership (full, partial or none). Figure 3 shows the two key strategic decisions and different entry modes based on the decisions.

<i>Ownership by entrant</i>	<b>Full</b>	Direct export via company owned channel (sales subsidiary, direct-to-customers)	Wholly owned subsidiary (greenfield or acquisition)
	<b>Partial</b>		JVs in production or marketing (majority, 50-50, or minority)
	<b>None</b>	Indirect exporting or direct exporting via host country intermediaries	Contractual modes (licensing, franchising)
		<b>Marketing only</b>	<b>Production and Marketing</b>
		<i>Location of entrant’s operations in the host country</i>	

**Figure 3** Entry modes classification by location and ownership characteristics (Sharma & Erramilli 2004, 3)

In contrast to Sharma and Erramilli's classification, Pan and Tse's (2000, 535-538) classification on entry modes does not have emphasis on the location of an entrant's operations in the host country. As illustrated in figure 4, Pan and Tse divide entry modes into equity and non-equity entry modes. Equity entry modes (e.g. JVs, wholly owned ventures, greenfields and acquisitions) involve relatively large commitment to investment and thus they require higher level of control. Non-equity modes (e.g. export, licensing, R&D and alliances) involve less investment and thus they require lower level of control. (Pan & Tse 2000, 535-538.) As illustrated in figures 3 and 4, there are different classifications on entry modes.



**Figure 4** Entry mode classification (adapted from Pan and Tse 2000, 535-538)

Equity entry modes can also be referred as FDI. The three main FDI forms are JVs, acquisition of assets in a country, and greenfield ventures in which a firm builds its own business or manufacturing facilities in a country (Chung & Bruton 2008, 31). China's government defines FDI in China as "*foreign investment in China through the establishment of foreign invested enterprises, cooperative exploration and development of petroleum resources with domestic investors and the establishment of branch organizations of foreign enterprises*" (China Statistical Yearbook 2014). FDI into China has been previously studied extensively (e.g. Chung & Bruton 2008; Fetscherin, Voss & Gugler 2010). Chung and Bruton (2008, 34) divides the research on FDI in China into two stages. The first stage from 1993-1997 focuses on "*describing and understanding what was then a new phenomenon: FDI into China*". The second stage from 1998 to 2006 focuses on "*more complex issues that pull on greater theoretical foundations and*

*seeking to generate richer insights*". The second stage includes the research on entry decision, process of value creation and performance. (Chung & Bruton 2008, 34.) Fetscherin et al. (2010, 239-242) distinguish four main research streams on FDI in China; the motives and determinant of FDI to China, 'inside' the multinational enterprise (MNE), the impact of MNE activities and policy implications for the host country. The research varies from studying the background of the beginning of FDI in China to the processes and activities in the FDI. (Fetscherin et al. 2010, 239-242)

There are many factors that impact on the choice of FDI type in China. Previous literature has studied the factors that impact on the choice of WFOE and JV (Luo 2001, 465-467; Wei, Liu & Liu 2005, 1504; Bontempi & Prodi 2009, 18; Chang, Chung & Moon 2013, 336). Luo (2001, 465-467) found that WFOE is chosen as an entry mode, if host-country experience of the company or the need for knowledge protection or global integration is high and if the FDI project is located in an open economic region. JV is chosen, if government intervention or environmental uncertainty is perceived and the FDI project is located in less-developed, less-open region. (Luo 2001, 465-467.) Research by Wei et al. (2005, 1504) indicates that if good host country conditions and industrial location are not met, the EJV mode would be of greater use. Like WFOEs, EJVs are positively associated with the asset intensity of the host industry. A good specific location makes the CJV a preferable entry mode because uncertainty is reduced and confidence is enhanced. Compared with overseas Chinese investors from Hong Kong, Macao, and Taiwan, other foreign investors prefer EJVs over WFOEs and CJVs because of the relatively larger cultural distance. (Wei et al. 2005, 1504.) Similarly, Bontempi and Prodi (2009, 18) found that WFOE is preferred in high technology industry, because high intellectual property rights (IPR) are needed. JV is preferred within intermediate goods industry with mature products, when no protection for products needed. Small companies tend to choose JV, because they need support from the local partner. Medium and large corporations choose JV if legal restrictions to set up WFOE in their industry. (Bontempi & Prodi 2009, 18.) A study by Chang et al. (2013, 336) also indicates that JV should be chosen, if the local partner can bring skills or resources that are not otherwise available.

The findings from previous studies on factors that impact on the FDI type choice are listed in table 1. Table 1 shows the factors that have an impact on the choice of WFOE and JV in China. The specific factors on the two types of JV, EJV and CJV, are listed separately.

**Table 1** Factors that impact on the choice of foreign direct investment type in China (Luo 2001, 465-467; Wei et al. 2005, 1504; Bontempi & Prodi 2009, 18; Chang et al. 2013, 336)

FDI type	Factors impacting on the choice of FDI type
WFOE	<ul style="list-style-type: none"> <li>• large investment commitment</li> <li>• a high level of the host country experience</li> <li>• a good specific industrial location</li> <li>• a high asset intensity in the host industry</li> <li>• the need for knowledge protection or global integration is high</li> <li>• FDI project is located in an open economic region</li> </ul>
JV	<ul style="list-style-type: none"> <li>• government intervention or environmental uncertainty is perceived</li> <li>• FDI project is located in less-developed, less-open region</li> <li>• intermediate goods industry, when no IPR is not needed</li> <li>• local partner skills</li> <li>• legal restrictions to set up WFOE in the host industry</li> </ul>
CJV	<ul style="list-style-type: none"> <li>• FDI project has a good specific location</li> </ul>
EJV	<ul style="list-style-type: none"> <li>• the host country conditions and good specific location are not met</li> <li>• little experience and knowledge in China</li> <li>• reducing uncertainty</li> <li>• to establish a network with the Chinese government or related industries</li> </ul>

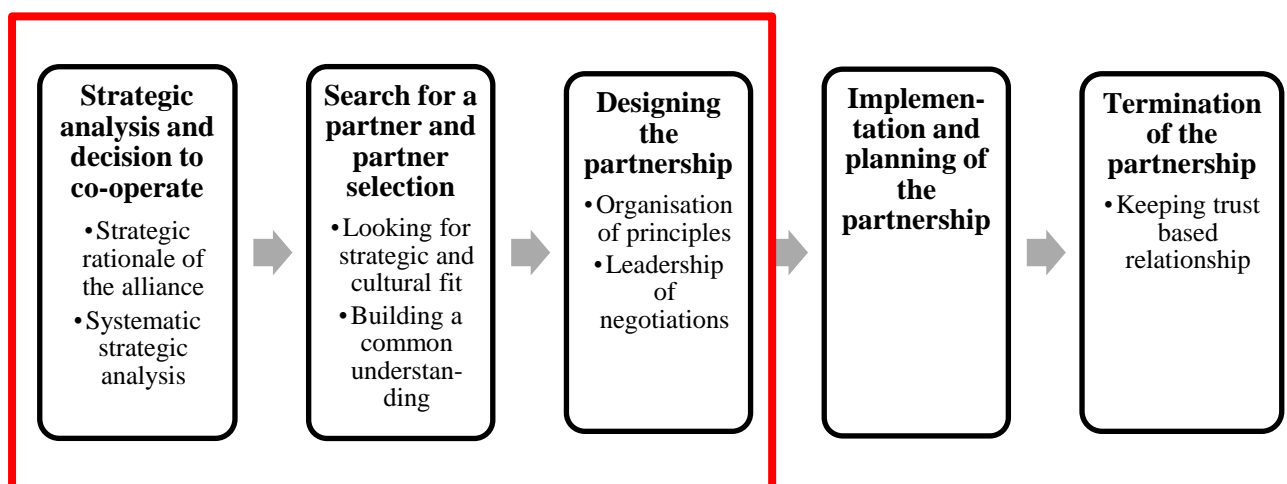
A comparison of the factors impacting on the choice of WFOE and JV in China is a good starting point for the literature review about the formation phase of Sino-Western JVs. The WFOEs and JVs are very different entry modes and they serve different purposes. The industry and the host country specific factors have a significant effect on the entry mode preferred by the companies. The following sub chapter will discuss about the JV formation phase and its segments.

## **2.2 The formation phase of Sino-Western joint ventures in China**

Once a JV is selected as a form of FDI, the JV formation phase can begin. A number of studies have found that the formation phase is important for the success of the JV (Stafford 1994, 73; Martinsons & Tseng 1995, 56; Hoffman & Schlosser 2001, 376; Wang 2007, 174). A study by Stafford (1994, 73) suggests there are three key principles in establishing the foundation for a successful partnership: 1) the co-operative strategy; 2) the relationship; 3) the partner. Consideration of each of these principles is fundamental

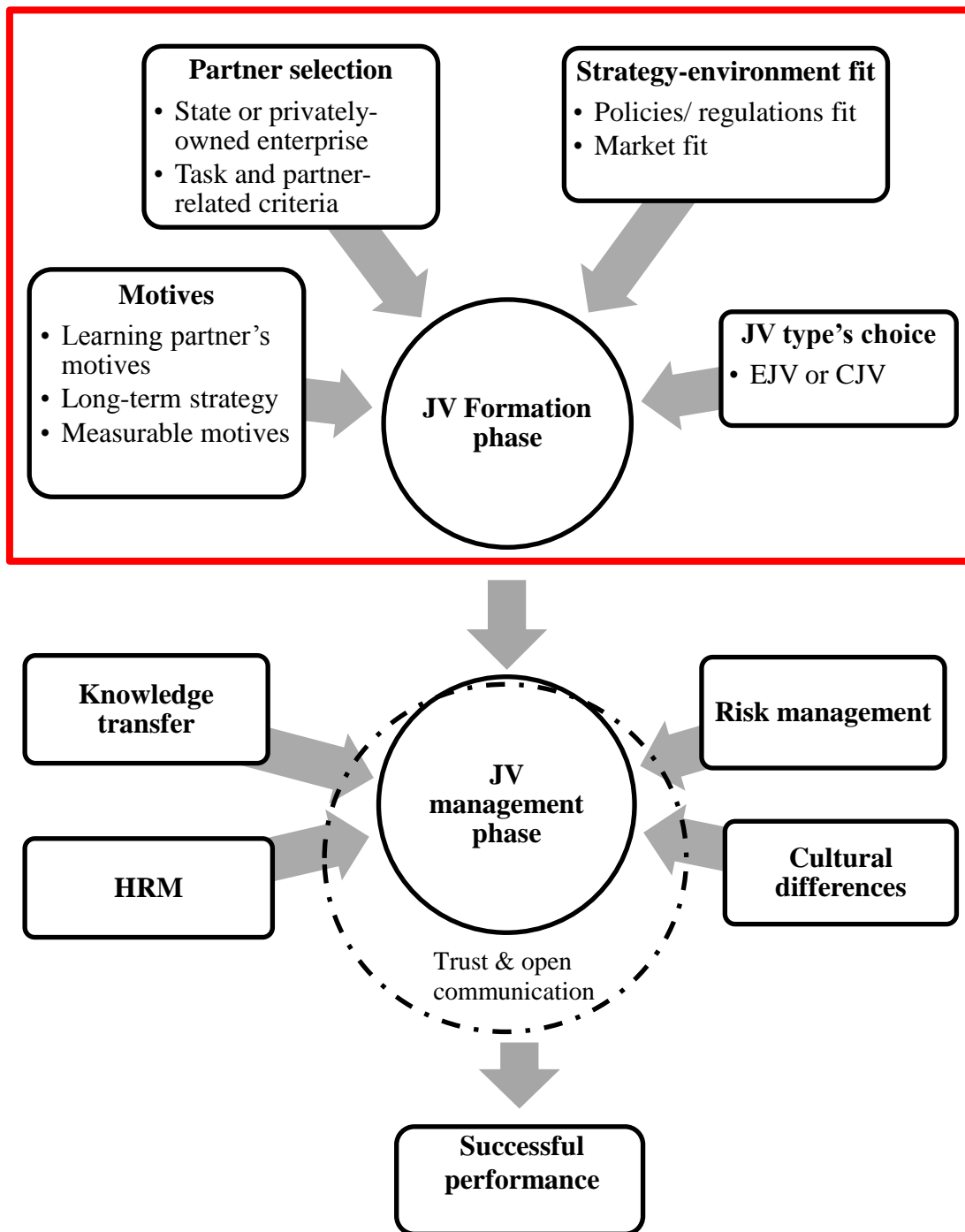
to the success of the partnership. Combining co-operative strategies and relationships can create unique synergies between the partners. Understanding the synergies can help the partners to position the partnership in terms of the needs of the partners and the competitive market environment. (Stafford 1994, 73.) Furthermore, Martinsons and Tseng (1995, 56) showed that the critical success factors for a JV in China are: 1) select suitable partner; 2) bridge cultural differences (knowledge about Chinese cultural values and business systems); 3) develop a relationship before signing the contract (mutual goals, feasibility study); 4) facilitate technology transfer; 5) institutionalize quality. The partner selection, relationship building and creating synergies between the partners through strategies have been shown to be essential for the partnership.

Hoffman and Schlosser (2001, 365) studied the entire evolution of a partnership and suggest success factors in the different stages of the partnership evolution. The most important success factors include trust, strategic compatibility, appropriate governance mechanisms, careful strategic planning, and good partnership preparation. As illustrated in figure 5, most of the success factors are focused on the formation phase, which is highlighted with a red box.



**Figure 5 Success factors in the stages of alliance evolution (adapted from Hoffman and Schlosser 2001, 365)**

Wang (2007, 174-176) studied Sino-Finnish JVs in China with an aim to identify the key activities which relate to the performance of the partnership. Wang (2007) created a framework for JV development in China (figure 6), which consists of the JV formation and partnership management phases. The formation phase is highlighted with a red box in figure 6.



**Figure 6 Sino-Western joint venture development in China (adapted from Wang 2007, 174-176)**

As illustrated in figure 6, the key activities that are positively related to the performance of a partnership in its formation phase include motives, partner selection, strategy-environment fit and JV type's choice. During the management phase, activities that positively relate to the performance of a partnership include HRM, knowledge transfer, risk management and cultural differences. In the formation phase of a JV, the partner



firms should define their own motives and also each other's motives in order to analyze their fit as partners. EJVs and CJVs are the two main JV types in China, from which a choice need to be made. Partner selection criteria can be used for assessing the right partner. In addition, the Western company should pay attention to matching the investment strategy to the business environment in China, such as the current policies and regulations. (Wang 2007, 81, 179.) From a more pragmatic perspective, the most important issues that should be investigated in the initial stages of planning a JV in China include: 1) legal conditions on foreign investment in the industry, specific sector and location; 2) tax issues and incentives; 3) location and industry-related incentives; 4) structure of the profit repatriation; 5) due diligence on the JV partner (EU SME Centre 2012, 1-2). This is a useful list for the companies that are planning a JV in China.

Based on the previous literature on the JV formation phase (Stafford 1994; Martinsons & Tseng 1995; Hoffman & Schlosser 2001; Wang 2007) four themes were selected to study further; the motives, the partner selection, the JV type's choice and the negotiations. The following sub chapter will discuss about the theoretical background on the motives for Sino-Western JVs in China.

### **2.3 Motives for Sino-Western joint ventures in China**

It is vital for companies to define their goals and motives for establishing a JV in order to clarify the expectations for the JV. The JV partners should be also aware of the motives of the partner company to be able to build the cooperation around mutual understanding. (Büchel, Prange, Probst & Rüling 1998, 16.) The motives for companies to establish JVs have been extensively studied in the previous literature.

According to Killing (1983, 6-7) the typical reasons for establishing a JV are developing new markets, gaining access to raw materials, government insistence, sharing costs of a project and sharing skills such as technical and marketing. Harrigan (1986, 16) divides the motives for establishing JVs into three categories: internal use, competitive use and strategic use (table 2). *Internal uses* emerge from the capabilities and tangible and intangible resources of the company that are beneficial for the JV. They include 1) uncertainty reduction by cost and risk sharing; 2) obtain resources; 3) obtain financing to supplement company's debt capacity; 4) share outputs of large minimum efficient scale plants; 5) obtain new technology; 6) innovative managerial practices; 7) retain entrepreneurial employees. The *competitive use* of a JV is to strengthen current strategic position of the company, for instance, by blocking the competition. They include 1) influence industry structure's evolution; 2) preempt competitors with first-mover advantages; 3) defensive response to blurring industry boundaries and globalization; 4) creation of more effective competitors. The *strategic uses* are to augment strategic posi-

tion of the company and they include 1) creation and exploration of synergies; 2) transfer of technology; 3) diversification of business. (Harrigan 1986, 16.)

**Table 2 Motivations for forming joint ventures (Harrigan 1986, 16)**

<b>Internal use</b>	<ol style="list-style-type: none"> <li>1) uncertainty reduction by cost and risk sharing</li> <li>2) obtain resources</li> <li>3) obtain financing to supplement a company's debt capacity</li> <li>4) share outputs of large minimum efficient scale plants</li> <li>5) obtain new technology</li> <li>6) innovative managerial practices</li> <li>7) retain entrepreneurial employees</li> </ol>
<b>Competitive use</b>	<ol style="list-style-type: none"> <li>1) influence industry structure's evolution</li> <li>2) preempt competitors with first-mover advantages</li> <li>3) defensive response to blurring industry boundaries and globalization</li> <li>4) creation of more effective competitors</li> </ol>
<b>Strategic use</b>	<ol style="list-style-type: none"> <li>1) creation and exploration of synergies</li> <li>2) transfer of technology</li> <li>3) diversification of business</li> </ol>

Contractor and Lorange (1988, 10) present seven strategic objectives for companies to establish a JV: 1) risk reduction; 2) economies of scale and production rationalization; 3) technology exchanges; 4) coopting or blocking competition; 5) overcoming government-mandated trade or investment barriers; 6) facilitating initial international expansion of inexperienced companies; 7) vertical quasi integration advantages of linking the complementary contributions of the partners in a value chain. The strategic objectives have many benefits. JV *reduces risks* by sharing the investment and resources between the JV partners. The companies can enjoy the *economies of scale* and production rationalization by having lower cost and by having a comparative advantage of each partner. The JV partners can benefit from *technology synergies*. A JV can be established in order to *block competition*. In IJVs, a local partner can help a foreign partner to *overcome the host government mandated trade barriers*. JV can *facilitate the initial internationalization* of inexperienced companies, and the inexperienced company can benefit from a local partner's knowledge in a new foreign market. JV is a strategic choice for companies in a *value chain*, where each JV partners' complementary contributions are useful. (Contractor & Lorange 1988, 10.) The benefits of each of the seven strategic objectives are shown in table 3.

**Table 3 Strategic contributions of joint ventures (Contractor & Lorange 1988, 10)**

<b>Rationales</b>	<b>Benefits</b>
1) Risk reduction	<ul style="list-style-type: none"> <li>• Product portfolio diversification</li> <li>• Dispersion and/or reduction of fixed cost</li> <li>• Lower total capital investment</li> <li>• Faster entry and payback</li> </ul>
2) Economies of scale and production rationalization	<ul style="list-style-type: none"> <li>• Lower average cost from larger volume</li> <li>• Lower cost by using comparative advantage of each partner</li> </ul>
3) Technology exchanges	<ul style="list-style-type: none"> <li>• Technological synergy</li> <li>• Exchange of patents and territories</li> </ul>
4) Co-opting or blocking competition	<ul style="list-style-type: none"> <li>• Defensive JVs to reduce competition</li> <li>• Offensive JVs to increase costs and/or lower market share for a third company</li> </ul>
5) Overcoming government-mandated trade or investment barriers	<ul style="list-style-type: none"> <li>• Receiving permit to operate as a “local” entity because of local partner</li> <li>• Satisfying local content requirements</li> </ul>
6) Facilitating initial international expansion of inexperienced companies	<ul style="list-style-type: none"> <li>• Benefit from local partner’s know-how</li> </ul>
7) Vertical quasi integration advantages	<ul style="list-style-type: none"> <li>• Access to materials, technology, labor, capital and distribution channels</li> <li>• Regulatory permits</li> <li>• Benefits from brand recognition</li> <li>• Establishing links with major buyers</li> <li>• Drawing on existing fixed</li> </ul>

Based on the research by Killing (1983), Harrigan (1986) and Contractor and Lorange (1988) reduction of risks, creation of synergy and exchange of skills or technology emerge as major motives for companies to establish a JV. When establishing a JV, the partners can spread the risks and the potential gains over more than one company (Harrigan 1986, 15-23). The JV partners can reduce risks by enabling diversification of their product portfolio. The capacities of the both firms can be used in creating a new product or bringing a large variety of existing products to the market. The risks are reduced also by enabling faster entry and payback. Entry into a new market with the resources of several companies can provide better chances for the entry to succeed and create profit. (Contractor & Lorange 1988, 11.) Companies are seeking to create syner-

gy via establishing a JV. Many studies suggest that forming complementary motives between the JV partners is essential (Harrigan 1986, 16; Contractor & Lorange 1988, 10). The companies need to define their own motives, but taking into consideration the JV partner's motives is also necessary. Exchange of know-how can act as the initial motive for the establishment of the JV. Having complementary technology, skills or know-how can serve as a very good starting point for the JV (Contractor & Lorange 1988, 13).

Buckley and Casson (1988, 41-42) explain the reasons for the JV establishment by three factors; internalization economies, indivisibilities and obstacles to merger. Each partner in the JV has symmetrical motives for internalizing. The JV is built based on indivisible economies. The partner companies find creation of a JV a better option than to merge their businesses due to such reasons as legal obstacles and difficulties in financing. Kogut (1988, 230-234) suggests three approaches for explaining the reasons behind establishing a JV: 1) transaction costs; 2) strategic behavior; 3) organizational knowledge and learning. Based on transaction costs the firms choose how to transact according to the criterion of minimizing the sum of production and transaction costs. JVs act as an efficient solution to the hazards of economic transactions. Strategic behavior is explained by a firm maximizing its profits through improving its competitive position. JVs can be used in positioning two or more firms in a more competitive position. Organizational knowledge and learning approach explains JVs as means by which firms learn or seek to retain their capabilities. (Kogut 1988, 230-324.)

The motives for Sino-Western JVs have been studied from the perspective of both the Western and the Chinese partner. The motives for establishing JVs in less developed countries include laws and legislations in the host country, the partner's skills and attributes or assets (Beamish 1988, 11). Glaister and Wang (1993, 13) suggest that the main motives for the Western companies to establish a JV in China are the large market size, low cost labor, good export base for foreign markets, natural resource availability and attractive tax regime/financial incentives. Glaister and Wang's (1993) study was done two decades ago and some of the findings should be considered carefully. For instance, Kettunen et al. (2008, iii) argue that China as a low cost investment is becoming a less important motive for foreign investors as the costs overall are getting higher in China. Nevertheless, they agree that China's market potential is still a primary motive for Western firms. Kirby and Kaiser (2003, 232-233) found that the two primary motives for the Western firms are the size of the market and the availability of cheap labor in China. Touru, Suominen and Rönkkö (2009, 177-179) studied internationalization of Finnish software firms in the Asian market. They found the most popular destination for the Finnish software firms is China. One of the motives of the Finnish firms for internationalization into China was that the company's key customers already operated there. Other motives included requests by partner organizations, Finnish market is too small

and large customer base and having a better reputation in China. (Touru et al. 2009, 177-179.)

The motives from the perspective of the Chinese company are different to the perspective of the Western companies to some extent. Dong and Glaister (2006, 596, 598) found the most important strategic motives of Chinese firms include market position in China, international expansion and technology exchange. Geert, Saebi and Qinqin (2007, 18-21) found the key drivers for Chinese companies to establish a Sino-Western JV are access to international markets, access to technological and managerial competences and access to intangible assets.

There are previous studies that have focused on both Chinese and Western perspectives (Si and Bruton 2005). Si and Bruton (2005, 1465) studied Sino-American JVs in China from the perspective of both American and Chinese managers. Their findings show that the establishment of IJVs for both American and Chinese managers in China is driven by three motivational categories: knowledge acquisition, transaction costs savings and strategic behavior. Wang (2007, 175) studied Sino-Finnish JVs in China from the perspective of Chinese and Finnish companies and found that the motives for Sino-Western JVs should stem from the long-term strategies of the partners. In order to achieve goals of the Sino-Western JV, the partners need to acknowledge each other's motives and create a long-term strategy (Wang's 2007, 175).

The Chinese government provides incentives to attract foreign investment into China (Kettunen et al. 2008, iii). China's government regulates the industries and activities, where FDIs are approved. Within the Catalogue for the Guidance of Foreign Investment Industries, industries are listed in four categories: permitted, encouraged, restricted and prohibited for foreign investment. Permitted activities are generally those that are not mentioned in the catalogue. Encouraged foreign investment industries are prioritized and supported by China's government by different means, such as tax incentives or less administration. These include, for instance, agriculture, power production and supply, new technologies and manufacturing of specified products. Restricted activities or industries, such as out-of-date technologies, mining, unfavorable natural resources and cultural heritage, are controlled or protected by China's government. Prohibited industries cause damage to environment or society. (Provisions 2007, art. 4-7; Catalogue 2012.) Currently, China's government encourages projects for new and high technology and advanced applicable technology, which can improve performance of products and increase techno-economic efficiency of enterprises or produce new equipment and material (Provisions 2007, art.5).

There are many motives for Western and Chinese companies to establish a JV in China. The motives based on the findings from previous studies are summarized in table 4.

**Table 4 Motives for forming Sino-Western joint ventures in China**

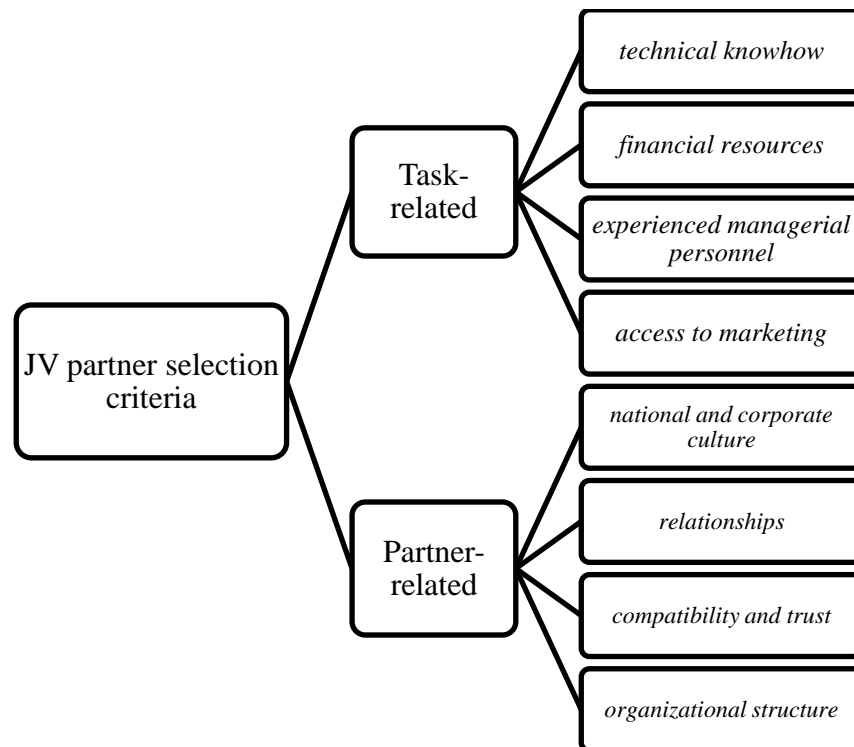
<b>Motives for Western companies</b>	<b>Motives for Chinese companies</b>
<ul style="list-style-type: none"> <li>• Large market size and vast market opportunities</li> <li>• Attractive tax regime/financial incentives</li> <li>• Chinese government incentives and encouragement</li> <li>• Local partner's skills and attributes</li> <li>• Good export base for foreign markets</li> </ul>	<ul style="list-style-type: none"> <li>• New market position in China</li> <li>• Technology exchange and access to new technology</li> <li>• Access to managerial competences</li> <li>• Access to intangible assets</li> <li>• International expansion/ access to international market</li> </ul>

The Western and Chinese companies have some different motives in establishing a JV in China. The Western companies are motivated to establish a JV in China due to the large market size, market opportunities, the host government incentives and China being a good export base for foreign markets. In contrast, the motives of the Chinese companies include market position in China, international expansion and access to technology, management knowhow or other intangible assets. Moreover, the motives of the JV partners should stem from the strategies of the companies and each JV partner needs to acknowledge each other's motives.

### 3 SINO-WESTERN JOINT VENTURE FORMATION PHASE IN CHINA

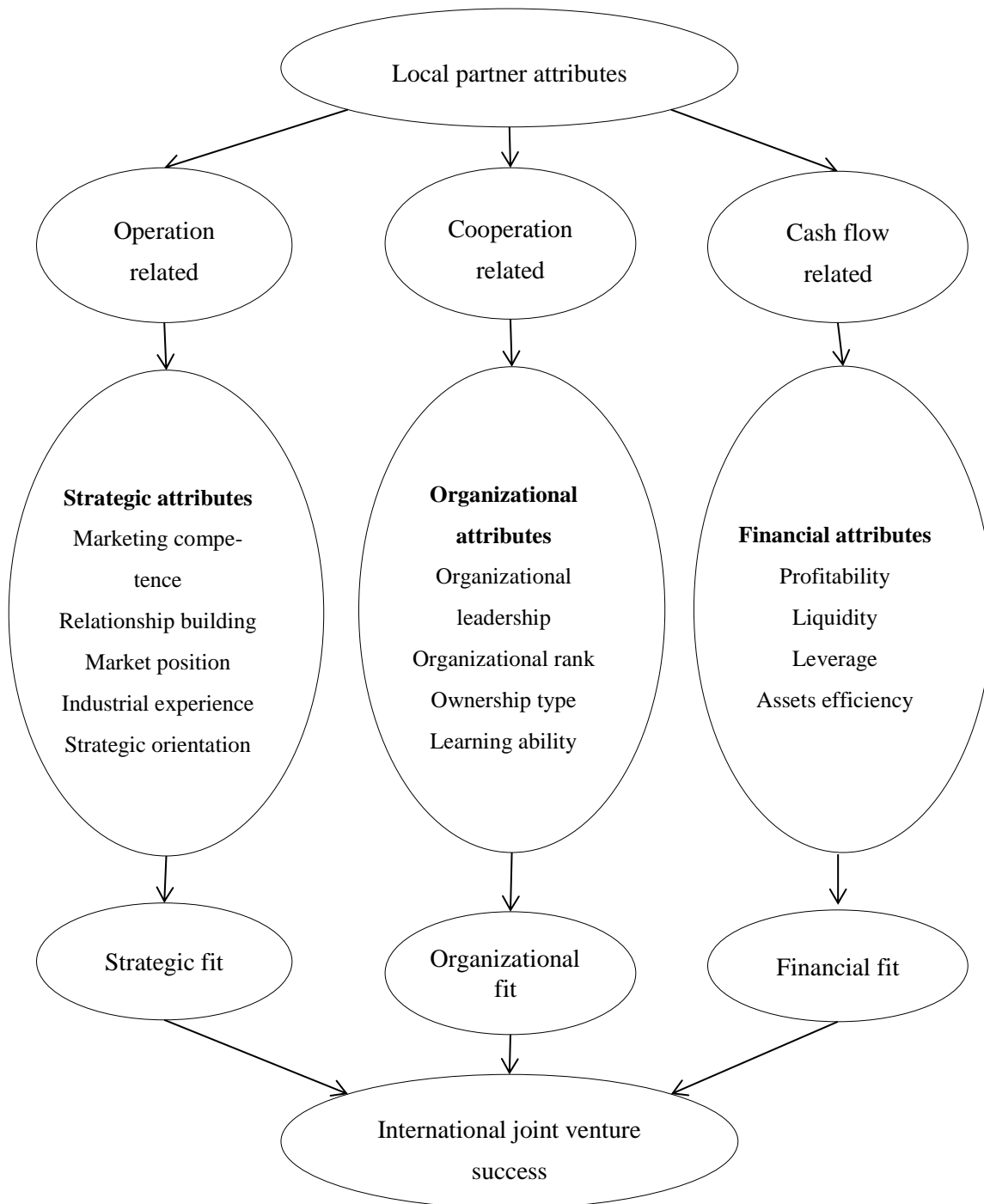
#### 3.1 Partner selection for Sino-Western joint ventures in China

Selecting the right partner is essential for the success of a JV (Harrigan 1988; Killing 1983; Hitt, Dacin, Levitas, Arregle & Borza 2000). Poor selection of alliance partners is among the most common reasons for the failure of the alliance (Medcof 1997, 718), therefore, companies should strive to select the most suitable partner for a JV. Geringer (1991, 45-46) distinguishes IJV partner selection criteria into task-related and partner-related (figure 7). Task-related criteria refer to those variables which are intimately related to the viability of a proposed venture's operations regardless of whether the chosen investment mode involves multiple partners. Examples of task related criteria include patents or technical knowhow, financial resources, experienced managerial personnel, and access to marketing and distribution systems. In contrast, partner-related criteria refer to those variables which become relevant only if the chosen investment mode involves the presence of multiple partners. Examples of partner related criteria include a partner's national or corporate culture, the degree of favorable past association between the partners, compatibility of and trust between partners' top management teams, and a partner's organizational size or structure. (Geringer 1991, 45-46.)



**Figure 7** Joint venture partner selection criteria (Geringer 1991, 45-46)

Luo (1998) extended Geringer's (1991) idea on partner and task-related criteria to also measure financial fit between the partners. Luo (1998, 146-148) suggests that during the process of establishing an IJV, foreign parent firms must identify appropriate criteria for local partner selection as well as the relative importance of each criterion. He created a three-fold classification scheme on local partner attributes and JV success based on IJVs in China, which is illustrated in figure 8.



**Figure 8** Local partner attributes and joint venture success: three-fold classification scheme (Luo 1998, 146-148)



The scheme in figure 8 shows strategic, organizational and financial attributes of the local Chinese partner that are crucial to the success of the IJV. A partner's strategic traits influence the operational skills and resources needed for the JV's competitive success. Organizational traits affect the efficiency and effectiveness of inter-firm cooperation. Financial traits impact the optimization of capital structure and cash flow. Partner selection should be a part of a foreign company's strategic goals. (Luo 1998, 146-148.) The scheme can work as helpful tool for international managers, when selecting potential JV partners in China.

The partner selection criteria differ between the companies from emerging and developed countries. Hitt et al. (2000, 462) studied the differences and similarities in the partner selection criteria for emerging and developed market companies. They found that emerging market companies emphasize financial assets, technical capabilities, intangible assets and willingness to share expertise in partner selection. Different to the emerging market companies, developed market companies put more emphasis on partners' unique competencies and market knowledge, partners' previous alliance experience, the cost of alternatives, and industry attractiveness and special skills to learn from a partner. Both emerging and developed market companies find complementary capabilities and managerial capabilities equally important. (Hitt et al. 2000, 462.) Previous studies have also found that one of the key issues in Sino-Western JV partner selection is finding complementary strengths and motives (Hitt et al. 2000, 462; Kirby & Kaiser 2003, 229; Si & Bruton 2005, 1471; Dong & Glaister 2006, 598), in addition with sharing compatible goals and a cooperative culture between the partners (Luo 1998, 161).

Dong and Glaister's (2006, 591-592, 598) study focused on Chinese companies' selection criteria for a Western JV partner. Table 5 shows the JV partner selection criteria in the ranking of importance. The most important task-related selection criteria include product-specific knowledge, finance and international market knowledge. The most important partner-related selection criteria include reputation and financial stability of the partner and the trust between the top management of the foreign company. Luo (2002, 490) found that Chinese firms select foreign JV partners based upon organizational learning considerations and the need to acquire knowledge from the partner firms, rather than transaction cost concerns. Moreover, the foreign firm's technological capabilities can spur the Chinese firm's expansion goals.

**Table 5 Partner selection criteria for a Western joint venture partner (Dong and Glaister's 2006, 591-592)**

	Rank
<i>Task-related selection criteria (access to)</i>	
Product-specific knowledge	1
Capital/finance	2
International market knowledge	3
Production technology	4
Distribution channels	5
International regulatory knowledge	5
<i>Partner-related criteria</i>	
Reputation of the partner	1
Financial stability of the partner	2
Trust between the top management teams	3
Favorable past association between the partners	4
The partner company's size	5
Relatedness of partner's business	6

Glaister and Wang (1993, 13-14) found that the foreign companies put the most emphasis during the JV partner selection on the Chinese local partner's ability to negotiate with host government, relatedness of business, trust between top management, and financial status/resources of the partner. The importance of different skills and characteristics is presented in table 6. Similar to Glaister and Wang's (1993) study findings, Zhang (2000, 199) found that the Western companies put emphasis on good credit of the Chinese partner and the Chinese partner's capability to deal with the local authorities.

**Table 6** Necessary skills or characteristics of a Chinese joint venture partner  
(Glaister & Wang 1993, 13-14)

Skills or characteristics	Rank
Ability to negotiate with the host government	1
Relatedness of business	2
Trust between top management	3
Financial status/resources of partner	4
Established marketing and distribution system	5
Reputation	6
Complementary resources	7
Experiences in technology application	8
Favorable past association	9
Partner company's size	10
Management in depth	10
International experience	12
Access to technology	13

From a more pragmatic perspective, three different types of partners can be found in China: 1) the *'nuts and bolts partner'*; 2) the *'well-endowed godfather'*; 3) the *'four hands on the wheel partner'*. The *'nuts and bolts partner'* helps to solve problems or access to land, resources, labor, government, distribution etc. The relationships are likely short-term and problems may arise easily. This type can be ideal for first-timers in China. The *'well-endowed godfather'* is more powerful such as government authorities. Besides power they have access to resources and are especially helpful in the start-up phase. Godfathers often take minority stakes and are less involved in day-to-day management. The *'four hands on the wheel partner'* is a strategic partner who is interested in developing own strategic position. This partner has goals to expand not just by one JV in national level, but also via other IJVs. This partnership type is believed to have a higher chance to survive. (The Economist Intelligence Unit 1995.) The depiction of the partner types in China was done two decades ago, which should be acknowledged, when considering China's business environment today.

Ambler and Witzel (2000, 120) suggest five key factors to consider when choosing a partner in China, which can be useful in developing the JV partner selection criteria in China:

- 1) *Technical expertise*. What skills does the prospective partner have? Can the Western firm provide the missing skills, and at what cost?

- 2) *Facilities*. What facilities (production, distribution, etc.) does the prospective partner have or have access to? Will these need to be modernized or upgraded, and what will be the cost?
- 3) *Location*. Is the Chinese partner geographically well placed to exploit market opportunities? This is particularly important given the physical problems associated with distribution in China. Setting up an operation in Guangzhou to market in Sichuan is likely to involve a lot of extra time and expense.
- 4) *Relationships*. How good are the Chinese partner's personal connections with other firms in the supply chain, with customers, with the government?
- 5) *Partner goals*. What do partners want? Are they 'nuts and bolts' partners, or might there be true strategic vision in their thinking?

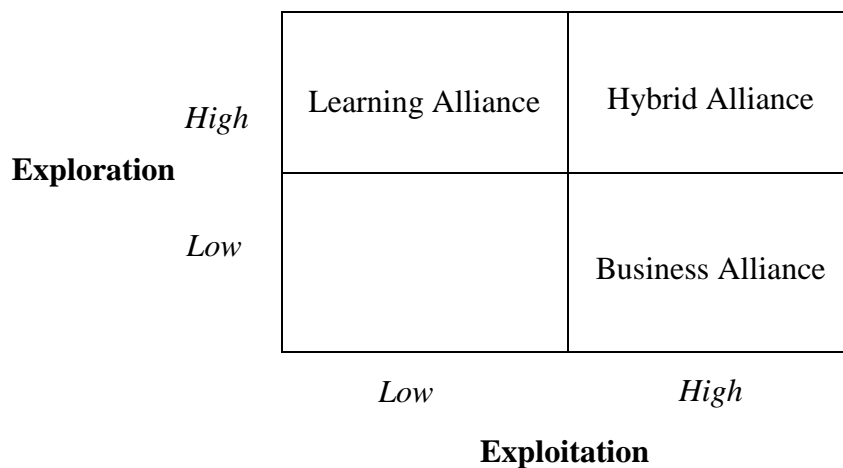
Wang (2007, 179) points out that it is very important for the Chinese companies that the Western partners are willing to adopt a flexible attitude in the JV partnership and for the Western partners to be able to build a relationship with a partner they can trust and communicate openly. There are similarities and differences in the JV partner selection criteria between the Chinese and the Western companies. Both Chinese and Western companies put emphasis on finding a JV partner that is trustworthy and has capital and finances for the JV. The Chinese companies emphasize the foreign partner's international market knowledge, whereas the Western companies select a Chinese JV partner based on its ability to negotiate with the local authorities and the host government and the relatedness of its business. The empirical study of this thesis will focus on the JV partner selection from the perspective of the Finnish software firms. Nevertheless, it is important to acknowledge that there are differences in the partner selection criteria between Chinese and Western companies.

### 3.2 Choice of a joint venture type in China

Stafford (1994, 66-67) suggests three basic types of relationship that can tie partners closely together for the long-term: *contracts*, *creative joint ventures* and *acquisitive joint ventures*. *Contracts* are non-equity agreements specifying the co-operative contributions and powers of each partner. *Creative joint ventures* involve partners contributing resources to the formation of a new separate subsidiary, jointly owned by the partners. Although the new entity may have its own assets and management team, its parents typically take an active role in the JV's strategic decisions. *Acquisitive joint ventures* differ from creative joint ventures in that while the alliance involves exchanged equity between the partners, no separate entity is created. In acquisitive JVs one partner acquires partial interest of the other, and the partners work together with joint management teams and joint-owned assets. One primary concern of acquisitive JVs, however,

is the delicate power balance established between partners. Unlike the joint management of a separate entity, acquisitive JVs require a far more intimate setting for partners to operate. (Stafford 1994, 66-67.)

Koza and Lewin (2000, 148-149) divide strategic alliances into learning alliances, business alliances and hybrid alliances (figure 9). *Learning alliances* join companies sharing strong exploration intents, and with limited or no explicit or hidden exploitation intents. Learning alliances can reveal new information and insights about (1) markets, including local competition, regulations, customer tastes and habits, marketing infrastructure, and the like; (2) new core competencies such as just in time processes, negative working capital, one on one marketing, and mass customization; and (3) new technologies, such as competency destroying innovations, new complementary technologies, as well as franchising capabilities. *Business alliances* link companies with strong exploitation intents, but with limited or no exploration intent. Typically, these alliances seek to establish a position in a geographic or product market or market segment. Typically the overriding objective of a business alliance is to secure new incremental revenues from the combination of specific assets unique to each parent. *Hybrid alliances* join companies with strategic intents that include strong exploration and exploitation objectives. In these alliances the companies seek to simultaneously maximize opportunities for capturing value from leveraging existing capabilities, assets, and the like, as well as from the opportunity to create new value through their joint learning activities. (Koza & Lewin 2000, 148-149.)



**Figure 9** Three types of strategic alliances (Koza & Lewin 2000, 148-149)

Büchel et al. (1998, 17-22) suggest important dimensions that can be used to distinguish between different types of JVs and the areas in which they are used. Five important dimensions include: 1) *Relationship of the JV partners*; 2) *Internationality*; 3) *Position in value-added chain*; 4) *Equity relationship*; 5) *Strategic orientation*. The di-

mensions are presented in table 7. The *relationship of the partners* can be distinguished as horizontal, vertical or neutral. Horizontal relationship indicates that the JV partners are competitors outside the focus of the JV. Vertical relationship means, for instance, a supplier-customer relationship. JV partners with neutral relationship come from different business areas and the most important concern is the strategic orientation of the JV. The *internationality* dimension is concerned with two issues; the context of where the JV partners operate and whether the JV partners are from different countries. The different cultural, legal and geographical backgrounds have an impact on the JV. The *position in the value-added chain* of the JV partners affects the autonomy of the JV and the control of the JV. The *equity relationship* is an important dimension, because it has an impact on issues such as the ownership and the daily operations of the JV. *Strategic orientation* indicates the autonomy of the JV versus the association of the JV with the partner companies' areas of business. (Büchel et al. 1998, 17-22.)

**Table 7 Dimensions for describing joint ventures (Büchel et al. 1998, 17-22)**

<b>1. Relationship of the JV partners</b>	Horizontal		Vertical		Neutral
<b>2. Internationality</b>	National		Binational		International
<b>3. Position in value-added chain</b>	R&D	Supply	Production	Sales	
<b>4. Equity relationship</b>	Equal			Unequal	
<b>5. Strategic orientation</b>	Technology transfer	Economies of scale	Market access	Spreading risk	

In China, JVs are classified under three different types: EJVs, CJVs and joint exploration projects. This thesis discusses only about EJVs and CJVs, because they are the two most common FDI modes. JV is a company owned partially by foreign investor(s) and partially by Chinese investor(s). EJV and CJV differ primarily in terms of the way in which profits and losses are distributed. (Dezan Shira & Associates 2012, 7-8.) Some of the advantages of JV are to gain access to an already developed network, to have a strategic local partner or to share operational costs. (EU SME centre 2012, 1.) In EJV profits and losses are distributed between parties in proportion to their respective equity interests. The foreign partner should hold at least 25 % of the equity interest in the registered capital of the EJV. EJV has limited liability as a Chinese legal person. In CJV profits and losses are distributed between parties in accordance with the specific provisions in the CJV contract. CJV can operate either as a limited liability company or as a non-legal person. (Dezan Shira & Associates 2012, 8.) The foreign investment in China can be made in forms of cash, physical investment, intangible assets and equity, in addi-

tion with reinvestment of the foreign enterprises with the profits gained from the investment (China Statistical Yearbook 2014).

The first law on Chinese-foreign EJVs was adopted on July 1, 1979. The law was amended on April 4, 1990 (Law 2005b). Later on, the law on Chinese-foreign CJVs was promulgated on April 13, 1988 (Law 2005a). Laws are complemented by regulations and rules for their implementation (Regulations 2003; Detailed Rules 1995; Detailed Rules 2003a; Detailed Rules 2003b). According to the current EJV law on foreign investment, technology and equipment contributed as investment by a foreign partner must genuinely be an advanced technology and equipment appropriate for China's needs (Law 2005b, art, 5). The law on CJVs state that the state shall encourage the establishment of productive CJVs that are export-oriented or technologically advanced (Law 2005a, art 4). The Chinese government encourages JVs in technology advanced businesses.

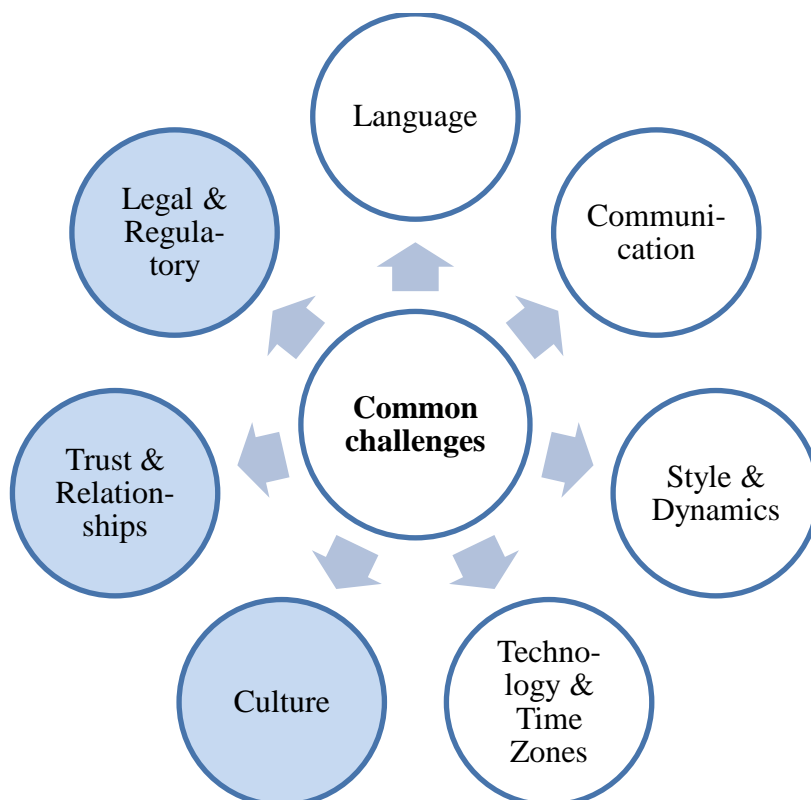
### **3.3 Negotiations for Sino-Western joint ventures in China**

The JV negotiations can begin once the partners are convinced that they can achieve strategic objectives better together than apart. The aim of the negotiations should be to create a JV agreement that satisfies all parties and forms an operational basis for the JV. (Vihakara 2006, 136, 140.) Büchel et al. (1998, 51-61) outlines the IJV negotiation process into four different stages: 1) Signing Memorandum of Understanding (MOU); 2) Developing pre-negotiation strategy; 3) Negotiating and writing the agreement; 4) Evaluating the agreement. Signing the MOU indicates the interest of each party towards establishing an IJV. MOU does not have a legal standing, but it is an important basis for the start of the negotiations. The development of pre-negotiation strategy decreases the chances for the failure of the IJV negotiations. The negotiators are able to forecast the issues and expectations from their own and the partner's point of views before the actual negotiation begins. Negotiating and writing the agreement is a phase, when all the important issues, such as technology transfer, management structure and equity structure regarding the IJV are decided between the partners. Finally, before signing the agreement it is necessary to evaluate issues such as the scope of the agreement and the legal requirements. (Büchel et al. 1998, 51-61.) This outline of the IJV negotiations is a useful guideline for the negotiation process. Nevertheless, it is important to take into consideration the host country characteristics.

In China, the nature of negotiation is perceived as continuous, which means that the different segments of the negotiation are always renegotiable. This is not always understood by the Western negotiators, who see each segment completed before continuing to the next. (Shapiro, Behrman, Fischer & Powell 1991, 225.) Generally, the JV negotia-

tions tend to take a long period of time. Previous studies have reported that the JV negotiations in China have lasted from two to four years (Davidson 1987, 78; Nair & Stafford 1998, 141).

According to the EU SME Centre (2013b, 1-2), the most critical challenges that European companies face when negotiating in China are language, style and dynamics, technology and time zones, culture, trust and relationships, communication and legal or regulatory challenges. The challenges are illustrated in figure 10. Language barriers may lead to misunderstandings between the JV negotiating partners, which can be minimized by hiring a translator. Communication challenges relate to the language, but also to the culture and how the different parties perceive things. The negotiating style and dynamics, such as Chinese perception of a negotiation as a continuous process, can have major impact on the negotiations. A more pragmatic challenge is the time zone difference between China and Europe as well as the technological challenges. (EU SME Centre 2013b, 1-2). The Chinese culture, trust and relationships and the legal and regulatory environment challenges are discussed more thoroughly next.



**Figure 10** Common challenges faced in negotiating with the Chinese (EU SME Centre 2013b, 1-2)

Building trust with the Chinese negotiating partner is essential, but challenging. Trust is a prerequisite to Chinese business exchanges (Nair & Stafford 1998, 141). Negotiation has a lot to do with people. Chinese negotiation teams may consist of 15-20 repre-



sentatives including the potential partner, officials from local government and ministries and bank (Melvin 1995, 23). Lorange, Roos and Bronn (1992, 14-15) suggest that people shape the success of a partnership, thus choosing the right people with the right competencies in the key positions during the negotiations has an impact to its ongoing success. The people in the negotiating team must reflect the firm's strategic intents towards the JV.

Laws and regulations regarding the selected JV type (EJV or CJV) should be investigated carefully. The more the foreign partner is familiar with the legal procedures, the smoother the negotiation can proceed. (Shapiro et al. 1991, 227-231; Reuvid 2003, 215.) Legislation in China is sometimes seen unclear and can be interpreted in many ways. Since joining the WTO in 2002 the Chinese legislation has been made clearer. However, there still exists some issues, for instance, there have been cases that new modifications to the legislations are informed just before they become valid and sometimes only the Chinese JV partner has been informed about the changes in the legislation. (Kettunen et al. 2008, 118.) Contract is an essential part of the negotiation phase. Understanding the meaning of a contract is one of the major challenges for foreign companies in China. The Chinese perceive contract as an agreement to begin a project and the details of the agreement are negotiated throughout the project. In contrast, the Western perceive contract as an end-all agreement. Nevertheless, negotiations should be taken seriously in China because it is difficult to deviate from a term of reference once it is established. (Melvin 1995, 22.) Chinese negotiators are more concerned with the means than the end, and with the process more than the goal. The best compromises are derived only through the ritual back-and-forth of haggling. (Graham & Lam 2003, 84.)

Understanding the roots of the Chinese culture is important in overcoming the cultural challenges in Sino-Western JV negotiations. Graham and Lam (2003, 84-85) point out four threads that hold the Chinese culture together and are strongly present in negotiations with the Chinese:

1. *Agrarian society and its values.* In Chinese thinking agriculture has always represented strong roots and business growing branches.
2. *Confucian moral concepts that have a connection to Taoism.* Chinese negotiators carry more concern towards ways rather than end results, more on processes than goals. Thus process should not be cut off too early.
3. *Chinese language and its characters.* In Chinese words are more pictures than a series of letters. This is why the Chinese see entities and are not so stuck on details as Westerners are.
4. *The suspicion towards foreigners due to experiences in history.* Suspicion stems from the country's own chaotic periods. It is said that the Chinese believe in only Tao things: own family and own bank account.

From the four threads, Graham and Lam (2003, 85-91) depict eight elements that together constitute the power of negotiations in China:

1. Guanxi (personal connections)
2. Zhongjian ren (the intermediary)
3. Shehui dengji (social status)
4. Renji Hexie (Interpersonal harmony)
5. Zhengti Guannian (Holistic thinking)
6. Jiejian (Thrift)
7. Mianzi (Face)
8. Chiku Nailao (Endurance)

Guanxi indicates social network, which involves an individual's group of friends, relatives and close associates. Guanxi is the basis of relationships in China and it requires time to build close relationship with people, including business partners, in China. An *intermediary* plays an important role in establishing a connection with a new business contact. *Social status* is important during the negotiations and one's social status should not be undermined. Hierarchy is an important part of the Chinese culture and the Western company should assign negotiators that have similar social status to the negotiators of the Chinese company. By neglecting to do this, shows lack of respect to the Chinese negotiating party. The Western company should put emphasis on developing *interpersonal harmony* with the Chinese business parties. It takes a long time to create interpersonal harmony via several meetings, dinners and social occasions. *Holistic thinking* means that the Chinese negotiators consider the negotiation as a whole rather than breaking a complex negotiation into a series of smaller issues. The Chinese tend to be *thrift*, when it comes to negotiating about the costs and the money. The concept of saving *face* is very important to the Chinese. *Face* refers to an individual's reputation or social standing in the society. The Western companies should attempt not to embarrass the Chinese counterparty. *Endurance*, relentlessness or eating bitterness and enduring labor are important characteristics of the Chinese business culture. Chinese value hard work to a larger extent than Western people often do. During the negotiations this can be seen, for instance, as Chinese being more prepared and expecting longer bargaining sessions. (Graham & Lam 2003, 85-91.)

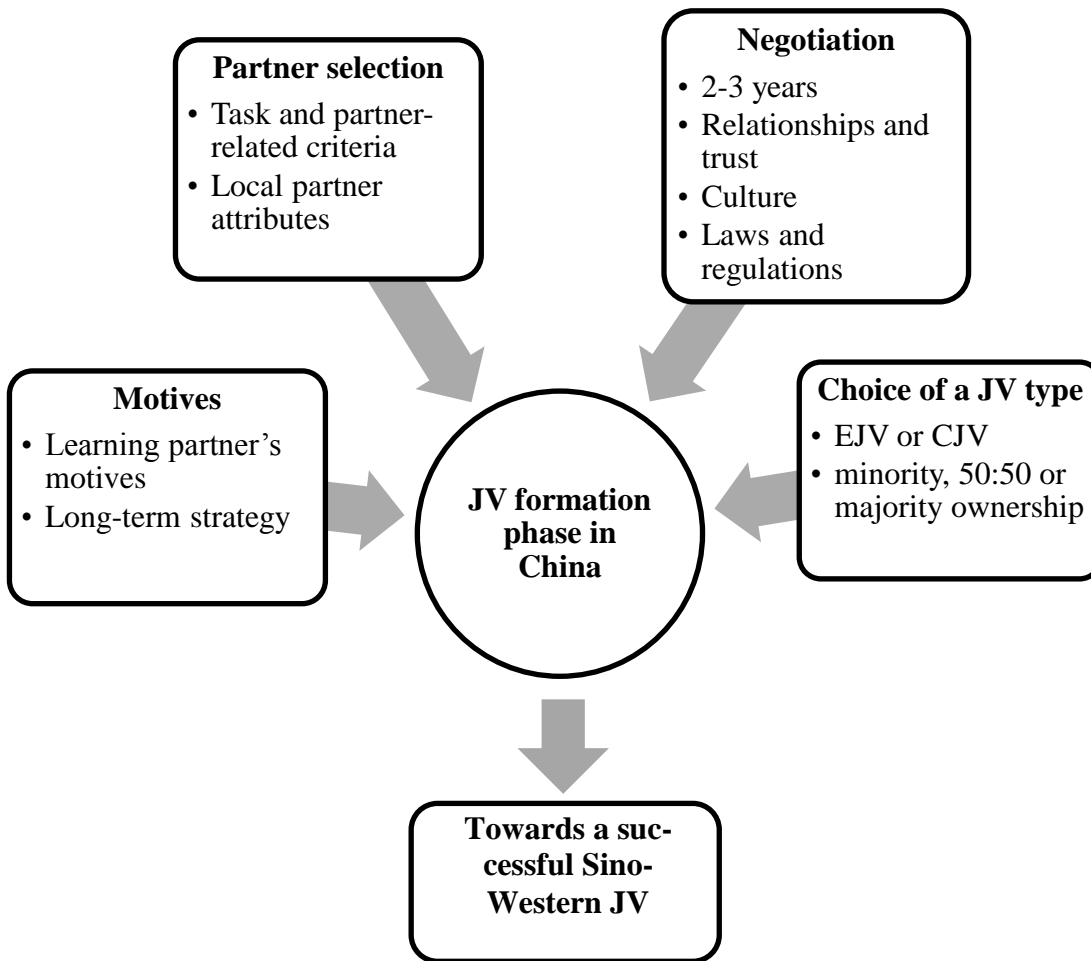
Graham and Lam's (2003) depiction of Chinese negotiation was done over a decade ago, in 2003. It needs to be acknowledged that China has been influenced by the Western countries and their findings can be out dated to some extent. More and more Chinese are educated in the Western countries and have gained knowledge and experience on the Western way of conducting business. Tung, Worm and Fang (2008, 73) argued that several cultural factors that relate to the Chinese negotiation, have remained unchanged until today. These include attitude toward time, importance of guanxi and face, significance of hierarchy and tendency to adopt a holistic approach. The Chinese orien-

tation toward time is different compared to the Western orientation, they value patience and time during negotiations. The Chinese put heavier emphasis on guanxi and face, which means that relationships are important. The role of hierarchy is strong in China, especially where government officials are involved. Chinese tend to adopt a more holistic approach to analyzing problems and issues than the Western people. Today, there exists differences in China between the young and old, coastal regions and interior provinces, large and small enterprises, the experience levels of the local Chinese companies with foreign companies. (Tung et al. 2008, 72-73.) It has been acknowledged that Sino-Western JV negotiations face many challenges such as culture.

### **3.4 Synthesis of the literature review**

The literature review identified the main motives and key activities in Sino-Western JV formation phase. JVs are a challenging entry mode and they often end up in failure. This study assumes that good planning and preparation is important for the success of Sino-Western JVs in China. However, a well-planned JV does not guarantee its success, but there are many challenges in the management and the operations of the JV too. The figure 11 illustrates the main findings of the theoretical study.

As illustrated in figure 11 the motives for Sino-Western JV in China are based on the strategies of the firms. Traditionally, the main motives for establishing a JV are risk reduction, synergies and exchange of technology and resources. The motives from the perspective of the Western and Chinese companies are different to some extent. The Western companies seek new opportunities in China's large market. In addition, other motives for Western companies include lack of experience or knowledge in China's business environment. The main motives for Chinese companies to establish a JV with a foreign partner include international market expansion and access to new technology. The creation of the partner selection criteria is essential, when the partner selection process begins. Negotiating towards a Sino-Western JV takes a long time. There are many challenges in the negotiations such as culture, relationships and trust building as well as laws and regulations. The main JV types in China are EJV and CJV. The equity ratio between the Chinese and the Western company is an important decision. A broad definition of the JV ownership can be defined as minority, 50:50 or majority ownership.



**Figure 11** Theoretical framework for the formation phase of a Sino-Western joint venture

The framework provides structure for the empirical study and its analysis. The theoretical framework will be used as the basis of operationalization and will be modified according to the results of the empirical research in order to build the final framework. The context of the theoretical framework is on Sino-Western JVs, but the final framework will focus on the context of Sino-Finnish JVs within software industry. The main purpose of this thesis is to create the best practices for forming Sino-Finnish JVs in China within the software industry.

## **4 METHODOLOGY**

### **4.1 Research approach**

This thesis aims to discover the best practices in forming Sino-Finnish JVs for Finnish software companies. Qualitative method is considered most suited to finding answers to the research question of this thesis. Qualitative research focuses often on processes (Ghauri & Grønhaug 2010, 86). The focus of this thesis is on the process of forming a JV. Qualitative research focuses on understanding the respondent's point of view. It is an interpretative and rational approach, and observations and measurements are made in a natural setting (Ghauri & Grønhaug 2010, 105). The empirical research was done by interviewing experts on Sino-Finnish JVs. The interviews were analyzed and a framework was built based on the interpretations from the analysis.

All research methods are in close connection to research philosophy and to the ways in which it is possible to bring forward new knowledge through research (Eriksson & Kovalainen 2008, 10). Ontologies concern the ideas about the existence of and relationship between people, society and the world in general (Eriksson & Kovalainen 2008, 13). Qualitative methods often focus on subjective ontologies (Ghauri & Grønhaug 2010, 105), meaning that the research is based upon perceptions and experiences that may be different for each person, and change over time and context (Eriksson & Kovalainen 2008, 13). Epistemology defines how knowledge can be produced and argued for. Epistemology defines the criteria by which knowledge is possible. Based on subjective epistemological views, no access to the external world beyond our own observations and interpretations is possible. (Eriksson & Kovalainen 2008, 14.) This thesis adopts a subjective view to social reality. Thus, the world is regarded as a social construct that can evolve. It is easier for a researcher to realize that knowledge is seldom based on one unified idea of science and research by understanding the ontological and epistemological views. (Eriksson & Kovalainen 2008, 15.)

**Table 8**      **Operationalization table**

<b>The research question</b>	<b>The sub research questions</b>	<b>Concepts</b>	<b>Theory background</b>	<b>Question No</b>
What are the best practices for forming Sino-Finnish joint ventures in China for Finnish software firms?	What are the main motives for forming a Sino-Finnish joint venture in China within the software industry?	Motives	Kirby & Kaiser 2003; Dong & Glaister 2006; Vihakara 2006; Wang 2007	2,3
	How do the Finnish software firms select a joint venture partner in China?	Partner selection	Geringer 1991; Glaister & Wang 1993; Luo 1998; Ambler & Witzel 2000; Zhang 2000; Dong & Glaister 2006; Vihakara 2006; Wang 2007	2,4
	How do the Finnish software firms choose a joint venture type in China?	Choice of JV type	Stafford 1994; Koza & Lewin 2000; Wei et al. 2005; Wang 2007	2,5
	What are negotiations for a Sino-Finnish joint venture like?	Negotiations	Lorange et al. 1992; Melvin 1995; Nair & Stafford 1998; Graham & Lam 2003; Vihakara 2006; Tung, et al. 2008	2,6

The operationalization table (table 8) depicts the main research question and the sub research questions of this thesis. The sub research questions link to the key concepts, which arise from the previous literature. The question number refers to the interview questions (appendix 1 and 2).

## 4.2 Data collection

The chosen research approach and the research question should guide the collection of most useful empirical data for the research (Eriksson & Kovalainen 2008, 77). The nature of the research question and sub questions indicates that this research is qualitative. Data collection sources can be divided into secondary and primary data. Secondary data is collected by others and its purpose may therefore be different from the purpose of the research. Primary data is original data that is collected by the researcher him/herself to answer the research problem. (Ghauri & Grønhaug 2010, 90.) Primary data was chosen as a data collection source for this research, because there is no existing secondary data on the context of Sino-Finnish JVs within software industry. Thus, the researcher could gather the original data to answer the research question. The data for this study was collected via expert interviews. The aim of collecting data via interviews was to study people's experiences as seen from their own point of view, or the social construction of knowledge concerning the chosen topic (Eriksson & Kovalainen 2008, 81). Interviews for this research were conducted with experts, who have experience and knowledge in Sino-Finnish JVs in China within software industry. The selection criteria for the interviewees are further explained later in this sub chapter. Interviews were an effective method of gaining understanding of the phenomena of Sino-Finnish JV establishments from the experts, because the purpose of the study was to provide best practices. Some perceive expert interviews as just a way of collecting facts and knowledge, but expert interviews are a very popular way of collecting data (Bogner, Littig & Menz 2009, 5).

Interviews can be divided into structured, semi-structured and unstructured interviews. In a structured interview the questions and answers are predetermined and the respondent chooses the predetermined answer from a list of choices. In semi-structured interviews questions are predetermined and the respondent can answer in his or her own words. In unstructured interview the questions are predetermined to some extent and the respondent forms the answer in his or her own words. Both semi-structured and unstructured interview questions are used to obtain information about personal, attitudinal and value-laden material that call for sensitivity. (Ghauri & Grønhaug 2010, 118, 126.) With semi-structured interview the emphasis is on how the interviewee frames and understands issues and events. That is, what the interviewee views as important in explaining and understanding events, patterns, and forms of behavior (Bryman & Bell 2007, 475). Semi-structured interview was chosen as a data collection method for this study in order to collect the interviewees' opinions and knowledge on their area of expertise. A theme-based interview guide (appendix 1 & 2) was used.

The interviewees were selected based on their expertise in the scope of the study. Each interviewee had recent experience or knowledge (within the last 5 years) on establishing Sino-Finnish JVs in China within the technology or software industry. The in-

interviewees include one lawyer, entrepreneurs, consultants, and China specialists from public and private companies. Both Chinese and Finnish people were interviewed in order to gain knowledge from the perspectives of both nationalities. Since there were no systematic differences in the answers from the different nationalities, there will be no distinction made between the nationalities of the interviewees in the findings of the interviews in chapter 5. Table 9 shows the interviewees' names, their current position and company, nationality and the interview details.

**Table 9 Interview details**

<b>Current position</b>	<b>Expertise</b>	<b>Nationality</b>	<b>Date and place</b>	<b>Length and Language</b>
CEO	Chinese software industry	Chinese	11.11. Office in Espoo	48min, English
Entrepreneur1	Chinese market entry of Finnish IT company	Chinese	8.12. Skype with voice and video	35min, English
Operating Manager	Consulted Finnish companies in China	Chinese	9.12. Phone	47min, English
Lawyer	Sino-Finnish legal matters	Chinese	10.12. Office in Helsinki	48min, English
Entrepreneur2	Invested on Sino-Finnish business	Chinese	11.12. Skype with voice	35min, English
Consultant1	Chinese market entry	Finnish	13.11. Phone	45min, Finnish
Entrepreneur3	Established Sino-Finnish JVs in China	Finnish	13.11. Skype with voice	39min, Finnish
Consultant2	Chinese market entry	Finnish	20.11. Office lobby	42min, Finnish
Director	Established a Sino-Finnish JV in China	Finnish	25.11. Office in Helsinki	47min, Finnish

In total, nine interviews were conducted between November and December in 2014. The total number of the interviews was not defined in the beginning of the data collection. Once the same themes started to reoccur within the interviews, the researcher decided to finish the data collection. The interviews were conducted either face to face (four interviews) or via phone or skype (five interviews). Three of the face to face interviews were done in the offices of the interviewees and one of the face to face interviews



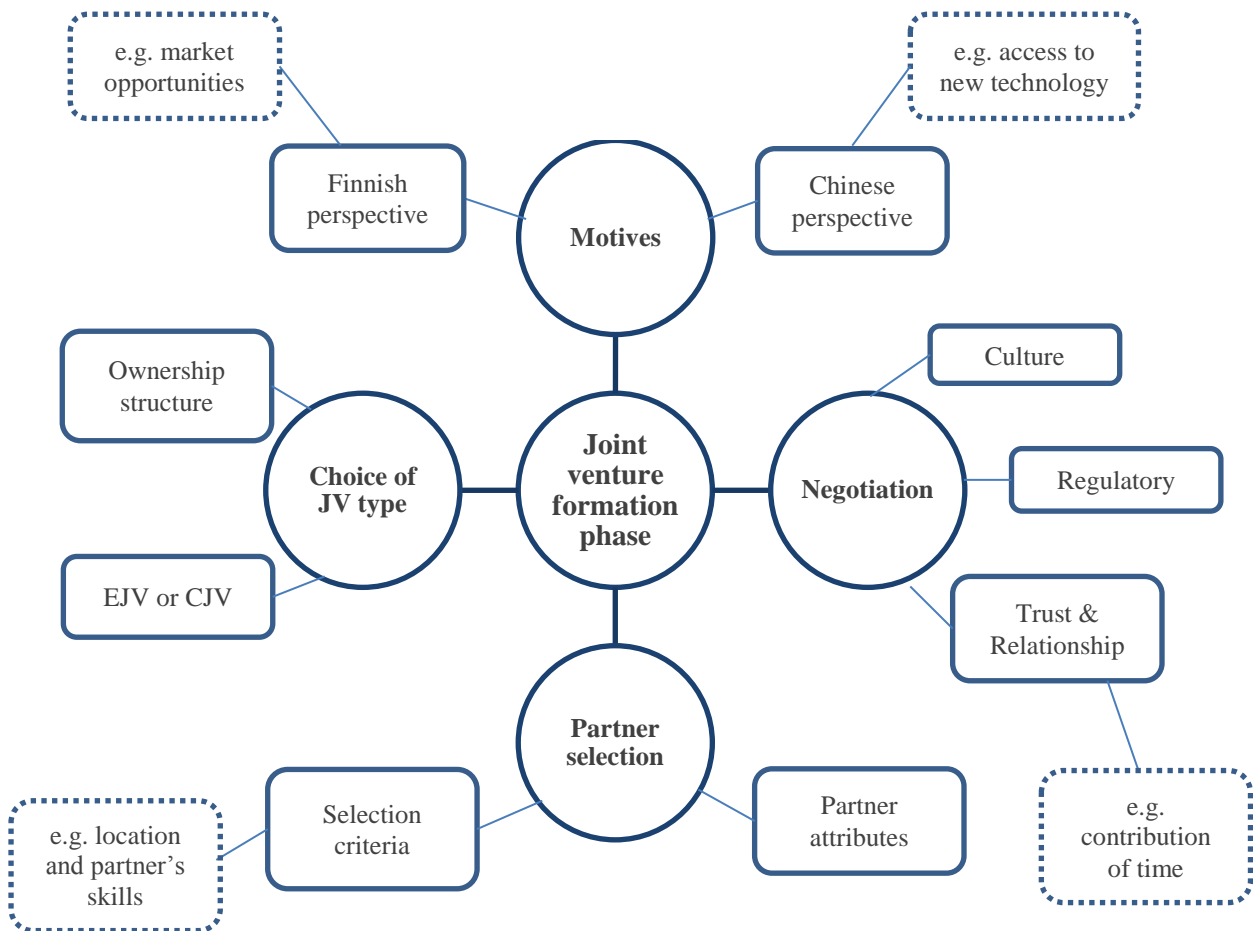
was done in a lobby of an office building. Two interviews were conducted via phone and three via Skype. The aim was to conduct as many face to face interviews as possible, but five of the interviews had to be done via phone due to the interviewee's location and, in one instance, the interview had to be conducted via phone due to personal affairs of the interviewee. There were some disruptions during the interviews, such as an interviewee needing to answer a phone call or to take care of a baby, and the bad quality of connection via phone or Skype caused further disruptions. The disruptions did not have a major impact on the interview results. The researcher followed the interviews carefully and made notes in order to continue the discussion after the disruptions occurred. All of the interviewees consented to the recording of the interview. There were no perceived changes in the interviewees' attitude or willingness to speak once the recording was switched on. Five of the interviews were held in English and four in Finnish. English was a non-native language to both the interviewees and the interviewer. The interviewer and the interviewees' level of English skills were good so that possible miscommunications were minimal. Each interviewee requested the possibility to review their interview findings before the thesis would be printed. The interviewees' anonymity was preserved by not mentioning their name or organization. The notes and the recordings worked as the basis of the analysis. All of the interview recordings were transcribed. Transcribing enabled the analysis of the results without the need to listen the interview over and over again. Also it enabled the possibility to re-check efficiently what had been said by the interviewees. The selected quotations from the Finnish interviews were translated by the researcher and the translation was double checked by the researcher's friend.

### **4.3 Data analysis**

In qualitative research, the amount of data is often massive and the research may feel overwhelming with the amount of data. The purpose of data analysis can be seen as the process of bringing order, structure and meaning to the mass of collected data. (Marshall & Rossman 1995, 111.) The qualitative research analysis can be described in a form of a spiral, where the data analysis is discussed with the previous literature and background from where the findings and conclusions are made. After this more data can be collected and the process starts again and is repeated until a clear picture is formed on the scope of the study. (Hirsjärvi, Remes & Sajavaara 2012, 223.)

Analyzing qualitative data does not have very strict rules and there are many different analysis methods. It is possible to process the qualitative data with statistical methods, but the most common methods are thematic analysis, conceptualization, categorizing, discourse analysis and conversation analysis (Hirsjärvi et al. 2012, 224). Thematic analysis was chosen as the data analysis method for this study. The purpose of thematic

analysis is to organize qualitative data into a more understandable form by creating themes out of the data and structure these themes further into thematic network. In thematic analysis, themes are divided into three different levels. Different levels of thematic network are: i) lowest-order premises evident in the text (Basic Themes); ii) categories of basic themes grouped together to summarize more abstract principles (Organizing Themes); and iii) super-ordinate themes encapsulating the principal metaphors in the text as a whole (Global Themes). (Attride-Stirling 2001, 386, 388.) The figure 12 illustrates the thematic network used in this study.



**Figure 12** Thematic network of the study of establishment of a joint venture

In this study the overall themes were observed in the literature review, which was a good starting point for the analysis. Thematic analysis begins by collecting basic themes from the data and moves inwards toward a global theme (Attride-Stirling 2001, 389). In this study, the analysis began by reading the interview transcriptions carefully and categorizing the data under the basic themes. Thematic networks work only as a tool for the analysis and not the analysis itself. They are useful for the researcher to understand the

text and also work as a visual aid for the reader to understand the text better (Attride-Stirling 2001, 389.) Once the thematic network was completed, the network was observed more closely and in relation with the literature review.

#### 4.4 Trustworthiness

The baseline for the qualitative research is open subjectivity of the researcher and accepting that the researcher is the main research tool. The criterion for trustworthiness of qualitative research is the researcher her/himself, and that is why evaluating trustworthiness concerns the entire research process (Eskola & Suoranta 1996, 165.) In this research the attempt has been to evaluate the research process through the entire lifecycle of the research. The traditional concept about trustworthiness is based on an objective assumption that there exists only one concrete reality that is pursued by the qualitative research. In naturalist qualitative research it is assumed that there are multiple realities, and that research generates a certain perspective about the phenomenon, but not an objective truth. This is why the traditional evaluation criteria are not suitable for a qualitative research. (Tynjälä 1991, 390.) Naturalist criteria for trustworthiness created by Lincoln and Guba (1985, 301-328) include four aspects; credibility, transferability, dependability and confirmability.

The purpose of *credibility* in evaluating trustworthiness of a research is to indicate that the reconstructions developed during the research correspond to the original constructions from reality (Tynjälä 1991, 390). The operationalization table on the appendix 1 shows how the research questions relate to the previous theory and studies. The interview questions are based on the operationalization and the collected data was analyzed based on the previous theory. This triangulation confirms the credibility of the research to some extent. Language misunderstandings may have occurred that has an impact on the credibility of the research. For instance, the interview was conducted in Finnish, but the data was analyzed in English. The language misunderstandings were minimized by having the researcher's friend to double check the translations of the quotations from the Finnish interviews. The Finnish nationality of the researcher may have had an influence on the interpretation of the interview findings; however, the international study background of the researcher decreased the bias created by the nationality. Finally, the credibility of the study was increased by describing the interviewees' expertise in the interview details (table 9).

The essence of *transferability* is on how the research results and findings can be transferred into context other than the research context (Tynjälä 1991, 390). One of the contexts of this study is software industry. The results can be transferred into other similar high intangible asset industries. Another context of this study is Sino-Finnish JVs.

The study findings can be generalized into other Sino-Western JVs, especially other Nordic countries that are culturally similar with Finland.

*Dependability* takes into account different factors that cause external variables and also factors that are caused by the research or phenomenon itself (Tynjälä 1991, 391). The interview situation and the implications the situation had on the research findings was described in data collection in sub chapter 4.2. For instance, disruptions caused by a ringing phone or a crying baby during the interviews may have had an impact on the quality or length of the interviewees' answers. The researcher carefully followed the interviews and made notes in order to continue the interview discussion in the case of a disruption. The impact of the external factors on the interviews was minimized by an attempt to choose as quiet environment as possible for the scheduled interview. For the face-to-face interviews, the interviewer suggested a quiet interview location. However, during the telephone and the skype interviews the interviewer was able to choose the environment for him or herself.

*Confirmability* is based on the neutrality of the research; the emphasis of neutrality in qualitative research should be in the research data. It should be possible to repeat the research and an external person from the study should evaluate the findings to confirm them (Tynjälä 1991, 392). Each stage of the research process from the research methodology to data collection and analysis was described as explicitly as possible in chapter 4 to increase the study's confirmability. The analysis of the interview findings was sent to the interviewees to evaluate the results and to confirm the authenticity of their quotations used in the analysis.

## 5 SINO-FINNISH JOINT VENTURE FORMATION PHASE IN CHINA WITHIN SOFTWARE INDUSTRY

The following sub chapters present the empirical research findings based on the interviews with the Finnish and Chinese experts on Sino-Finnish JVs in software and technology industries. The interviewees are referred to by their current position. All interview details are listed in table 9 (chapter 4.2).

### 5.1 Motives for Sino-Finnish joint ventures in China

The previous literature suggests that the formation phase is an essence for the JV success, but it does not guarantee the success of the JV (Hoffman & Schlosser 2001, 376; Wang 2007, 174). The interview findings are in line with this. Careful planning prior to the JV establishment provides a strong foundation for the JV operations (Consultant2):

*“The more ready you are to it; you have a good package before you establish the actual JV, the better. The more homework you have done; the more specific and clearer plan you have, the better.”* (Consultant2)

There are various motives for Finnish and Chinese companies to establish a JV in China. Based on the interview findings, the motives for Finnish software companies to establish a JV in China include little resources, experience or skills in the Chinese market and the large market size in China. These motives are in accordance with the previous research (Glaister and Wang 1993; Kirby & Kaiser 2003). If a Finnish company does not have existing knowledge or experience on Chinese market, establishing a JV with a local Chinese partner can be a good option (Consultant2; Entrepreneur2). Especially for a first-timer in the Chinese market, lack of experience or knowledge about the Chinese market environment can be a challenge (Consultant2):

*“...if you at that moment don't have any operations in China and you lack money or skills to enter Chinese customers, therefore, one of the options can be some kind of joint venture arrangement.”* (Consultant2)

The Chinese market is one of the largest markets in the world. The vast market size brings many opportunities for foreign companies (Kirby & Kaiser 2003, 232-233). The large market and many market opportunities in China are one of the main motives for Finnish software companies to enter into the market (CEO). In the past, the Western companies entered into China's market due to the low costs (Kettunen et al. 2008, iii).

Today, many Western companies are surprised that China is no longer a cheap labor country. Skilled management labor in China can cost even more than it does in Finland (Director of Innovation):

*“The labor costs in China are not as low as they once were. Proper and real labor costs quite a lot and if you want intelligent management labor, it can cost more there than it costs here. This is a surprise for many.”*

(Director of Innovation)

The technology capabilities of the Chinese companies have developed increasingly over the years. The interviewees point out that technology acquisition or exchange is still one of the main motives for Chinese companies to establish a JV with a Finnish company (Consultant2; Director of Innovation; Lawyer; CEO). In addition, learning new management or technology methods motivates Chinese companies to establish a JV with Finnish companies (Lawyer). One of the main strategic motives for Chinese companies to establish a JV with a foreign partner in China is international expansion (Geert et al. 2007; Dong & Glaister 2006). The interview findings are in line with this. The Chinese companies may be looking for the sales channels of a Finnish company. If the long-term strategy of a Chinese company is to expand abroad, establishing a partnership with a Finnish company that has existing international sales channels can be useful (Lawyer).

The JV should be built around common and mutual goals (Harrigan 1986; Contractor & Lorange 1988). It is necessary for a company to define its own motives for a JV, but it is also necessary to understand the JV partner’s motives. Having mutual goals between the JV partners is one of the most important factors, when forming a Sino-Finnish JV (Entrepreneur3; Director of Innovation; Consultant1; Lawyer; Entrepreneur2). A JV should be treated as a true partnership, where decisions are made together with the partner (Consultant1):

*“Most relevant for the success of a joint venture is that the joint venture is established around common goals and also around what each partner really understands.”* (Consultant1)

As an example of complementary motives, the combination of China’s large market potential and Finnish technology can act as complementary motives between partners in a Sino-Finnish JV (CEO). Moreover, a JV should be established not only around mutual or complementary goals, but around a mutual win-win situation for each partner. The partners need to make an effort to understand the outcomes of the JV from the perspec-

tive of each partner and aim towards a beneficial JV for both, rather than only considering individual benefits:

*“Can we find a mutual business case that benefits the both parties? How Chinese should solve the mutual win-win and what does it mean in practice. There can be many elements that are not necessarily economical but also other factors. It should be understood from both Finnish perspective and that Chinese perspective.”* (Consultant2)

It is important that companies identify and clarify their motives for establishing a Sino-Finnish JV in China. The companies need to allocate enough time to truly understand each other’s motives and goals prior to making any decisions about the establishment of a JV in China (Lawyer). It could be costly to terminate the JV later, because the partners realize that there are no mutual or complementary motives between the partners.

Table 10 summarizes the interview findings on the motives for forming a Sino-Finnish JV in China. Table 10 is based on table 4 that presented the previous literature findings on JV motives. The new findings that arose from the interviews are written in italicized text.

**Table 10 Main motives for forming Sino-Finnish joint ventures in China**

Motives for Finnish software companies	Motives for Chinese companies
<ul style="list-style-type: none"> <li>• Large market size and vast market opportunities</li> <li>• <i>Lack of experience or skills in the Chinese market</i> → Partner’s skills and attributes</li> <li>• <i>Little resources to enter China on their own</i></li> <li>• Chinese government incentives and encouragement</li> </ul>	<ul style="list-style-type: none"> <li>• New market position in China</li> <li>• Technology exchange and access to new technology</li> <li>• Access to managerial competences</li> <li>• Access to intangible assets</li> <li>• International expansion/ access to international market</li> </ul>

As illustrated in table 10 the main motives for Finnish software firms include seeking for new opportunities in China’s vast market. If Finnish companies have a lack of skills or resources to enter into the Chinese market, establishing a JV with a Chinese company can be a good option for them. For Chinese companies one of the main motives is technology acquisition, but there are less and less opportunities for Finnish software companies as China’s technological capabilities are developing quickly. The Chinese compa-

nies seek Finnish JV partners in order to develop a new market position in China and to expand their business internationally through the international networks of the Finnish company. Building a JV around mutual goals is important and it should also be one of the main factors in selecting a JV partner in China.

## 5.2 Partner selection for Sino-Finnish joint ventures in China

Selecting a suitable JV partner can be very challenging and time-consuming in China (Lawyer). One of the most important factors in the JV partner selection is to find a JV partner with similar or complementary goals. Mutual and complementary motives do not guarantee a successful JV, but it gives a good foundation for the operation of the JV. There does not exist a right or wrong way to find and select a JV partner in China. Often the JV partner is found through an existing network of the Finnish company. Another usual way to find a JV partner is, when two long-term business partners decide to strengthen their cooperation by establishing a JV (Director of Innovation; Lawyer). Existing networks should be carefully considered, when beginning a seeking for JV partners. Existing network can be only utilized, when the Finnish company has existing business in China or with Chinese companies.

Generally, the JV partner should be selected out of many potential partners. A Finnish software company should not choose the first potential partner, but to make the selection out of many potential partners (Consultant1):

*“It should be so that we find several partners to the table and drop them, when someone says crazy things to us. It is not reasonable to get together with the first. But to look out of a bigger group with whom we really want to be.”* (Consultant1)

A key to selecting the most suitable JV partner out of many potential partners is to gather information (Entrepreneur3; Consultant1). Information about the potential partners can be gathered via official authorities such as government or via consulting and auditing firms. In addition, “quiet” information such as rumors about the potential partner companies is relevant for the decision making (Consultant1). The gathered information and rumors should be used to support the partner selection. One interviewee suggested that Finnish companies should do a track record about the potential JV partners (Entrepreneur3). The track record of the potential JV partners can reveal about their corporate culture and also about their trustworthiness. The Finnish company can understand about the corporate culture of a potential Chinese JV partner better via learning how the top management leads a company. The JV partners’ trustworthiness can be



measured via a track record; it can reveal how the Chinese company has treated their customers earlier. For instance, if the Chinese company has been reliable towards their customers, presumably they will be reliable in future.

There are many factors to take into consideration, when selecting a JV partner in China. Location is one of the key factors in the JV partner selection in China (Ambler & Witzel 2000, 120). China is a large continent that varies not only culturally and linguistically from one province to another, but also from industry to another via government legislation and encouragements. One interviewee points out the Chinese company's business skills, network and scope of power varies by its location in China. Thus, it is important to investigate, which location is the most suitable for one's business scope. As an example, the business skills of a Chinese company can be limited to a certain area or a city in China; if a Chinese company knows how to do business in Beijing, it may not know how to do business in Shanghai (Consultant1):

*“If we have selected the partner well, the partner can scale us quickly, for example, in some city or province into a new direction. And on the other hand, if we choose the partner well, it can take us to an important position within whole China level. We have to consider or at least accept that China is a continent. And if someone can operate in Beijing, it does not mean that it can operate in Shanghai or vice versa.”* (Consultant1)

In addition to the business skills, the scope of power and the network of the Chinese JV partner, other issues vary with the location, such as the availability of the skilled labor, the customer reach and the industry specific requirements (Consultant 2):

*“...depending on what you are doing; do you have software or production. One factor is skilled labor that is accessible in different ways in different locations. And another factor is customers in some areas. Very many factors need to be considered, where you should even theoretically search for partners.”* (Consultant2)

Luo (1998, 146-148) suggests that local partner attributes, including strategic, organizational and financial attributes, contribute to the success of the JV. The interview findings indicate that the strategic attributes are important for the Finnish companies. The strategic attributes of the local Chinese partner influence the operational skills and resources needed for the JV's competitive success. The interviewees point out that becoming familiar with the Chinese partner's skills is important (Consultant1; Lawyer). The Finnish company should find out the skills that the partner in reality has and define those skills that the local Chinese partner should have (Consultant1):

*“If you have selected the partner well after that everything becomes much simpler. Then we know we are with the right people and we know what they can do and we know what they can’t do. And when we actually establish the joint venture we know the kind of things we should focus on with the Chinese.”* (Consultant1)

The organizational attributes of the local Chinese JV partner influence the efficiency and effectiveness of inter-firm cooperation. One interviewee point out that trust and dedication are important in Sino-Finnish JVs (Operating manager). The Finnish companies should select a JV partner that they can trust and who is dedicated to the JV. The Finnish company should not blindly choose a partner, but to find one, who they can trust and who is dedicated to the mutual goals. Another important organizational attribute is relationship building skills. Existing network and relationships of the local Chinese partner is beneficial for a Sino-Finnish JV in China (Entrepreneur3; Lawyer). However, the Finnish firms should be critical not to overestimate the partner’s network (Entrepreneur3):

*“...if a company or a partner says that they know some politician, or some official, who can arrange all. There is a lot of talk that should be treated with caution. Some of the claims may not be reliable. A partnership should not be built only based on talk or claims.”* (Entrepreneur3)

The JV partner selection from the perspective of a Finnish company is not only about creating partner selection criteria and based on the criteria, selecting the most suitable partner. The Finnish companies need to dedicate a lot of time and effort to create a good first image to the Chinese party in the partnership establishment phase. A good first image can help in developing trust with the Chinese partner (Entrepreneur3):

*“That first image is perhaps the most critical. So Chinese generally keep Europeans quite lazy, as ones that don’t work much nowadays. And then you can distinguish yourself from others and get the partner enthusiastic that you are truly working.”* (Entrepreneur3)

Overall, it is challenging to find a right partner for a JV in China. The JV partner should be selected out of many potential partners; therefore, finding the most suitable partner can take a long time. Gathering information about the potential JV partners is important. It should also be considered whether it is necessary to select a JV partner or could the partnership begin with a simple contract and once the trust and relationship is

built an actual JV can be established. The interview findings show that creating a selection criteria and considering the local partner's attributes are important in selecting a JV partner in China. In addition, the different factors that can influence the partner selection are also important to consider. The interviewees pointed out several factors that are important for Finnish companies to consider, when selecting a JV partner in China. The partner selection should be based on the location, skills, dedication and network of the Chinese partner.

### 5.3 Choice of a joint venture type in China

The choice of a JV type varies case by case. Currently, EJVs are a more popular JV type than CJVs in China (figure 2). The main difference between EJVs and CJVs is on how the equity is shared among the JV partners. In EJV, the foreign partner must have at least 25 % of the equity. In CJVs, the partners decide the share of equity within a contract. EJV is considered an easier JV type in terms of splitting profits and CJVs have advantages as long as the contract is made carefully (Lawyer). The interviewees did not have opinions on which JV type is better for Finnish software firms, but the interviewees gave an insight on what kind of aspects should a Finnish firm consider, when choosing a JV type. Generally, the choice of JV type depends on different products and different businesses (CEO). In addition, the relationship between the potential JV partners influences the choice of JV type (Director of Innovation).

One of the most critical issues in choosing the JV type is to define, who takes the majority of the JV shares (Entrepreneur2). The Chinese partner often wants to take the majority of the shares of the JV, which can be problematic from the perspective of a Finnish company (Entrepreneur3). When defining the ownership of the JV, it is essential that each JV partner company considers their readiness and capabilities for the JV and also the risks that can arise. The ownership of a JV means that the company is committed to the JV. Thus, more ownership of the JV requires more commitment to the JV (Consultant2):

*“If the starting point is such that, for example today a JV is established and it is owned fifty-fifty. So you are a share owner and you are committed to the JV. If there is a need that capital needs to be bought to ten times, is there capability and readiness to be part of it. You have half of the shares. You are responsible for half of it.” (Consultant2)*

The equity ratio among the JV partners is a critical decision to make, when choosing a JV type. One interviewee suggests that the equity ratio should be based on what kind

of skills each partner can bring into the JV (Consultant1). As an example, one of the JV partners could have stronger management skills and the other could have stronger technological skills. One of the partners could also have the all of the skills required for the JV. One of the interviewees also points out that the dominance of each partner influences on the equity ratio between the JV partners (CEO):

*“...if the Finnish company are in dominant position, they must be can chose the majority of the share, vice versa, if the Chinese company are in the dominant position, they must like handle this company by themselves.” (CEO)*

The dominance in a JV can be defined by the resources of the JV partners. As an example, if the local Chinese JV partner is a large company with a lot of resources and the Finnish JV partner is an SME with little resources, the Chinese JV would likely have dominance over the JV. The interview findings indicate that giving control over the JV to the Chinese partner is a good idea, because the Chinese company has more knowledge to determine what is best for a JV that operates in China (Consultant2). It may feel problematic for the Finnish company to give the control over to the Chinese company, but the local knowledge is important in creating the best decisions towards the operations of the JV in China. Good planning and creating common guidelines are necessary to make this work.

When discussing about the choice of a JV type, a few interviewees pointed out a variable interest entity (VIE) as an option to enter into the Chinese market (Consultant2; Entrepreneur3). VIE allows the foreign companies to establish a JV and its ownership into Hong Kong and do business in mainland China. Hong Kong is seen as an easier location in terms of legal and business environment to establish a JV. Via the VIE in Hong Kong, a WFOE can be established into mainland China. VIE is also a very common structure among foreign companies entering into the Chinese market.

The choice of a JV types depends on many factors, such as skills, resources and dominance of the partners. These factors should be carefully considered. The Finnish company should evaluate their own and the local Chinese JV partner's skills, commitment and dedication to the JV. The share of the equity ratio should be based on an analysis and evaluation of the partners capabilities.

## 5.4 Negotiations for Sino-Finnish joint ventures in China

Negotiating with the Chinese can be described as a flow rather than as a process. The Sino-Finnish JV negotiations in China takes a long time and there will be many challenges.

*“There are no steps in my opinion. It is kind of, it is like a 1000m hurdling; there are obstacles, which cannot be anticipated beforehand other than they exist. And basically it is more like a, it is not a process, but it is a flow, that needs to reach a goal.”* (Entrepreneur3)

Culture is one of the main challenges in the Sino-Western negotiations (EU SME Centre 2013b, 1-2). A Finnish company benefits from having a good understanding of the Chinese culture and how it can impact on the Sino-Finnish JV negotiations.

*“If you have found a good partner and if you have good intentions and the partner has good intentions and both have the same state of desires, it will anyways not be easy, because you come from different backgrounds. Therefore, if we look at best practices; they are different in Europe compared to China.”* (Consultant2)

Chinese people are very pragmatic and they tend to look at things in a shorter timeframe compared to Europe. One of the interviewees pointed out that Chinese deal very practically with a JV investment and they want to see revenue fairly quickly (Entrepreneur3). The main purpose of a JV is making profit, no matter from where the companies are from. However, the timeframe for gaining profit in China is faster than the Europeans are used to (Entrepreneur3). The Finnish companies should create a similar mindset with the Chinese about making profit. The Chinese companies have different mindset about other issues too. As an example, one interviewee told that a Chinese company can propose establishing a JV fairly quickly to the foreign company. In reality, they may not mean anything concrete with the proposal, but to show their initial interest in getting to know the counterparty (Entrepreneur3).

The Chinese business environment is continuously changing. Because of the continuous changes, the Sino-Finnish JV negotiations tend to be volatile to changes too (Operating Manager). Meetings tend to be organized with a shorter notice in China compared to Finland. The Finnish companies should be prepared that anything can change during the negotiations with the Chinese. It was suggested by one interviewee that Finnish companies should allocate someone during the entire JV negotiations phase in China, in order to be flexible enough for the continuous changes (Entrepreneur3):

*“In my opinion, an old Chinese saying describes JV establishment very well, which is: “In China nothing is easy, everything is difficult, but everything is possible”. It is a good guideline that mentally you should often get used to a thought that there is always something that will change. Always there is something that will be difficult, but everything is negotiable usually.” (Entrepreneur3)*

Another challenge in negotiating with the Chinese is relationship building (EU SME Centre 2013b, 1-2). Negotiations in China are more about having a good personal relationship than they are about formality (Director of Innovation). Thus, building a good relationship with a Chinese company is very important during the JV negotiations. One interviewee concludes that the Chinese negotiating party often will not have the decision maker in the table. Nevertheless, it is important to make sure that the Chinese negotiating members have a good relationship with the actual decision-maker. It should be acknowledged that there is always a chance that the Chinese negotiator does not understand the foreign negotiators pursues or miscommunicates it with the decision-maker. (CEO.) It requires contributing a lot of time, including personal time for dinners and parties, to develop a good relationship with the Chinese company. The interview findings indicate that building a good relationship in China could take 7-8 years (Entrepreneur1). It does not mean that the Chinese businesses are not ready to begin co-operation with a Finnish company until they have built a relationship for 7 years, but it is good to denote that it generally takes a long time to build a good relationship with the Chinese.

The interview findings indicate that conducting industry and market research prior to the beginning of the negotiations is important. Conducting a prior research enables the Finnish companies to build an understanding of the industry characteristics and map out, where the business is positioned in the market (Consultant1). They can plan what their options are with the potential partner. Thus, they have some negotiating power. Without knowing one's options in a market, there is not much negotiating space left. Moreover, creating goals or aims will make it easier during the negotiation process, to understand, for instance, when it is and when it is not a good timing to give concessions (Consultant1). When it comes to price and money, a best price for the Chinese does not necessarily mean the lowest, but it is based on the value of the technology. The Chinese companies are very interested on the quality of the technology of the foreign companies (Director of Innovation):

*“They are not like “not invented here”. They want to buy with a best possible price, the best possible technology. And with the best possible*

*price, it is meant the best price for them. The value can be that it is expensive. You don't have to decrease it.*" (Director of Innovation)

The Chinese perceive a contract as an agreement to begin a project rather than an end-all agreement in Western perspective (Melvin 1995, 22). The interview findings also indicate that the Chinese prefer a simpler contract compared to the Finnish (CEO; Operating Manager; Entrepreneur1). Chinese prefer simpler contracts, because negotiating is perceived as an on-going process. After the actual contract is signed, and the operations of the JV begin, the Chinese want to continue modifying the contract. The Finnish companies should acknowledge that the Chinese have a different perception about contracts and adapt their negotiating tactics accordingly.

*"And it's an ongoing process. It's not like Finnish mentality that you agree on a paper, you share pens. It's sometimes not settled even after it's negotiated on the table, but an on-going process that Finnish side has to adapt to changes."* (Operating Manager)

Another critical aspect in negotiating towards a Sino-Finnish JV in China is to deal with the JV as a partnership that creates mutual benefit and a win-win situation to each JV partner (Consultant1; Entrepreneur3). The importance of co-operation should not be underestimated. However, it needs to be acknowledged that although the JV partners have found mutual goals in the beginning of Sino-Finnish JV negotiations, it does not guarantee that the negotiating will be easy.

The negotiation process for a Sino-Finnish JV is often challenging and time consuming. The Finnish software companies need to take several issues into consideration during the Sino-Finnish JV negotiations. The cultural differences and continuous changes in the Chinese business environment influence the negotiations, which can be overcome by allocating the negotiating team during the negotiations in China. In order to know one's position in the industry and to gain negotiating power, the Finnish firm should conduct a thorough industry and market research prior to the negotiations. The Chinese tend to like simpler contracts compared to the Europeans, because the Chinese perceive negotiating a contract as a continuous process rather than end-all agreement.

## **5.5 The challenges in the formation phase of a Sino-Finnish joint venture in China**

This sub chapter will present the challenges concerning forming Sino-Finnish JVs and the software industry in China. One of the main challenges in forming a JV in China is

the commitment and dedication required for it to succeed. JV is often referred to as a marriage (Ott et al. 2014, 873). One of the interviewees highlighted that JV requires not only commitment, but also tolerance between the JV partners, just like in a marriage (Lawyer). It is a mistake to think that things automatically work in a similar way in China that they do in Finland. The JV laws and regulations in China have loosened, but establishing a JV in China is not simple.

The Chinese working culture is very different in comparison to Finland. Everything is not always planned carefully and things can happen with a shorter notice. It is more efficient to do build relationships and networks, if the Finnish companies allocate personnel in China. Having presence in China allows quick responses to the changing business environment (Entrepreneur1). A Finnish software company may not realize how much faster business is done in China. The growth targets of the Chinese companies may seem absurd and challenging to achieve for Finnish software firms. The Finnish companies should change their mindset towards the Chinese market and its characteristics. Understanding the demands of the Chinese business environment is essential in order to scale the business relatively. If the Finnish company has no prior understanding of the business environment and the demands of it, the JV can end up in failure. One interviewee pointed out that often the Western companies follow their local market's business model, when entering into the Chinese market. However, the Finnish companies should adapt their existing business model to the Chinese market (Entrepreneur1).

Software industry in China is growing and China's own technological capabilities have improved over the years (EU SME Centre 2013a, 3-4). Software industry is seen a very competitive industry. The industry can be very challenging to access for Finnish companies, because they have to compete with the local Chinese companies and the rest of the world too (Entrepreneur2):

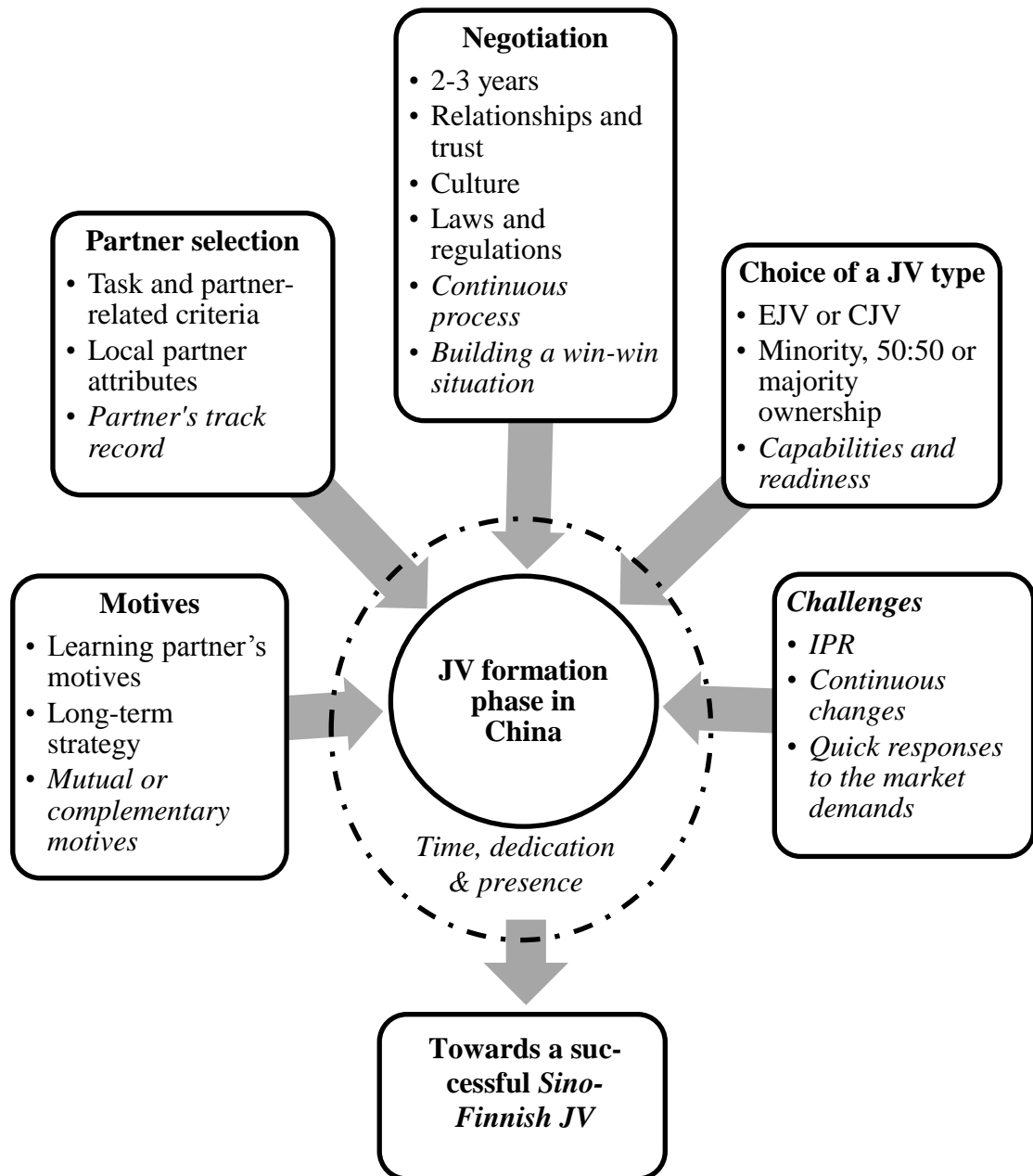
*“We have increased technology abilities in software industry, so actually there is less and less that we need from Finland. But Finland still has some advantages, for example, you have a very good educational system, and also an innovation system”* (Entrepreneur2)

The Finnish software companies have faced problems with the IPR in China (Touru 2009, 4). Protecting the software and technology is necessary from the early phases of the entry into China. Some interviewees highlight that the IPR in China has been improving over the past years in China (Consultant2; Entrepreneur3). The understanding of the Finnish firms about the IPR in China is still inadequate. The IPR is supervised increasingly in China. In China getting a copyright is a very cheap and quick process, but if the Finnish company does not do it, then someone else will do it. (Consultant2.)



## 5.6 Best practices for forming a Sino-Finnish joint venture in China

According to the theoretical and empirical findings, a framework to forming a Sino-Finnish JV in China is suggested based on the framework in sub chapter 3.4 (figure 13). The empirical research findings of this thesis are presented as italicized text in figure 13.



**Figure 13** Framework for forming a Sino-Finnish joint venture in China within software industry

As illustrated in figure 13, in addition to learning partner's motives and having motives based on long-term strategy, having mutual or complementary motives was found to be an essential part of the motives for Sino-Finnish JV in China. The partner selection criteria and local partner attributes are the key to selecting a suitable JV partner in China. Important to the partner selection is also to gather information about the potential JV partners, which can be done, for instance, via doing a track record. The literature review findings indicated that Sino-Western JV negotiations take many years and is influenced by many factors such as culture, relationship, trust, laws and regulations. The empirical findings indicate that the negotiation is a continuous process and one of the important factors in the JV negotiations is to build a mutual win-win situation between the JV partners. The choice of a JV type is usually made between the two main JV types in China, EJV and CJV. The empirical study findings indicate that one of the primary factors influencing the choice of a JV type is the capabilities and readiness of the partners. The challenges in forming a JV in China are added to the framework base on the empirical findings. The IPR legislation has been improving in China, but the knowledge of the Finnish companies on IPR is inadequate. The continuous changes in China's business environment can influence the JV formation process. The Finnish companies need to be aware of the business environment and be ready to adapt to the changes as well as to respond to the fast market demands of the Chinese market. Time, dedication and presence are added in the middle of the framework, because the interview findings show that forming a JV in China is time-consuming, China's business environment changes continuously and the business environment requirements are best responded by having presence in the market.

The framework presented the industry specific findings in the Sino-Finnish JV formation phase. The main purpose of this study was to create the best practices for forming a Sino-Finnish JV in China for Finnish software firms, which are presented in table 11.

**Table 11 The best practices in the formation phase of Sino-Finnish joint ventures for Finnish software companies**

1. Research IPR in in China and protect the software or any other IPs.
2. Be present in China and allocate enough time.
3. Conduct industry and market research, and learn about Chinese business environment.
4. Define own motives to enter the Chinese market via a JV.
5. Find several potential JV partners based on the market and industry research and own motives.
6. Gather information about the potential partners.
7. Select a JV partner with complementary goals and motives.
8. Negotiate with the JV partner aiming to create a business case with mutual win-win situation.
9. Choose a JV type that suits the motives and goals of the JV.

It needs to be acknowledged that establishing a JV in China is unique case by case depending on, for instance, the Finnish firm's level of experience in China. As shown in table 11, the first step for a Finnish software company is to learn about IPR in China and protect the company's software and technology. Being present in China and allocating enough time throughout the JV formation phase makes it easier for the Finnish company to respond to the continuous and fast changes in the Chinese business environment. The pace of doing business in China is quicker than companies are used to in Finland. Conducting a market and industry research is important to; for instance, learn about one's position in the industry. The research is also important for defining motives for entering China's market via a JV. The clearer the motives are in the beginning of the JV formation, the better the chances for its success are. Ideally, the JV partner should be selected out of many potential partners. To select the most suitable partner, information about the partners should be gathered via different sources, such as government and consulting companies. Once the potential partner or partners are selected, and mutual goals have been established for a JV, the JV negotiations can begin. The negotiations should aim to building a business case, where the JV partners have an understanding of each other's goals and the partners can thrive towards a mutual win-win situation. A JV type should be chosen, that suits the motives of the JV partners and the mutual goals of the JV.

## 6 CONCLUSION

### 6.1 Theoretical contribution

China's market is full of opportunities for Western companies. Since 1979, China has been opening up its economy to foreign investment and currently it is the largest host country FDI in the world. China's government encourages certain industries, such as software industry, by different means. There are many opportunities in China's software market for Finnish companies. Finnish companies can enter into China's market by different modes. The most common FDI entry mode is WFOE, which is entirely owned by the foreign firm and has limited liability. WFOEs became a more popular FDI mode than JV, once the legislation towards establishing WFOEs was loosened in China. Today, JVs remain as the second popular FDI mode into China. JV is a company owned partially by a foreign company and partially by a Chinese company. JV can be chosen as a FDI mode due to many reasons, such as the risks and resources can be shared between two or more companies. Generally, JVs are seen a challenging entry mode because of the high failure rates, due to too little preparation or understanding about the mutual business. The formation phase is important in developing a good foundation for the operations of the JV. Thus, the main objective of this study was to analyze the Sino-Finnish JV formation phase within the software industry.

In this study the JV formation phase is outlined as the motives, the JV partner selection, the choice of a JV type and the negotiations for a JV. The motives for a JV vary between companies and some are industry specific. Selecting a suitable partner can take a long time. In China, there are different JV types, EJVs and CJVs, and the choice of a JV type depends on various considerations. During the negotiations, the potential JV partners define the frames for the mutual business. According to the traditional JV literature, the main motives for companies to establish a JV include reduction of risks, creation of synergy and exchange of skills or technology (Killing 1983; Harrigan 1986; Contractor & Lorange 1988). This was the result obtained in this study as well. Western companies are motivated to establish a JV in China due to the market opportunities (Kirby & Kaiser 2003, 232-233). In addition, they choose JV over WFOE due to lack of knowledge or experience in China's market (Wei et al. 2005, 1504). The findings are in line with the previous studies. The main motives for the Finnish software companies to establish a JV with a Chinese partner include lack skills or experience in China's market. The Chinese companies are motivated to establish a JV with a Western firm in order to expand internationally and gain new technology or skills (Dong & Glaister 2006, 596; Geert et al. 2007, 18-21). The findings of this study also suggest that Chinese companies are interested to establish a JV with Finnish software firms, because they

want to gain the newest technology or benefit from the existing international markets of the Finnish firm.

According to the previous literature, foreign parent firms must identify appropriate criteria for local JV partner selection as well as the relative importance of each criterion. A partner's strategic attributes influence the operational skills and resources needed for the JV's competitive success. Organizational attributes affect the efficiency and effectiveness of inter-firm cooperation. Financial attributes impact the optimization of the capital structure and cash flow. (Luo 1998, 146-148.) The findings indicate that Finnish firms should put emphasis on the local partner's strategic attributes such as the partner's skills and the organizational attributes, such as the trust and dedication of the JV partner. The findings show no evidence on the importance of the financial attributes of the JV partner. Furthermore, there are many factors that impact the JV partner selection in China. Ambler and Witzel (2000, 120) defined five key factors that impact the JV partner selection in China: 1) technical expertise; 2) facilities; 3) location; 4) relationships; 5) partner goals. The findings are in accordance with the previous literature. According to the literature, complementary goals and motives is one of the key aspects in Sino-Western JV partner selection (Hitt et al. 2000, 462; Kirby & Kaiser 2003, 229; Si & Bruton 2005, 1471; Dong & Glaister 2006, 598). This was the result obtained in this study as well. In addition to the complementary or mutual motives, the findings indicate that the Sino-Finnish JV should be built around a mutual win-win situation between the partners.

In China, EJVs and CJVs are the most popular JV types. In EJVs the foreign partner need have at least 25% share of the equity. In CJVs the equity ratio is defined by the JV partners. (Dezan Shira & Associates 2012, 8.) Definition of the equity relationship between the JV partners is important, because it has an impact on the issues such as the ownership and the daily operations of the JV (Büchel et al. 1998, 17-22). This study found the factors that impact on the decision about the equity relationship. These include the skills of the partners, what each partner can bring to the JV and the dominance of the partners. The negotiations are considered as a continuous process in China rather than as a means to an end from the Western perspective (Shapiro et al. 1991, 225). In addition, the negotiations are time-consuming in China (Davidson 1987, 78; Nair & Stafford 1998, 141). The findings of this study indicate that Finnish firms should adjust their mindset towards the Chinese perception of negotiations and a contract, and they should take into consideration that the negotiations can take a long time.

## 6.2 Managerial implications

Nowadays and in the past, many Western companies are driven by the high economic growth and large market in China to seek opportunities to enter the Chinese market. The JVs have been a popular entry mode into China for many decades, but establishing a JV in China continues to be challenging (Das & Teng 2000, 77). This study indicates several factors for the managers of Finnish software companies to establish a JV in China. When establishing a Sino-Finnish JV in China, it is essential to define own motives to establishing a JV in China. JV is often established, because of reducing risks, finding synergies and sharing technology between the JV partners. Sometimes establishing a JV is a way to leverage the relationship between existing partners. For Finnish software firms the Chinese market offers many opportunities due to the large market size and incentives provided by the Chinese government. It is essential not to only define own motives, but to also understand the motives of the JV partner. Having complementary or mutual motives can provide a good basis for the success of the JV.

Furthermore, it is useful for Finnish companies to allocate personnel in China, when they begin to search for a potential JV partner. A key to finding potential JV partners in China is to build relationships and a network of connections that is called Guanxi. The relationship building process takes a much longer time than it does in Finland. The Finnish companies need to allocate time to network and meet with different people on different social occasions. The Finnish firm should not to rush into establishing a JV with the first potential partner, but they should gather information concerning potential JV partners and make the selection based on the information.

To conclude, the JV formation phase provides a foundation for the operations of the JV. If the formation phase is successful, there are better chances for the success of the JV. Nevertheless the findings do not suggest that a successful formation phase automatically leads to a successful JV. The Chinese software industry is growing and has many opportunities for Finnish software companies. JV is one possible entry mode into the Chinese software market for the Finnish software companies. All the different entry modes should be researched in order to justify that a JV is the most suitable entry mode. The Finnish software companies should begin their market entry into China by building an understanding of the software market and its characteristics in China. They should aim to find a JV partner with complementary motives and skills. The findings of this study act as a guideline for Finnish software companies and their managers in establishing a JV with a local Chinese partner in China. In addition, the Chinese companies can gain insight into the motives of the Finnish software companies to enter into China's market.

### **6.3 Limitations and suggestions for future research**

This study has limitations in the research scope. The thesis attempted to map the best practices for forming a Sino-Finnish JV in China for the Finnish software companies. The thesis focused on the four themes within the formation phase that emerged from the previous literature. Considering the time limitations of the study, the analysis of the results could have been broader, if the research scope was narrowed down to one or two themes in the formation phase.

The empirical data of this thesis was collected via expert interviews. In future research, it could be interesting to explore one or two cases of Finnish software companies entering into China via a JV. This could add a more detailed understanding of the different factors impacting on the JV formation phase. The advantages and disadvantages of a JV as an entry mode for Finnish software companies is another interesting topic for future research. In addition, as JVs are only one of the possible entry modes for Finnish software companies into China, future research is needed to make a comparison of the different market entry modes into China.

Finally, a study investigating outward FDI from China into Finland would be very interesting in future. Outward FDI (OFDI) from China into Europe has increased over the past years (Euro-China Investment Report 2013-2014). Currently, the investments from Finland into China are over 10 billion euros and investment from China into Finland is approximately 100 million euros. Thus, the difference in the investments between the two countries is significant. It would be interesting to study the opportunities and challenges of the Chinese OFDI into Finland.

## 7 SUMMARY

When China opened up its economy to foreign investment in 1979, JVs were the only FDI type that was allowed by the Chinese government. Since the 1990s, Sino-Western JVs have been extensively studied in previous research (e.g. Woodward & Liu 1993; Luo 1998, 2001, 2002; Vihakara 2006; Wang 2007; Ott et al. 2014). Establishing an IJV is not an easy task. IJVs have high rates of failure and instability (Davidson 1987, 77) due to the many challenges they face. JVs are often referred to as a marriage (Ott et al. 2014, 873): they require commitment, trust and good understanding from all parties. Many factors have an impact on the success of a JV. Establishing a good foundation for the JV is important for its success (Hoffman & Schlosser 2001, 376; Wang 2007, 174). This thesis chose to find the best practices in the Sino-Finnish JV formation phase for Finnish software companies. Based on the previous literature four themes were found to be essential within the formation phase: the motives for the JV, the JV partner selection, the choice of the JV type and the negotiations.

Moreover, the purpose of the research was to examine the formation phase of a Sino-Finnish JV in China to develop best practices for the Finnish software companies. The main research question ‘*What are the best practices for forming Sino-Finnish joint ventures in China for Finnish software firms?*’ was answered through the following sub questions:

1. What are the main motives for forming a Sino-Finnish joint venture in China within the software industry?
2. How do the Finnish software firms select a joint venture partner in China?
3. How do the Finnish software firms choose a joint venture type in China?
4. What are negotiations for a Sino-Finnish joint venture like?

The sub questions of this study were created to understand the four important themes within the JV formation phase. The questions were directed to examine the Sino-Finnish and the software industry context.

This qualitative research was conducted by interviewing nine Chinese and Finnish experts on Sino-Finnish JVs in China. The interviewees were entrepreneurs, consultants, a lawyer and China specialists from public and private companies. All the interviewees had recent knowledge and experience on establishing Sino-Finnish JVs in within the software or technology industry. The data was gathered through semi-structured interviews that allowed the interviewees to discuss openly about their personal opinions. All of the interviews were recorded and transcribed. The results were categorized and interpreted by using thematic analysis.

The findings reveal the best practices for the Sino-Finnish JV formation phase for Finnish software companies. It should be acknowledged that forming a JV is unique case by case depending on, for instance, the Finnish firm’s level of experience in China.



The formation phase should begin by a careful industry and market research in China. The findings indicate that the main motives for the Finnish software companies to enter into the Chinese market via a JV are China's vast market opportunities, favorable legislation towards the software industry, little experience and lack of skills and resources in China's market. The main motives for the Chinese companies, to establish a JV with a Finnish software company, are to acquire the newest technology and to expand internationally. The findings indicate that having mutual or complementary motives between the JV partners is important. The JV partner should be selected out of many potential partners and it is important to gather information about the potential partners in order to select the most suitable partner. The Finnish companies should seek a JV partner with complementary motives and skills. The JV should be built around a common win-win situation.

According to the findings the most relevant concern in choosing the JV type in China is the share of equity ratio between the JV partners. In EJVs the foreign partner should have at least 25% share of equity. In CJVs the equity ratio is defined by the JV partners. The factors impacting on the equity ratio include the skills of the partners, what each partner can bring to the JV and the dominance of the partners. The choice of the JV type should be a result of a careful consideration of the skills and resources of each partner. Moreover, the findings indicate that the Chinese cultural characteristics, continuous changes in the Chinese business environment and laws and regulations have an influence on the JV negotiations. Negotiation is perceived as a continuous process rather than end-all agreement in China. Developing personal relationship with the Chinese JV partner is essential to build trust.

This study contributes to the existing research on Sino-Western JVs with its focus on the formation phase and its context in the software industry. The previous studies focusing on the formation phase in Sino-Western JVs are few. The study created best practices and a framework for forming Sino-Finnish JVs. Moreover, the software industry has not been the interest of the previous Sino-Western JV studies. The study findings revealed the unique characteristics of the software industry in China.

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## **APPENDICES**

### **Appendix 1 Interview questions in English**

#### **Opening questions**

1. Tell me something about your background.

#### **Joint venture formation**

2. Can you describe the joint venture formation phase in China (before start of operations of JV)? These concepts can be used as guidance:
  - a. Motives
  - b. Partner selection
  - c. Choice of joint venture type
  - d. Negotiation / Contract
3. What are the typical motives behind Sino-Finnish joint venture?
4. How is the joint venture partner chosen? Is there a criterion that firms can use in selecting the partner? If yes, can you describe it?
5. How is the type of joint venture chosen? (EJV or CJV)
6. What is the negotiation process like? What are the most important/critical things that need to be negotiated? Should there be any written documents/contracts made?

#### **Joint venture success in China**

7. How would you define the success of a joint venture in China?

#### **Critical success factors in formation stage of joint venture**

8. How do the different activities in partnership formation stage contribute to the success of a Sino-Finnish joint venture?

#### **Closing questions**

9. Is there anything else that we have not discussed that you think is important?

## **Appendix 2 Interview questions in Finnish**

### **Alustavat kysymykset**

1. Kerro jotain omasta taustastasi.

### **Yhteistyön muodostaminen**

2. Voitko kuvailla yhteisyrityksen yhteistyön muodostamisen eri vaiheet (ennen yhteisyrityksen toiminnan aloittamista)? Näitä konsepteja voidaan hyödyntää ohjeistuksena:
  - a. motiivit
  - b. kumppanin valinta
  - c. yritysmuodon valinta, JV muodon valinta
  - d. neuvottelu / sopimus
3. Mitkä ovat yhteisyrityksen perustamisen motiivit Kiinaan?
4. Miten kumppani valitaan? Käytetäänkö kumppanin valinnassa jotain kriteerejä? Jos käytetään, millaisia?
5. Miten investointimuoto valitaan? (Kiinassa on nykyisin 5 erilaista FDI muotoa, mutta riippuen JV:n perustamisen ajankohdasta tämä saattaa olla eri) Miten yhteisyrityksen muoto valitaan? (EJV vai CJV)
6. Millainen neuvotteluprosessi on? Onko neuvotteluissa avainkysymyksiä? Tehdäänkö kirjallisia dokumentteja/sopimuksia?

### **JV:n menestys Kiinassa**

7. Kuinka määrittäisit menestyneen yhteistyöyrityksen?

### **Menestystekijät JV:n muodostamisvaiheessa**

8. Miten yhteistyön muodostamisen eri vaiheet edesauttavat Kiinalais-Suomalaisen yhteisyrityksen menestymistä?

### **Lopetuskysymykset**

9. Onko vielä jotain mitä haluaisit lisätä, josta emme ole vielä keskustelleet?