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Institutional Differences and Arbitration Mechanisms in International Joint Ventures

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Institutional Differences and Arbitration Mechanisms in International Joint Ventures

ABSTRACT

Research summary:

We theoretically and empirically study the effects of legal institutions on the inclusion of arbitration provisions in international joint venture (IJV) contracts. Legal institutions offer a public trilateral forum to handle inter-partner disputes. However, these institutions function differently across countries, which can impede IJV partners from resolving disputes effectively through court systems. Alternatively, partners can take advantage of private trilateral resolution mechanisms in the form of arbitration. We argue and demonstrate that differences among partners' home country legal institutions regarding the legal traditions, as well as the importance of procedures and costs imposed in these countries for enforcing contracts, increase the likelihood of choosing arbitration over litigation. We also compare results for partners' recourse to IJV boards as a private, bilateral means of addressing conflicts.

Managerial summary:

International joint ventures (IJVs) are powerful levers for market expansion and access to resources and capabilities. The risks of corrosive disputes caused by conflicting interests or misunderstandings among partners are nonetheless far from being negligible. Our study helps decision makers and managers increase their understanding of the options and remedies available for resolving disputes. We consider three mechanisms in particular: public courts, arbitration, and the board of directors. Findings show that considering the partners' home country legal environments but also the discrepancies between these environments is essential when it comes to giving preference to arbitration over public courts. Findings also suggest that decisions related to internal private ordering (i.e., relying on the JV board of directors) are driven by the exchange characteristics more than by institutional considerations.

Keywords: international joint venture; dispute resolution; arbitration provision; transaction cost economics; institutional and legal environment.

INTRODUCTION

National institutions critically influence the development of markets, the flow of investment, and the organization of economic exchanges in international contexts (e.g., Acemoglu, Johnson, & Mitton, 2009; Globerman & Shapiro, 2003). Firms operating in global markets have to consider the institutional settings carefully when making investments and securing commitments from counterparties because the costs of exchange depend not only on the transaction characteristics but also on the institutions of different countries (Coase, 1998; Williamson, 2000). Specifically, ideas originating in new institutional economics and its cognate theoretical tradition of transaction cost economics (TCE) suggest that legal institutions can help improve the efficiency of exchanges by supplying the general rules that combine with the transaction-specific rules formulated in the agreement to set expectations about the post-contractual behavior of exchange parties (Henisz & Williamson, 1999; North, 1990). Insofar as “the formal and informal rules of the game” vary across home countries, exchange parties may face risks arising from the absence of shared expectations, and the uncertainty about commitments induced by contractual terms (Gaur & Lu, 2007; Greif, 2005; McMillan & Woodruff, 1999). Parties may also remain uncertain about the competence and fairness of each other’s public legal institutions to support the efficient settlement of disagreements, and may have to devise private mechanisms for governing complex transactions.

International joint ventures (IJVs), one of the most complex and frequently employed vehicles of exchange in international business, bring partners to work together by an incomplete contract (Anderson & Dekker, 2004; Buckley & Casson, 1996; Contractor & Reuer, 2014). As highly specialized forms of exchange, they often involve partners hailing from different nations that do not share institutional backgrounds and holding disparate expectations about the rules

that guide each others' behavior during the partnership. A robust IJV governance design anticipates disputes arising from partners' divergent interests in the timespan in which the contract remains in force and accordingly provides a means to restore order (Williamson, 1985). A dispute settlement machinery that can assure efficiency and equity to all the transacting parties is therefore essential for complex exchanges such as IJVs (Williamson, 1979). When parties foresee impediments to the dispute resolution process by using the default option of public legal institutions (i.e., litigation in courts), they may craft specific bilateral and trilateral mechanisms to buttress the dispute resolution capacity of their agreement (Lin & Germain, 1998; Morris et al., 1998). In particular, these private mechanisms aim to foster credible commitment to contractual terms while preserving amicability and continuity of the relationship (Williamson, 1985). Accordingly, partners may consider the relative merits of agreeing to provisions relying upon trilateral private mechanisms in the form of arbitration *vis-à-vis* public legal institutions in the event they fail to address conflicts bilaterally. It is therefore remarkable that international studies on alliance governance have not devoted systematic empirical attention to the influence of institutional discrepancies of partners' home countries on the choice of arbitration as a means to settle possible disputes.

Arbitration offers the opportunity to engineer *ex ante* transparent, detailed, and commonly understood rules that enable IJV partners to achieve clarity about enforcement *ex post* as well as mitigate perceptions of unfairness (Bernstein, 2001; Bonn, 1972). It also serves as a means of circumventing slow, disorganized or corrupted public courts (Leeson, 2008). The decisions awarded by an arbitrator become enforceable internationally because they receive backing from multilateral treaties such as the 1958 New York Convention. By contractually committing to submit any conflict unresolved bilaterally to private trilateral adjudication, IJV

partners can take advantage of the facility to appoint mutually agreeable arbitrators and to adopt the procedural rules stipulated by an administrative arbitration group (e.g., American Arbitration Association), all the while still borrowing the support of public institutions for award enforcement (Pinkham & Peng, 2017). By selectively using such privately crafted rules and institutions to govern an exchange based on its attributes and anticipated exchange hazards, as the discriminating alignment hypothesis of TCE suggests (Williamson, 2000), IJV partners can gain dispute resolution efficiencies. Our study employs the theoretical framework of new institutional economics as developed by Williamson (2000) to examine the effects of legal institutions of partners' home countries on whether partners include arbitration provisions or not in IJV contracts for resolving potential disputes. New institutional economics suggest that the costs of economic exchange are often not negligible, and depend on the transaction characteristics as well as the institutions that support exchange in different national economies (Coase, 1998; Williamson, 2000). Building on the well-established differences that exist among legal institutions across the world (Djankov, La Porta, Lopez-de-Sinales, & Shleifer, 2003), we focus on the effects of particular characteristics of legal institutions that present specific concerns to partners for the resolution of potential disputes in IJVs. Because IJVs are both contractually defined as well as legally independent entities, we consider variation in the legal institutions of the parents along dimensions that potentially affect the uncertainty IJV partners face about how emergent disputes get resolved *ex post*. They include the law on the books governing commerce and investment activity as well as the practice of law through the court systems of the home countries of partners. These dimensions of national institutions jointly influence how parties adhere to contractual terms and therefore govern their IJVs.

More specifically, we argue that because legal institutions form the bedrock on which contracts are interpreted and enforced, asymmetries in their functioning in partners' native countries can indicate potential problems in relying on public courts when disputes arise. Therefore, we propose that differences in the legal systems of IJV partners' home countries, as well as disparities in the procedures and costs involved in enforcing contracts, drive a wedge between partners' expectations about how they can rely on legal institutions to secure fair and efficient dispute settlement and safeguard their investments. For testing our hypotheses, we used data collected by surveying managers of JVs established by Dutch companies. Regarding these IJVs, we obtained information about arbitration-related provisions, transactional characteristics, and governance mechanisms supporting such agreements.

Our study contributes in several ways to the international business (IB) literature and the alliance governance literature. We first enrich research on disputes and settlement of disputes in alliances by considering choices for public or private trilateral ordering for handling disputes that are not resolved bilaterally. Existing research has mostly focused on contractual and corporate ways of alleviating and resolving disputes (e.g., Barden, Steensma, & Lyles, 2005; Geringer & Hébert, 1989; Gong, Shenkar, Luo, & Nyaw, 2007; Luo, 2005; Mjoen & Tallman, 1997; Pesch & Bouncken, 2017). The scope of our study goes beyond these internal mechanisms and examines third-party ordering alternatives. Second, we study the institutional conditions under which IJV partners turn to private and trilateral ordering (i.e., arbitration) instead of public courts for dealing with bilaterally unresolved conflicts. Consistent with the notion of institutional borrowing (Pinkham & Peng, 2017) and the "discriminating alignment" precept forwarded by TCE, our findings show when transacting parties tend to opt for arbitration mechanisms as opposed to public institutions to support IJV governance. In particular, in line with our

theoretical arguments, findings suggest that because countries' institutional characteristics, and specifically divergences in them across partners' host countries, can raise the costs of IJV implementation and enforcement, they can affect the choice between arbitration and public courts. By implication, the results of our study also help understand how a broader set of international inter-firm exchanges can rely on private and trilateral alternatives to resolve disputes (Bensaou & Anderson, 1999; Li, Xie, Teo & Peng, 2010).

THEORY AND HYPOTHESES

Background Theory

Legal institutions. Legal institutions support the conditions necessary for voluntary exchange to take place by inducing agents to commit credibly to fulfilling contractual obligations. They define the laws and regulations that coordinate the behavior of transacting parties, and they prevent the occurrence of contractual breaches by determining and implementing legal sanctions (Williamson, 1979). These institutions effectively help determine the costs transacting parties bear for not adhering to the terms of the contract, and they represent public ordering mechanisms authorized and administered by the state (Hadfield, 2005). Accordingly, legal institutions enable public ordering through two complementary mechanisms: (1) the contract law, which defines the rules of commercial engagement and enables accurate interpretation of the contract to approximate parties' *ex ante* intentions; and (2) the court system, which adjudicates on disputes related to the contract and implements appropriate remedies. We build on the notion Williamson puts forth that institutional environments are defined by the formal rules of the game and that it is a first-order concern for understanding how resources are allocated and utilized in an economy (Williamson, 2000). Williamson (1979) posits that exchanges based on incomplete contracts only occur when transacting parties share confidence in the functioning of the dispute settlement

machinery provided by the court system. While parties that belong to the same institutional environment are less likely to possess divergent beliefs about the functioning of institutional mechanisms that settle disputes, the same may not hold in an IJV context given the different international backgrounds of the partners involved and their relatively limited knowledge about the other partners' legal institutions. As we will discuss, these institutions are therefore anticipated to cast a shadow on the design of governance mechanisms in IJVs and other forms of international exchange.

The extent to which national and legal institutions can support and enforce contracts is not perfect. They are often constrained by many factors that make enforcement costly and render contracts partly ineffective. Courts can enforce order efficiently when they can verify information related to the transaction, ascertain the degree to which disputing parties have taken actions that align with contractual terms, and allocate the responsibility for any performance shortfalls (Greif, 2005; Williamson, 1985). Lacking a credible way to access and validate information material to the adjudication of a dispute, courts may find it difficult to make such judgments, particularly in the case of complex transactions such as IJVs. Contract enforcement by courts may also be hindered by the inefficiencies in the organization of the court system or by the misaligned incentives of the personnel staffing the courts to implement the law (Leeson, 2008; McMillan & Woodruff, 2000). Also, the geographic purview of courts is limited by the boundaries of the state, beyond which their jurisdiction and administrative capacity disappear. These limitations of public legal institutions imply that when contracting parties cannot form congruous expectations about the cost, speed, and efficacy of resolving disputes, they may prefer private means over public institutions to achieve enforcement.

Arbitration. Instead of relying on the public institutional infrastructure for enforcing contracts and handling disputes, exchange parties can agree on a set of private rules and procedures when drafting their original contract. Arbitration corresponds to a private dispute resolution mechanism in which parties have the opportunity to define *ex ante* the rules for examining contractual terms, the gamut of issues that require arbitral adjudication, the specific procedures that need to be followed, and the range of relief that can be awarded (Leeson, 2008; Stipanowich, 2001). In the event of a breakdown of bilateral mechanisms crafted in the contract, parties may proceed to arbitration by calling on a mutually agreed third party to intervene and settle the dispute. Following this procedure enables contracting parties to submit their dispute to an independent and neutral forum, typically one with expertise in the subject matter at the center of the dispute (Bernstein, 2001). The arbitrator serves to verify the facts and adjudicate on the dispute following the contractually agreed-upon set of transparent rules and procedures. Compared to public legal institutions, which are encumbered by the constraints of applying a general set of principles associated with the judicial process and its evidentiary standards (Hylton, 2005), expert arbitrators can reach a decision regarding a particular dispute based on the norms of fair commercial practice and trade custom (Bernstein, 1996; Domke, 1965). The expertise of the arbitrators places them in a better position compared to public judges in interpreting parties' intentions, and ascertaining the implied and presumed promises behind complex exchanges. Because of its flexibility, arbitration also compares favorably to public litigation in speed and economy (Bonn, 1972; Drahozal, 2008). These benefits largely stem from the decision of partners to legally commit to the final settlement made by arbitrators with the losing party having little leeway to appeal the arbitration award (Bonn, 1972).

Arbitration therefore offers several attractive features for exchange partners in international business as it enables them to circumvent the discrepancies among their respective legal institutional frameworks. Arbitration provisions allow parties to reduce the *ex ante* cognitive burden of imagining the possible set of contingencies and crafting mutually-agreed responses to them. Instead, parties can lighten this burden and reduce the associated costs by agreeing to adjust mutually to contingencies over time and rely on arbitration in the event of any unresolved differences. Arbitration indeed relies on a set of procedures which are independent of the legal institutions of any one of the parties' home countries. It allows them to select a neutral arbitration institution (e.g., International Court of Arbitration, American Arbitration Association), and partners also can choose arbitrators who are experts in both subject matter as well as judicial process, and who are renowned for their impartiality, integrity, and fairness (Sternlight & Resnik, 2005; Stipanowich & Lamare, 2014). It also provides IJV partners with more leeway to decide on the language and site of dispute resolution, the applicable laws that will govern their dispute, and the powers of the arbitral tribunal (Leeson, 2008).

Another key feature of arbitration that is valuable in cross-country settings is the support offered by the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (Dasgupta, 2003; Lew, 2009). Article IV of The NY Convention provides that member countries shall recognize foreign decisions as “binding and enforce them in accordance with the rules of procedure of the territory where the award relied upon.” The convention stipulates that the national courts will only review the arbitrator’s decision in situations when the arbitral agreement is invalid, when a transacting party did not have the opportunity to be heard, or when contractually agreed procedures have not been followed (Lew, 2009; Park, 1998). Opting for

arbitration therefore increases the chance of recognition and proper enforcement of the adjudication award by the national courts of IJV partners.

Dispute Resolution in IJVs. IJVs are separate legal entities established by two or more partners from different countries that share equity and pool resources to realize mutual gains. IJV partners negotiate a contract at the outset of their relationship, which serves as the basis for taking part in cooperative activities (see Schepker, Oh, Martynov, & Poppo (2013) for a review). The contract not only codifies the rights, responsibilities, contributions, and incentives of the partners but also specifies how partners bring order to the relationship (e.g., Luo, 2002). From a TCE perspective, despite partners' best attempts to specify the contract in as much detail as possible, gaps remain (Crocker & Reynolds, 1993) and disputes can arise when partners act in ways to gain at the expense of their counterparts (Williamson, 1985). To the extent that partners are farsighted and consider at the contracting stage potential exchange hazards and conflicts during the implementation of the joint venture, they may incorporate specific internal mechanisms through which conflicts can be addressed (Luo, 2002; Mohr & Speckman, 1994; Reuer, Klijn, & Lioukas, 2014). These steps taken at the contracting stage help forestall disputes that may emerge in implementing the IJV (Geringer & Hébert, 1989; Killing, 1983; Lyles & Salk, 1996).

Unlike domestic collaborations in which exchange partners belong to a common institutional environment, IJVs are formed in a cross-country context in which partners' post-contractual behaviors are shaped by the way legal institutions in their home country implement and enforce contracts (Baxter, 1985). The functioning of legal institutions in different countries is highly heterogeneous in how the law is defined in the books, as well as how it is practiced when enforcing contracts. Such discrepancies among legal institutions can influence how parties design dispute resolution mechanisms at the outset and more broadly the governance of their

international collaborations. Institutional environments of the home countries of the partners therefore cast a shadow on the design of IJV agreements in general (Luo, 2002). When the institutional environments of the IJV partners possess characteristics conducive for the development of common expectations and shared understanding of contractual terms, IJV partners can bring order by taking advantage of bilateral control or relational processes (Madhok, 1995). On the other hand, divergence in the institutional environments can escalate potential threats concerning partners' adherence to contractual terms as well as concerning the degree to which legal institutions can be relied upon to achieve enforcement. Accordingly, parties to an IJV contract are likely to consider the economic implications of choosing the institutional framework of one among the partners' home countries (Bhattacharya, Galpin, & Haslem, 2006; Spar, 2001).

When partners are unfamiliar with the functioning of each other's legal institutions, they may not find it practical to resort to litigation in a given country. This is so partly because of the pitfalls associated with navigating a foreign judicial process, and because of the potential for new disputes arising from an inaccurate understanding of and divergent expectations from legal institutions (Mistelis, 2004). Differences among national courts in their ways of approaching disputes set different expectations about the likely judgment about a dispute (Nunn, 2007; Oxley & Yeung, 2001). Furthermore, foreign court judgments typically require ratification by the local court system, and differences in legal institutions mean that the domestic courts may not ratify or may even overturn a judgment made abroad. Winning parties have to execute the judgment through a foreign country's court system with coercive power over the losing party (Dasgupta, 2003), a process made difficult and unpredictable in the absence of multilateral covenants governing the recognition and enforcement of foreign judgments (Paige, 2003; Roth, 2006).

Given these challenges that differences in legal institutions of partners' home countries generate, partners are more likely to turn to private ordering mechanisms such as arbitration for a fairer, quicker, and more efficient means of resolving disputes compared to public courts.

The decision to opt for private ordering through arbitration may be partly determined by relative efficiency considerations. When partners can respond to institutional constraints by structuring their IJV's governance appropriately, and by fortifying bilateral monitoring and control mechanisms, they can still operate efficiently under the shadow of the legal institutions of their home countries (Williamson, 1985). However, when the institutional circumstances make it costly to overcome these limitations, they may contemplate arbitration provisions to handle disputes (Drahozal & Hylton, 2003; Eisenberg & Miller, 2007; Hagedoorn & Heslen, 2007). The choice to include arbitration provisions in contracts can create some upfront costs associated with negotiating and agreeing on the procedures (Kolkey, 1988). Partners may also account for the opportunity costs associated with the limited scope for appeal in the case of arbitration (Brousseau, Chasserant & Coeurderoy, 2007; Drahozal, 2005). Indeed, the presumption of continuity is much stronger in the case of arbitration relative to litigation. Arbitrators, in contrast to the adversarial positions adopted by public judges, are more inclined to deliver compromising awards, which may not adequately safeguard against egregious forms of opportunistic behavior (Eisenberg & Miller, 2007; Williamson, 1985). All of these considerations are consistent with the discriminating alignment proposition that parties will selectively rely upon arbitration as a remedial mechanism based upon the relative efficiency considerations we have highlighted.

In what follows, we specify how the aforementioned merits of arbitration may lead partners to use this private ordering arrangement relative to public legal institutions for resolving

disputes. Given that IJVs are the creation of a contract entered into by legally-independent entities, we consider the heterogeneity of legal institutions among partners' home countries along the dimensions of the law on the books that defines the rules of commercial engagement, the functioning of courts that enforce the contract, and the strength of protections offered to investors. More specifically, we consider differences in the legal rules and quality of their enforcement that drive partners to consider the common set of rules and procedures that arbitration offers. Taken together, these characteristics of the legal institutions are likely to amplify the uncertainty that partners face at the negotiation stage about the how potential disputes are resolved ultimately via public institutions (we summarize these ideas in Figure 1).

Insert Figure 1 here

Research Hypotheses

Legal traditions. The traditions from which the legal infrastructures of partners' home countries emerge can influence partners' *ex ante* expectations about IJV dispute management in important ways. The origins of legal institutions affect the constitution of both substantive contract law as well as procedural law. The contemporary legal institutional structure of most countries traces its antecedents to either civil law (e.g., France, Spain) or common law (e.g., US, UK) traditions (Glaeser & Shleifer, 2002; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000; Litch, Goldschmidt, & Schwartz, 2005; Spamann, 2010). These two traditions have some important differences in the principles that recognize the establishment of a contract and bind the parties. For example, two features of contracts in the common law tradition which are not recognized by

the civil law tradition are the *doctrine of consideration* which determines the binding force of a contract, and the *doctrine of privity*, which determines the enforceability of the contract. The *doctrine of privity* is a common law principle which provides that a contract cannot confer rights or impose obligations upon any person who is not a party to the contract. Similarly, the principle of good faith in performing contractual obligations is central to the civil law tradition but is not universally recognized in the common law tradition (Pejovic, 2001). These differences in the substantive law and how it is interpreted may make it difficult for contracting parties from different home countries to develop common expectations and shared understanding about each other's behavior, and about the execution of the contract.

Legal institutions also differ in matters of procedural law, which can further widen the gap between partners from different legal traditions. The legal institutions of partners' home countries can have differences in the extent to which they are based on statutory law and settled precedents, the norms and standards of evidence, and the opportunity to seek superior review (Djankov et al., 2003). Because common law is bound by precedent, how similar disputes were resolved in the past has strong implications for how a court decides on the dispute in focus. By contrast, civil law is based on statute and code, and it is not uncommon for courts to arrive at dissimilar conclusions in similar cases. The two legal families also differ in the disclosure process for establishing evidence. The common law tradition tends to defend liberal discovery, according to which parties can look for evidence to support a claim after it has been filed (Elsing & Townsend, 2002; Rubinstein, 2004). Requests for specific documents in possession of the adverse party can be sweeping and extensive. Civil law jurisdictions rarely permit such discovery procedures, considering them as a violation of the expectations of confidentiality and privacy (Perlman & Nelson, 1983; Rubinstein, 2004). Given these differences in civil law and common

law traditions, IJV partners who belong to different traditions may have different expectations concerning the way possible disputes are likely to be addressed by intervention through legal institutions.

To mitigate these problems, partners may prefer to opt for the arbitral forum in their contract. Parties can incorporate their joint expectations about the arbitration process and dispute resolution in the contract (Franck, 2005). They can specify the institutional rules that arbitrators may follow when adjudicating on the contract, or may even articulate private rules particularly defined for the IJV contract. Unlike judges in public courts, who derive their adjudicative authority from the state, arbitrators derive their authority from the contract and are only bound by the rules that parties have chosen to apply to the contract. Arbitrators can dispense compromising legal formalities and apply substantive laws that best fit a particular case. They may also use their discretion to strike a balance in the level of detail when filing a statement of claim so that it is more elaborated for those partners accustomed to civil law and less detailed for partners that originate from countries that adopt common law. Such compromising practices aim to achieve a middle ground that is acceptable to both parties (Elsing & Twonsend, 2002). Arbitrators can also ask for and make use of information that may not be possible under the evidentiary standards employed in the legal traditions of the partners. Because arbitration allows parties to overcome problems associated with substantive and procedural law matters related to common law and civil law, we specify the following hypothesis:

Hypothesis 1: When the legal institutions of IJV partners' home countries belong to different legal traditions, the partners are more likely to include arbitration provisions in the contract.

Procedural Uncertainty. In the previous hypothesis, we focused on the content dimension of the legal institutional infrastructure as defined by the law on the books. We now turn to the practice dimension which is characterized by how court systems are organized in their support and maintenance of contracts between private parties. The legal institutional structure mandates the sequence of steps parties have to go through to resolve contractual disputes. The number of procedures that must be undertaken to enforce private contracts serves as a good indicator for assessing the procedural uncertainty of national legal systems (Nunn, 2007). These procedures may relate to the assignment of the case to a judge, mandatory mediation, the oral hearing or trial, and the court's notification of the parties that the written judgment is available in the courthouse (Djankov et al., 2003; Spamann, 2010). A large number of procedures increases the uncertainty of the process and makes it difficult for litigating parties to predict the outcome (Djankov et al., 2003). Each additional procedure demands interaction between the parties themselves, or between them and the judge or court officer, which opens the possibility of meeting new and emergent statutory as well as ad-hoc requirements of the legal institutional structure. These interactions exacerbate uncertainty that partners face about when and how the dispute will get resolved.

The procedural flexibility of arbitration enables partners to circumvent challenges posed by extensive litigation-related procedures that are found in some legal environments. Arbitration affords IJV partners the freedom to define the contours of the dispute resolution process (Stevenson, 1979). The process of administering dispute resolution is based on the agreement between the parties. The arbitrator, who is appointed by the parties, is in a better position than court-driven procedures to achieve the required degree of coordination and to secure the necessary evidence. The arbitrator together with the parties can agree on the applicable

procedures to follow to fairly and efficiently resolve the dispute. The ability to choose an arbitrator with the required procedural expertise can also help the parties avoid procedural issues emanating from the lack of adequate human capital in the legal institutional infrastructure (Hadfield, 2005). Because arbitration procedures are independent of the state, and arbitrators have long-term incentives due to reputational considerations to act in a fair and consistent manner, arbitration corresponds to a useful means of minimizing the opportunity for some of the more egregious kinds of procedural maneuvering (Drahozal, 2005). Arbitration also allows overcoming the risk of corrupt judges managing cases by bribes rather than procedural rules (Bardhan, 1997). As a result, arbitration mitigates judicial inefficiencies that stem from extensive litigation-related procedures that IJV partners can be exposed to when they collaborate. We therefore predict:

Hypothesis 2: The higher the procedural uncertainty associated with contract enforcement in IJV partners' home countries, the more likely the partners are to include arbitration provisions in the contract.

Litigation costs. While the extent of procedures is an appropriate predictor of the uncertainty of the administration of judicial process, the differences in litigation costs among countries represent another indicator of the discrepancies of legal institutional structures (Djankov et al., 2003; Nunn, 2007). Ideally, courts should afford a convenient and relatively low-cost venue for providing the assurance that property rights are upheld and contracts entered in private commercial exchange are enforced (North, 1990; Olson, 1993). In countries where national court systems tend to be slow or disorganized, for instance, delays may magnify litigation costs (Perlman & Nelson, 1983). These expected costs affect whether IJV partners would choose to

litigate, given the expected value of the settlement award (Priest & Klein, 1984). Thus, when the costs of litigation are high, partners may choose to not rely on public court systems to resolve disputes.

When litigation costs vary much among IJV partners' countries, arbitration offers several key advantages over litigation in public courts. First, arbitration provides the opportunity to make detailed arrangements regarding the allocation of costs of the arbitration proceedings or to follow the well-developed rules of arbitral tribunals such as the ICC or UNICTRAL on the allocation of costs (Leeson, 2008; Perlman & Nelson, 1983). By so doing, IJV partners mitigate the difficulties of anticipating costs up-front. Second, arbitrators have different incentives than judges when resolving disputes. Arbitrators get selected by IJV partners themselves and get paid only when they engage in arbitration (Tullock, 1980). By contrast, judges of public courts get assigned randomly to cases and get paid fixed salaries by the government. Hence, arbitrators compete for business and have an incentive to resolve disputes efficiently (Drahozal & Hylton, 2003). Finally, the binding nature of the arbitration decisions makes this resolution mechanism compare favorably to public litigation in efficiency because national courts honor arbitration awards and are less likely to recognize the awards of foreign courts (Bonn, 1972; Drahozal, 2008). Given the limited opportunity for appeals, the escalation of costs is reduced. This leads us to our third hypothesis:

Hypothesis 3: The higher the litigation costs associated with contract enforcement in IJV partners' home countries, the more likely the partners are to include arbitration provisions in the contract.

Protection of shareholders. The hypotheses thus far derive from the fact that an enforceable contract underpins IJV governance. IJVs are also organizational forms that entail equity investment by each of the partners, and this brings another dimension of the legal institutions into focus. Specifically, the extent to which the legal systems of partners' countries protect investors is anticipated to cast a shadow on the governance of IJVs (La Porta et al., 2000). As one example, legal institutions along with other regulatory agencies influence the conduct of investors by setting information disclosure standards and the punitive terms in the event of malfeasance. As we discuss below, variation among partners' home countries concerning investor protection is therefore relevant when considering the governance of joint ventures.

When national legal systems of IJV partners' home countries provide a low level of investor protection, partners are likely to be apprehensive about transparent and reliable information transmission amongst each other and with public authorities. IJV partners' behavior also tends to be conditioned by the corporate norms and rules prescribed and enforced in their respective national legal environments (Bruton, Filatotchev, Chahine, & Wright, 2010). In environments offering weaker protections, it is more likely that national courts interpret respective commitments, rights and duties, and disputes at the expense of foreign partners (Heugens et al., 2019). Such bias against foreign firms should, in turn, encourage opportunistic behavior from incumbents and precipitate disputes which require extensive fact discovery procedures, which vary from country to country (Doidge, Karolyi, & Stulz, 2004). More generally, minority shareholders can fear that foreign judges give an unfair advantage in the home-court of a partner and can undermine confidence in judicial remedies and make IJV partners reluctant to engage in litigation.

As a result, weaknesses in rules and sanctions about investor behavior as well as their enforcement from courts and regulatory agencies are likely to encourage opportunistic behavior and poorly discipline partner behavior (Doidge et al., 2004). Arbitration, by contrast, imposes a set of fact discovery and adjudication procedures that can serve as a valuable remedy to disputes and can encourage cooperative behavior and continuity. In contrast to litigation, arbitration allows IJV partners the opportunity to select impartial arbitrators to refer to when investment-related disputes require an external forum for resolution (Sternlight & Resnik, 2005; Stipanowich & Lamare, 2014). Given the business expertise of arbitrators, they may also be better positioned than judges to understand and implement contractual provisions aimed at offsetting weak shareholder protection by investors in international joint ventures (Klapper & Love, 2004). Enforcement uncertainty is also reduced given the arbitrators' propensity to deliver more neutral awards compared to judges of national courts, so judgments are more likely to be recognized and enforced even in weaker environments. Hence,

Hypothesis 4: The lower the shareholders protection in IJV partners' home countries, the more likely the partners are to include arbitration provisions in the contract.

RESEARCH METHODS

Data and Sample

We tested our hypotheses using data obtained from a survey on IJV governance. To identify organizations that were engaged in IJVs, we first relied on two secondary data sources, namely Thomson Reuters' Security Data Corporation (SDC) database and the alumni database of a Dutch business school. From SDC, we compiled a list of Dutch organizations that established

one or more joint ventures. We then identified potential respondents by matching this list of Dutch organizations with the alumni contacts of the business school. We focused primarily on potential respondents who had at least ten years of work experience. Due to their seniority within the organizations as well as their broader internal networks, these respondents were well-positioned to participate in our survey or to refer us to an executive who was directly involved in joint ventures. We asked the respondents to complete the survey for the IJV with which they were most familiar. Our approach is consistent with prior work that relied on the SDC database as the main source for researching alliance governance (e.g., Anand & Khanna, 2000) or as an initial source for identifying organizations cooperating in alliances (e.g., Ariño, 2003).

We used key informants to collect our data for two reasons (e.g., Krishnan, Martin, & Noorderhaven, 2006; White & Lui, 2005). First, given the lack of information on IJV contracts in secondary data sources as well as the confidential nature of such information in general (Weber, Mayer, & Wu, 2009), the use of key informants is an appropriate method. Second, obtaining responses from multiple survey participants is extremely difficult in IJV research due to the staff turnover in joint ventures and the relatively small size of such organizations (e.g., Kumar, Stern, & Anderson, 1993). As a result, IJV governance research, and in particular research on their underlying contracts, often relies on single key informants to obtain high-quality data (e.g., Krishnan et al., 2006; Luo, 2002;). Following this approach, we used the list of alliance managers to mobilize the alumni network and construct the respondent pool for our survey. After eliciting individuals' interest in participating in the survey, we approached about 11% of our respondents directly through the alumni office. We also used the alumni database to identify senior directors who worked for the Dutch parent company and were associated with the JV and sought their help to obtain responses (65%). Finally, we placed cold calls to alliance

managers and gathered responses in about 23% of the cases. Comparing the distribution of arbitration provisions, we did not find any significant difference between responses received through the alumni database and those obtained through cold calling ($\chi^2 = 0.019$; $p=0.89$).

To ensure face validity of our instrument, we performed several pretests. First, we held interviews with three senior executives either involved in contract negotiations or in managing an IJV. Second, we organized interviews with four leading academics with expertise on the topic of IJV governance. As deemed necessary, we made minor modifications to the survey instrument. We distributed 664 surveys in total in the year 2008 and obtained 175 responses (26.4%), of which 116 were international. More precisely, 58.6% of IJVs were established in Europe, 14.4% in East Asia (i.e., China, Taiwan, Hong Kong and Japan), 10.6% in the Middle East (i.e., Oman, Qatar, Saudi Arabia and United Arab Emirates), 5.8% in South Asia (i.e., Thailand, Singapore, Malaysia, India, Philippines and Indonesia), and 5.8% in South America (i.e., Brazil, Bolivia, Dominican Republic and Chile), 3.9% of the IJVs in North America (i.e., United States), and 0.9% of the IJVs in Africa (i.e., South Africa). Given that our hypotheses pertain to IJVs only, we excluded domestic JVs from our sample. After accounting for responses with missing data and outlying observations, the final sample consisted of 104 IJVs. The response rate can be attributed to the initial efforts made to identify the target population, the follow-up messages transmitted by email and phone, the motivation of alumni to participate in a research project organized by their business school, promises of confidentiality as well as access to the study's findings (e.g., Dillman, 2007).

We also performed several tests to ascertain the quality of our data. First, we assessed the respondents' competence. In particular, we followed Kumar et al.'s (1993) recommendation that alliance-specific measures of informant competency are preferable to company-specific

measures. Respondent profile shows that 95% of the participants had directly negotiated, managed or evaluated the joint venture, which indicates the competency of the survey participants.

Second, we analyzed the potential for response bias by comparing early and late respondents under the assumption that late respondents are more similar to non-respondents than early respondents are to non-respondents (Armstrong & Overton, 1977). Test statistics revealed no significant differences between the temporal or sectoral distributions of early and late respondents (i.e., t -value = 0.21, n.s. and $\chi^2 = 0.01$, n.s., respectively). We also investigated the possibility of significant variation across early and late respondents for all our theoretical variables in the models. These results also indicated that our data were not affected by response bias.

Third, we adopted several procedural remedies for common method bias and also performed tests to assess this potential problem. First, we relied on quasi-objective theoretical variables in our survey (e.g., arbitration provisions included in IJV contracts) that did not relate to attitudes, behaviors or perceptions (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). Second, both our theoretical and independent variables originate from different data sources, which reduces the possibility for common method bias for the specifications. Third, in spite of those procedural remedies, we still investigated common method bias by performing Harman's (1967) one-factor test. More specifically, to identify whether a significant amount of common variance exists in the variables obtained from our survey, we conducted an exploratory factor analysis, which revealed seven separate factors with an eigenvalue greater than one. Also, the first factor explained only 15.9 % of the variance in the variables used in the study. Further, we performed a second test for common method bias by using the general factor covariate technique and adding

the first unrotated factor as a control in the multiple regression models (Podsakoff et al., 2003). Given that the inclusion of this factor did not change our results, we conclude that common method bias does not account for the findings presented below.

Measures

Dependent variable. The dependent variable in our study reflects whether or not the parties agreed to arbitration in the IJV contract. Due to the binary nature of the dependent variable, we used a probit model. Given that in some cases we obtained multiple responses per parent organization on separate joint ventures, we accounted for possible interdependencies by clustering observations and using robust standard errors.

Independent variables. Our first explanatory variable relates to the legal traditions of the IJV partners' countries. We created a dummy variable that equals one if the parent countries are rooted in different legal traditions (i.e., civil vs. common law), and zero otherwise (i.e., *Different legal families*). To identify the legal traditions in the countries, we relied on La Porta et al. (2000), Licht et al. (2005), Spamann (2010) and the CIA Fact Book. In line with La Porta et al. (2007) and Spamann (2010), countries with socialist origin are assigned to civil law. Our results remain consistent when taking the number of partners from a different legal tradition into account.

In our second hypothesis, we investigate the effects of procedural uncertainty arising from extensive litigation procedures. We relied on the Doing Business indices reported since 2004 by the World Bank. This database is widely adopted for research on international business activities (e.g., Djankov et al., 2006; Klapper & Love, 2004; Nunn, 2007; Spamann, 2010). Specifically, we relied on Djankov et al.'s (2003) measure of procedural uncertainty. This measure corresponds to the number of legal procedures necessary for enforcing contracts. The

list of procedural steps compiled for each country traces the chronology of a commercial dispute before the relevant court. In line with our conceptual framework, we collected the values for this index for the set of IJV partners' home countries and took the highest of those values for computing our variable *Procedural uncertainty*.

In our third hypothesis, we investigate the effects of costs involved in resolving commercial disputes through local courts. The World Bank database reports costs that correspond to the sum of court costs, enforcement costs, and average attorney fees as a percentage of the claim. Similar to the previous variable, *Litigation costs* were obtained by accounting for the highest litigation costs among partners' home countries (e.g., Djankov et al., 2003).

Our fourth hypothesis is concerned with the legal protection of shareholders against corporate insiders and other shareholders in IJV partners' countries. We used data assembled by the World Bank (e.g., Djankov et al., 2008). The index consists of several components covering areas such as: (1) the ability of the shareholder plaintiffs to sue directly or derivatively for damages; (2) to hold majority shareholders and approving bodies (the CEO, members of the board of directors or members of the supervisory board) liable for damages; (3) to receive payment for damages or repayment of profits; (4) to see liable shareholders be fined and imprisoned or disqualified upon a successful claim; and (5) to make the court void transactions causing damages to shareholder plaintiffs. We accounted for the lowest value among IJV partners' countries (i.e., *Shareholders' protection*).

Control variables. We included several control variables that are potentially related to our theoretical variables about legal institutional characteristics and the propensity of partners to opt for arbitration to resolve disputes. Our first set of controls capture the complexity of the

collaboration (Anderson & Dekker, 2005; Sternlight & Resnik, 2005). Increasing complexity of collaboration can make it arduous for partners to foresee future contingencies, thus increasing the likelihood of gaps and the attendant need for expert third-party intervention such as arbitrators' intervention to fill those gaps. To control for IJV complexity, we included variables which are related to the scope and size of IJVs. Broad scope IJVs require partners to specify *ex ante* rights, obligations or legitimate claims for an array of activities which increases the potential for gaps in contract and conflict between partners (Borys & Jemison, 1989; Reuer, Zollo, & Singh, 2002). We measured scope (i.e., *IJV scope*) by the number of functional activities included in IJVs. We obtained this information by asking respondents about the activities conducted under the IJV: basic research, new product or process development, testing and getting regulatory approval, manufacturing, marketing, sales, and distribution (e.g., Li, Eden, Hitt, Ireland, & Garrett, 2012). We controlled for the size of the IJV (i.e., *IJV size*) because larger ventures naturally imply greater operational complexity (e.g., Linck, Netter, & Yang, 2008).

We controlled for several other IJV characteristics that follow from the transaction cost logic. Specifically, investments dedicated to the IJV and not easily deployable elsewhere if the IJV dissolves (i.e., *Asset specificity*) can cause hold-up problems and become a source of conflict between partners *ex post* that can call for third-party intervention (Williamson, 1979; Luo, 2007). As a result of the specificity of the assets involved and the risk for hold-up, partners may value the potential to promote continuity of exchange and the amicable outcomes facilitated by arbitration (Macneil, 1962). To measure *Asset specificity*, we relied on Ariño (2001) to ask respondents their agreement to the the following five statements, ranging from negligible to substantial (Cronbach's alpha = 0.71): a) Our investment in dedicated personnel specific to this venture; b) Our investment in dedicated facilities to the venture; c) The time required to learn

about our partner's style; d) non-recoverable investments in equipment, people, etc. if the venture would be dissolved; e) the difficulty we would have in redeploying our people and facilities presently serving the venture to other uses if it would be terminated. Further, per transaction cost logic, the conditions under which IJV partners establish the contract also affect whether partners are likely to behave opportunistically. Specifically, a contracting environment with few potential partners can expose IJV partners to contractual hazards and hold-up concerns (Pisano, 1989; Williamson, 1985). To control for such small numbers bargaining situations, we asked respondents to assess the number of other firms that would be interested in forming a collaborative venture with them in case the IJV would be discontinued (i.e., *Small numbers*).

Concerns of opportunistic behavior because of goal conflict or knowledge misappropriation may also derive from the extent that partners' end markets are overlapping (e.g., Oxley & Sampson, 2004). Our measure was obtained by summing three Likert-type items that assess the degree to which the firms operate in similar (1) product markets, (2) geographic markets, and (3) customer markets (i.e., *Market overlap*). Disputes and the need for third-party intervention to check opportunistic behavior by partners may also arise when the duration of the IJV shortens the "shadow of the future" thus weakening the self-enforcing ability of the contract (Heide and Miner, 1992). Accordingly, IJV partners with finite or short-term contracts may opt for closed form solutions such as arbitration to resolve conflicts (Lumineau & Malhotra, 2011; Poppo, Zhou, & Ryu, 2008;). We proxied for the duration of the joint venture by creating a dummy variable for time-boundness of the IJV (i.e., *JV duration*) which equals one when the contract specified a predefined length of time and zero when the IJV spanned an indefinite period (e.g., Reuer & Ariño, 2007). Finally, the likelihood of unforeseen contingencies destabilizing the partnership increases when partners face high environmental uncertainty

(Crocker & Reynolds, 1993). We adopted Kumar and Seth's (1998) measure for environmental uncertainty and asked the respondents to indicate the degree to which the following five external factors were predictable using a five-point Likert-type scale ranging from "Not at all predictable" to "Accurately predictable": (1) government policies and regulations, (2) customer demand, (3) supply of raw materials and equipment, (4) competitive climate, and (5) technological trends (Kumar and Seth, 1998). We reverse coded the scores such that greater values for these items reflect greater uncertainty (i.e., e_i , $i=1$ to 5). Because these aspects of environmental uncertainty may affect specific IJVs differently, we weighted these items based on respondents' allocation of 100 points among the five factors regarding their importance in determining the ultimate success of the IJV (i.e., w_i , $i=1$ to 5) (i.e., *Environmental uncertainty*). The measure of environmental uncertainty was then calculated as follows:

$$\text{Environmental uncertainty} = \frac{1}{100} \sum_{i=1}^5 w_i \cdot e_i \quad (1)$$

We also controlled for factors at the partners' level that influence the extent to which formal mechanisms are required to govern the IJV. First, we included a variable that captures the collaborative history between IJV partners because such ties may reduce the likelihood of opportunistic behavior (Gulati, 1995; Poppo et al., 2008). Our variable corresponds to the number of prior relationships formed between the IJV partners (i.e., *Prior ties*). Second, we controlled whether the IJV was set up by two or more partners because IJVs involving multiple partners are more likely to experience goal incongruence and free-riding behavior thus increasing the need for formal mechanisms and severe sanctions (e.g., Garcia-Canal, Valdes-Llaneza, & Ariño, 2003) (i.e., *Dyadic IJV*). Last, cultural differences between partners may be related to their institutional backgrounds and also impact the likelihood of opting for private ordering

through arbitration. We measure cultural differences between the partners (*Cultural distance*) using the dimensions developed by Hofstede (1980).

Partners may also specify a detailed set of contractual safeguards, and use arbitration provisions to address residual concerns. Although bounded rationality considerations limit the possibility of drafting a complete contract, partners may draft detailed provisions to address *ex post* contingencies and to limit their exposure to the risk of opportunistic behavior (Contractor & Reuer, 2014). To account for the specificity with which contractual terms are designed (i.e., *Contract term specificity*), we adopted a measure from Luo (2002). *Contract term specificity* uses a five-point Likert scale to elicit responses regarding how the IJV is set up and managed and how partners cooperate and bilaterally deal with disagreements and how they terminate the IJV (Cronbach's alpha = 0.72). The experience of partners in handling joint ventures may enable them to anticipate and address transactional concerns. We thus control for the partners' joint experience of working with joint ventures (*Partners' JV experience*) by counting the number of joint ventures formed in a 5-year window before the focal joint venture (Sampson, 2005).

Our final set of controls captures the industry and institutional context of IJVs that can have a bearing on the merits or drawbacks of using arbitration. We controlled for the quality of the rule of law in the IJV's host country. Our variable corresponds to the Worldwide Governance Indicator developed by Kaufman, Kraay and Mastruzzi (World Bank, 2009) (i.e., *Host country rule of law*). A related concern is "home turf" advantage that a parent might enjoy when one of the partners' home nations also doubles up as the host for the IJV. IJV partners vulnerable to "home turf" advantage to the counterparty can envision such a possibility, and craft mitigating safeguards in the contract. To control for this effect, we included a dummy variable *Shared parent and JV nationality* that equals one when any of the parents share nationality with the IJV

and zero otherwise. Because there is growing evidence that both trade and foreign investment activity have a strong regional dimension that can shape partners' expectations and understandings (Rugman & Verbeke, 2004), we also accounted for whether the IJV partners belong to the same trading block (i.e., *Same trading bloc*). We relied on Arrègle, Miller, Hitt and Beamish (2013) and considered the following trading blocs: EU, NAFTA (USA, Canada and Mexico), MERCOSUR (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, Paraguay, Uruguay and Venezuela), ASEAN (Thailand, Singapore, Vietnam, Malaysia, Philippines, South Korea and Indonesia) and ANZCERTA (Australia and New Zealand). We have followed previous research in grouping the various industries in our sample into a smaller set of sectors such as agriculture and mining, transportation, manufacturing, etc.. We further consolidated the six sectors into three broad categories namely manufacturing (*Manufacturing sector*), service (*Service sector*) and others (omitted category) to facilitate our analysis. Finally, we included *Time fixed effects* to capture differences in the advantages or drawbacks of arbitration over time that may hinder or encourage arbitration (Stipanowich & Lamare, 2014).

RESULTS

Table 1 reports descriptive statistics and correlations for the variables included in the model. Overall, 76.4% of the IJV contracts in our sample include arbitration provisions. It implies that partners prefer to anticipate the likelihood of disputes that they cannot resolve either bilaterally or through public trilateral mechanisms, *i.e.*, via public courts, by opting for arbitration. The highest absolute correlation is 0.55 and the maximum variance inflation factor (VIF) is 2.3, which is well below common thresholds that indicate multi-collinearity problems.

Insert Table 1 here

Table 2 presents the main findings of our analysis. In Model I we show the control variables, and we sequentially introduce our theoretical variables in Models II – Model IV. For discussion, we use the results presented in the full model as shown in Model V. In our first hypothesis we have argued that differences in substantive and procedural law arising from different legal origins positively influence the choice of arbitration. In support of our arguments, the coefficient estimate of *Different legal families* is positive and significant ($p = 0.04$). When covariates are held at observed sample values, we find that the likelihood of finding arbitration provisions in IJV contracts increases by 17% on average when partners do not share the same legal tradition. These results support the theoretical argument about the increase in the likelihood of arbitration provisions when partners' home countries have legal institutions originating from different legal traditions.

Insert Table 2 here

In hypothesis 2 we predict that uncertainty arising from the procedures to follow for enforcing a contract can encourage partners to employ arbitration. Consistent with this prediction, we find that procedural uncertainty has a positive effect on the likelihood of arbitration provisions in the contract ($p < 0.001$). Analysis of marginal effects reveals that an increase of procedural uncertainty by one standard deviation from the mean leads to an increase in the probability of having arbitration provisions in IJVs contracts by 31% ($p < 0.001$) on average with the other covariates held at observed sample values. These results support our argument that uncertainty caused by a large number of judicial procedures will induce partners to seek recourse to private trilateral mechanisms in the form of arbitration.

Our third hypothesis expects a positive relationship between litigation costs in IJV partners' home countries and the likelihood of arbitration provisions in the contract. The results in Model V support our expectation that the high cost of intervention through public institutions will make arbitration more attractive ($p < 0.001$). Estimated marginal effects indicate that a one standard deviation increase in court inefficiency from the mean will increase the likelihood of arbitration by 75% ($p < 0.001$) on average with the other covariates held at observed sample values.

In our fourth hypothesis we developed the argument that strong protection offered to shareholders decreases the likelihood of arbitration provisions in the contract. The results in Model V indicate a negative and significant coefficient ($p < 0.001$). The marginal effects analysis revealed that a one standard deviation reduction in shareholder protection from the mean, the likelihood of arbitration increases by 46% ($p < 0.001$) with the other covariates held at observed sample values.

Finally, some of the findings for the control variables in Model V are noteworthy. First, we find that transaction characteristics that increase the scope for opportunistic behavior negatively impact the likelihood of arbitration provisions in the contract. The negative and significant relationship between asset specificity, small numbers as well as market overlap and arbitration can be explained by the need for strong sanctions when facing the risk of opportunistic behavior (Drahozal & Hylton, 2003). Interestingly, these results tend to run against the argument according to which high risks for hold-up situations magnify partners' inclination to favor remedies that promote exchange continuity and compromising settlements (Bernstein, 2001; Macneil, 1962). In cross-country joint venture settings, it appears that partners prefer the less conciliatory stance that is typical of public courts relative to arbitrators when the risk of

opportunistic behaviors is non-negligible (Drahozal & Ware, 2010). As expected, the results for prior ties indicate a positive impact on the adoption of arbitration provisions. Given that relational norms emerge with an increase in the number of prior ties, IJV partners may value the arbitrators' awards that promote compromise, amicability, and continuity. We also find that the coefficient for *dyadic JV* is positive and significant ($p = 0.004$). This result suggests that private trilateral mechanisms are easier to design when consensus is not impeded by an increase in the divergence of expectations with an increase in the number of partners.

Supplementary analyses

Given our interest in investigating the choice of private ordering mechanisms, we have considered the potential for the influence of institutional discrepancies on trilateral ordering through arbitration. However, it is also possible that IJV partners turn to boards of directors for private and bilateral ordering, so it is of interest to determine whether the institutional variables investigated above relate uniquely to arbitration choice or whether they also pertain to choices regarding IJV boards. More specifically, boards of directors in IJVs are statutory and serve as an important bilateral means to address disputes surfacing at the highest organizational level (Klijn et al., 2013; Reuer et al., 2014; Perkins et al., 2014). Because boards monitor and ratify decisions (Adams & Ferreira, 2007), they can also play a pivotal role in reconciling partners' needs and interests (Kumar & Seth, 1998), resolving conflicts (Pisano, 1989) and promoting mutual adjustment (Ravasi & Zattoni, 2006).

In order to disentangle the effects of the discrepancies among partners' home country legal institutions on trilateral private ordering (i.e., arbitration) and bilateral private ordering (i.e., oversight provided by the boards of directors), we simultaneously estimate choices regarding arbitration and the size of the board of directors. To do so, we used a conditional mixed process

method (e.g., Roodman, 2011). This method also enables us to account for possible interdependence between those two governance-related choices. Our first dependent variable of interest, arbitration, is a binary variable. The second dependent variable is a log transformation of the number of directors appointed on the board (i.e., IJV board size). Results shown in Table 3 reveal that the level of shareholders protection in partners' home country positively influences IJV board size ($p < 0.05$), which is opposite to the effect observed for arbitration provisions. Furthermore, we observe that the other institutional variables – legal tradition, procedural uncertainty and litigation costs – do not influence the size of the board in IJVs. This finding is consistent with our overall endeavor aimed at primarily considering the binary choice between trilateral public and private ordering. In other words, legal institutions have an impact on the efficiency of trilateral public intervention and accordingly should influence similar intervention privately through arbitration. However, we would not expect these same legal institutional variables to shape the design of IJV board of directors, which is a qualitatively distinct bilateral governance mechanism shaped by transactional considerations (Reuer, Klijn, van den Bosch, & Volberda, 2011). The results shown in Table 3 below support this line of argument and demonstrate the role of institutional characteristics in uniquely relating to arbitration as a dispute resolution mechanism for IJVs.

Insert Table 3 here

We also performed several supplemental analyses to examine the robustness of our results. Our first set of robustness tests relate to the construction of the measures for the hypothesized variables of interest. We characterize the institutional variation among partners by looking at their strength/weakness. We also measure variation in legal institutions of partners by

measuring our core explanatory variables by employing differences in costs, procedures and shareholder protection measures for legal institutions in partner countries. We obtain qualitatively similar results when we use these alternative measures. As indicated above, we have obtained data from World Bank's Doing Business database in order to develop measures for three of our four independent variables of interest (i.e., procedural uncertainty, court inefficiency and shareholders protection). While the Doing Business database provides data starting in 2004, some of the IJVs in our sample were formed before 2004. Based on the premise that institutions remain rigid in the near term and hence do not experience much change, we employed values in the year 2008. As a robustness check, we have used values from the year 2004 for IJVs which were formed in or before 2004. We note that we found little to no variation in the values between 2004 and 2008, and use of the latter data yielded the same interpretations.

Moreover, to account for any changes in institutional environments over time, we excluded from our sample IJV deals that were negotiated before 1998 and obtained similar results. We also used several alternative measures for shareholder protection such as the anti-director rights introduced by Djankov et al. (2008). This measure assesses the protection of minority shareholders from conflicts of interest and opportunism by insiders (Djankov et al., 2008; Klapper & Love, 2004). Our findings remain consistent while using this measure as an alternative to the director liability index in our final model (Model V). Finally, we tested the same set of models on a sub-sample that exclusively includes IJV formed by two partners as it is more straightforward to account for differences in institutions across partners' countries for such collaborations. Findings reveal that our four hypotheses are supported while considering a subsample of two-partner joint ventures.

DISCUSSION

In this paper, we investigated whether and how the native institutional frameworks of partners influence the design of dispute resolution provisions in IJV contracts. We sought to clarify the institutional antecedents of dispute resolution mechanisms in IJVs by joining ideas from new institutional economics that suggest that the costs of economic exchange are often not trivial, and depend on the transaction characteristics as well as the institutions that support exchange in different national economies (Coase, 1998; Williamson, 2000). International transactions come in a variety of forms, and efficient design requires matching of transaction characteristics with governance attributes for preserving order and continuity of the relationship (Williamson, 1979). We focused on legal institutions because the ability of contracts to induce order depends mostly on the availability of a legal system that facilitates defining and enforcing contracts (Williamson, 2000). To the extent that transactions that span national boundaries require transacting parties to work under multiple legal systems, designing governance mechanisms should take into account not only the transactional features but also the costs of using the court systems to manage contracts and settle disputes (Pinkham & Peng, 2017). Legal institutional diversity among partners' home countries has an important impact on the governance design of IJVs. We suggested that different institutional regimes of partners can undermine consensus and confidence in the functioning of the dispute settlement machinery and encourage partners to opt for third parties in the form of arbitrators to support private ordering.

Our study contributes to alliance governance research by highlighting partner firms' anticipation that possible disputes may not be resolved internally. Existing strategy research has extensively acknowledged and examined the effects of conflicts on the stability and performance of alliances (e.g., Killing, 1983), yet it has mostly focused its attention on internal mechanisms crafted for bilaterally dealing with conflicts (e.g., Steensma et al., 2008). In the joint venture

context, in particular, the distribution of ownership and the allocation of controls have received wide scrutiny from international business scholars (e.g., Pisano, 1989; Ravasi & Zattoni, 2006). . In our study, we account for the opportunity to design *ex ante* agreements in such a way that possible disputes unresolved internally are settled by third parties. Choice between alternative trilateral orderings – arbitration and public courts – has not received systematic research attention in the alliance governance literature.

Our study also contributes to IB research more generally that explores the impact of institutional environments on MNEs and their expansion strategies. IB scholars have widely examined the effects of institutional environments on the relative merits of various entry modes such as IJV, acquisitions and greenfield investments (Aguilera, 2011; Davidson & McFetridge, 1985; Gomes-Casseres, 1989; Henisz & Williamson, 1999; Oxley, 1999; Shleifer & Vishny, 1997; Stevens & Makarius, 2015). We extend this line of research by considering the effects of native institutional frameworks beyond the decision to elect an entry mode in these broad terms. The present study offers a more fine-grained investigation of the institutional environment and more particularly the legal institutions that bear upon the micro-foundations of the collaboration (Contractor & Reuer, 2014). By considering the dispute resolution provisions *per se*, our study reveals that national institutions may not only impact decisions related to bilateral mechanisms but also impact decisions related to trilateral mechanisms. Beyond the fact that bilateral mechanisms function under the shadow casted by institutions, parties may indeed seek alternatives at the legal institutional level in order to ensure the efficacy and credibility of their fall-back options. In line with Abdi and Aulakh (2012), our findings imply that the efficacy of governance mechanisms is dependent on the ability of the underlying institutions to credibly restore order.

We further contribute to the IB literature by showing how alliance partners make use of dispute resolution mechanisms (1) for circumventing poor home-country institutional frameworks and (2) for helping reduce misunderstanding derived from the differences between legal institutional environments of the partners. To begin with, countries involved in the IJV may not possess legal institutions able to properly support the execution and enforcement of contracts (Khanna & Palepu, 2010). Firms collaborating in such settings can in effect opt out of their national legal institutional settings by borrowing private institutions (Pinkham & Peng, 2017). In this respect, our study shows that procedural uncertainty, litigation costs and poor shareholders' protection in IJV partners' home countries induce them to opt for arbitration as a means of resolving conflict. In addition, our study also reveals that legal institutional diversity among partners' home countries affects the governance design and mechanisms of IJVs and in particular the arbitration choice. Consequently, institutional frameworks of partners' countries are shown to be essential when it comes to considering institutional voids and institutional borrowing.

Finally, our supplementary analysis concerning the influence of home-country legal institutions and their disparities on IJV boards offers further contribution to IB and alliance-related research. Although IJVs possess strong bilateral alignment mechanisms such as equity sharing and boards of directors (Dhanaraj & Beamish, 2009), it appears that they may be more effective in addressing concerns derived from transactional opportunism concerns, but are not particularly helpful in dealing with institutional concerns. Future research can study however how arbitration can complement or substitute for internal governance mechanisms aimed at dealing with conflicts. More specifically, Hagedoorn and Hesen (2007) point out that firms may agree *ex ante* to bring disputes to an external forum after failing to resolve them in an internal,

predefined forum. Partners therefore anticipate dealing with conflicts by sequentially escalating from private to public procedures.

Limitations and Future Research Directions

A first limitation of our study is that we build on the challenges of interpretation and enforcement presented by institutional differences for explaining the choice for arbitration. It is possible that the nature of potential conflicts may greatly diverge following these two underlying mechanisms and it is therefore interesting to see how partners achieve a match between the instrument to address conflict and the underlying mechanism causing the conflict. Future research could examine the pathways in which interpretation and enforcement pose challenges and the specific remedies partners employ to deal with such challenges. In addition, future research can consider the effectiveness of arbitration as a tripartite mechanism to offer governance support to transactions and therefore enhance survival and performance (Abdi & Aulakh, 2013; Chan, Isobe, & Makino, 2008;).

Second, because our data originates in the SDC database, it inherits some of SDC's limitations. We used SDC data as a starting point to identify the alliances formed by firms for conducting our survey. To the extent that SDC's coverage of firms that fall outside the regulatory purview of U.S. Securities and Exchange Commission (SEC), our coverage of Dutch IJVs may be restricted.

Our data also restricted us in studying details in arbitration clauses and future research may aim to investigate differences among arbitration provisions (e.g., number of arbitrators, issues to be arbitrated, arbitral rules, and schedule and form of award). For instance, it would be interesting to explore the choices by IJV partners between ad hoc or institutional forms of arbitration (Leeson, 2008; Mattli, 2001). The ad hoc form is organized and administered

independently of any arbitral institution. In contrast, the institutional form takes place under the aegis of an arbitral institution, usually according to the institution's own rules of arbitration. It may be useful to study the choice between an ad hoc *versus* institutional arbitration to understand the extent to which dispute resolution mechanisms are crafted to suit transactional and institutional characteristics. Besides the choice between ad hoc and institutional arbitration, scholars may also shed more light on the detailed ways in which IJV partners seek to handle disputes while accommodating their institutional differences.

Finally, it would be worthwhile to study the performance implications of the choice of dispute resolution mechanisms and, more broadly, its consequences (e.g., duration of the IJV, tensions avoided, conflicts resolve successfully, etc.). The objective of our research has been to investigate the legal institutional antecedents of choosing arbitration. As a follow-up to our study, it would be valuable to explore whether adequately aligning institutional discrepancies with dispute resolution mechanisms at the formation phase contributes to governance efficiencies. It would also be interesting to examine the actual choice made by IJV partners during the implementation of collaborations between internal mechanisms, arbitration, and public courts when disputes actually occur. Even if partners agree to opt for arbitration, they may switch to another remedy once disputes of particular kinds arise, for instance. Future research should therefore jointly examine the choice for arbitration at the formation phase, but also when it comes to dealing with disputes.

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Table 1: Correlations and Summary Statistics

#	Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1	Different legal families	0.44	0.50	1.00																				
2	Procedural uncertainty	35.06	5.80	-0.03	1.00																			
3	Court inefficiency	30.71	13.07	0.22	0.03	1.00																		
4	Shareholder protection	3.64	1.37	0.18	-0.11	0.14	1.00																	
5	IJV scope	3.74	2.09	0.00	0.04	0.15	-0.02	1.00																
6	IJV size	3.22	2.45	-0.17	0.06	-0.19	-0.12	0.15	1.00															
7	Asset specificity	15.03	3.47	-0.19	-0.03	-0.07	-0.16	0.17	0.00	1.00														
8	Small numbers	7.80	3.04	-0.08	-0.16	-0.06	0.15	0.10	0.22	0.07	1.00													
9	Market overlap	2.86	1.09	0.03	0.01	0.35	-0.10	0.03	-0.17	0.04	-0.19	1.00												
10	JV duration	2.46	0.74	0.10	-0.02	0.00	-0.05	-0.02	-0.06	0.06	-0.11	0.13	1.00											
11	Environmental uncertainty	0.22	0.42	-0.15	-0.08	-0.11	-0.11	-0.20	0.08	0.06	-0.08	-0.12	0.04	1.00										
12	Prior ties	0.75	0.44	0.02	-0.18	0.01	0.11	0.00	-0.20	-0.01	-0.01	0.01	-0.18	-0.12	1.00									
13	Dyadic JV	0.27	0.49	-0.12	-0.13	-0.02	0.18	0.15	0.00	0.03	0.19	-0.07	0.16	0.09	-0.19	1.00								
14	Cultural distance	1.89	1.35	-0.20	0.36	-0.04	-0.54	0.11	0.01	0.13	-0.14	-0.01	-0.03	-0.01	0.04	-0.09	1.00							
15	Contract term specificity	15.41	3.73	0.01	0.10	-0.01	0.08	0.01	0.04	0.01	0.00	-0.04	-0.17	0.05	0.11	-0.01	-0.02	1.00						
16	Partners' JV experience	0.81	1.34	0.13	0.09	0.22	-0.06	0.19	0.11	0.07	0.03	-0.08	0.06	0.04	-0.05	0.12	0.13	0.09	1.00					
17	Host country rule of law	1.06	0.92	0.28	-0.39	-0.01	0.41	0.01	-0.11	-0.04	0.25	-0.14	0.09	-0.09	0.00	0.07	-0.55	-0.04	-0.24	1.00				
18	Shared parent and JV nationality	0.60	0.49	-0.10	0.22	-0.06	-0.21	-0.02	-0.22	0.07	-0.16	0.00	0.06	-0.03	-0.25	0.00	0.31	-0.07	-0.10	-0.31	1.00			
19	Same trading bloc	0.41	0.50	0.00	-0.48	0.08	0.24	0.01	-0.13	-0.07	0.29	-0.03	0.00	0.02	0.08	0.24	-0.41	-0.05	-0.11	0.47	-0.26	1.00		
20	Manufacturing sector	0.42	0.50	-0.10	0.21	-0.21	-0.07	-0.10	0.24	-0.08	0.06	0.04	-0.06	0.01	0.00	-0.08	0.06	0.02	0.01	-0.18	-0.21	-0.24	1.00	
21	Services sector	0.16	0.37	0.03	-0.12	0.02	0.18	0.04	-0.25	-0.05	-0.07	0.11	-0.07	-0.05	0.08	0.03	-0.04	-0.01	-0.06	0.05	0.10	-0.05	-0.38	1.00

Table 2: Determinants of Arbitration Provisions in IJV Contracts

Variables	(1)	(2)	(3)	(4)	(5)
Different legal families		1.326** (0.440)	1.308** (0.429)	0.838 (0.514)	2.620* (1.276)
Procedural uncertainty			0.110* (0.045)	0.119* (0.051)	0.846*** (0.226)
Litigation costs				0.103* (0.042)	0.887*** (0.252)
Shareholder protection					-5.196*** (1.556)
IJV scope	-0.001 (0.063)	-0.019 (0.058)	-0.031 (0.058)	-0.092 (0.073)	-0.673*** (0.180)
IJV size	-0.079 (0.147)	-0.068 (0.138)	-0.074 (0.149)	-0.048 (0.148)	0.438* (0.217)
Asset specificity	-0.273* (0.122)	-0.178 (0.139)	-0.108 (0.150)	-0.105 (0.199)	-1.299*** (0.332)
Small numbers	-1.019*** (0.257)	- (0.245)	-1.306*** (0.267)	-1.633*** (0.357)	-7.220*** (2.036)
Market overlap	-0.149* (0.063)	-0.165** (0.062)	-0.185*** (0.054)	-0.265*** (0.077)	-1.162*** (0.343)
JV duration	0.025 (0.396)	-0.013 (0.381)	0.141 (0.347)	0.237 (0.427)	3.206* (1.383)
Environmental uncertainty	0.020 (0.157)	-0.032 (0.171)	-0.043 (0.171)	-0.094 (0.190)	-1.219** (0.454)
Prior ties	0.784* (0.348)	1.148** (0.366)	1.165** (0.373)	1.560*** (0.370)	7.988** (2.481)
Dyadic JV	0.278 (0.417)	0.253 (0.439)	0.346 (0.459)	0.710 (0.559)	7.812** (2.683)
Cultural distance	0.117 (0.143)	0.287* (0.137)	0.273* (0.138)	0.306+ (0.183)	0.269 (0.256)
Contract term specificity	0.187*** (0.055)	0.197*** (0.056)	0.164** (0.055)	0.192** (0.061)	0.834** (0.266)
Partners' JV experience	0.372* (0.152)	0.334* (0.133)	0.452** (0.144)	0.413* (0.173)	2.157*** (0.555)
Host country rule of law	0.466* (0.207)	0.390 (0.252)	0.587** (0.212)	0.588* (0.291)	5.763*** (1.560)
Shared parent and JV nationality	-0.631 (0.555)	-0.632 (0.562)	-1.021+ (0.588)	-0.927 (0.676)	-2.886+ (1.506)
Same trading bloc	-0.895 (0.652)	-0.524 (0.565)	-0.205 (0.571)	-0.544 (0.683)	-2.298* (1.162)
Manufacturing sector	-0.044	0.122	-0.021	0.243	3.887*

Services sector	(0.406)	(0.380)	(0.438)	(0.465)	(1.557)
	-1.007*	-1.222**	-1.276**	-1.452**	-1.361
Constant	(0.430)	(0.444)	(0.466)	(0.515)	(0.854)
	1.939	1.806	-0.950	-2.888	-24.116***
	(1.672)	(1.687)	(2.056)	(2.733)	(7.039)
Log likelihood	-28.431	-25.817	-23.859	-22.372	-12.061
Chi squared	55.428	68.265	95.167	78.212	351.381

N=104. *** p<0.001, ** p<0.01, * p<0.05, + p<0.10. Robust standard errors in parentheses.

Table 2: Results of bivariate estimation of arbitration provisions and size of JV board

Variables	Arbitration	Board size
Different legal families	2.614* (1.154)	-0.101 (0.076)
Procedural uncertainty	0.845*** (0.213)	-0.012+ (0.007)
Litigation costs	0.885*** (0.230)	-0.003 (0.002)
Shareholder protection	-5.187*** (1.413)	0.070* (0.031)
IJV scope	-0.673*** (0.179)	-0.006 (0.020)
IJV size	0.437* (0.193)	0.029* (0.014)
Asset specificity	-1.299*** (0.331)	-0.046 (0.029)
Small numbers	-7.208*** (1.871)	0.032 (0.039)
Market overlap	-1.161*** (0.317)	-0.003 (0.012)
JV duration	3.198** (1.181)	-0.052 (0.085)
Environmental uncertainty	-1.217** (0.419)	0.017 (0.030)
Prior ties	7.979*** (2.305)	0.015 (0.099)
Dyadic JV	7.797*** (2.320)	-0.154+ (0.092)
Cultural distance	0.270 (0.264)	0.059+ (0.030)
Contract term specificity	0.832*** (0.242)	0.016* (0.008)
Partners' JV experience	2.156*** (0.531)	0.082** (0.026)
Host country rule of law	5.756*** (1.464)	0.023 (0.047)
Shared parent and JV nationality	-2.885+ (1.498)	0.035 (0.083)
Same trading bloc	-2.293* (1.132)	-0.219* (0.086)
Manufacturing sector	3.880** (1.439)	-0.184* (0.089)
Services sector	-1.364 (0.861)	-0.207* (0.104)
Constant	-24.073***	1.766***

	(6.430)	(0.371)
Rho		-0.005
		(0.257)
Log likelihood		-40.184
Chi squared		935.522

N=104. *** p<0.001, ** p<0.01, * p<0.05, + p<0.10. Robust standard errors in parentheses.

Figure 1: Overview of dispute resolution mechanisms

