Analysis of Formal Governance on the Performance and the Value Creation in International Joint Ventures (IJV)

Author: Michael Städli, B.A.Sc., MBA
mstudli@outlook.com

Supervisor: Tobias Greven L.L.M.
tobias.greven@merckgroup.com

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List of Abbreviations and Definitions

A. Abbreviations

IJV: International Joint Venture
CG: Corporate Governance
JV: Joint Venture
GmbH: Gesellschaft mit beschränkter Haftung
AG: Aktiengesellschaft
US: United States
UK: United Kingdom
EU: European Union
TFEU: Treaty on the Functioning of the European Union
KPI: Key Performance Indicators
FOS: Fully Owned Subsidiary
FTC: Federal Trade Commission

B. Definitions

Analysis: Study of academic journals, practitioners and case studies.

Formal: Legal as opposed to Informal (behavioral or organizational science).

Governance: Inform, Direct, Control and Monitor of a venture, project or business.

Performance: The function and efficiency of the direction and control performed by the management upon the corporation.

Value Creation: Benefit of tangible or intangible actions that may have financial or organizational impact and increase the worth of the partnership.¹

IJV: Equity based partnerships with two or more international companies

Corporate Strategy: The overall scope and direction of a corporation.²

Shareholder: equity owner in part or in full of a business entity.

Stakeholder: a party bearing an interest or accountability or responsibility in the activities or functions of a business process.³

Ex-Ante: “based on assumption and prediction and being essentially subjective and estimative an ex ante plan for the budget”⁴

Ex-Post: “based on knowledge and retrospection and being essentially objective and factual”⁵

Information Asymmetry: deals with the study of decisions in transactions whereby one party has access to more or better-quality information as the other party.⁶

Game Theory: A study of models describing conflict and cooperation.⁷

Adverse Selection: The effect of mis-representation of facts and information that may have an impact on the quality or result of the

Moral Hazard: refers to an economic risk that may be taken due to the security of not bearing the costs of the risks.⁸

Gun Jumping: using sensitive information for decision making purposes that has not yet been approved by regulators.⁹

⁴ Merriam Webster I (2018).
⁵ Merriam Webster II (2018).
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0. Thesis Introduction and Purpose

Globalization and innovation are only two of the mega trend growth drivers of corporate strategies. Be it, organic, semi-organic or inorganic; strategic partnerships play key roles as part of both equity and non-equity business models. Although, each model has its advantages and its short comings, some of the methods for governing are common. The focus on International Joint Venture (IJV) with two or more equity shareholders is the focus of this thesis due to the current trend, need for improvements and the lack of guidance of applied research. The failure rate of IJVs is considerably high at around 49%, caused in part by complexity in the formal -legal – aspects of the partnership and markets.

This thesis has the objective of analyzing the components of Corporate Governance (CG) of IJVs in order to identify the challenges (risks) and opportunities (value creation) for a formal governance that if well managed would bring performance and bring value to the IJV. Therefore, if the hypothesis is correct, good CG within the IJV will increase the potential (performance and/or value) and create as we will see either shareholder value or productive coalition with interested parties. The board and management, elected or nominated on behalf of the shareholders to pursue the IJV objectives with accountability and responsibility for decision making, reporting and monitoring, and compliance which should be based on clear and solid CG policies, guidelines or rules.

This paper takes a holistic CG approach to IJVs with a strong focus on the formal (legal) as opposed to information (organization behaviour). The aim is not only to analyze the potential of performance and value creation but also to serve as a reference for aspects, trends and developments that IJVs are being challenged with.

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10 Bamford, Ernst, Fubini (2004).
1. Introduction to IJV Partnerships

A. Defining an IJV

An International Joint Venture or IJV is a broad term that can have different interpretations, it is therefore helpful for the sake of this thesis to clearly define the scope of the IJV as follows:

A. It is an international (cross-border) scope of business activity for one or more of the partners.\footnote{Hewitt (2001).}
B. It involves two or more shareholders or partners.
C. It is an equity entity most often legally independent – as opposed to a contractual agreement.
D. It is characterized by a management team – Supervisory board, board of directors and CEO (or Venture Manager).
E. It has sufficient resources to operate independently on the market.\footnote{OECD (2017).}
F. It performs business activities outside the scope or field of its parent companies\footnote{OECD (2017).}
G. It is or is working to generate over half its sales to third parties.\footnote{OECD (2017).}

The purpose of creating a joint venture is to establish a common business activity in which the partners jointly and directly participate.\footnote{Hewitt (2001).} The term joint venture comes from the Joint Adventure\footnote{Hewitt (2001).} that was coined in the middle ages for purposes of joining forces with someone and doing trade – a boat owner and a silk trade for example. Albeit, there are many different motivations for companies to form a joint venture, the common denominator is often the mitigation of risks where an individual effort would be too costly (risk of insufficient capital), too time consuming (risk of being late to the market), product performance (risk of market acceptance). The opportunity of cooperating with a business partner(s) has several business models, which for one make the scholarly study of IJVs difficult however can be categorized as follows:

\begin{itemize}
  \item Hewitt (2001).
  \item OECD (2017).
  \item OECD (2017).
  \item OECD (2017).
  \item Hewitt (2001).
  \item Hewitt (2001).
\end{itemize}
A. **Joint Research Venture**: Parties choosing to combine the R&D activities to develop new products or service.

B. **Joint Financing**: Parties choosing to reduce risk or financial exposure by jointly investing in a project (ex: real estate)

C. **Market and Technology venture**: One party brings a technology, another party brings market access.

D. **Economic gain venture**: Economies of scale or scope by combining two business units to perform as a stronger one on demand of supply side of the market.

E. **Public-Private Partnerships (3P) ventures**: Agreements between public and private governments and enterprises, often seen in infrastructure projects.

F. **Market Entry joint ventures**: One party bringing a product, another party bringing market access.

G. **Startup or accelerator ventures**: Sponsoring and financing new technologies through entrepreneurial people or young companies.

There are many different types of partnerships that are not in the scope of this thesis, such as alliances and supplier partnerships. As, they are not the focus to this thesis, short definitions can be found in Appendix A.

### B. The market for IJVs

According to Bamford and Ernst (2004)\(^\text{17}\), in the period between 1999 and 2004, over 5,000 JVs have been launched worldwide. In 2004, 100 of the largest JVs represented more than USD 350 bn in combined annual revenues.\(^\text{18}\) JVs are used by all types of companies, with most larger ones having 10 or more sizeable JVs accounting for between 10 and 20% of their revenues.\(^\text{19}\) KPMG (2012)\(^\text{20}\) estimated 35% of global corporate revenues comes from non-operated business (partnerships in general that includes alliances), and furthermore predict it could rise to 75% by 2017.

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\(^\text{17}\) Bamford, Ernst, Fubini (2004).
\(^\text{18}\) Bamford, Ernst, Fubini (2004).
\(^\text{19}\) Bamford, Ernst (2005).
\(^\text{20}\) van Grondelle (2012).
C. Success and Failure of IJVs

There is no official report that tracks the success and failure rate of IJVs nor JVs, since the objectives and strategies are for the most part objective and subjective and typically ask the question to management if they are satisfied with the results – subjective. Assessments have however been made by Bamford, Ernst and Fubini (2004) and found that 51% are successful based on the criteria for shareholder return on the cost of capital – financial objective.

D. Economic Theories leading to International Joint Ventures

When business growth strategy is viewed and analyzed from a scholarly perspective, there are two economic models or theories that lead strategists to International Joint Ventures.

Cournot Competition – Economic Model: The model describes a duopoly of companies without collusion aiming to compete, they will set prices and perform actions as a result thereof. Competition as opposed to a monopoly, in which if the companies were to cooperate would result in arguable short term advantageous (output (quality or price) is negative for the market). Therefore, corporate strategists in certain cases of a highly competitive market with many players, choose to cooperate by joining forces (competitor or strategic partner) in order to make a competitive advantage that is against the Cournot competition economic model and can result in performance gains. Note: regulations on unfair market handling will be covered in Section 6.

Transaction Cost Theory: is according to (Williamson (1981)) “when a good or a service is transferred across a technologically separable interface”. When applied to IJVs, the theory promotes the idea that a combination and

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23 Williamson (1981)
integration of certain interfaces allows a reduced cost – this could be for example, the interface of a new technology in a new market. A firm may not be efficient at providing both market and technology and a corporate strategist looking to gain a competitive advantage (time, cost, quality) will seek out a partner to integrate and reduce the separable interfaces. The theory as we will see in section 5, also applies to management who is monitoring an activity – there is a transaction cost associated to the interface. An external advisor or independent director may also bear a transaction cost due to the limitation of prior knowledge in the specifics of the matter at hand.

E. Generalized and Simplified process definition of an IJV

In this thesis, there are three stages that will be characterized as the process for an international joint venture. This is however a simplified and neutral perspective of the process that should not be underestimated in terms of effort, time, cost and professional advisors involved.

![Figure 1 - IJV Life-Cycle Process](image-url)
2. Introduction to Governance

Governance as it applies to corporations – thus corporate governance, and not governments, is a relatively new subject that has been formalized in recent years. Beginning with the Cadbury report\(^\text{24}\) in 1994, one of the first statements outlining the meaning and impact of management accountability and was put into the spotlight in the early 2000s with the demise of companies such as Enron\(^\text{25}\) which failed shareholders by not having implemented an accountability standard practice. It is a period in time that is referred to as “The end of History for Corporate Law”\(^\text{26}\) – emphasizing the major role at play for good CG. Governance has since become an ever-increasing tool used in corporate processes to denote the mechanisms of protecting shareholder interest. Further developments continue to be made both by scholars and practitioners to define and set the standards for Governance of corporate institutions. CG rules and regulations are regularly found in publicly traded companies; however, they are less often found in small businesses such as family-owned businesses that may have different expectations from owners on the management. The trend as we will see, is moving towards an increased level of CG especially for partnership projects with a high level of complexity.

The following sub-sections is a general review of corporate governance that is mostly found in a “single dimension” corporate structure (one set of Shareholders), expanding further into “multi-dimensional” corporate structure (two or more sets of Shareholders) governance where more than one shareholder’s interests may be influence control and direction of a joint corporation (refers to an equity cooperation).

A. Governance in General - What is governance?

Corporate Governance was defined by Sir Adrian Cadbury in the Cadbury Report of 1992 as: “…the system by which companies are directed and controlled”\(^\text{27}\). The report focused specifically on the legal framework of corporate law and corporate

\(^{24}\) Schmidt, Brauer (2006).
\(^{25}\) Currall, Epstein (2003).
\(^{26}\) Hansmann, Kraakman (2000).
\(^{27}\) Johnston (2009).
decision making of the management of companies. It can also be referred to as the context of managerial accountability to shareholders.

B. What is the fundamental need for establishing Corporate Governance?

There are two well-known models that guide corporate governance and accountability of management.

**Shareholder Value Model**: Shareholder Value is a corporate model that is most often found in the US and UK aimed at maximizing the return to the owner (shareholders) of the company. Owners or shareholders establish objectives for maximizing shareholder value, board and management are made accountable to the owners and shareholders to pursue management efficiency and produce financial returns.

*General Electric (SWX:GE) is an example of a company that has a shareholder value strategy – “...expand our growth rate, improve our margins and create value for GE Shareholders...”*28.

**Productive coalition Model**: Takes a stakeholder view of a corporation. In addition to the interests of the owner or shareholder, Management will consider both the interests of the internal (management and employees) and external (debtholders, creditors, suppliers, customers) stakeholders. Decisions are aimed at balancing the best interest of both the stakeholders and the shareholders. Such a model is often seen in the EU and could for example consider incorporating a representative of a stakeholder (such as a union labour representative) for decision-making votes.

*Volkswagen AG (SWX: VW) is an example of a Productive coalition Model, of the 20 Supervisor Board members, at least 10 are representatives of work councils, government affairs or management representation.*29

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C. What is Corporate Governance trying to achieve?

At a high level, CG can be understood as a process for managing the needs of shareholders (owners) and stakeholders (party with direct affect interests) in the guidance of corporate strategy and operations. According to generally accepted CG theorists\textsuperscript{30}, there are two principle theories CG must consider as aspects for contracting and incentivizing a planned outcome.

**Agency Theory:** An agency problem is created by two parties, the principle and the agent, the agent is contracted by the principle to manage and overview his/her business interests with an assumed alignment of goals. However, the theory firstly predicts, the agent will follow his/her own interests aimed at maximizing their personal returns – not necessarily those of the principle. It secondly predicts an asymmetry of information that the agent will have in and as opposed to the principle which may lead to mis-aligned goals due to missing information required to interpret the goals. And thirdly, it predicts a difference in the perception of risk between the agent and the principle (equity and contract). **CG mechanisms plays a key role in resolving the agency theory problems that are typically found at the owner, board, or CEO positions of a business and ensures that the aspects of director (in)-dependence (section 3), decision making (section 4), reporting and monitoring (section 5), and compliance (section 6) activities are part of a formal understanding and process.**

**Stewardship Theory:** A stewardship is described as a person/party who is not considered to be acting in his/her personal interest or for financial incentives, but rather to be acting upon the objective of doing everything that is in the best interest of the company. According to (Glinkowska and Kaczmarek (2005))\textsuperscript{31} they will choose reputation and job satisfaction as incentives over personal interests.

**CG plays a role in the stewardship theory by aligning the beliefs of the owners and the beliefs of the respective managers. A steward board or management,**

\textsuperscript{30} Glinkowska, Kaczmarek (2015).

\textsuperscript{31} Glinkowska, Kaczmarek (2015).
will require a cultural guidance to base certain decisions and a level of trust that will safeguard the respective interests.\textsuperscript{32}

Figure 2 represents an overview of the stakeholders and their specific interests in the business. A good CG policy will consider the interests of each and will establish mechanisms that reflect same.\textsuperscript{33}

\begin{table}
\centering
\begin{tabular}{|l|l|l|}
\hline
\textbf{Stakeholders} & \textbf{Interest} & \textbf{Desired management} \\
\hline
Shareholders & Maximize profits & Profitable management \\
 & Asset protection & Sound management \\
Investors & Efficient investment & Exploitation of profitable investment \\
Creditors & Protection of receivables & Sound management \\
Main bank & Corporate growth & Sound management \\
 & Pursuit of productivity growth & \\
Employees & Pay raise & Profitable management \\
 & Secure employment relationship & Sound management \\
 & Promotion & Sustainable corporate growth \\
Consumers & High quality goods and services & Profitable growth \\
Suppliers & Business stability & Sound management \\
 & Expansion of business & Sustainable corporate growth \\
\hline
\end{tabular}
\caption{Constituents of corporate governance}
\label{table:constituents}
\end{table}

\textit{Figure 2 - Table outlining the stakeholders and interests they have in CG}\textsuperscript{34}

D. What structure does Corporate Governance play in a corporation?

There are two generally accepted supervision constructs applied for public and private companies. While they may differ from region to region – as discussed later in this chapter, they fundamentally serve the same purpose, performing the activities of CG rules and policy.

\begin{flushright}
\textsuperscript{32} Donaldson, Davis (1991).
\textsuperscript{33} Sakai, Asaoka (2003).
\textsuperscript{34} Sakai, Asaoka (2003).
\end{flushright}
One-Tier Board System: A single board that is responsible to the shareholders to oversee the executive management, firm performance and supervision.

A US or UK publicly listed company or a German GmbH.

Two-Tier Board System: Introduces a supervisory and Management Board that are separate and independent from one another. The Supervisory board is nominated and elected by the shareholders and the management board is selected by the supervisory board. It provides an extra dimension of controls and dependence on behalf of the shareholders.

A German AG (both public or private), a Chinese publicly listed company (most often – but must not be) are typical to have a two-tier structure.

According to Urbanek (2005)\textsuperscript{35}, the primary task of the supervisory board is “…the assessment of actions taken by members of the board, evaluation of their management skills and their input into meeting shareholders’ expectations…”. In order to better understand the primary tasks of the supervisory board, a more detailed review of the relationship between shareholders, boards, Executive management and functional management is required. Figure 3 represents a simplified stakeholder map with a graphical representation of their CG involvement and table represents a detailed analysis on the role, functions and activities of one-tier and two-tier boards.

\textsuperscript{35} Urbanek (2005).
Table 1 - Analysis of Interested Parties of an IJV. Interpreted based on the work of Glinkowska and Kaczmarek (2015)36

E. What makes good governance and bad governance?

According to (Bamford and Ernst (2005))37, good and bad governance can be characterized and reflected in terms of risk to their business objectives.

**Good governance:** is characterized as fast, accountable and transparent governing principles that leads to good performance as a result.38

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37 Bamford, Ernst (2005).
Bad governance: is characterized as being prone to gridlock, weak in performance management, high levels of mistrust and stagnation of the opportunity that is value destructive.  

E. What is a General Definition for Corporate Governance?

It is therefore possible, based on an analysis of scholarly works and the understanding of the activities of corporate governance to develop a definition that can be used as the overarching principle to be further studied in the following subsections referring to the specific needs of partnership Corporate Governance and specifically IJV corporate governance.

The following statement or definition for CG in general (not IJV specific) is proposed:

**CG at the highest level is the alignment of the shareholders and the stakeholders towards accountability and responsibility of meeting corporate interests. CG at a practical level is the alignment of a contracted representative accountable and responsible for managing the interests of the parties directly related to company.**

F. Partnership Governance as it relates to IJV

The singular-dimension aspect of CG (a single company with a single set of stakeholders) used in a multi-dimension corporate setting that can be understood as partnering (partnership) or the formation of a cooperation. According to (Tjemkes et Al. (2018)) a corporate partnership is defined as an engagement between separate organizations to combine resources aimed at jointly achieving a strategic goal – that alone might be too costly, too risky, too slow or simply not feasible.

For the purposes of this analysis on CG partnerships, the focus will be on International (global environment) Equity (each party owns a stake in the new
venture) Partnership that has the objective of teaming efforts of two or more organizations to pursue a business venture.

G. What aspects of Corporate Governance are special to Partnering?

The introduction of multi-dimension ownership within Partnerships, has attracted substantial attention in the last decades. According to Peter Drucker in his book Classic Drucker\(^{42}\), he confirms the complexity in the following way: “Today businesses grow through alliances (partnerships), all kinds of dangerous liaisons and joint ventures, which, by the way, very few people understand.” As was discussed in Section 1, successful joint venturing or partnerships in general are difficult to achieve and thus the importance of good CG.

H. Trends and Current Developments

The current trend is for increased independence between the shareholders and management at the Board of Directors level.

**CG Trend A:** There is a trend that can be seen in US listed companies for boards to become more independent from the management. In only 50\(^{43}\) of the companies does the CEO serve on the board. There is a further case law with Oracle (SWX: ORCL) – whereby according to (Block and Gerstner (2016))\(^{44}\) – the chairman must have no material relationship with the listed company, an issue that arose for the founder and major owner Larry Ellison. Furthermore, 29\% of S&P 500 boards have truly independent chairmen as compared to 9\% in 2005.

**CG Trend B:** Dependant and independent directors. According to (Block and Gerstner (2016))\(^{45}\) 84\%\(^{46}\) of S&P 500 boards are now independent

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\(^{42}\) Drucker (2006)  
\(^{43}\) Block, Gerstner (2016).  
\(^{44}\) Block, Gerstner (2016).  
\(^{45}\) Block, Gerstner (2016).  
\(^{46}\) Block, Gerstner (2016).
CG Trend C: According to (Block and Gerstner (2016))⁴⁷ 91% of board members stand for election on an annual basis as opposed to only 51% in 2004.

⁴⁷ Block, Gerstner (2016).
3. IJV Board and Management

With section 1 developing the context for IJV to operate and section 2 the general CG functions in a multi-dimension ownership structure, this first of four subject matters will look toward the application of CG through the management structure. Focusing on the accountability of stakeholders, under contract to the shareholder, with respect to the performance and value creation of IJVs. It should be noted, that each business venture will be unique due to venture specific details and partner negotiations. There are however, certain establishment processes that will have common aspects. The objective of this section is therefore to analyze the general behaviours of board and management in CG of IJV board and management that will hopefully lead to more successful business ventures.

Thesis: Formal CG applied at the ownership, board and management levels will set the foundation for delivering success to the partnership by: fair decision-making processes, engagement by the partners through equity commitments, and management team that focuses on aligning established objectives.

A. Ownership Structure

Structuring the ownership of an IJV, can be a catch-22 paradoxical situation. Corporate strategists responsible for finding new value will create scenarios for business opportunities that may have no current market, no current product, or no current market access. The scenarios will attempt to quantify a business model but will be flawed at best due to Ex-Ante knowledge of the defined IJV scope. The concept of Ex-Ante according to Elfenbein and Lerner (2003) is made on the foundation of incomplete contracts, whereby the agreement including the objective is built upon expectations rather than facts (i.e.; Ex-Post). As such, the pre-formation phase is one that will qualify partners for the challenge and may set the equity level of each partner for the specific circumstances of each venture. The three commonly accepted ownership categories are:

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48 Reuer, Klijn, Lioukas (2014).
**Majority:** Share equity ownership of greater than 50%. Also referred to as dominant partner or super-majority shareholder (when share is greater than 70%).

**Equal:** Each partner owns an equal percentage of the equity. In the case of a partnership consisting of two equity partners, each partner owns 50% and are typically referred to as 50/50 partners.

**Minority:** Equity share ownership of less than 50%.

Unlike alliances that typically have a higher dependence on each partner (without one partner the other cannot operate) and lower equity investments – joint ventures are aimed at creating new value that each partner may not be able to achieve alone but by combining the knowledge, assets or resources of each partner, will make it possible.

Ownership structure is also highly influenced by local regulations or tax planning that are regulatory requirements used for market protection. China has in the past required the home country to hold a minimum of 50% equity share, this however is becoming a reduced regulatory requirement for entering the Chinese markets, thereby creating an opportunity for negotiators to leverage ownership and decision-making power.

As part of the ownership structure, there are two/three key considerations that when used in good faith help both partners achieve their goals, namely:

**Minority Protection:** A fair method for the minority partner to have a say on the strategic direction of the structure. Governance mechanisms which specifically allow minority partners to safeguard and influence the venture. They can be found under contractual protection (See Decision Making in Section 4).

**Exit and Termination process:** A clear method for partners to end the partnership through an agreed upon set of parameters and conditions that

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also provide for the venture the possibility to continue its existence without the other partner involved.

Good corporate governance in ownership structuring is one that allows for changes. According to (Bamford, Ernst, Fubini (2004))\textsuperscript{53} the following points are key CG topic points at both the IJV pre-formation and IJV execution.

**Strategic Alignment:** understanding why the JV is created, what purpose it will serve and what the interests and expectations of each partner are. High importance on resolving strategic conflicts will lead to a unified interpretation of value.

**Governance System:** a method of communicating stakeholder interest and performance expectations through the right to direct the venture. See Board Structure.

*Note: A more detailed analysis of Ownership structure and decision making is covered in Section 4 – Decision Making.*

### B. Legal Form

The legal form of an IJV requires considerable thought not only in terms of the operational circumstances but also in terms of risk and tax planning.

**Country and State:** The selection of the Country and State are important aspects not only for access (market, resources, talent) but also for experience in dealing with conflict resolution. In the US for example, Delaware is often chosen by stock corporations due to the well-established corporate laws.\textsuperscript{54} When solid CG is applied in markets with strong corporate laws, not only are the expectations upon management transparent, but they can also expect consistency.

**Corporate Structure:** The nature of a JV requires it to form a separate legal entity – leading to a decision as to the form (type) of incorporation.

\textsuperscript{53} Bamford, Ernst, Fubini (2004).

\textsuperscript{54} Hewitt (2001).
SE: The EU in its effort to become a single market has introduced the form SE (Société Européenne) taking the form of a German AG with the benefit of flexibility when it comes to operating within the EU.

AG: An IJV can take the form of a German AG with a supervisory board with the possible benefit of having an independent nature to the business.

Dissolution and Exit: A well formulated and negotiated partnership agreement will provide the dissolution trigger and scenario for the venture. It offers the partners a defined exit strategy and a clear path for the continuation or dissolution of the business.

According to Stienstra and Marting (2017)\textsuperscript{55} there are four possible exit scenarios that return value to one or the other partner.

Buyout: One partner will purchase the other partners’ equity shares in the IJV.\textsuperscript{56} CG mechanisms allowing the opportunity for one partner to buyout allows for risk management and focus amongst the market and partners.

Acquisition: One partner will acquire the other partner and thus its equity shares in the IJV. A form of market entry for the partner with the benefit of information asymmetry (Ex-Post knowledge of the scope and business opportunity).

Bankruptcy (of the venture): Other than through forced bankruptcy, a risk mitigation that requires consent of all partners involved. May occur in the form of a liquidation (choosing not to re-invest) or insolvency (bankruptcy).

Public Listing: One method to dissolve a joint venture is to transform the IJV into a publicly listed company and sell shares on a stock exchange. In Germany this may be in the form of an AG, in the US this

\textsuperscript{55} Stienstra and Martin (2017)
\textsuperscript{56} Stienstra and Martin (2017)
may be in the form of an LLC. It is worth noting from a Transaction Cost point of view, operating a Joint Venture in an AG form does bear a cost and must be considered.

The pre-formation stage as according to (Bamford, Ernst and Fubini (2004)) has an impact on how the venture will perform and create value. Governance is therefore not only applicable to the IJV once created, it is also found early on in the discussion process and should be clearly established within the partners own governance mechanisms.

C. Board Structure

The board of IJVs can be made up of both dependant and independent members that are appointed by the parties to lead the governance activities of the IJV. The role of the board based on (Boot and Macey (2004)) was identified as the key monitoring and supervising activities – a topic that will be further developed in Section 5 – Monitoring and Reporting. According to (Glinkowska and Kaczmarek (2015)), the functions of the board are:

- Supervision
- Consulting
- Decision-making
- Cooperation
- Information exchange
- Stakeholder coordination

The structure must reflect the strategy, function and size of the venture especially considering the complexity in their collaboration. Complexities arise from the nature of multi-dimension collaboration when dealing with three or more stakeholders, that is two shareholders and the executive management. According to (Klijn, Reuer, Van

58 Bamford, Ernst, Fubini (2004).
59 Refaat, Schmidt (2016).
60 Refaat, Schmidt (2016).
den Bosch and Volberda (2013))\(^{61}\) coordination of actions between the partners and the venture are the main objective of the board.

There are several considerations in the board structure that according to practice and research lead to performance and value creation; some of these considerations are:

**Size:** The size of the board of directors typically have to do with the IJV size and with the amount of supervision required by the parent companies.

**Independent directors:** Using independent directors to contribute a new dimension to the venture that the venture partners may not hold. There is research according to (Lai et Al. (2014))\(^{62}\) that a mix of independent board members brings an aspect of external professionalism and structure. Another consideration for nominating independent directors is with a view to resolving a decision gridlock that may occur in equal venture partnerships\(^{63}\). (Earnst and Bamford (2005))\(^{64}\) have also referenced that adding one single outside director to the board injects discipline on the boards behaviour – transparency and financial returns.

**Chairman:** The Chairman of the board may in circumstances of a tie vote bring an extra dimension through a casting or determining vote. In the case of an equal equity partnership, the chairman may play an alternating (year-by-year) role for example\(^{65}\).

**One-Tier or Two-Tier:** As discussed in the ownership structure section, a German AG may require the appointment of a two-tier board. This according to (Johnston (2005))\(^{66}\) may introduce an increased level of autonomy to the venture that is then seen from the shareholders point of view as a venture capital investment as opposed to a cross-synergy merger model.

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\(^{61}\) Refaat, Schmidt (2016).
\(^{63}\) Refaat, Schmidt (2016).
\(^{64}\) Reuer, Klijn, van den Bosch (2011).
\(^{65}\) Miller, Segall (2017).
\(^{66}\) Johnston (2009).
**Freedom to operate:** The board has the function of putting into operation strategy or objectives for the venture business as expressed by the partners and must have the freedom and tools (including funding) to do so.

**Appointment and Removal:** The underperformance and removal of a dependant director may bring an aspect of micropolitics in the re-organization for better performing directors.67

**Involvement:** It is suggested by (Kumar and Seth (1998))68 in the theory of Structural Contingency that the involvement of boards should be greater when a joint venture and a parent firm are strategically interdependent. According to (Reuer et Al. (2014))69 the board will delegate to local management when significant cultural differences or environmental uncertainty are present..

**Meetings:** A minimum number of Board meetings per calendar year should be pre-established. According to Garcia-Canal et al. (2003)70, board meeting for IJV occur 5.1 times on average per year.

**An expectation of stability:** The board itself is nominated and elected by its parent company (directly or indirectly) to serve the board position. The nature of a JV is according to (Reuer et Al. (2011))71 a transitional form of organization and must use good CG practices to stabilise the business volatility.

If good corporate governance is introduced in IJVs, the director structure should allow the venture to perform and create value by enabling the Board to seek opportunities to guide, consult, supervise as opposed to dealing with micro-politics or micro-management.

Notes. The board is the contract enabler – it has a different principle as public companies. It must complete the incomplete ex-ante with ex-post.

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69 Reuer, Klijn, Lioukas (2014).
70 Sanchez, Pablo & García-Canal, Esteban. (2005)
71 Reuer, Klijn, van den Bosch (2011).
### IJV Board functions:

<table>
<thead>
<tr>
<th>IJV (Multi-Dimension)</th>
<th>Corporate (Single Dimension)</th>
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<tr>
<td>Coordinating partner and venture actions</td>
<td>Coordinating individual or sets of shareholders with venture actions</td>
</tr>
<tr>
<td>Facilitating strategic planning</td>
<td>Facilitating strategic planning</td>
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<tr>
<td>Alignment of needs in the partnership</td>
<td>Overseeing senior management</td>
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<tr>
<td>Overseeing senior management</td>
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<tr>
<td>Deciphering the information asymmetries</td>
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<td>Monitoring</td>
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<td>Advice/Consulting</td>
<td>Strategy crafting – Strategic Planning</td>
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<td>Resource provision</td>
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<td>Strategy crafting – Strategic Planning</td>
<td>Legal compliance - locally</td>
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<td>Succession planning</td>
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<td>Legal compliance - globally</td>
<td>Setting dividends</td>
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<td>Setting dividends</td>
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*Table 2 - Comparison of Multi and Single Dimension Shareholder Board functions*
D. Management Structure

Due to the nature of the partnership formation (two shareholders with a common goal) ownership and management should have a defined degree of separation with a clear governance structure and performance metrics.

Appointment: Depending on the ownership structure, the right to appoint the CEO may be pre-determined. The key attributes of the CEO with be his/her skills and capabilities in leading the strategic vision of the founding partners. Good governance mechanisms and clearly defined performance metrics and

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*Table 3 - Reflective questions to consider when applying business practice to governance issues.*

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Reuer, Klijn, van den Bosch (2011).
timeframes will layout clear scorecards\textsuperscript{73} from the board to the CEO in order to meet the objectives set out by the board.

\textbf{Authority:} The level of authority of the CEO will be decided upon by the board and will play a key role in realizing the objectives of the new business. As the trust relationship grows and performance metrics are realized, the CEO’s level of authority may be increased. Again good governance practices will ensure monitoring and supervision to confirm management’s results.

\textbf{Responsibility:} It is the case in most legal jurisdictions for the venture CEO to be contracted, thus meaning the legal responsibility for the venture will lie in the board of directors appointing the CEO.

The CEO has the role of coordinating and balancing the needs and requirements of the partners and integrating the synergies of the two business units in order to create value in the product or service. It is the case that good governance practices, the understanding of the CEO with respect to his authority and responsibilities will set the expectation for results.

Although, the above can be seen as more generalistic, the partner negotiations will want to consider certain aspects of management governance that will use their synergies to benefit the IJV. The ultimate setup of the management structure of the joint venture will require strong governance to reduce the transactional costs of supervision and management.

It is reported by Water Street Partners (a JV advisor) that only 5\% of JV CEOs have experience in running partnership ventures.\textsuperscript{74} The nomination of the CEO is the responsibility of the board who are accountable to the shareholder. Discussed in the following sub-section.

\textsuperscript{73} Johnson et Al. (2017).
\textsuperscript{74} Bamford (2018).
E. Accountability and Responsibilities

In section 2A on the definition of CG we saw the first mention of the accountability and responsibilities upon the management involved in CG. Good CG practice will typically refer to three specific elements of duties of the directors or management acting on behalf of the shareholder.

**Skills and Care:** The objective and subjective application of knowledge, skill and experience. There is an expectation that an IJV partner will appoint a board manager that is competent in his/her abilities to lead a venture. According to Hewitt (2004) there is case law in UK courts for liability of supervision when the Director ought to have supervised or ought to have known.

**Fiduciary duties:** Directors of IJVs have defined fiduciary duties, in the case of a director who is serving both the partner company and the IJV. The director must act in the best interest of the IJV. Good CG will further define the scope of the director’s responsibilities in regard to the company, for example the allowance and permission to exercise independent judgement. This CG action may enable better decisions in favour of the IJV, leading to overall value creation and performance.

G. Innovations in IJV Leadership

Innovations in organizational behaviour at the Board and Management level are led by the negotiations of the two partners and their experience dealing with joint ventures. There are however, certain governance areas that should be addressed to increase the success rate of the venture business.

**Independent directors:** the use of independent directors in single-dimension companies is known and has been studied suggesting a shift in the S&P 500 towards increased levels of independent directors and independent

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75 Hewitt (2004)
76 Hewitt (2004)
Joint ventures are also using independent directors to govern the business, leading to conflict resolution methods, technical or business external advisory, minority right protection mechanisms and a way of public marketing by involving a public figure.78

**Committees:** the typical reporting and monitoring committees as we will see in Section 5 are being complimented by technology committees who are specifically created to make key technical direction decisions.

**Venture Management:** According to (Babitz and Glover (2012))79 there is a trend to assign two venture CEOs. Assigned by each of the partners, it is designed to serve overlapping terms or be responsible for distinct operations within the venture (ex: building construction and building operations or Product manufacturing and Product Marketing).

**Local Management:** According to (Reuer et Al (2014))80, a trend of allocating more authority to local management for certain international collaborations may have efficiency considerations on CG specifically as concerns the understanding of local laws and business practices.

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77 Reuer, Klijn, Lioukas (2014).
78 Babitz, Glover (2012).
79 Babitz, Glover (2012).
80 Reuer, Klijn, Lioukas (2014).
4. Decision Making (Control in IJV)

Decision making in hybrid organizations such as IJVs is according to (Dann (2011)) a major consideration on not only the contractual element of the articles of incorporation but on the interaction of the partners. The effect of multi-dimensional shareholder structures on hybrid organizations with regard to the set of capabilities and degree of cooperation are causes of misalignment, ineffectiveness and inefficiencies of governing and the decision-making process.

In order to apply formal governance (direction and control) to an IJV, an analysis of decision-making economic theories must be developed and understood.

A. Decision Making and Corporate Governance

With the creation and the formalization of a joint venture between two partners, a contract whereby an equity based legal entity will be formed and created in order to pursue the joint opportunity. It is however an Ex-Ante process that has limitations as concerns company specific attributes at the pre-formation stage. Attributes such as management, employment, market, resources (tangible and intangible), etc.. The intent of the partners is to pursue the opportunity with a common belief of achieving a common objective. It is therefore the task of the various levels of management assigned to the governance of the IJV to deal with further Ex-Ante or Ex-Post events that have strategic or operational impact on the venture entity.

**Voting:** Although voting rights may be clearly outlined in the contractual agreement between the partners or the constituting documents of the venture, there are aspects of decision making in majority, minority and equality that raise issues for the need to protect the interests of various shareholders while at the same time ensure performance and value creation efforts of the joint venture. In most cases, voting is based on the equity ownership of the partners, however some partnerships may include minority or adjusted voting.

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81 Dann (2011).
82 Dann (2011).
in order to balance certain aspects of the contract or abide to local corporate law. In the two generally accepted supervision constructs referenced in section 2, voting may depend on class rights or share rights (according to UK law) – this thus allows a structure that if well executed, will allow the respective class or share rights holders to execute decisions based on their objectives (individual and/or joint).

Two-Tier board structure: Decisions at the Supervisory board level (the board nominated and elected by shareholders) include selecting directors to the Management Board, ownership and issues related to corporate constitution as well as dividend payments. At the Management board level voting rights will be on decisions which are venture specific activities such as investments, management and strategy.

Single-Tier structure: In a single-tier board construct (most likely in an IJV) the Board may have both the voting rights to affect the constitution of the IJV, as well as voting rights for venture specific activities. Essentially a combination of the above stated two-tier board structure.

Although there is no specific research that has been made with regard to the commonality of these structures nor the performance implication of the class rights in joint ventures, it is suggested that in accordance with Killing (1982), that the roles and responsibilities of to each level of governance (shareholder, board and management) must be clear and precise – that any escalation or misuse of veto or voting must not be politically interfered with, but solely used in the pursuit of the venture firms success. The structure of the voting rights and enabling of veto should thus be a pre-formation negotiation strategy that is performed Ex-Ante and only with a good structure can Ex-Post information be handled efficiently with clear decision-making powers and directors voting in the interest of the IJV itself.

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84 Cuypers et al (2016).
87 Killing (1982).
In the event of a deadlock (where a vote of Directors results in neither the approval or disapproval of a resolution) the venture must have certain safeguards that enable a resolution of the deadlock which does not affect the continued governance tasks of the board nor the operations of the IJV. A mechanism for breaking the deadlock could be:

**Chairman’s Casting Vote:** A right awarded to the chairman in an effort to decide upon conflicting views. This is often found with the majority partner.\(^{88}\)

**Reference to escalation of venture management:** in the event of a deadlock, a governance clause may allow for the partners CEOs to decide together on the outcome based on their judgement and their expertise with executing the decision.\(^{89}\)

**Reference to Independent party or swing vote:** reference to an external independent party who is not an active member without relational circumstances such as a judge or legal professional may be an option to break deadlock.\(^{90}\)

**Reference to arbitration or mediation:** A democratic approach using professional mediators to resolve diverging decisions.\(^{91}\)

Again, there is no quantitative research that would suggest one method or the other is best or results in value creation. It is most likely that positive experiences by negotiators and lawyers will lead them to one method or the other. However, the importance of deadlock solution that is quick, precise and in the best interests of the venture must be in place, especially considering the impact to the venture if a decision with regard to budget or investment is not taken in a timely manner. Failing a deadlock solution may result in grounds for dissolution of the IJV whereby according to Hewitt (2004)\(^{92}\), the alternative to not arriving to a common decision may lead to litigation of one party against the other in a court and based on English law may lead to a wind-up and insolvency of the business.

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\(^{88}\) Hewitt (2001).
\(^{89}\) Hewitt (2001).
\(^{90}\) Hewitt (2001).
\(^{91}\) Hewitt (2001).
\(^{92}\) Hewitt (2001).
Deadlock provisions are key requirements for IJVs to have in place in order to minimize setbacks to the performance of the common objective.

B. Economic Theories for decision making – focused on IJVs

There are several economic theories that have been developed for general management regarding decision making and control. Due to the complex nature of IJVs the aspect of how a decision may be made is directly correlated to the basis for the decision making theory. These economic and game theories on IJV economic governance will serve as a framework for posing further hypothesis and underlining the challenges of decision making in complex situations. In order to analyze the static and dynamic effects we will use Game Theory as a method of evaluating the players of the partnerships in regard to adverse selection, agency theory and moral hazard as it applies to agency theory.

Game Theory in General: Game theory is aimed at providing logical paths in situations occurring between co-operation and conflict. The behaviour of the players can be cooperative and non-cooperative. The information provided can be common information (information known equally between both partners), perfect information (all options transparent and known – chess for example) and imperfect information (hidden data or knowledge from one partner to the other). Game theory is typically represented in either a Matrix or a game tree. The balance of incentives, information and pay-offs, along with players and time structures. According to (Ott (2006)), the games in IJVs are too complex to describe and are thus often replaced with timeline representations. The game will develop situations and solutions to conceptualize an event or scenario of events that may occur. This has all the practicability in IJVs and is a structured method of understanding the external as well as internal causation of decision making.

Adverse Selection: According to research, a duration of time or experience with a partner will reduce the adverse selection quotient and thus lead to higher

performance and conflict resolution. However, adverse selection can lead to a reduced behavior of relying and creating written agreements of the formal kind. It is therefore a conclusion of Ott (2006), that a time component to very diverse cultural partners is required in order for benefits to be understood by one another and allow for optimal cooperation.

Adverse selection must consider the abilities and competencies of players involved in the IJV. In the formation process, the nomination of board and the nomination of the CEO are elements of asymmetric information that will cause other participants and players to doubt for example the quality of a manager, or a partner (player) to doubt the other partner in her ability to reach the targeted market. This aspect of doubt is understood as being unfair towards the cooperation (the IJV partner), that leads to tension and trust in the cooperation. CG rules must manage the authority and the expectation for reducing doubt through either communication or policies.

The effect of adverse selection can be reduced and controlled through the implementation of due diligence (typically found for legal, financial and business). However, intangibles such as the knowledge one person or group of persons may or may not have to develop a new technology be not understood – due to complexity, or communication or interpretation and can be further considered “unfair”.

Thus, the experience gathered and gained by each partner over time, will remove certain Ex-Ante asymmetric information and result in better judgement of abilities and competencies of the other partner. Adverse selection and its incorporation in corporate governance, ranging from how often meetings are set, methods of allowing learning, a sharing of information, and a system of identifying what information may be missing will lead to cooperative results and have an impact on the performance (timely decision making, understanding for complexity) and value creation (learning, information, better decisions).

**Agency Theory**: In decision making process, the agency theory introduces aspects of contractual arrangements between the players that are of importance to the performance of IJVs. According to Ott (2006), there are three forms of arrangements

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95 Ott (2006).
for IJVs, namely: independent, shared and dominant, this categorization introduces an aspect of effort and incentive on the players in their specific cooperation’s. Incentives can range from contractual (ex. salary) agreements, trust contracts (ex. departure payment) and bonus contracts (ex. special payment or dividend payment).

Based on the work in developing and applying game theory to IJVs\textsuperscript{96} has been able to show how contracts issued by the partner companies upon their venture have an influence related to the effort for their management to cooperate – thus the effort to apply governance. It furthermore indicates the incentives or payoffs must be aligned with the categorical arrangement of the IJV, a shared partnership must have the feeling in the case of equal incentives that both partners contracted agents (i.e: the board of directors) are applying the effort and that there is no adverse selection involved to call the partnership unfair. Therefore for governance amongst the partners (shareholders) and amongst the players (board) the incentives must be representative of the efforts. If properly contracted this will lead to a reduced agency problem and better transparency on the output of boards, management and employees of each firm that is partaking in the venture business.

**Moral Hazard related to Agency:** There is another element of agency theory not related to the performance but to value destruction (also covered in section 6). The implication of effort upon partners and players according to game theory and analysis developed by (Ott (2006))\textsuperscript{97} has to do with low effort levels resulting in the form of cheating, shirking, embezzling and sabotage. Good CG policy practice will consider the unfortunate circumstances when taking a short-cut is easier than performing.

A hazard to the partnership occurs when a partner is not delivering or outputting the relational understanding that was explicit or implicitly agreed upon. It is in some cases the wish of JVs to perform learning exchange in order to leverage each others offering (synergetic product and service for example) benefitting from learning characteristics however the governance of IJVs must understand the actions of the partners and the certain payoffs that could be generated once the learning has been

\textsuperscript{96} Ott (2006).

\textsuperscript{97} Ott (2006).
accomplished. Governance matching the specific business objective will balance the hazards and possible lead to positive performance value of the players.

C. Decision Making areas of particular attention in IJVs

Termination Decision Making applied using Game Theory: In most cases of partnership contractual agreements there appears to be a termination clause that is drafted Ex-Ante at the time of formation, expecting a certain outcome or result. The termination may be planned or unplanned, it may be time restricted or event restricted (failure to reach a KPI) and most often considers the partners that are inexperienced with one another. The method of planned termination whether it be set pricing, right of first refusal (shotgun) or share valuation process can have an impact on the venture throughout the life of the IJV and can determine the relationship between the partners and their dealings amongst themselves.

The potential of asymmetrical distribution of information in the termination results could be one for concern regarding safe-guarding the business and keeping competition at bay. Knowledge or the lack of knowledge that one partner would source a competitor as future partner will institute a value (business future valuation of the company) that is un-attached from an asset or liquidation valuation of the venture. Moral Hazard may apply in the case of retaining certain information or technology (through resources used or involved in the IJV) in the termination. Information asymmetry will also apply from the point of view between executive management, the board and the shareholders. Although there are legal frameworks for handling exit provision such as: tag along, drag along, put and call options (shotgun agreement), public offering and/or liquidation, the situational elements will have an impact on the handling of the company.98

Levels of Management Decision Making: Strategic misalignment is according to (Dann (2011))99 a major cause for concern and points to clear enunciation of the mutual and joint objectives. Communication and culture can also play a role in making and developing both strategic and operational decisions. According to

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99 Dann (2011).
shareholder complexity, information complexity and decision complexity are three factors are a cause for concern in IJV. The challenges of making a decision large or small will entail some sort of information asymmetry and depend heavily on moral hazard of information quality that are taken in Ex-Ante circumstances. As discussed in Section 2, governance may be put in place as a tool to manage the transition between Ex-Ante (pre-formation phase) and the Ex-Post (execution phase).

Due to the nature of the dynamics and the changes that cause the partnership to find a competitive advantage, the decisions made and taken at all levels with continue to be and remain Ex-Ante. The decided IJV framework structure will be known (Ex-Post) and until the termination when one or both partners have exited the venture can the view be Ex-Post. I would argue therefore, that the circumstances and understanding of the market, assets, operations, customers can only approach an Ex-Post situation but never be one entirely.

With the above kept in mind, the information asymmetry that each level of management receives will by nature be distorted due simply to the ways and methods information in corporations is communicated. The most amount of information is found at the executive or middle management, with reports or briefs submitted upwards and orders submitted downwards to function employees. The withholding (due to limitations of summaries) characteristic to information that if known could help make better informed decisions. However, the aspect of information for decision making at all levels is a key governance topic that if studied well and under the right transaction costs will improve the performance and value creation of the business.

D. Decision Making Inclusion

There lacks the quantitative support to make a scientific statement as to the fact that good governance in decision making can drive performance and value creation in an IJV. It does however point to the fact that good governance must take into
consideration many elements of the decision-making process, policy and application because partners will have other objectives and may lack information as we saw in the agency theory and the moral hazards. Corporate governance policies which deal with the points for decision making from the on-set is a positive step in the direction towards identifying performance and value creation opportunities.
5. Monitoring and Reporting

Up to this point, the analysis has focused on active control in corporate governance, whereby the actions are taken in the pre-formation and the decisions are taken in the execution. In this section of the thesis, I would like to focus on the passive aspect of reporting and monitoring that looks objectively and subjectively at performance and value creation – that quantifies and qualifies: decisions (input drivers), performances (results), behaviours (management), and identifies risks and challenges (business risks).

Good CG requires excellent monitoring and reporting practices which benefit the decision-making process, and which can result in value creation. The opposite, slow and complicated identification (monitoring and reporting) of problems and inefficiencies, is according to (Bamford (2007))\(^\text{101}\) a major reason why IJVs underperform, create risk or are prematurely terminated.

A. Monitoring

The need for monitoring comes from the Agency Theory, already discussed in Sections 2, 3 and 4, it is the prime method for the agent and principle to ensure if the mechanisms to achieve objectives, incentives and results are aligned and produce ethical and fair results in the interest of the venture. Depending on the board and management structure of an IJV, monitoring each level of management, can cause undue stress due to the general complexity of the corporate structure. A transaction cost perspective may be used to determine the extent of monitoring, (i.e. what should be monitored, to what level and what cost of monitoring is acceptable to manage the size of the risk). The cost of monitoring is not the only consideration as there are several legal monitoring requirements which must also be adhered to and discussed further.

\(^{101}\) Ott (2006).
Monitoring Behaviour: According to (Child (2015))\textsuperscript{102}, the dual agency problem is one that is specific to JVs and IJVs, whereby there are two principals (Parent entities) with multiple agents (board) and multiple principals (board) with a single agent (CEO). The responsibilities for monitoring can be understood through the following three levels of IJV management:

**Ownership Monitoring:** Stakeholder or Shareholder – owners of the capital. Seeking through monitoring to ensure the capital or debt is being properly invested and managed.

**Strategic Control Monitoring:** Board of Directors – contractual engagement by the shareholder. Seeking to ensure the resources (assets, human resources, market development) are properly utilised and imposes KPIs upon the CEO for achieving objectives.

**Operational Monitoring:** CEO – contractual agreement with the board. Seeking to ensure his/her executive management staff are coordinated and execute the strategy with the view of achieving stated KPIs.

An aspect according to (Child (2015))\textsuperscript{103}, that often happens with monitoring behaviour is the influence of control. A board member for example that oversteps the CEO, this can lead to a loss of control and result in the failure or inability for the CEO to perform his duties. Thus, the aspect of monitoring is one that should be purely observational. It should also not be openly challenged to cause distrust in the hierarchy or distort management intensions.\textsuperscript{104}

**Monitoring through committees:** Monitoring is typically processed through the formation of committees that may include internal or external advisors determined to identify both the quality of information and the results of the strategy. This form of bureaucratic and structured monitoring mechanisms could be considered a burden and cost to the company, however as (Child (2015))\textsuperscript{105}, rightfully points out that bureaucracy means the effective use of structure to resolve or understand the

\textsuperscript{102} Child (2015).
\textsuperscript{103} Child (2015).
\textsuperscript{104} Child (2015).
\textsuperscript{105} Child (2015).
business mechanisms and is given an official purpose and allowance to review the key business activities. Therefore, despite the process being bureaucratic and require a cost to perform them, they are seen and understood to be long term benefits leading to performance enhancement and potential value creation of the companies.

- Audit.
- Strategy.
- Compensation.
- Technology. Focused on the qualification and decision-making processes of technology (asset or development) technology committees in JVs are highly prized and regarded as specific monitoring systems for highly dynamic markets.

**Monitoring management effectiveness:** According to (Child (2015))\(^\text{106}\), since the early 2000s and in light of the Enron collapse, monitoring has been emphasized in good corporate governance and has taken a more active role. Monitoring of CEO performance in publicly-listed companies is a transparent measure of matching shareholder expectations and the hiring/firing of the CEO.

**B. Reporting**

Reporting by parent companies on IJV performance is according to (Bamford, Ernst (2005))\(^\text{107}\) without good governance at the parent company an activity that is often lacking by the parent given the fact that it is not an FOS. Notwithstanding, reporting plays a major role in the assessment of not only financial accounts but also technology and market readiness. In this sub-section, the focus of corporate governance will revolve around the challenges faced by IJVs specifically, the quality of reports, the standards and the various issues regarding transparency and external reporting.

\(^{106}\) Child (2015).
\(^{107}\) Bamford, Ernst (2005).
Reporting Standard: As can be anticipated when operating in international markets there may be reporting challenges as a result of conflicting or varying accounting and auditing standards. According to (Charkham (2005))\(^{108}\), the simple aspect of language that is used when describing or reporting can differ. An example is the description that is formally and informally used to describe revenue of a company such as: revenue, sales, turnover, income, top-line, gross revenue, gross receipts (for non-profits)\(^{109}\). Added to the consideration that there are several accounting methods (cash basis and accrual basis)\(^{110}\) for processing the measure of revenues generated by a company. The complexity in international markets can understandably be further affected by language or level of education of the management involved at each level of the IJV. The reporting standard is an area that is often overlooked as an issue for good corporate governance but is one that if well structured and develop clear policies could benefit the mutual understanding of the partners.

International Reporting Quality: in the context of IJV the quality of reporting has an impact on due care to be placed on information being asked to be reported. According to (Child (2005))\(^{111}\), the quality of reporting that is typically found in Latin America or Asia is of lesser quality than reporting in European and North American countries. The value of the company can therefore be misrepresented by the simple means of reporting quality standard.

Reporting Transparency: The culture in certain countries may vary in terms of reporting results to employees and external partners. According to (Charkham (2005))\(^{112}\), the transparency or reporting between the management and the board is in the example of Enron a key aspect for information and communication to be transferred between levels. The level of transparency and regulation for the reporting of information applies not only to

\(^{108}\) Charkham, Ploix (2005).
\(^{109}\) https://en.wikipedia.org/wiki/Revenue
\(^{110}\) https://en.wikipedia.org/wiki/Revenue
\(^{111}\) Child (2015).
\(^{112}\) Charkham, Ploix (2005).
shareholders and management but also to markets, media, intermediaries, governments and possibly rating agencies.\(^{113}\)

**Independence and External reporting:** There is according to (Bamford, Ernst (2005))\(^{114}\) the benefit for companies to initiate an independent review process that uses outside auditors for aggressively benchmarking the performance of the business. Despite the “loss of control” effect as discussed in Sub-Section A, an external method of reporting could benefit from goodwill management and the neutral opinion of an expert advisor.

The function of reporting in IJV is for CG policy making an important area of focus that will allow management to obtain quality and accurate reporting on which to base their decisions. Reporting is however, not only financial based, the board and management performance are also reported that ensures the objectives are matched with strategy. According to (Schmitt and Brauer (2006)) a method or reporting the value created by the management is the comparison between strategy announcement and the actual resource allocation that can determine whether for example the boards strategic decision was executed.

Above and beyond performance of management, there are reporting regulations for publicly traded companies (in the US) that are moving from a major equity reporting mechanism to a major risk reporting mechanism. This entails changes to the financial auditing process of listed companies with minority interests but have for example a large exposure and risk analysis intended for shareholders.\(^{115}\)

\(^{113}\) Charkham, Ploix (2005).
\(^{114}\) Bamford, Ernst (2005).
\(^{115}\) Bamford (2018).
6. Compliance and Regulations

Compliance and Regulation matters is another key CG activity fundamental to the processes of directing the company and abiding by corporate laws. In this chapter the attention of performance and value creation will turn to value destruction caused by poor governance in the field of laws and regulations of IJVs. Due to the nature of the multi-dimension equity ownership in hybrid organizations and the international operation of the venture, governance must pay specific attention to the demands of external stakeholders (such as governments and regulatory agencies) that can impact the business abilities to perform. According to (Georgieva et Al. (2012))\(^{116}\), firms with a higher legal and regulatory environment are more likely to form joint ventures with firms in lower legal and regulatory environments and with higher cultural, language and religious disparities – emphasizing the need for a strong governance standard at both formation and operational stages of an IJV.

(Georgieva et Al. (2012))\(^{117}\) classifies laws, regulations and culture in two categories: formal and informal, however due to the nature of this analysis in the domain of business and legal studies the informal institution will not be studied – despite value creation can be found in the informal aspects - for example using culture diversity between the partners.\(^ {118}\)

**Formal institution:** Legal and Regulatory. Referring to the quality of how corporate law is applied to joint business ventures.\(^ {119}\)

**Informal institution:** Culture, Language and Religion. Referring the soft business aspects of business ventures usually understood as behaviour.

According to (De Brauw Blackstone Westbroek), a European Law Firm, corporations must not forget compliance programs for the subsidiaries and joint venture activities. Arguing that parent companies are liable for cartel conduct made by their subsidiaries and joint ventures if the subsidiary does not independently decide on its own market conduct.

\(^{116}\) Georgieva et Al. (2012)
\(^{117}\) Georgieva et Al. (2012)
\(^{118}\) Georgieva et Al. (2012)
\(^{119}\) Georgieva et Al. (2012)
A. Regulations (General)

The applicability of regulations to joint ventures is one that requires management attention at both the board and execution levels. The governance mechanisms must include both the local and international applicability of laws and processes. According to (Reuer et Al. (2014))\textsuperscript{120} he board may delegate to the local management responsibility for regulatory compliance in an effort to allow local management to apply formal knowledge of the local legal system, this however means less direct involvement and a decentralized approach to dealing with external laws and regulations. However, as (Bamford and Ernst (2005))\textsuperscript{121} points out, the risk of a lack of monitoring has for one industrial conglomerate caused a financial exposure of USD 400m due weak reporting process of a decentralized venture. Regulations applicable to JVs with a governance aspect can be understood in two topics:

**Merger control:** is typically seen in the merger of two companies or in the acquisition of a company where a change in the control of the strategic business decisions are made – also called “decisive control”. It acts as market regulatory process to ensure requirements upon the served market will remain competitive in the concentration.

**Antitrust:** defined according to the FTC\textsuperscript{122} as the collaboration between or among competitors to engage in economic activity resulting therefrom. The following 4 subjects can also be considered in the antitrust category of the TFEU.

- Restriction of competition  TFEU Art. 101
- Market dominance  TFEU Art. 102
- Horizontal Agreements (Cartels)  TFEU Art. 101
- Vertical Agreements (Cartels)  TFEU Art. 101

\textsuperscript{120} Reuer, Klijn, Lioukas (2014)
\textsuperscript{121} Bamford, Ernst (2005).
\textsuperscript{122} Federal Trade Commission (2000).
Merger control and antitrust enforcement have the purpose of regulating (protecting and increasing) the competitiveness of a market by method of restricting a change of control and policing the method in which companies will combine efforts to reduce market competition by coordination or alignment\(^\text{123}\). Joint ventures are by nature of their definition combined, coordinated or aligned efforts of two companies to engage in product, market or business opportunity, thus the study of regulations and specific cases studies are relevant to understanding the aspect of IJV regulations. In addition, the close link of two companies operating in close-coordination with each other – openly learning and exchanging information that may be deemed restricting competition will be the close study of the following sub-sections.

**B. Merger Control**

Merger control applied to joint ventures has become in the event of brown field (contribution of assets from existing business - merged with those of a competitor or supplier) more and more discussed and reviewed as part of large conglomerates seeking efficiencies or competitive advantages. Not all brown field joint ventures however are subject to merger control, market dominance (>20% according to TFEU\(^\text{124}\)), significant business size (250m according to TFEU)\(^\text{125}\). In the less likely occurrence that there is no overlapping market share, there remain as we will see provisions in the TFEU directives for vertical market control restrictions.

**Scope of the Merger as an identifier of the impact on the market:** According to (Babitz et Al. (2012))\(^\text{126}\) the scope definition, non-compete and other opportunity provisions are three important aspects for Merger Control in identifying the relation to market competitiveness. Based on the development between the partners of the scope definition, a non-compete will be drafted to ensure both partners commitment and alignment to the venture and ensure the capital or resources will be protected until termination. However, the non-compete may cause less competition due to the

\(^{123}\) Lovells (2013).
\(^{124}\) Whish, Bailey (2015).
\(^{125}\) Whish, Bailey (2015).
\(^{126}\) Babitz et Al. (2012).
restriction imposed. One option proposed\textsuperscript{127} would be to keep the scope of the non-compete narrower than the scope of the venture and the other opportunities\textsuperscript{128}. It is thus, my hypothesis that only a strong board governance will be able to manage both the merger control and the difference between actual (current) and potential (later) opportunity considering merger control the contractual agreement of non-compete between the partners.

**Merger Control approvals a positive outcome:** As discussed in the opening paragraph, part of the pre-formation of the joint venture entity may require approval by merger control and have effects if not met. According to (Schoneveld et Al. (2011))\textsuperscript{129} – and a first for Chinese authorities – MOFCO (China’s Ministry of Commerce) in 2011 ruled in favour of a joint venture between GE (General Electric Company) and Shenhua (China Shenhua Energy Company Ltd) for the licensing of technology used in the gasification of liquefied coal slurry and the construction services. The significance of the ruling shows that joint ventures can be subject to antitrust review especially when according to (Schoneveld et Al. (2011))\textsuperscript{130} is the precedence for the meaning and understanding of concentration in joint ventures.

**Merger Control approvals a negative outcome:** The approval of the merger control bureau becomes a license to operate the business in a form of joint coordination. In 2018, MOFCOM issued two penalty decision for reasons of gunjumping\textsuperscript{131}. The first case was regarding the establishment of a JV between CM Qingdao and Qingdao Port (Group) Co., Ltd. The second case also involving CM Qingdao, but this time with Qingdao New Qianwan Container Terminal Co., Ltd. The MOFCOM decided that the establishment of the JVs were a motion to exercise decisive influence over the other.\textsuperscript{132} This according to PRC (People’s Republic of China) antimonopoly law constitutes a concentration. As there was no precedent, MOFCOM issue penalties of RMB 200,000 to each partner. According to (Wang and

\begin{footnotesize}
\textsuperscript{127} Babitz et Al. (2012).
\textsuperscript{128} Babitz et Al. (2012).
\textsuperscript{129} Schoneveld, Fu, Jiang (2011).
\textsuperscript{130} Schoneveld, Fu, Jiang (2011).
\textsuperscript{131} Wang, Chen (2018).
\textsuperscript{132} Wang, Chen (2018).
\end{footnotesize}
Chen (2018))\textsuperscript{133} this is only two of six cases decided upon by the MOFCOM, five of the six however had to do with gun-jumping.

The hypothesis of good governance at the pre-formation and due diligence stage of IJV creation includes teams consisting typically of business professionals, accountants and lawyers can have specific impact on the performance and value of the joint venture.

**Merger Control in operating markets:** According to (Wei et Al. (2010))\textsuperscript{134}, two foreign international airlines Air China and Cathay Pacific who are competitors chose to setup a JV with a cargo transportation scope that would operate in European Union member states. Due to the turnover generated by the JV and the change in control, the two companies as part of merger control notified the EU Merger Regulation and were approved just over one month after application. The approval process as pointed out by (Wei et Al. (2010))\textsuperscript{135} may also be required to be filed in the US due to the regulatory requirements and limits for JV turnover.

C. Antitrust

Antitrust laws are market regulation fairness mechanisms that have had a huge impact on corporate governance through the creation of policy and compliance programs that are enforced at various levels throughout the global markets. These policies are used to govern how certain principles of business are made and set in the guidance rules.

**Cartel:** The work of Roberts (1988)\textsuperscript{136}, despite being an old reference, summarized cartels and joint ventures: “Cartels are always illegal; members generally face potential criminal liability. Joint Ventures on the hand are presumptively lawful...”. This categorical definition guides the aspect of market effects, Roberts (1988) also proposes that “Cartels restrain competition and restrict output. Joint Ventures can

\textsuperscript{133} Wang, Chen (2018).
\textsuperscript{134} Lovells (2010).
\textsuperscript{135} Lovells (2010).
\textsuperscript{136} Roberts (1988).
promote competition and enhance output."\textsuperscript{137} There is a level of subjectivity that must be considered as there are certainly a certain shade of grey that is acceptable and legal and another that is considered a Cartel.

\textbf{Sharing of information}: Antitrust law begins by considering how market information is exchanged and whether it is fair to the competitiveness. According to (Steren and Wagner (2018))\textsuperscript{138} even at the IJV pre-formation phase certain competitive information may be exchanged that are unlawful in the understanding of the regulators, price-fixing and market allocation for example.

\textbf{Parental Liability for Joint Venture Cartel}: Joint ventures are not immune to cartel law, and quite the opposite are, depending on the business scope, under higher scrutiny. The effect however of poor corporate governance at the Joint Venture level results in, despite it being a separate legal entity, a liability on the parent companies. The example is made in by an ECJ decision Case T-91/13\textsuperscript{139} for the matter involving both parent companies LG Electronics (LG) and Koninklijke Philips Electronics (Philips) for their 50/50 ownership JV called LG Philips Displays (LPD). In 2006, the JV was declared bankrupt, and in 2012 the European Commission adopted a decision against the parent companies according to Art. 101 of the TFEU (Treaty on the Functioning of the European Union)\textsuperscript{140}. The manufacturers had fixed prices, share markets and shared customers by allocation of volumes, customers and shares, restricted production and exchanged sensitive commercial information. The commission fined both parent companies for sizeable amounts\textsuperscript{141}. LG and Philips filed applications to the ECJs decision that developed the following key principles to be considered in the behaviour standard of corporate governance in Joint Ventures:

\begin{itemize}
  \item JV supervisory board held management positions at parent companies. The case of dependant directors tasked with guiding the joint venture
  \item The supervisory board met regularly during the infringement period and discussed relevant market, sales, prices, stocks and new investments in
\end{itemize}

\textsuperscript{137} Roberts (1988).
\textsuperscript{138} Steren and Wagner (2018)
\textsuperscript{139} Atlee, Botteman (2015).
\textsuperscript{140} Atlee, Botteman (2015).
\textsuperscript{141} Atlee, Botteman (2015).
new product. Exchange of sensitive information between two direct competitors.

- Supervisory board took decisions on the LPD Joint Venture that was deemed to support cartel motives – centralizing the group management team.

**Precedent on parental liability in Joint Ventures**: The precedent for parent liability in JV cartel was according to (Chaplin and Bignall (2013))\(^{142}\) in the case of El DuPont (Dupont) and Dow for their cartel judgement in 2013 of their 50/50 joint venture. The court ruled and confirmed the undertaking of an entity or group of entities function as a single economic unit.\(^{143}\) Thus a parent can become liable for actions and of the joint venture depending on the interpretation of decisive influence held by the parent and importantly the tie between the joint venture and its two parent companies.

The example of LG, Philips, Dupont and Dow are two examples of the impact of good corporate governance not only at the joint venture board and management levels but also within parent companies who are engaged in corporate partnerships. The ruling of the ECJ according to (Atlee and Botteman (2015))\(^{144}\) is a wake-up call for the global community who operates subsidiaries, joint equity partnerships or any partnership that may be privy to decisive influence.

\(^{142}\) Lovells (2013).
\(^{143}\) Lovells (2013).
\(^{144}\) Atlee, Botteman (2015).
7. Conclusion and Further Research Recommendation

A. Conclusion

There is a lack of jurisprudence or authorities in the field of IJV CG, which given the increased trend towards IJVs are presenting challenges on organizations due to the sheer complexity of jointly governing and jointly operating a business with many variables that are Ex-Ante in nature.

Organizations forming IJVs that can afford the transaction cost who have set-in-place a CG policy which is implemented and observed will undoubtably have a better success rate than one that does not. An IJV is extremely complex and extremely regulatory due to the nature of its business. A CG policy must establish the rules by which the organizations cooperate, the boards and management function (performance) and create solutions and achieve the objectives of the IJV (value). The rules must be clear and transparent at all levels and respect both behavioural and economic functions such as transaction costs and agency theory. The ownership rules and methods of handling decisions must be fast and efficient and not result in lengthy delays in the event of deadlock or disagreement amongst the partners. Performance will be enhanced through monitoring and reporting policies that provide for the quality and quantity of information to arrive at cost efficient decisions. Clear guidelines and policies to ensure compliance with local or global market regulators is essential for success. In addition, CG policy should, as required, include provision for independent guidance to management, in the form of monitoring or technical committees in order to bring a neutral, actual and accurate opinion to the intentions of the stakeholders and those of interest connected parties.

Albeit the need for academic research in this field is high, the effort and transaction cost to obtain the complete aspects of formal CG in IJVs provides added value and may reduce failure rates among IJVs.
B. Further Research:

The following are areas or questions that are either proposed here throughout the thesis, or aspects that are truly missing when researching in the field of IJV governance.

1. A comparison of greenfield and brownfield IJVs success and general performance. *(From section 1)*
2. A comparison of the failure rate or risk of forming an IJV to investing in external innovation (Startup or accelerator programs for example). *(From Section 1)*
3. What is the correlation of CG of an IJV in comparison to their parent companies – do they have stricter or more lenient policies. *(From section 2)*
4. Is the renumeration of management (board and CEO) of single-dimension and multi-dimension corporations comparable?
5. Does renumeration of a director affect liability of the director? No-renumeration means no liability?
6. What are the effects of turnover in IJV management (board and CEO)?
7. What are the qualifications for IJV board and CEOs?
8. How are the qualifications for knowledge of local law systems for IJVs?
9. Can Trust and Control of stakeholder hierarchy be quantified to present a guidance to the methods of applying policies in IJVs?
10. What are the best practices in dealing with conflicting fundamental or core philosophies? Such as Civil and common law? Religion? Culture?
Appendix A – Types of Partnerships

**Strategic Alliance:** a contractual relationship agreement between two or more organizations to jointly engage in a business activity. The type of activities may simply be the licensing of IP with little interaction or a “virtual company” that has periodic interaction.

**Supply-Demand Partnership:** Contractual agreements in a vertical supply of business that may highlight a unique process or a shared investment for exclusivity.

**Joint Venture:** an equity agreement between two or more organizations that form a new entity with the aim of combining resources in order to either: enter a market, develop a technology, product a product, offer a service. The organizations are co-owners of the newly formed entity.

**International Joint Venture:** similar to a joint venture with the added aspect of one or more organization being a foreign party with different legal system, culture, regulations and corporate laws.

**Interfirm agreements:** Although interfirm agreements are in the circumstances of SMEs (Small and Medium Sized Enterprises) not dealt with in formal matter other than processes and possible internal business development managers. For large conglomerate companies such as Bosch, Samsung, Sony, GE, ABB, Siemens who drive synergies by grouping certain segments – interfirm agreements do correspond with a certain level of governance that could make the. Example: Samsung battery division, manufacturers, develops and supplies battery modules for each division of the Samsung group that are each separately segmented in focus markets such as appliances, entertainment, etc... this involves a legal contract to manage the interfirm agreements.
Abstract:

Globalization and innovation are only two of the mega trend growth drivers of corporate strategies. Be it, organic, semi-organic or inorganic; strategic partnerships play key roles as part of both equity and non-equity business models. Although, each model has its advantages and its short comings, some of the methods for governing are common. The focus on International Joint Venture (IJV) with two or more equity shareholders is the focus of this thesis due to the current trend, need for improvements and the lack of guidance of applied research. The failure rate of IJVs is considerably high at around 49%, caused in part by complexity in the formal - legal – aspects of the partnership and markets.

This thesis has the objective of analyzing the components of Corporate Governance (CG) of IJVs in order to identify the challenges (risks) and opportunities (value creation) for a formal governance that if well managed would bring performance and bring value to the IJV. Therefore, if the hypothesis is correct, good CG within the IJV will increase the potential (performance and/or value) and create as we will see either shareholder value or productive coalition with interested parties. The board and management, elected or nominated on behalf of the shareholders to pursue the IJV objectives with accountability and responsibility for decision making, reporting and monitoring, and compliance which should be based on clear and solid CG policies, guidelines or rules.

This paper takes a holistic CG approach to IJVs with a strong focus on the formal (legal) as opposed to information (organization behaviour). The aim is not only to analyze the potential of performance and value creation but also to serve as a reference for aspects, trends and developments that IJVs are being challenged with.

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Curriculum Vitae

Michael Alexander Stüdli

Born on April 2nd, 1986

Citizenship: Canadian and Swiss

Contact: +41 766 425 420 // mstudli@outlook.com

Work Experience:

2015 to 2018  Vice President - Head of Global Business Innovation at HOERBIGER Antriebstechnik Holding GmbH – Germany.
2009 to 2014  Manager – District Manager at S&C Electric Canada Inc. – Canada.

Education:

2014 to 2015  Master of Business Administration (MBA) at University of St.Gallen - Switzerland.
2004 to 2009  Bachelor of Applied Sciences in Electrical Engineering (B.A.Sc.) at Queen’s University – Canada.

Professional License:

2013  Professional Engineer Licensed in Quebec, Canada with the order of the engineers (OIQ – Ordres des Ingenieurs du Quebec)
Declaration of Authorship

I hereby declare:

- that I have written this paper without any help from others and without the use of documents and aids other than those stated above,

- that I have mentioned all the sources used and that I have cited them correctly according to established academic citation rules,

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18.07.2018

Michael Stüdli