OWNERSHIP ACROSS NATIONAL FRONTIERS

Richard D. Robinson*

February, 1969  368-69
OWNERSHIP ACROSS NATIONAL FRONTIERS

Richard D. Robinson*

February, 1969 368-69

*This paper is not to be reproduced in whole or in part without the author's permission.
- OUTLINE -

Is Inter-National Ownership Different? 2
   Political commitments 2
   Legal concepts 2
   Levels of national wealth 3
   Monetary relationships 4

Choice of Ownership Strategy 6
   Competitive position 8
   Availability of acceptable associate 9
   Legal factors 10
   Central requirements 13
   Benefit/cost analysis 16

The Government Partners 26
One of the most controversial subjects in international business circles is that of ownership. Debate over the relative merits of one-hundred percent ownership versus joint venturing versus contracting goes on interminably. The hundred percenters speak of conflict of interest, control and integration; the joint venturers, of local national contributions and commensurate right of local nationals to share ownership; the contractors, of taking full advantage of one's monopoly position in regard to either market access or technology, or both. The purpose here is to develop a scheme for evaluating alternative ownership strategies as an aid to decision-making.

It should be held clearly in mind that the ownership decision - which is a policy decision in that it is not subject to easy, short-term change - should not be made in splendid isolation. Ownership is one strategy set in the flow of decisions called forth by the forging of an international business linkage. I visualize the flow being of this nature, probably starting in the marketing strategy area.

Chart I
Only a few of the feedback loops are shown here. In each case, a tentative policy is derived, fed into the next strategy set, and retested to see if it should remain unchanged. By the time one gets to the ownership area tentative decisions should have been made as to what one plans to sell, to whom, where, from what source, produced by whom, and managed by whom.* These are essentially economic questions dealing with market conditions - i.e., the choice of target markets, optimum points from which to supply that market, possible labor-management inputs. What combination most nearly achieves corporate goals? An ownership policy should be conducive to achieving this optimum mix, but will be influenced in turn by financial, legal, and control requirements.

**Is Inter-National Ownership Different?**

All of the foregoing may be admitted readily, but an important question is still begged: Why consider ownership across an international frontier as different from the purely domestic, or uninational, situation? There are, I suggest, four possible answers.

First, political commitments differ among nations in that national priorities vary in respect to what is considered the appropriate allocation of a country's resources - i.e., of its land, its waterways, its minerals, its manpower, its skills, its R & D effort, its financial capital. Appropriateness is determined by national priorities in respect to allocating resources between investment and consumption, military and civilian, private and public sector, (i.e., the use of market versus non-market forces), human resource and physical asset development, full employment and technical efficiency, international integration and autarky, maintenance of environmental integrity versus environmental exploitation. There is no right mix. We are speaking here of underlying cultural differences which activate differing governmental policies relevant to the allocation of resources.

Penetration by an alien enterprise, regardless of its ownership policy or its nature, means the commitment of local resources. No nation-state will tolerate unlimited penetration by an alien enterprise in which control is vested in a management headquartered in another nation-state. The degree of penetration that will be tolerated is possibly a function of (1) the relative size of the two national economies, (2) their historical relationship, (3) the size and importance of the enterprise relative to the host economy, (4) the nature of the enterprise (e.g., the degree of its public service, strategic and/or essential consumer content), (5) the nature of the international linkage - i.e., from complete alien control of decision-making to virtually no control (as in the case of a simple sale and purchase agreement), (6) the nature and effectiveness of the political elite of the host nation, and (7) the "image" and political effectiveness of the alien's parent country and of the alien firm itself.

Second, one must consider international ownership differently from uninational because legal concepts generally differ more from country to country than within a single country, even those of a federal nature. Some nations do not even recognize the inherent right of private individuals - whether domestic or foreign - to own certain types of, or possibly any, real estate, mineral rights, productive machinery, and/or valuable intangible rights. Even the development of personal skills and their employment may be subject to central control. Sometimes these rights vis-a-vis aliens are considered to be reciprocal ones. That is, if the alien's country recognizes rights for nationals from the other nation, the latter will recognize similar rights for alien from the reciprocating country. Even some of our own state and federal laws in the area of banking, property and mineral rights ownership seem to be of this nature. In other cases, ownership may be considered in the nature of a lease
or public trust - as in Yugoslavia - where the trustees are relatively autonomous working communities. Such a lease or trust may be subject to periodic revaluation.

Third, a difference between international and uninational ownership may likewise appear because of differences in levels of national wealth. If the difference is great, the use of scarce resources (i.e., those that are capital or foreign-exchange intensive, such as high-level skills, capital equipment, and already fully-employed inputs of local origin) may be considered a matter of vital national interest. Given the vast disparity in time horizons between the decision-making political elite and the mass of consumers (who may be existing only slightly above subsistence level), market forces may not be perceived by the elite to be such as to achieve national development objectives. A responsible elite (responsible in terms of trying to act in such manner as to promote maximum, long-term national development) may well use other measures for evaluating alien use of local resources than internal, financial profit-and-loss. Some of these measures may be balance-of-payments effect, national income effect, public revenue effect, long-run growth effect, allocational effects.*

Thus, the reception an alien proposing to establish a local enterprise should anticipate may differ substantially from the purely domestic situation in which internal, profit-and-loss considerations are more likely to dominate. For example, within a much broader set of constraints, the allocation of resources induced by domestic market factors in the United States is assumed to approximate national interest.

Fourth, differences in monetary systems and wealth levels, dictate a further disparity between the inter- and uninational case. Assuming that the alien interest is of U.S. origin, profits must be repatriated in dollars or something of value ultimately convertible to dollars. Because of the

forced-draft development that a wide international disparity in per-capita national wealth dictates sooner or later, a development-committed political elite may be inclined to enforce its consumption preference for that of the masses. One way of doing that is to husband scarce resources - including scarce foreign exchange such as dollars - and to allocate them via administrative procedures to high priority imports. Hence, the exchange rate is not market-determined, but is pegged, which means that scarce foreign exchange is undervalued. That is, the local currency buys more dollars - or the dollars fewer local currency units - than would be the case if the conversion rate were determined by a free movement of exports and imports. Therefore, an alien firm repatriating dividends at the pegged official rate will receive more dollars than its local currency earnings really justify, in that the marginal value of those dollars to long-term development is likely to be very much greater than that implied in the official exchange rate. The more local resources that one capitalizes via the reinvestment of local earnings, the more is this true. Suppose, taking an extreme case, one invests a thousand dollars, reinvests all earnings for ten years and invests no new dollars, either directly or in dollar costs. If the project generates a twenty percent (after local tax) profit, one would have a total investment at the end of the tenth year of something over $6,000. Then assume that the alien owner starts repatriating all earnings at the rate of twenty percent. He would be taking home some $1,200 a year. This return is based on the initial $1,000 input plus $5,000 of earnings acquired via local sales and invested in the acquisition of local assets. If the value of this flow of $1,200/year starting ten years hence, discounted to the present,* is felt by the local authorities to exceed $1,000 (plus the net external economies created thereby in the intervening years) discounted to the present, then they may perceive that the

*A very high discount rate is likely to be used, for the real MV of capital is high
nation is losing more than it is gaining. If so, they will either shut
the door on continued alien ownership or enforce reinvestment of all earnings
over and above a certain percentage. At some point in time, as the tenth
year draws closer, the perceived value of the $1,200 outflow is likely to exceed
the value of the external input, unless the inputs continue. The existence
of different monetary systems can thus make a difference.

All of these national pressures generated by disparities in political
commitment, legal system, level of per capita wealth, and monetary system,
in turn generate a distinctive nationalism. This nationalism becomes relevant
when it leads to restraints on alien ownership of commercially valuable assets
located within the national territory, or on the repatriation of earnings
generated by such assets. Therefore, international ownership can be - and
usually is - very different from uninational ownership, in terms of how
ownership is perceived and valued by the relevant authorities, which in turn
may be equated with different sets of restraints imposed on alien ownership.

**Choice of Ownership Strategy**

In a very real sense, every overseas enterprise is a joint enter-
prise whether or not the participating interests are formally represented.*
One might look at any enterprise as representing a choice of project (or
choice of sector), a relationship (ownership of varying degrees and/or
some contractual relationship), and a series of operating policies. These
three must remain within the range tolerated by the parties involved - i.e.,

*The term joint enterprise is used here in order to avoid confusion with
the equity-sharing concept, which is inherent in the phrase "joint venture" as commonly used.
the alien firm, the associated local business interest (whether partner contractor, contractee, supplier, and/or consumer), the host country government, and the parent country government. Hence, we generate this matrix:

<table>
<thead>
<tr>
<th>Chart 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Firm</td>
</tr>
<tr>
<td>Associated Business Interest</td>
</tr>
<tr>
<td>Host Government</td>
</tr>
<tr>
<td>Parent Government</td>
</tr>
</tbody>
</table>

Here, we concern ourselves with the "relationship" column. It should be kept in mind that the full range of international business relationships run the gamut from a 100 percent-owned subsidiary through zero ownership to a negative 100 percent (i.e., the ownership of the firm by the associated overseas business interest), and a range of possible contractual relationships, which can run likewise in either direction. Thus -

<table>
<thead>
<tr>
<th>Chart 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
</tr>
<tr>
<td>100%</td>
</tr>
<tr>
<td>0%</td>
</tr>
<tr>
<td>-100%</td>
</tr>
</tbody>
</table>

*Refers to the licensing of intangible property - i.e., trademarks, brand names, firm names, copyrights, patents, trade secrets.
Under some conceivable set of circumstances, any possible combination of these is possible, although as one approaches 100% ownership some of the contractual relationships become increasingly unlikely, indeed, may be forbidden by law.

Forgetting for the moment personal preferences on the part of decision-makers and the extent of a firm's resources, five factors are relevant to making an optimum ownership decision: (1) competitive position, (2) availability of acceptable associates (and/or consumers), (3) legal constraints, (4) control requirements, and (5) benefit/cost relationships. We shall consider each in the order indicated. Hence:

**Chart 4**

- Competitive position
- Availability of acceptable associates
- Legal constraints
- Control requirements
- Benefit/cost relationship

**Competitive position** refers to the degree of uniqueness of what the firm has to sell. If the firm's good or service is, in fact, uniquely superior and has commercial value, it may well opt for 100 percent ownership if this relationship will better protect the uniqueness of its product than would lesser ownership and some contractual relationship. If, however, another alien firm - or local firm - offers to do the same thing at a lesser cost in terms of scarce inputs (such as foreign exchange), the initial firm may find itself under pressure to reduce return, either by selling some part or
all of its equity to a local firm and relying on a contractual relationship that generates an appropriately reduced income or, if already linked by contract, by reducing the percentage fee stipulated therein. The latter is often easier to accomplish, particularly if forced on the firm suddenly. Reducing a royalty or fee is relatively easy; spinning off ownership is not. But for that very reason, this strategy (i.e., choice of contractual relationship) may be suboptimal. The host government's attitude toward private property (e.g., an ideologically-based commitment to protect property rights) may tend to restrain it from forcing a readjustment in ownership - and hence, of income. But it may be much less restrained in forcing renegotiation of a contract. Of course, most firms fall in between a pure monopoly position (whether based on a unique product, unique process, unique access to market, relevant skills and/or capital) and a perfectly competitive situation. In such case, willingness to meet competing offers in respect to ownership and contractual relationships is required. A flexible ownership policy is thereby indicated in the international case.

Availability of acceptable associates - whether a partner, contractee, contractor, licensor, licensee, supplier, or customer - obviously imposes a restraint. Even if one can find a suitable associate, how does one assure that he will retain his interest and not transfer it to others who may be less than acceptable? In any event, everyone dies sooner or later. What of the next generation? Here, local laws of inheritance and the possibility of imposing legal restraint on stock or contract transferance may be of critical importance. Barring this problem, and in the absence of an immediately available associate acceptable to the parent firm, the latter must consider the cost of finding and developing appropriate local national or nationals.
Consequently, one perforce gets into a benefit/cost analysis, but this sort of analysis is anchored in one's expectations as to what the local associate will contribute to the enterprise. We postpone further discussion of this dimension until later.

Next, one might appropriately consider the legal factors bearing directly on the matter of selecting an optimum ownership - contracting policy. Certain legal restraints have already been touched upon - i.e., inheritance law, law on restricting transfer of ownership, recognition of private property rights. Other legal variables directly relevant in some possible situations, insofar as a U.S. firm is concerned, may be listed as follows:

1. Foreign tax credit - in order to take the credit the U.S. firm must own at least 10 percent of the equity of a first-tier foreign subsidiary, which in turn must own at least 50 percent of the second.

2. U.S. tax liability - if the U.S. firm owns more than 50 percent of the voting power of a foreign corporation, it is a controlled foreign corporation and some part or all of its income may be taxable currently in the United States even if not repatriated.

3. Reduction of withholding tax - the withholding tax imposed abroad on dividends paid to a U.S. firm by an associated foreign firm may be reduced if the foreign firm is owned to a significant degree by the U.S. firm (e.g., The French withholding tax is reduced from 15 percent to 5 percent if the U.S. firm owns at least 10 percent of the paying French firm.)

4. Withholding tax and local ownership - the withholding tax imposed abroad may be reduced if local ownership is permitted (e.g., The Canadian withholding tax on dividends is reduced from 15 to 10 percent on those
paid by a Canadian subsidiary to a foreign parent if Canadians are permitted to participate in the equity and voting control of the Canadian subsidiary to the extent of at least 25 percent.

5. Tax exemption and ownership - some countries impose a low or no tax on dividends received from foreign subsidiaries if a minimum ownership test is met (e.g., If a Canadian parent corporation owns 25 percent or more of a foreign subsidiary, dividends received from the latter are exempt from Canadian tax.)

6. Liquidation - the redemption or sale of stock in, or liquidation of, a controlled foreign corporation (i.e., a foreign corporation in which more than 50 percent of the voting power is owned by U.S. persons or entities) results in ordinary income, not capital gain, and is taxable as such.

7. U.S. interest equalization tax - the tax is not imposed on a U.S. person or corporation acquiring stock, debt securities or other obligations of a foreign issuer if the buyer owns at least 10 percent of the total combined voting power of all classes of stock of the issuer.

8. Investment guarantees - in order to qualify for an AID guarantee, a U.S. corporation must be over 50 percent-owned by U.S. citizens; in order for an investment made by an associated foreign firm to qualify, the latter must be at least 95 percent owned by such a U.S. corporation (or by U.S. citizens).

9. Antitrust vulnerability - international ventures involving a U.S. firm may make the U.S. firm vulnerable to prosecution. (Some unresolved questions: how much of the foreign enterprise must the U.S. firm own to make itself invulnerable to charges of conspiracy with the foreign venture if the latter's trade with the U.S. is restrained or, conversely, how little must it own in order to protect itself if the foreign enterprise is a member of a cartel affecting U.S. trade?)
10. Export controls - a foreign firm controlled by a U.S. firm is subject to U.S. export controls. (Even the sale under contract to a non-controlled foreign firm of goods or services which are ultimately resold to a prohibited market may make the U.S. firm vulnerable, if it had reason to know the location of the ultimate buyer.)

11. U.S. controls over direct foreign investment - this applies to foreign corporations which are at least 10 percent owned by U.S. citizens or corporations.

12. Social security - in order to cover U.S. nationals employed in a foreign firm, the U.S. company must own at least 20 percent of a first-tier foreign firm, 50 percent of the second.

13. Treaty rights - in order to take advantage of certain treaties among foreign countries (such as those relating to right of establishment, national and most-favored nation treatment, access to local courts, double taxation, patent protection, and reciprocal dividend tax exemption), nationality tests in terms of ownership may be imposed.

14. Selling rights - in order to sell in certain restricted markets--government defense procurement, NATO, AID-financed projects--the firm may be required to meet nationality tests, including ownership.

15. Consolidation of financial statements - such consolidation (which may be used to alter debt/equity ratios, rates of return, margins, etc.) requires majority ownership of the foreign firm by the U.S. firm.

16. Restrictions on ownership - the host government may restrict the percentage of foreign ownership. (e.g., Japan)

17. Time limits on ownership - the host government may agree to recognize foreign ownership for only a stipulated period, at the end of which time the relationship is to be re-negotiated. (Always true for contracts.)

Examples: Indonesia, India
18. **Strategic industries** - in order to conduct certain types of business in the United States (e.g., communications) a certain percentage of ownership by U.S. nationals must be established. Comparable laws exist elsewhere.

19. Special tax allowances - depletion allowances and the right to include intangible development costs as current expenses (rather than capital investment) in respect to certain mineral explorations are available only for U.S. corporations, which means that any foreign ownership must be in the U.S. firm, not in the overseas venture (which must take the form of a branch to qualify for these allowances).

20. Special tax deductions - certain tax deductions (e.g., for Western Hemisphere Trade Corporations or China Trade Act Corporations) are only available to U.S. corporations, which rules out any foreign ownership of overseas enterprise.

Admittedly, some of these categories do not dictate ownership by U.S. nationals or corporations, but by compelling incorporation within the United States, participation by foreign business interests become more complicated.

In discussing **control requirements** - our fourth critical variable relative to choice of ownership strategy - it is important to make explicit the implicit assumptions made by those who simply equate equity ownership with control. These assumptions are:

1- That ownership rights resting on equity are less likely to be disturbed by a foreign government than purely contractual rights. (Empirically, this does not seem to have been the case.)

2- That total control by the U.S. company is necessary to accomplish corporate objectives (e.g., maximization of profit, return on investment.)
cash throw-off, growth, geographical spread and/or growth, or possible minimization of dividends). May or may not hold true in a particular case.

3- That adequate control without equity ownership is impossible. (This assumption implies that contractual rights cannot be enforced. Experience would not support this assumption.)

4- That total control by a U.S. company of a foreign enterprise is legally possible even with a majority or 100 percent ownership. (In fact, local law and regulation may seriously restrict freedom of decision in respect to personnel policy such as wage rates and hiring and firing, negotiation with unions, nationality of management and of labor, transfer pricing, product pricing, profit repatriation, local borrowing, contracting with the associated U.S. firm or entering into tying agreements, market restraints, expansion of plant, re-investment of earnings, purchase of materials, degree of local manufacture, import of further capital, use of external services, plant location - to mention a few areas.)

The need for controls arises in anticipation of conflict of interest. Possible conflict areas:

1. Ownership - i.e., the sale or transfer of equity to third parties.
2. Dividend policy - i.e., distribution vs reinvestment.
3. Borrowing - i.e., acceptable debt/equity ratios.
4. Plant expansion - i.e., what and where.
5. Research and development - i.e., level, purpose, location.
6. Production processes - i.e., degree of integration, degree of capital-labor intensity.
7. Source of supply - i.e., external or internal, transfer prices.
8. Quality standards - i.e., domestic or absolute, international standards
9. Product mix - i.e., diversification, competitive exports.
10. Reinvestment - i.e., dilution of equity held by a minority.
11. Terms of sales - i.e., credit, servicing, pricing.
12. Market area - i.e., restricted or open.
13. Market penetration - i.e., choice of channels, promotional effort.
15. Management selection and remuneration - i.e., nationality, skills required, number, salaries.
16. Political - i.e., honesty, company-government relations, degree of social responsibility.
17. Image projected.

The relevant query here is, given these possible conflict areas, what controls are needed to maintain a tolerable benefit/cost relationship for the firm? These controls may run via the leverage the firm can mount by reason of - - -

1) Ownership (e.g., control over the election of boards; hiring, development, and firing of managers; and/or determination of financial structure and profit distribution),

2) Market access (e.g., control over channels, trademarks, brand names and/or ownership of import licenses or business licenses),

3) Technology (e.g., control of patents, relevant R & D flow),

4) Finance (e.g., ability to provide debt, and/or working capital, such as commercial credit),

5) Personnel (e.g., ability to provide scarce skills - including management - and/or relatively cheap labor),

6) Political assistance (e.g., greater ability to deal effectively with governments in preventing restraints or gaining largesse; and/or to gain customer or market acceptability),

7) Supply (e.g., limitation of source to the associated firm), or

8) Physical assets (e.g., control over sites, specialized transport, power source).

In each case, the cost is that which would be incurred if the relevant contribution of the other associated firm (i.e., Firm B) were to be interrupted. Hence, the ability of Firm A to shut off any one of these flows is a control device and the ability of Firm B to do likewise, a restraint.
In summary, a firm should determine what it proposes to do and where, define the essential elements of control relevant to accomplishing that purpose, and then decide upon the best means of assuring that control. The often hidden cost of maintaining long distance control via equity should be included in this analysis. Otherwise the benefit/cost analysis will be invalidated and corporate objectives, possibly not be achieved.

Finally, one moves into the general area of benefit/cost analysis of various ownership relationships. The costs of the U.S. and associated foreign business interests may be seen as two sets of flows converging on the foreign entity - which, in the terminology used here is always a joint enterprise, not necessarily in an equity sense but always in the sense of recognizing and sharing common interests and responsibilities. These costs - or contributions (from the point of view of the joint enterprise) - may be classified generally in terms of assistance in marketing, technology, finance, personnel, political, supply and/or physical assets. It is important to distinguish here between a one-time contribution - or transfer - and one that continues over time.

Chart 5

- Diagram showing flows between U.S. Business Interest (Firm A), Joint Enterprise, and Foreign Business Interest (Firm B) in terms of marketing, technology, finance, personnel, political, supply, and physical assets (e.g., site).
On the other hand, the benefits accruing to the U.S. and foreign business interests may flow through a number of channels, thus -

Chart 6

These benefits - costs from the point of the joint enterprise - should likewise be viewed over time. Some flows, however, may be of a one-time nature such as in a simple sale or a turn-key operation.

A relevant question to ask at this point: Is there agreement as to whom contributes what, for how long, and receives how much, by what route, for how long? In other words, what are the expectations? As skills are transferred from the U.S. firm, the flow of management contribution in terms of personnel and development of local nationals may dry up. Is this anticipated by both parties? How soon?

The appropriate ownership policy in a given case for a U.S. firm may be diagrammed as below, using A to designate the U.S. business interest and B, the foreign interest.
The diagram illustrates a decision-making framework involving several factors:

- **Ownership Strategy for Firm A**:
  - **Profit Factor**:
    \[ \frac{(\text{Benefit}_A)}{\text{(Cost}_A)} \]
  - **Absolute Profit Factor**:
    \[ \frac{\text{MV to A of resources received}}{\text{MV to A of resources contributed}} \]
  - **Uncertainty Factor**:
    - Technical sophistication of A's management
    - A's knowledge of environment and market potential
    - Perceived market predictability
    - Perceived stability of environment

- **Risk Factor**:
  - **Controls needed**
  - **Restrants anticipated**

- **Conflicts of Interest**:
  - **B's profit factor**
    \[ \frac{(\text{Benefit}_B)}{\text{(Cost}_B)} \]

- **Dissatisfaction Factor**:
  - **Ability to measure one's own costs and benefits**
  - **Quality of communication between A and B**

- **Benefit/Cost Ratio**:
  - For A: \[ \frac{(\text{Benefit}_A)}{\text{(Cost}_A)} \]
  - For B: \[ \frac{(\text{Benefit}_B)}{\text{(Cost}_B)} \]

Indicates A's benefit/cost ratio as perceived by B.
This chart should be read in this fashion. The appropriate ownership policy for Firm A at a particular time in reference to a given project overseas may be stated thus:

\[
\text{Ownership} = \frac{\text{Self-perceived benefit to A}}{\text{Self-perceived cost to A}} = \left( \frac{\text{Controlled needed}}{\text{Restraints anticipated}} \right)
\]

The first expression * in equation (1) is really the profit factor, and the second, the generalized risk factor. Examining the first more closely, we may analyze it in this manner:

\[
\text{Benefit}_A = \int \left( \frac{\text{MV}_A \text{ of resources received}}{\text{MV}_A \text{ of resources contributed}} \right), \quad \frac{\text{Ability to measure}}{\text{Confidence}} = \int \left( \frac{\text{A's technical sophistication, A's absolute knowledge of environment and market potential}}{\text{A's perceived predictability of relevant markets over time, degree of perceived environmental stability}} \right)
\]

In which -

\[
\text{MV}_A \text{ of resources received and given} = \int \text{(wealth of A; income of A; A's time horizon; A's perceived uses, or opportunity cost, of these resources)}
\]

\[
\text{Ability to measure} = \int \text{(A's technical sophistication, A's absolute knowledge of environment and market potential)}
\]

\[
\text{Confidence} = \int \text{(A's perceived predictability of relevant markets over time, degree of perceived environmental stability)}
\]

In looking at the second expression in equation (1) above - i.e., controls needed/restraints anticipated - we can factor this with some usefulness thus:

\[
\text{Controls needed} = \int \left( \frac{\text{Conflict factor}}{\text{Dissatisfaction factor}} \right), \quad \left( \text{Conflict of interest, degree of dissatisfaction} \right)
\]

* Bear in mind that a cost of A or to B is a contribution - or input - to the joint enterprise and a benefit of A or to B is cost - or output - for the joint enterprise.
These expressions can be defined in this way:

(4) \[ \text{Conflict} = f \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right) \frac{\text{Benefit}_B}{\text{Cost}_B} \]

(5) \[ \text{Dissatisfaction} = f \left( \frac{\text{Benefit}_A/\text{Cost}_A}{\text{Benefit}_B/\text{Cost}_B} \right) \frac{\text{Benefit}_B/\text{Cost}_B}{\text{Benefit}_A/\text{Cost}_A} \]

In the first of these two last functional relationships - i.e., that relating to conflict of interest in equation (4) - the degree of potential conflict is measured by the extent to which

\[ \frac{\text{Benefit}_A}{\text{Cost}_A} > \frac{\text{Benefit}_B}{\text{Cost}_B} \]

That is, if the benefit/cost relationship for A differs substantially from that for B - as perceived by A and B, respectively - conflict of interest may emerge, depending upon the quality of communication between A and B, and the ability of each to measure his own costs and benefits. In the second of these equations (i.e., #5), that relating to dissatisfaction, if either expression falls significantly below a value of one, dissatisfaction is likely to appear, for such a value would indicate that one or both parties expect less profit than they believe the other will realize. Bear in mind that in this case we are dealing with the relative value of benefits and costs for both firms as perceived by one of them. In each case, the other-perceived ratios may be greater or lesser than the self-perceived.

All we have been saying is that the relevant ownership policy should be that designed to most nearly accomplish corporate objectives. Generally these can be stated in terms of maximizing the benefit/cost ratio, assuming a certain control/restraint relationship. These in turn are evaluated in terms
of the marginal value of resources contributed and received as discounted (1)
by one's ability to measure these resource flows as reduced by one's confidence
in these measures, (2) by perceived conflicts of interest in differing benefit/
cost ratios for the two firms, and (3) by degree of dissatisfaction as measured
by the benefit/cost ratio of the firm and that ratio perceived for its associate.

One may thus summarize:

(6) Ownership strategy_A = \int \frac{MV_A}{MV_A} \text{of resources received} \quad \text{of resources contributed}, \quad \frac{A}{A}

\text{conflict factor} \quad \text{dissatisfaction factor}

\frac{\text{benefit}_A}{\text{cost}_A}, \frac{\text{benefit}_B}{\text{cost}_B} ; \frac{\text{benefit}_A/\text{cost}_A}{\text{benefit}_B/\text{cost}_B} A, \frac{\text{benefit}_B/\text{cost}_B}{\text{benefit}_A/\text{cost}_A} B

The restraints anticipated by Firm A and the countervailing controls
needed by it rest on the degree of dissatisfaction generated. Collectively
these are used to discount the profit factor, which is already discounted by the
perceived market risk. These are interrelated, for controls and restraints
generate costs and curtail benefits. The optimum ownership policy is one that
maximizes this appropriately discounted ratio. If, by altering ownership policy,
the reduction in conflict and dissatisfaction factors decreases costs more than
benefits, or increases benefits more than costs, rationality would demand such
a change of policy.

To simplify this discussion, assume two individuals. They would only
combine their resources in a joint undertaking in the event that they both
perceived their respective benefits flowing from a combined effort as surpassing
those anticipated in an individual effort. A split in benefits is proposed -
say, 50-50. In the first instance, Mr. A would look at the benefit/cost ratio
as perceived by him - i.e., the self perceived value of what he will receive
as related to the perceived value of what he will contribute. This will be discounted by his ability to measure these flows and his confidence in this measure. In order to assure this flow, he should anticipate the need for some degree of control over the joint operation, which effort will be encountered by some restraints by Mr. B (i.e., by negative controls insofar as Mr. A is concerned), who is trying to do the same thing. If it is possible to reduce potential conflict of interest and dissatisfaction to a level that would leave the appropriately discounted flow of benefits still acceptably greater than the flow of contribution (i.e., significantly greater than that anticipated in a one-man enterprise) - for both parties - a joint enterprise should result. If not, it is because of the inability of Mr. A and/or Mr. B to adjust the expected flows of contributions and benefits, and/or design better measures for the flows, and/or develop a heightened confidence in them, and/or shift the cost of control.

To avoid a critical level of dissatisfaction, Mr. A's self-perceived benefit/cost ratio must be approximately equal to or exceed the ratio he perceives for Mr. B. The reverse must likewise be true. That is each must perceive his own profit as approximately equal to/\geq/ exceeding that of the other. Hence

\[
\begin{align*}
\text{(7) } \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right) & \geq \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right) \\
\text{(8) } \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right) & \geq \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)
\end{align*}
\]

Note that this condition implies nothing about the vertical or diagonal relationships. In fact, one should expect that over time Mr. A's perception of B's benefit/cost ratio will converge on B's self-perceived ratio, for both A and B should learn how to measure the flows better, and communications should be less
subject to effective manipulation by either. Thus, a long-run equilibrium would require that --

\[
\begin{align*}
(9) & \quad \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right)_A = \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right)_B, \text{ and} \\
(10) & \quad \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)_B = \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)_A
\end{align*}
\]

These relationships imply further that --

\[
(11) \quad \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)_A = \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right)_B
\]

That is, if the self-perceived benefit/cost ratios vary significantly, a potential conflict of interest is hidden in the situation. It is translated into overt dissatisfaction as one or both of the parties becomes aware of this disparity even though the initial conditions (equations 7 and 8) were met. Note that there is no mention of the actual benefit/cost ratios, only the self-perceived and other-perceived ratios, for reality is only relevant as it is perceived.
At the present state of the art, no method suggests itself for quantifying these factors in any precise manner, least of all those relating to determining the tolerable limits of conflict and dissatisfaction. But many firms do not even consider the range of possible benefit/cost relationships, but rather rush into all overs as adventures in accord to some fixed ownership policy. Even for the conflict and dissatisfaction factors, it is useful to try inserting carefully considered subjective values and consider at what point the inequalities in the conflict and dissatisfaction ratios will bring about significant added restraints and force a firm to incur added costs to maintain tolerable controls. A costing of various types of controls vis-a-vis possible losses (or gains?) in terms of achieving corporate objectives may be useful.

The point is that this sort of exercise leads one to ask the relevant questions - such as, which of the contributions that Firm A can make to the joint enterprise (i.e., cost to A) will Firm B accept at the same - or higher - value than assigned by A. Presumably this will result in the maximization of the benefit/cost ratio for A. This ratio should be adjusted until both the conflict of interest and dissatisfaction factors are approximately in balance - all else remaining equal. "All else" in this case refers to the cost of the added controls needed to balance any anticipated increase in restraints. Hence, the relevant questions for a firm are:

1. What value does firm (i.e., Firm A) place on what it proposes to contribute?
2. What value does Firm B place in A's contribution?
3. What value does Firm A place on the benefits to accrue to it?
4. What value does Firm B place on the benefits to accrue to A?
5. What value does Firm B place on the benefits to accrue to it?
6. What value does Firm A place on the benefits to accrue to B?

7. How certain is A of its measure of resources received and resources contributed?

8. What restraints does A anticipate?

9. What controls does A perceive to be necessary to reduce the effect of this restraint to a tolerable level?

10. What is the cost of maintaining these controls?

11. How will the value of all of these factors shift over time?

The importance of the final query lies in the fact that if any of the values shift significantly, mounting pressure toward a comparable shift in the flows of contributions and benefits should be anticipated. By anticipating such shifts, they may be made with minimum friction and cost - in both psychological and physical terms.

These questions suggest a possible technique for at least approximating the values required to make the evaluation system outlined on page 18 operative. Let each party to a proposed joint enterprise evaluate his own benefits and costs (i.e., self-perceived) arising by reason of the joint enterprise, both in its initial period and, say, ten years hence. Then let each party evaluate what he perceives the other party's benefits and costs are likely to be, initially and ten years later. This "other-perceived" data should then be exchanged. Similarly each party should determine an explicit discount rate for his own expected flows of benefits and suggest what the appropriate discount rate should be for his proposed partner. If the appropriately discounted cost/benefit ratio of A as perceived by A is seen by A to differ significantly from his benefit/cost ratio as perceived by B - which A now knows - he should expect an eventual conflicted relation. A may then which to adjust his self-perceived flows of benefits and costs and/or the discount rate. B undertakes a similar exercise. Both parties are now in a
position to compare self-perceived and other-perceived ratios. That is --

\[
\text{if } \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)_A \approx \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right)_B, \text{ and }
\]

\[
\text{if } \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right)_B \approx \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)_A
\]

then a tolerable relationship is possible. It is assumed that each firm has satisfied the conditions specified in equation (7) and (8). One should bear in mind, however, that if the two, the value of the self-perceived ratios - i.e., \( \left( \frac{\text{Benefit}_A}{\text{Cost}_A} \right)_A \) and \( \left( \frac{\text{Benefit}_B}{\text{Cost}_B} \right)_B \) -- are in fact different, one can expect a shift in the other-perceived ratio over time and possibly an increasingly conflicted situation.

**The Government Partners**

Having gone through this exercise, a management must concern itself with its other two partners, whether explicitly or implicitly present - namely, the parent and host governments. The important question here is the extent to which the values placed on the various flows by relevant official bodies vary significantly from thoses assigned by the business interests involved. It is probably a safe generalization that for a U.S. firm, the higher the capital intensity of its contribution the less likely are these assigned values to diverge significantly. Income from pure capital (i.e., debt) and from highly capital-intensive inputs (i.e., high-level skills and technology) and the sale of capital equipment are likely to be given priority in foreign exchange control systems over the repatriation of dividends representing, at least in part, return on less capital-intensive inputs - i.e., that derived from the use of local land, labor, and materials.
Assuming the same risk factor as for the capital-rich countries, capital-intensive inputs into capital-poor countries should enjoy relatively high returns. By diluting this input with more labor-intensive inputs, the rate of return can be expected to go down - all else being equal. Hence, maximization of rate of return - if this be the corporate goal - dictates limiting one's inputs and suggests a joint enterprise, whether via equity or some contractual relationship. The latter may, in some cases, minimize risk; there are relatively few cases of unilateral breaches of short-term (say, up to ten years) contracts. The initiating firm tends to maintain maximum leverage for it has a minimum commitment in immovable assets abroad that may be sequestered or over which control may be lost. It is difficult to sequester a flow of capital-intensive services or goods emanating from abroad.

Some firms have realized that the possible disparity between the values assigned to the four-way flows in the system described here by the two associated firms and the host government may be virtually eliminated by entering directly into an arrangement with an entity of that government - hence, the international mixed venture. In many of these cases, of course, the foreign firm is left no choice. But even so, the risk inherent in any significant disparity between private and official valuations placed on the flows of benefits and cost (derived from the political-social priorities suggested on page 2) may be reduced almost to zero. In such case, one need deal only with the first phase of this analysis, with some sensitivity of course, to the restraints that may be imposed by the parent government. Herein lies the rationale, other than sheer compulsion, for the international mixed venture.