How do firms expanding their business into a foreign country decide whether they should license their technology to a local firm or form a joint venture with the firm or acquire that firm? Which of these choices would give them the most benefits?

In a forthcoming paper in the *Journal of International Business Studies*, Pamplin management professor Anju Seth brings new insights to these questions. An important feature of her model is that the firms can switch from one arrangement to another during the life of the venture. For example, she says, firms can initially form a joint venture, but subsequently one partner can buy the other’s stake in the joint venture. Her model combines real options and game theory approaches and draws on dynamic capabilities theory, agency theory, and transaction cost economics to examine how four factors interact to influence these choices.

The results, Seth says, identify a number of conditions for one factor to dominate another. “So, they help to reconcile different theories that have resulted in contradicting predictions regarding the effects of such factors as uncertainty and differing speeds of learning by the multinational and the indigenous firm.”

Seth, who co-authored the paper, “A dynamic model of the choice of mode for exploiting complementary capabilities,” with Tailan Chi of the University of Kansas, says scholars have long recognized that multinational companies operating abroad transfer knowledge such as technology, marketing expertise, and management know-how to local firms.

“Our simulation results show that an otherwise profitable project might not be worth undertaking if the chosen mode is inefficient.”

In contrast to previous studies, the model Seth and Chi developed examines all the factors in a continuum of choices — with the local firm holding full ownership (as in a licensing agreement) at one end, to the multinational holding full owner-
ship (through an acquisition of the local firm) at the other end.

As an example, Seth says, consider a potential project between a multinational firm and a local firm that involves sharing tacit knowledge. “Because the transfer of such knowledge is costly, and the effort of each party is difficult for the other to monitor, the most efficient way for both parties to share their knowledge is likely a joint venture.” However, if the knowledge that they contribute is explicit and thus can be transferred at low cost, she says, one would expect there to be little reason for the parties to form a joint venture to exploit the synergy between their respective sets of knowledge, because they each can license the other’s knowledge easily.

“A surprising finding of our study is that in such a case, a joint venture — with the option for each party to acquire the other’s stake — is still the most profitable mode, because they both can gain from trading their stakes when one of them turns out to place a much higher value on the venture’s assets than the other.”

Seth notes a related, but equally surprising, finding: “Pursuing the gain from trading in their stakes can motivate the parties to engage in power jockeying and destroy the value that they could potentially create by exploiting their complementary knowledge in a joint venture.

“The propensity for power jockeying can cause the otherwise valuable mode-switching option to instead have a negative effect on profits.” This result, she says, implies that firms should restrict the exercise of the mode-switching option when the tacitness of their knowledge and their bargaining propensity are both high.

“Our simulation results show that an otherwise profitable project might not be worth undertaking if the chosen mode is inefficient,” says Seth. “In other words, the choice of how to structure a venture can have a critical influence on whether to undertake it.”

incorporating in states with less restrictive payout laws has drawbacks as well as advantages. New research by finance associate professor Sattar Mansi shows that stricter state laws regarding payouts from accumulated earnings, i.e., dividends and share repurchases, significantly decrease corporate bond yield spreads.

Mansi found that companies incorporated in states with stricter payout laws, such as New York or California, have higher credit ratings and lower yield spreads than those incorporated in less restrictive states, such as Delaware. Bonds from firms incorporated in more restrictive payout jurisdictions have yield spreads that are 7.6 percent lower than firms from jurisdictions with no constraints.

“Being incorporated in a state with more restrictive payout laws is a commitment on the part of the business,” says Mansi, who co-authored the article, “Credit Protection Laws and the Cost of Debt,” forthcoming in the Journal of Law and Economics.

In their article, Mansi and his co-authors assess state laws regarding restrictions on payouts and hostile takeovers from the perspective of bondholders. Their study, Mansi says, seeks to provide a more comprehensive view of the impact of these state laws on overall firm value by adding bondholder evidence to the stockholder evidence documented in prior research.

“Our results suggest that incorporation in a state with more restrictive payout laws commits managers to paying out part of the accumulated earnings as dividends. It’s a way to reduce management power by cutting back on their cash flow,” Mansi says. As reincorporation is costly, he says, state payout restrictions can credibly reduce the potential for managers to exploit bondholders through issuing debt and using the proceeds to pay out dividends or repurchase shares.

“While state payout laws have previously been associated with differences in firms’ liabilities, our analysis suggests that by constraining firm behavior, these laws reduce the agency costs associated with stockholder-bondholder conflict and thus provide for lower firm financing costs. As a result, these restrictions appear to be valued by the market, and firms subject to these restrictions are rewarded with lower financing costs.”

On the other hand, Mansi adds, the impact of antitakeover laws on bond yields is not significant; studies have found that these laws do not reduce financing costs, while they increase managerial entrenchment — “managers tend to stay on the job longer than they should, take advantage of the firm by adopting pet projects, or increase firm size to increase their power.” Therefore, firms refinancing to states with more stringent antitakeover laws would reduce their equity and total value.

However, firms incorporated in states with stricter payout laws benefit from significantly reduced debt costs, and this relation suggests that firms incorporating in a less constrained state, such as Delaware, lose this benefit while gaining more financial flexibility.

This tradeoff suggests that the choice of Delaware incorporation has drawbacks as well as advantages, Mansi says. While his research results are consistent with other studies questioning the advantages of Delaware incorporation for all firms, he says that the results also suggest that a variety of legal environments may offer advantages to firms. “A variety of jurisdictions may therefore allow firms to sort themselves so as to maximize value from those laws which best fit their needs.”

NEW YORK VS DELAWARE... Stricter state laws lead to higher corporate credit ratings