Host and home country co-determinants of foreign establishment modes: evidence from the Chinese natural resource industries

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Abstract: We analyse the impact of home and host country co-determinants on the foreign establishment modes of Chinese multinational enterprises in natural resource industries. Using data from the Chinese Ministry of Commerce, we document that host country factors have a direct effect on establishment modes, whereas home country factors, particularly those related to the province in which the company is located, have an indirect effect through their impact on the firm's capabilities. While companies are more likely to pursue acquisitions in host countries with a rule-based governance environment, this relationship weakens when either the resource endowments of the home province increase, or the business environment of the home province improves.

Keywords: foreign establishment modes; home country; host country; natural resource industries; hierarchical linear modelling.

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1 Introduction

Chinese Outward Foreign Direct Investment (OFDI) has increased rapidly and in 2019 was ranked fourth in the world, after Japan, the USA and the Netherlands (UNCTAD, 2020). However, our understanding of this phenomenon is still limited by non-contextualised theories based primarily on Western experiences. Numerous studies investigate general Chinese OFDI while ignoring the heterogeneity of the industrial context and home country factors at the regional level. Furthermore, Chinese OFDI is very dynamic in response to both domestic and international events. For example, although in the past Chinese enterprises preferred to set up wholly owned subsidiaries, more recently they have increasingly pursued mergers and acquisitions. For example, the number of mergers and acquisitions increased from 433 to 467 between 2017 and 2019. In 2019, the natural resource sector was the sixth largest, in terms of investment stock (Ministry of Commerce of China, 2020).

Chinese natural resource sectors are attracting increased attention and our focus on these industries is based on a number of considerations. First, the quest for foreign resources to support and secure China's future growth has been a hallmark of the globalisation of Chinese enterprises (Lattemann et al., 2012). Second, the state owns much of this sector, which may affect the firms' foreign investment behaviour. Natural resource industries are also important for Chinese national security and, consequently, receive special attention from Beijing. Third, multinational companies from emerging economies are expanding. An idiosyncrasy of Chinese multinational natural resource firms is their lower level of risk aversion (Buckley et al., 2009). Fourth, foreign investments in these industries are often large, involve significant sunk costs and are subject to increasing returns (David and Wright, 1997). Investments are also usually lumpy. Together, these features of natural resource investments imply that the internationalisation process tends not to comply with the more gradual Uppsala model-type process that prevails in other industries.

Since natural resources play geopolitical and strategic roles in a nation's development and national security, companies operating in these industries are even more prone to institutional and governmental influence that affects their establishment modes. For example, to date, most of the largest firms active in the mining sector originate in resource-rich, common law countries (Canada, Australia, the USA and South Africa) (Shapiro et al., 2018). However, this is changing as Chinese companies are beginning to take the lead in emerging markets.

Most of the research on Chinese OFDI has not focused on establishment modes, but rather on aggregate levels and flows of investment across countries (e.g., Buckley et al., 2009). Furthermore, much of the Chinese OFDI research has looked at factors related to either the home country (e.g., Alon, 2010; Tolentino, 2010) or the host country (e.g., Buckley et al., 2009). Increasingly, studies are now using information about both the home and host countries (Deng et al., 2017; Gammeltoft et al., 2010a, 2010b; Liu and Hill, 2013), and more disaggregation, including province-level rather than solely nation-level data (Chen, 2015). Recognising the importance of factors related to both the host and home country, the literature has called for more research attention focused on the simultaneous effects of these factors on foreign direct investment (Lu et al., 2014; Wei et al., 2015).

China has enormous regional disparities and heterogeneous regional institutional environments (Meyer, 2008). Thus, the environment fostering investment from China varies widely from province to province. These variations in regional institutions and

resource endowments must be taken into account when considering Chinese firms' behaviour and strategic choices during their internationalisation (Sun et al., 2015). Hence, in this paper, we will utilise both province-level and nation-level data to increase our granularity and accuracy.

This article contributes to the literature on Chinese OFDI in the natural resource sector by (1) examining the host and home country co-determinants, (2) disaggregating the establishment modes of this investment and (3) specifically examining the province-level factors of the home country. We developed and tested a comprehensive, multi-level model utilising both province-level factors of the home country and the nation-level factors of the host country to investigate Chinese establishment modes in the natural resource sector. More specifically, we hypothesised that the host country effects are direct, whereas the province-level factors of the home country are indirect. We based these hypotheses on the fact that the home country's factors affect a firm's capabilities, which, in turn, impact its internalisation strategies (Akkermans et al., 2009; Spencer et al., 2005; Yu et al., 2015). More specifically, in the natural resource sector, the advantages that the home country enjoys in terms of locational assets, combined with those of the firm, will affect establishment modes (Rugman and Verbeke, 2003). Host country factors, on the other hand, impact the choice of establishment mode directly, because the firm must tailor its entry into a foreign market to the characteristics of the host country.

This paper is organised as follows. In Section 2, we present our theoretical framework. Section 3 describes the data and methodology used to test this theoretical framework through a logit Hierarchical Linear Model (HLM). Section 4 discusses our empirical results, their theoretical and practical implications and limitations. Section 5 provides a conclusion.

2 Theoretical framework and hypotheses development

Over the last decade, there has been an increase in the scholarly attention paid to OFDI from emerging economies (Alon et al., 2018; Gammeltoft and Cuervo-Cazurra, 2021; Madhok and Keyhani, 2012). Due to the unique characteristics of such economies with respect to areas such as governance and economic development, scholars have begun to question the applicability of existing models (Cuervo-Cazurra, 2012; Gammeltoft et al., 2010a, 2010b; Xie and Li, 2017).

Institutional theory has been the dominant paradigm for explaining the globalisation of Chinese capital, but studies of establishment modes are still rare (Alon and Fetscherin, 2012). However, research on the choice of establishment mode has proliferated since Hymer's (1976) work was published. The determinants studied include host and home country characteristics, industrial conditions and firm characteristics (Slangen and Hennart, 2008; Xie et al., 2017). As for the host country factors, scholars have identified their geographic characteristics and their political and macro-economic environments as important determinants of the choice of establishment mode, because they constitute the national context and influence transaction costs (Cuypers and Martin, 2010; Dikova and Van Witteloostuijn, 2007). The literature also emphasises the importance of institutional and cultural environments, including regulatory, normative and cognitive dimensions, which are among the most widely studied features of the host market (Demirbag et al., 2010).

Of the studies investigating home country factors, economic policies, the institutional environment and cultural factors are usually all considered to have significant effects on decisions about the mode of investment. Cui and Jiang (2010) argued that government policies in the home country that promote investment encourage firms to set up wholly owned enterprises rather than joint ventures. Institutional factors are powerful determinants of the internationalisation of natural resource firms.

Given that natural resource sectors are foundations for economic development and national security, they are often supervised, controlled and tightly regulated by state agencies. In China, it is the provincial governments that authorise most natural resource concessions. Firms need to hold a license to operate in the natural resource sector (Alon and Cherp, 2012). Thus, natural resource firms usually have a close relationship with the provincial government, which aligns them with government policies. Furthermore, the local governments influence their behaviours (Kolstad and Søreide, 2009).

Since the 1980s, two policies have emerged that are strongly related to the choice of establishment mode of Chinese natural resource firms. First, in 2002 China announced the 'Go Global' policy to encourage OFDIs (Alon et al., 2014). The governments tried to improve the environment for Chinese firms to engage in overseas investments by encouraging the exchange of experiences among local firms, offering tax incentives, and providing subsidies and low-interest loans (China Going Global Think-Tank, 2014). Second, China has implemented economic reforms during the last three decades, aiming to develop and enhance its industrial competitive advantages. The reforms were usually implemented by both the central and local governments. Mergers and acquisitions are regarded as one of the important measures in a few target industries (Li and Zhou, 2005; Zhang, 2015).

Institutional theory establishes a link between institutional factors and a firm's strategies. This theory can be utilised to examine how firms enter and operate in diverse institutional contexts, each with its own specific rules, norms and values (Meyer and Nguyen, 2005). Usually, firms entering a new market will emulate or mimic the actions of the host country firms or those of their competitors in that same market in order to legitimise their operations and market presence (Kostova and Zaheer, 1999). Entry mode, and more specifically, choices about establishment modes, affect the legitimacy of the firm and define its operational activities and transaction costs (Hall and Soskice, 2003). Using this logic, firms will choose an establishment mode that legitimises their operations and reduces their transaction costs (Harzing and Pudelko, 2016).

Most prior empirical studies have considered host and home country determinants separately, not jointly, and suggested that they work in parallel (Cui and Jiang, 2010; Williams et al., 2017). However, factors may be embedded rather than parallel (Lattemann et al., 2017). In a parallel mechanism, the host country and home country factors would each have their own direct effects on the outcome. Both could influence the choice of establishment mode directly without being dependent on the relationships between the host and home country factors.

However, in an embedded mechanism, the descriptor 'embedded' means that firms come from home provinces with different backgrounds. These backgrounds (home country factors) can affect outcomes (establishment modes) only by influencing the relationship between the direct factors (host country factors) and the outcomes. Indeed, we argue that home and host country factors might well affect establishment modes at various levels.

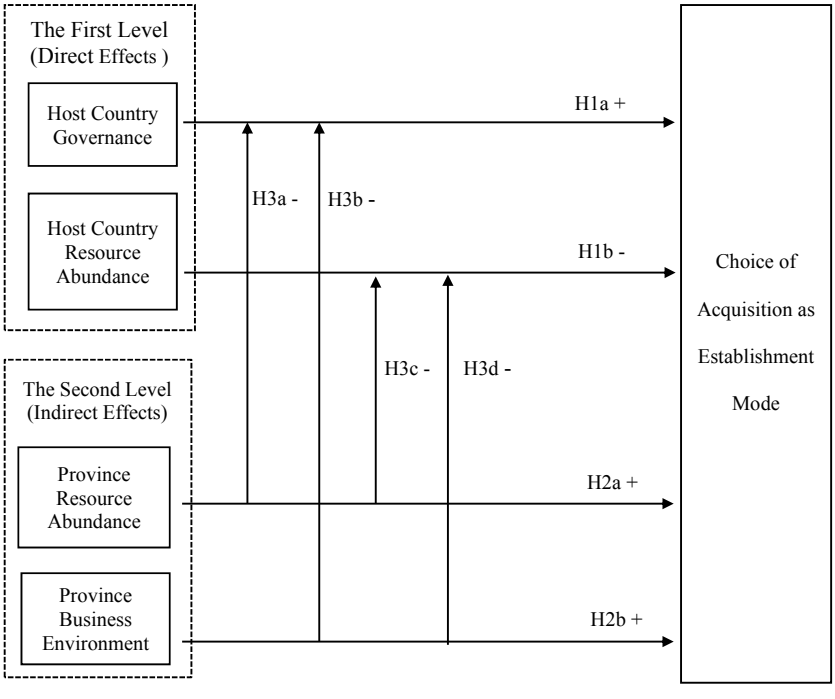
Numerous studies have proposed that home country advantages can be transferred to a firm's capabilities (Cuervo-Cazurra and Ramamurti, 2014). These home country factors

may affect foreign investments through a firm's specific capabilities. For example, Chinese overseas investments in the oil industry often apply the 'Angola model' in which infrastructure projects are exchanged for natural resources that are closely related to state-to-state links, concessionary aid, and preferential loans, in return for resource exports for China (Alon et al., 2015).

In China, the provincial governments authorise and supervise large natural resource firms. Furthermore, OFDI projects above 10 million yuan need to be approved by the provincial governments. Usually only large natural resource firms are capable of implementing OFDIs (David and Wright, 1997). Thus, their activities are more influenced by the provincial governments. The firms from the same province may have common characteristics. They are more likely to benefit from the measures taken by the governments, including tax deductions and simplified administrative processes. Thus, the home province's location advantages, when combined with other firm-specific advantages, can offer natural resource firms a competitive edge abroad. In other words, firms are embedded in their provincial environments. As a result, firms in the same province tend to make similar choices about their establishment modes. A hierarchical model is thus suitable for the analysis of determinants at different levels.

Our framework, illustrated in Figure 1, treats host country factors as directly affecting the choice of establishment mode, because the firm must tailor its entry to the specific characteristics prevailing in the host environment. Home country characteristics, on the other hand, indirectly affect establishment modes by moderating the host country's effects.

Figure 1 The theoretical framework



Notes: '+'/'–' denotes more/less likelihood of using acquisitions as opposed to greenfield investment.

2.1 Host country's institutional environment and abundance of resources

Our model considers the institutional environment and the abundance of natural resources in investigating the effects of the host country's factors on Chinese natural resource firms' internationalisation. The first factor provides insights into the external context, while the second highlights resource constraints.

Governance within a country usually includes governmental institutions (public institutions and policies) and non-governmental institutions (culture and information infrastructure). Li et al. (2004) compared rule-based governance with relation-based governance to describe the two poles of the governance spectrum. Li and Filer (2007, p.83) defined a rule-based system in which the law-making process is transparent and just and the law-adjudication function is independent. Thus, people predominantly rely on public rules to protect their social and economic exchange. However, relation-based governance has the opposite features.

Compared with greenfield investments, acquisitions usually entail difficult negotiations and contracts related to property rights between acquirers and targets, especially during post-acquisition restructuring and integration. Any risk of encountering property disputes will discourage firms from choosing acquisition. However, a country with a high degree of rule-based governance usually has more transparent and predictable government involvement, an independent legal system and adequate protection of intellectual property rights, all of which reduce the risk of property disputes and ease the process of resolving them should they arise. Therefore, when a firm enters a country with a strong rule-based governance system, it is more likely to choose acquisition. As for natural resource firms, they usually need to invest heavily in their new subsidiaries and are even more sensitive to risks. Thus, the advantages of rule-based governance may increase the chances of firms' pursuing acquisition. We propose that:

H1a: The stronger the degree of rule-based governance of the host country, the more likely Chinese natural resource firms are to pursue acquisitions to enter foreign markets.

Previous studies indicate that the subsidiaries of multinationals must deal with pressures from within the organisation (Kostova and Zaheer, 1999). By using greenfield investments, subsidiaries have less pressure from within the organisation because they are set up according to the parent firms' norms. As a result, the parent firms can control the subsidiaries' operations easily. By using acquisition as the establishment mode of investment, the knowledge and key components of the operation such as the relationship with the government and local interest groups are tied up with the acquired company (Harzing, 2002). If the integration after acquisition fails, the parent firm cannot acquire the resources. Most Chinese natural resource firms engage in OFDIs to seek resources as raw materials for domestic production (Ren and Yang, 2020). Thus, through OFDI, the firms would like to embed overseas production into the groups' operation, for example, by training the employees in the host country to meet the standards in China. Adopting this method will help ensure access to the resources in the long run. The more natural resources the host country holds, the more likely the parent firms would like to control the resources through OFDIs. The authorities of the host countries are usually cautious about natural resource investments, because they fear losing control of the resources in the acquired firms. Thus, Chinese firms are more likely to choose greenfield investments as their establishment mode. Therefore, we propose:

H1b: The greater the resource endowments of the host country, the less likely Chinese natural resource firms are to pursue acquisitions to enter foreign markets.

2.2 Home country's institutional environment and abundance of resources

Many studies about establishment modes have used the resource dependence theory to investigate the effects of home country factors on firms' internationalisation. Some scholars find that the policy advantages derived from the home countries can be transferred to both the firms' internal resources and their competitive advantage (Demirbag et al., 1995; Wilson, 1980). Since the 1980s, the evaluation of Chinese local governments has depended heavily on regional economic growth, such as GDP growth. Local governments are encouraged to stimulate economic growth. To avoid over competition, each province usually identified a few prominent sectors based on local endowments and helped these sectors grow (Li and Zhou, 2005). In provinces with abundant natural resources, firms in this sector are pushed to engage in mergers and acquisitions to expand production (Zhang, 2015). Thus, the firms acquired more knowledge about acquisitions. They are more likely to choose acquisitions because they possess the capabilities to acquire and integrate a target firm quickly. Therefore, we suggest that:

H2a: Chinese natural resource firms originating in well-endowed home provinces are more likely to pursue acquisitions to enter foreign markets.

Generally speaking, a good business environment provides the companies with more channels to obtain external resources and knowledge (Wang et al., 2017). For China, in a good provincial business environment, governments will simplify administrative procedures, encourage communication among the firms and provide financial benefits. For example, the government in Jiangsu province set up an industrial park for cooperation between Singapore firms and local firms. The government provided funds and infrastructure in this park (Pereira, 2004). As we discussed above, natural resource companies usually have a close relationship with provincial governments. They are likely to get more resources from business environment. One aim of the 'Go Global' strategy is to encourage international acquisitions. Such acquisitions are more valuable for provincial governments than greenfield investments because they signal the success of firms in the region. For maintaining government relationship and getting resources continuously, the natural resource firms are more likely to choose acquisition. Therefore, we suggest that:

H2b: Chinese natural resource firms originating in home provinces with better business environments are more likely to pursue acquisitions to enter foreign markets.

2.3 The moderating effects of home country factors

When a province is rich in natural resources, local firms may have more capabilities and experience of acquisition. Therefore, these firms are more likely to have capabilities for managing overseas subsidiaries, including the ability to make investments and manage risks. As discussed above, if the host country has a high degree of rule-based governance, firms are less likely to encounter property disputes, and these countries are safer for investments. A firm's ability to manage risks will reduce their need to rely on rule-based governance. Thus, the natural resources of their home provinces will reduce the

likelihood of Chinese investors utilising acquisitions in strong rule-based governance countries. Therefore, we propose that:

H3a: The larger the resource endowments of the home province are, the weaker the positive effect of rule-based governance in the host country on Chinese natural resource firms' preference for using acquisitions to enter foreign markets.

As discussed earlier, firms are more likely to pursue acquisitions when the host country has a rule-based governance environment. However, when the Chinese investors come from a province with a well-established business environment that has communication mechanisms for sharing information and experience among firms from the same province, it is likely that they can obtain information about the host countries in which they plan to invest. Access to this information reduces the risk of property disputes to the point that it outweighs the advantages of making acquisitions in rule-based countries. Therefore, we propose that:

H3b: The better the business environment of the home province is, the weaker the positive effect of rule-based governance in the host country on Chinese natural resource firms' preference for using acquisitions to enter foreign markets.

When considering host countries with abundant resources, the motivation of Chinese companies to obtain natural resources in the long term would make greenfield investments more attractive than acquisitions. Greenfield investments are easier for the parent companies to control than acquisitions. However, if the firms can integrate the acquired company successfully, the advantages of greenfield investments diminish. As we mentioned above, companies from home provinces well-endowed with natural resources often have that capability. Hence, abundant resources in the home province weaken the negative effect of the host country's abundance of resources. Therefore, we hypothesise that:

H3c: The larger the resource endowments of the home province are, the weaker the negative effect of natural resource abundance in the host country on Chinese natural resource firms' preference for using acquisitions to enter foreign markets.

In home provinces with well-established business environments, local firms will benefit from the governments' financial support, allowing them to gain experience and support in making acquisitions (Der Ploeg, 2011). The risk of not controlling the resources in the acquired firms declines. As a result, the negative effect of a rich host country's endowments on choosing acquisitions as an establishment mode weakens. We suggest that:

H3d: The better the business environment of the home province is, the weaker the negative effect of natural resource abundance in the host country on Chinese natural resource firms' preference for using acquisitions to enter foreign markets.

3 Research design and methodology

3.1 Data

Our unit of analysis is Chinese firms in natural resource sectors that established foreign subsidiaries between 2004 and 2015. We used a database from the Chinese Ministry of

Commerce (MOFCOM), which covers all OFDIs made by Chinese firms. The database is continuously maintained by MOFCOM and all its information accords with the firms' official registration with the Chinese administration. Data from each investment include the year of investment, destination country, home province and overseas activities. From this database we selected the projects where overseas activities were investments in the natural resource sector. We then collected information about the projects' establishment mode. We also collected data about the characteristics of the parent firm such as the year of foundation, the number of employees, and the ownership structure from the sample firms' annual reports and websites or from media reports. We could identify the establishment mode for only half of the investments, so the remaining investments were excluded from the database. Nearly 80% of these investments were greenfield and 20% were acquisitions. Several recent studies have indicated that data from official sources such as MOFCOM exhibit extensive volume and industry biases, because they include 'round-tripping' and 'onward journeys' through offshore special purpose entities (Sutherland and Anderson, 2015). However, since our research unit is firms in the natural resource sector, the bias problem caused by special purpose entities is less severe because natural resource firms rarely invest through 'round-tripping' and 'onward journeys'.

The sample initially included 1044 investments by 832 Chinese firms in natural resource sectors between 2004 and 2015, both years included. Owing the missing data about the establishment mode, our final sample consisted of 413 establishment mode decisions in 75 destination countries by 335 firms. Most of these investments were made in Australia, Indonesia and Canada. The Chinese investors originated from 30 different provinces, with Shandong, Beijing, Zhejiang and Hunan being the four most common. State-Owned Enterprises (SOEs) accounting for 61% of the sample. The distributions on the 10 largest destination countries and source provinces appear in Tables 1 and 2, respectively.

Table 1 Host country distribution of Chinese OFDI in the natural resource sector

Country	*Number of investments*	*Percentage*
Australia	54	13.1
Indonesia	52	12.6
Canada	32	7.7
Mongolia	21	5.1
Kyrgyzstan	18	4.4
Zimbabwe	14	3.4
Zambia	14	3.4
Russia	9	2.2
Cambodia	9	2.2
Peru	9	2.2
Other	181	43.8
Total	413	100.0

Source: Authors' elaboration

Table 2 Source province distribution of Chinese OFDI in the natural resource sector

Home province	*Number of investments*	*Percentage*
Shandong	49	11.9
Beijing	30	7.3
Zhejiang	27	6.5
Hunan	21	5.1
Central government-owned	20	4.8
Anhui	19	4.6
Jiangxi	18	4.4
Jiangsu	18	4.4
Hebei	17	4.1
Inner Mongolia	17	4.1
Other	177	42.9
Total	413	100.0

Source: Authors' elaboration

We also show the subsector distribution of both parent firms and overseas subsidiaries in Tables 3 and 4, respectively. In Table 3, nearly half of the parent firms did not register their subsectors, indicating only that their main business was mineral mining ('comprehensive'). Among the firms that registered their subsectors, 112 (27.1%) focused on metal mining, 20.1% were energy firms, and 3.6% were agricultural or metalloid mining firms.

Table 3 Subsector distribution of parent firms

Subsector	*Number of investments*	*Percentage*
Metal	112	27.1
Energy	83	20.1
Metalloid and Agriculture	15	3.6
Comprehensive	203	49.2
Total	413	100.0

Source: Authors' elaboration

Table 4 Subsector distribution of overseas subsidiaries

Subsector	*Number of investments*	*Percentage*
Metal	148	35.8
Energy	56	13.6
Metalloid and Agriculture	12	2.9
Comprehensive	197	47.7
Total	413	100.0

Source: Authors' elaboration

As for the subsector distribution of overseas subsidiaries, 47.7% indicated only that they were mineral mining firms, 35.8% were metal mining firms, 13.6% were in the energy sector and only 2.9% declared metalloid and agriculture as their main business.

Industrial factors have a moderating effect on the relationship between host and home country factors and the choice of establishment mode. Firms in different industries have different features, and their investments are driven by different motivations (Dunning and Lundan, 2008). We controlled for industrial effects as contingency variables in the model due to the importance of resource commitment and control over the choice of establishment mode.

3.2 Measures

Consistent with the theoretical framework and hypotheses previously described, our econometric model includes institutional and resource endowment variables in both the home region and host country, as well as the firm-level control variables. For the dependent variable (establishment mode), we used a dummy valued as 1 if the establishment mode was acquisition, and 0 for greenfield.

Considering first the host country governance, we created an index to determine the extent to which the governance environment is rule based. Li et al. (2004) suggested that a rule-based governance environment contains three dimensions: public rule making, public rule interpreting and public rule enforcing. In contrast, relation-based societies rely on private information and enforcement, and on personal relations and networks with 'insiders' such as officials and industry leaders. Exchanges in any society involve a specific type of governance and function. If the rule-based system is ineffective, a relation-based system will prevail (Wang and Li, 2018). This system may be based on the rule of village elders, feudal lords, organised crime, or on other types of non-government mechanisms (Intriligator, 1994). Thus, we considered governance as a continuum between two extreme poles, rule based at one end and relation based at the other. Other researchers such as Li et al. (2004) and North (1990) have also expressed this idea even though they used different terms.

A number of studies have developed indicators of the governance environment. For example, Kraay et al. (2002) created a governance index based on three dimensions and used two indicators to measure each dimension. This index has been adopted by a large number of studies and has been updated continuously since it was first created, the last update being in 2010 (Kaufmann et al., 2010). Among these indicators we adopted 'rule of law,' 'voice and accountability' and 'control of corruption' to reflect the establishing, interpreting and enforcing of rule-based, rather than relation-based, public governance. Rule of law captures the perceptions of the extent to which agents have confidence in and abide by the rules of society. This indicator shows to what extent a country's citizens are likely to obey the rules. Voice and accountability capture the perceptions of the extent to which a country's citizens are able to participate in political affairs and have freedom of expression. This indicator reveals to what extent the country has a transparent legal process. Control of corruption captures the perceptions of the extent to which public power is exercised for private gain. This indicator shows to what extent public institutions will enforce the law impartially and efficiently. We integrated the three indicators into an aggregate indicator by summing up their values and assessed it with a one-year lag. The higher the value, the more rule-based the governance environment, whereas the lower the value, the more relation-based the governance environment.

Considering still the host country, usually, three measurements can be employed to indicate natural resource abundance: exports, reserves and production (Stijns, 2005). However, not all reserves can be exploited because they are too difficult to mine. Furthermore, accurate data on reserves are often inaccessible. However, export and

production data are publicly available. As H1b stated, we posited that an abundance of natural resources would be closely connected to the investment opportunities available in the host country. Most natural resource-seeking investments are made to expand production and to serve the home market. Exports indicate the amount of natural resources not consumed in the host country. These natural resources can be exploited by multinationals. Production indicates only the resources that can be consumed rather than exploited by multinationals. Thus, exports are a more suitable indicator. We used a one-year lag of the proportion of ore and metal exports (which includes most of the products in our sample) in merchandise exports. Our data came from the World Bank.

As for the business environment at the provincial level within China, we used the index of the general evaluation of the business environment in the Business Environment Index for China's Provinces Report to determine whether the business environment was good for enterprises. This index is a general assessment of government management, the legal environment, tax burdens, financial services, human resource support, infrastructure, intermediary organisations, technical services and the social environment within a specific province (Wang et al., 2017). The index is updated every two years. Thus, we considered the updated year and the following year as being the same and so used a one-year lag of this index.

In H2b, we noted that large natural resource firms have often developed in regions with abundant natural resources. Some reserves are more difficult to exploit, so reserves are not necessarily related to the size and/or the capabilities of local firms. Rather, production output reflects the size of the industry in the region. As for the natural resource sector, it is closely related to the size and capabilities of local firms. Thus, we used a one-year lag of the proportion of fixed asset investment in the mining industry to that of the total industries in that region. This data came from the National Bureau of Statistics of China.

In addition to the characteristics of the host country and home region, we also included three firm-level control variables in the econometric model. We checked for firm size and type of ownership of the firm by using a logarithm of assets and a dummy variable, which was set to 1 if the firm was a SOE and 0 otherwise. We also controlled for the age of the firms, using a continuous variable indicating the number of years since the founding of the firm in which the investment was made. All of this information came from the State Administration for Industry and Commerce of China and was published on the National Enterprise Credit Information Publicity System. Table 5 provides a detailed list of the variables and their data sources.

Table 5 Variables and data sources

Variables	*Measurement*	*Data sources*
Dependent variable		
Establishment mode	1 =acquisition, 0 = greenfield	Ministry of Commerce
Independent variables		
Host country's governance	The extent to which the governance environment is rule based. We summed the values of the three indicators, 'rule of law,' 'voice and accountability' and 'control of corruption.' Values ranged from -7.5 (weak) to 7.5 (strong).	World Bank

Table 5 Variables and data sources (continued)

Variables	*Measurement*	*Data sources*
Host country's resources	The proportion of ore and metal exports in merchandise exports	World Bank
Home province's business environment	The general evaluation of the business environment. Values ranged from 1 (poor) to 5 (good).	Business Environment Index for China's Provinces Report
Home province's resources	The proportion of fixed asset investment in the mining industry compared to that of the total industries in the region.	National Bureau of Statistics of China
Control variables		
Firm's size	Log of assets	State Administration for Industry and Commerce of China
Firm's ownership	1 = SOE, 0 = non-SOE	State Administration for Industry and Commerce of China
Firm's age	The age of the firm at the time the investment was made	State Administration for Industry and Commerce of China

Source: Authors' elaboration

3.3 Data analysis method

Based on the theoretical framework described above, we performed an econometric analysis using a logit hierarchical linear model, which can separate direct and indirect effects according to the theory. The primary attribute of the dichotomous dependent variable (i.e., choice of establishment mode), and the embedded effects of host country and home regional factors meant that this model would be an appropriate method to test our hypotheses.

When choosing a host country, each establishment mode decision is independent. The choice of the establishment mode is the 'result' of the OFDI. Furthermore, the OFDI enterprises do not belong to a host country until the investment itself has been made. Therefore, according to the hierarchical linear model's grouping criteria, it is not appropriate to group the samples according to host country. The empirical results grouped by host country also show that the direct effect of the host country factors cannot be confirmed. However, OFDI enterprises naturally belong to their home provinces. They are imprinted by their regional culture and their institutional environment. Therefore, classification by home province can reflect the mechanisms of the impact more clearly. Both host country factors and firm-level characteristics are independent factors that have a direct influence on the choice of establishment mode. Thus, we included both of them as first-level factors in our analysis, whereas home province factors were included as second-level factors. Moreover, to avoid the problem of omitted variables, we controlled for industrial fixed effects in the analysis (Wooldridge, 2010). The formulas are as follows:

Level-1 Model

$$\begin{aligned} &Prob\left[Acquisition(1)=1 \mid \beta_j \right]=\phi_{0ij} \\ &Prob\left[Acquisition(0)=\ 0 \mid \beta_j \right]=\phi_{1ij}=1-\phi_{0ij} \end{aligned} \tag{1}$$

$$\begin{aligned} log\left[\frac{\phi_{0ij}}{\phi_{1ij}}\right] &= \beta_{0j}+\beta_{1j}Host\ Country\ Govt_{ij}+\beta_{2j}Host\ Country\ Res_{ij} \\ &+\beta_{3j}Firm\ Own_{ij}+\beta_{4j}Firm\ Ass_{ij}+\beta_{5j}Firm\ Age_{ij}+c_i+r_{ij} \end{aligned} \tag{2}$$

Level-2 Model

$$\begin{aligned} \beta_{0j} &= \gamma_{00}+\gamma_{01}Province\ Res_j+\gamma_{02}Province\ Bus_j+u_{0j} \\ \beta_{1j} &= \gamma_{10}+\gamma_{11}Province\ Res_j+\gamma_{12}Province\ Bus_j+u_{1j} \\ \beta_{2j} &= \gamma_{20}+\gamma_{21}Province\ Res_j+\gamma_{22}Province\ Bus_j+u_{2j} \\ \beta_{3j} &= \gamma_{30} \\ \beta_{4j} &= \gamma_{40} \\ \beta_{5j} &= \gamma_{50} \end{aligned} \tag{3}$$

Mixed Model

$$\begin{aligned} log\left[\phi_{0ij}/\phi_{1ij}\right] &= \left[\gamma_{00}+\gamma_{01}Province\ Res_j+\gamma_{02}Province\ Bus_j\right] \\ &+\left[\gamma_{10}+\gamma_{11}Province\ Res_j+\gamma_{12}Province\ Bus_j\right]*Host\ Country\ Govt_{ij} \\ &+\left[\gamma_{20}+\gamma_{21}Province\ Res_j+\gamma_{22}Province\ Bus_j\right]*Host\ Country\ Res_{ij} \\ &+\gamma_{30}Firm\ Own_{ij}+\gamma_{40}Firm\ Ass_{ij}+\gamma_{50}Firm\ Age_{ij} \\ &+u_{0j}+u_{1j}Host\ Country\ Govt_{ij}+u_{2j}Host\ Country\ Res_{ij}+c_i+r_{ij} \end{aligned} \tag{4}$$

For nearly half of the sample, we had no information about the establishment mode. Therefore, we conducted an independent sample *t*-test to compare the differences between the two sub-samples with and without the establishment mode information. The results reported in Table 6 indicate that the mean value of the host country's governance environment, the host country's natural resource endowments and the home province's business environment showed no significant differences. However, there were significant differences with regard to the home province's natural resource endowments. Given that we used the resource endowments of the entire nation, the resource endowments of central government-owned enterprises were relatively high, so the mean value of the firms whose establishment mode could be found was significantly different from the other samples. However, all central government-owned enterprises belong to the same group when we use HLM. This can control for the disturbance of these anomalous samples. Therefore, we concluded that the sample was still representative.

Table 6 Independent *t*-test results

Variable	*Variance Assumption*	*Levin's test for equality of variance*		*T-test for equality of means*			
		F	*Sig*	*t*	*df*	*Sig*	*M.D.*
Host country govt.	Equal variance assumed	3.67	0.06	–1.76	1042	0.08	–0.10
	Equal variance not assumed			–1.81	–	0.07	–0.10
Host country res	Equal variance assumed	5.06	0.02	0.47	1042	0.64	0.66
	Equal variance not assumed			0.48	–	0.63	0.66
Province bus	Equal variance assumed	0.06	0.81	–0.26	1042	0.79	0.00
	Equal variance not assumed			–0.26	–	0.79	0.00
Province res	Equal variance assumed	4.38	0.04	–2.25	1042	0.02	–0.50
	Equal variance not assumed			–2.21	–	0.03	–0.50

Source: Authors' elaboration

4 Results and discussion

Table 7 presents the correlations of the variables used in the study. Most of the coefficients are below 0.5, so multicollinearity is not a serious problem.

Table 7 Correlation matrix

	Acquisition	*Host country govt.*	*Host country res*	*Firm age*	*Firm size*	*Firm ownership*	*Home province bus*	*Home province res*
Acquisition	1							
Host country govt.	0.41***	1						
Host country res	–0.04	0.15***	1					
Firm age	0.05	0.15***	–0.05*	1				
Firm size	0.23***	0.33***	0.01	0.37***	1			
Firm ownership	0.06	0.17***	0.06	0.12**	0.46***	1		
Home province bus	0.00	0.08	–0.07	0.12**	–0.10	–0.09*	1	
Home province res	0.01	–0.17***	0.07	–0.09**	0.07	0.15**	–0.55***	1

Notes: *** $p < 0.01$, ** $p < 0.05$, *$p < 0.1$.

Table 8 shows the impact of host country and home province factors on the choices of establishment mode that Chinese OFDIs in natural resource sectors made using the logit hierarchical linear modelling. The null model depicts the baseline model without any

variables. The main effect model includes both host country factors and firm-level characteristics in the first level. The mixed model shows the full model with all variables included. For easier interpretation and better comparison of the empirical results, we computed semi-elasticities. The semi-elastic coefficient is the percentage of change in the dependent variable (the probability of choosing acquisitions) when the independent variable changes by one unit.

Table 8 Results of the logit hierarchical linear modelling analysis

Effects	*Variable*	*Param*	*Null model*	*Main effect model (semi-elasticity)*	*Mixed model (semi-elasticity)*
Independent direct effect	Firm owned	γ_{30} .		–0.31	–0.40
				(0.24)	(0.28)
	Firm size	γ_{40}		0.13**	0.13**
				(0.06)	(0.06)
	Firm age	γ_{50} .		–0.02	–0.01
				(0.02)	(0.02)
	Host country govt.	γ_{10}		0.68***	6.78**
				(0.11)	(2.76)
	Host country res	γ_{20}		–0.01**	–0.38**
				(0.01)	(0.19)
	Province bus	γ_{01}			–1.03
					(1.07)
	Province res	γ_{02}			0.04
					(0.05)
way interactions	Province res * Host country govt.	γ_{11}			–0.08**
					(0.04)
	Province bus * Host country govt.	γ_{12}			–1.85**
					(0.85)
	Province res * Host country res	γ_{21}			0.00
					(0.00)
	Province bus*Host country res	γ_{22}			0.11**
					(0.06)
Industrial fixed effects				Hold	
ICC				>5.9%	
–2 log likelihood			466.12	384.56	368.56
Correctly predicted percentage			–	79.18%	79.18%
Obs.			413	413	413

Notes: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

As the null model shows, the Intra-class Correlation Coefficient (ICC) of the model is larger than 5.9%, indicating that the second-level factors (between-group variation) have significant influences on establishment modes and that a hierarchical model can correctly separate the effects of the factors at each level. Thus, hierarchical linear modelling should be used to measure the effects of the first level and the second level variables on the choice of establishment mode.

To test our hypotheses, we used a mixed model to separate the effects of different level factors and investigate their interactions. The results indicate that host country factors do have direct effects on the choice of the establishment mode. Furthermore, home province factors, except the governance environment, do not have a direct effect on the choice of establishment mode. However, they do exert influence through the interactions with host country-level factors. This finding modifies the prevailing argument in the literature, which states that home country factors will directly affect the OFDI's choice of establishment mode (Dai et al., 2015).

As a whole, our results confirm H1a and H1b that host country factors have varying effects on the decisions of Chinese natural resource firms about how to establish themselves in foreign markets. The host country's governance environment has a positive, marginally significant effect on the choice of establishment mode (a semi-elasticity of 6.78 with $p < 0.05$). Thus, a rule-based governance environment will increase the likelihood of choosing acquisition. We also found a separate, negative effect of the host country's natural resource endowments on the choice of establishment mode (a semi-elasticity of –0.38 with $p < 0.05$), which concurs with what was previously hypothesised.

However, our results did not confirm H2a and H2b. The coefficients of the home province's business environment and resource endowments were not significant and had no significant direct effects on the choice of establishment mode.

The mixed model showed that the resource endowments of the home province do have a significant and negative moderating effect on the relationship between the host country's governance environment and the choice of establishment mode (a semi-elasticity of –0.08 with $p < 0.05$). The resource endowments of the home province weakened the positive effect of the host country's governance environment on the choice of using acquisitions. As stated earlier, when the home province is rich in natural resources, firms in resource-based industries have more experience, better risk-managing capabilities and supportive policies, reducing the importance of the strength of the host country's governance when deciding on establishment modes. In other words, the likelihood of using acquisitions will decline.

The moderating negative effect of the home province's business environment on the relationship between the host country's governance environment and decisions about establishment modes is also significant (a semi-elasticity of –1.85 with $p < 0.05$). A well-established business environment in the home province will weaken the advantages of the rule-based governance environment of the host country, as those enterprises already have strong capabilities to reduce the risk. Therefore, the better the business environment of the home province is, the weaker the positive effect of rule-based governance in the host country on Chinese natural resource firms' preference for using acquisitions to enter foreign markets.

The significant moderating effect that the home province's business environment has on the relationship between the host country's natural resources and the choice of establishment mode (a semi-elasticity of 0.11 with $p < 0.05$) is very interesting. The better the business environment in the home province, the weaker the negative effect of rich resource abundance in the host country on Chinese natural resource firms' preference for using acquisitions to enter foreign markets.

However, there is no empirical evidence to support our supposition of another moderating effect that richer home province resource endowments will weaken the negative impact of the host country's resource endowments on Chinese natural resource

firms' preference to use acquisitions. Hence, only H3a, H3b and H3d are supported. The model also indicated that host country and home country factors play different roles in firms' decisions about establishment modes. The former has direct effects on this choice, while the latter exerts indirect influence by moderating the relationship between the host country factors and the decision about establishment mode. The correctly classified percentage of the mixed model is 79.18%, the same as the main effect model, and –2 log likelihood decreases, which means that the mixed model is convincing. This result confirms our initial arguments that the impact of host country factors and home country factors on decisions about establishment modes are embedded rather than parallel.

As for control variables, only firm size has a positive significant effect on the establishment mode choices. Larger firms were more likely to utilise acquisitions, probably due to the economic reforms we have discussed before. Most large firms in China expanded during the reforms through mergers and acquisitions and accumulated rich experiences. The age of the firm does not have a significant impact on the choice of establishment mode. In terms of the firm's ownership, this result is inconsistent with previous studies (see Ramasamy et al., 2012). One possible reason is the importance of the license of entry for Chinese firms in the natural resource sector. Even when these firms are private, they are almost always closely connected to the government. Therefore, private natural resource firms tend to behave similarly to state-owned natural resource firms.

5 Conclusions

Our study that investigated the joint effects of home country and host country factors on foreign establishment modes in Chinese natural resource industries revealed several insights. First, a few studies have indicated that home country advantages can be transformed into firm-specific advantages. However, the exact source and nature of these advantages and the historical process though which they are transferred over time to firm-specific advantages remains an open question. The transfer process has not been fully understood, but our analysis can provide an empirical method to disentangle the effects. Second, we investigated the province-level factors of the home country, which have received little attention in previous studies (Cui and Jiang, 2012; Pan, 2002). In the case of China and other large countries, provincial data enable better and more precise analyses than nationally aggregated data. Third, we suggest that institutions and resources in a natural resource firm's environment can be transferred into firm-level capacities. These institutional and resource-based advantages combine to form each firm's competitive advantage.

Our analysis also has a number of practical implications. It is likely that this type of analysis can be generalised to other industries that operate in close relationship with governments. In such industries, firms should be aware of the different roles that host country and home province factors play when making decisions about entering foreign markets. Host country factors have a decisive impact on the internationalisation of these sectors, while home province factors only have an indirect effect through their impact on the firm's capabilities. One possible reason for this phenomenon is that natural resources are significant assets for most host countries. Thus, the regulations, interest groups and other companies in this industry in the host country limit OFDIs. Home country environments can provide only limited support for these investments.

There are also implications at the policy level. If the host governance environment can reduce constraints on choosing the establishment mode, the country will be more attractive to investors. Thus, for the host country's government, improving rules and regulations, and creating a rule-based system will reduce the costs and risks of FDI and will promote foreign investment. For example, small enterprises usually tend to choose rule-based countries in which to invest because they cannot incur the high risk of a less than favourable governance environment without external support. For the home country's government, it is better to provide guidance for OFDI, such as encouraging enterprises from well-established business environments to invest overseas, as they will face fewer constraints. The Chinese government offers loan packages supporting multi-purpose development projects in various sectors to enable investment deals in the natural resource sector, and Chinese firms act as a group to fulfil the Chinese government's commitments to the host country's government. Furthermore, when guiding OFDI, governments should not only consider the host country's environment, but should also adjust the measures based on the province's conditions.

Like all studies, ours suffers from a number of limitations that also provide direction for future research. First, more variables on firm-specific factors could be included in the model, because firm-specific assets play an important role in the choice of establishment mode. Previous research has determined that this choice is contingent on a firm's internal capabilities and strategies (Slangen and Hennart, 2008). Second, a more qualitative-driven analysis including questionnaires and case studies would produce more evidence and contribute more analytical depth to establishment mode studies (Liu and Deng, 2014). Third, considering host country factors at the regional rather than the national level could have strengthened the analysis, had such data been available. Nevertheless, our study provides a unique model that examines factors related to the host and home countries jointly. Because the fundamental theories we used are related to the features of the Chinese natural resource sector, this model is likely to be applicable only to sectors with similar characteristics in terms of the close relationship with the local government. Therefore, the concepts should be adjusted to the specific industrial context considered.

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