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Title: Political hazards and entry modes of Chinese investments in Africa

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Political hazards and entry modes of Chinese investments in Africa

Abstract Africa has achieved the fastest growth rate of inward foreign direct investment (FDI) recently. Yet heightened political hazards present substantial challenges to foreign firms in Africa. This study examines the entry strategies that firms may take to mitigate such hazards by exploring the relationship between political hazards and entry mode choices in Africa. We further consider how an investing firm's host country experience and foreign aid provided by its home country government to host countries in Africa can influence this relationship. In a sample of listed Chinese firms' investments in Africa from 2000 to 2014, we find that Chinese firms tend to use the joint venture mode when political hazards are high in an African country. This relationship is weakened when they accumulate host country experience and when the Chinese government's foreign aid to an African country increases. Our findings point to firm-level strategies to mitigate political hazards as well as instruments available to home country governments to help their multinational firms operating in host countries characterised by unstable political environments.

Key words Political hazards · Foreign aid · Entry mode · Foreign direct investment · Africa · China

Political hazards and entry modes of Chinese investments in Africa

Africa plays an increasingly important role in global economic development. According to Ernst & Young's (2015) Africa Attractiveness Survey in 2015, Africa's share of global foreign direct investment (FDI) capital flows more than doubled from 7.8 percent in 2013 to 17.1 percent in 2014. While Africa has become an important investment destination, there are many challenges for multinational enterprises (MNEs) operating in Africa. One such challenge is the heightened political hazards (Zoogah, Peng, & Woldu, 2015). For example, the same survey by Ernst & Young (2015) reported that more than half of the survey respondents consider the unstable political environment as the biggest barriers for foreign companies doing business in Africa.

Defined as policy instability rooted in a country's political institutions (Delios & Henisz, 2003; Henisz, 2000; Miller, 1992), political hazards can have a severe adverse effect on MNEs, ranging from changing the terms of the agreement to the confiscation of wholly or partially foreign owned business property (Henisz & Delios, 2001; Weston & Sorge, 1972). Given the severe consequences of political hazards, it is important to understand how MNEs can structure their investments to manage the political hazards in Africa.

In the fields of strategic management and international business, the choice of organizational form in foreign investment is an important research question because the structural features of organizations and the specifics of their governance structures affect economic processes and outcomes (Williamson, 1985). MNEs have several choices about the structure of foreign investments. The most significant one is the decision about the choice of ownership structure, which is to enter a foreign market by wholly-owned subsidiary or by joint venture. As one of the major considerations in the FDI decision of MNEs, foreign entry mode choice has been extensively studied (Maekelburger, Schwens, & Kabst, 2012; Meyer, Estrin,

Bhaumik, & Peng, 2009; Pan & Tse, 2000; Tihanyi, Griffith, & Russell, 2005). The majority of prior research employed transaction cost theory (Williamson, 1975, 1981) to examine how the nature of a firm's assets can affect its choice of entry mode to minimize potential contractual hazards arising from asset specificity (Anderson & Gatignon, 1986; Brouthers, 2002; Gatignon & Anderson, 1988; Maekelburger et al., 2012).

While transaction cost theory has contributed to conceptual and empirical advances in the understanding of the ownership decision in the entry mode choice, it is of lesser relevance in the context of Africa as many investors there do not typically possess ownership advantage such as advanced technology or well-known brands (Li, 2010; Luo & Tung, 2007; Moon & Roehl, 2001). In contrast, political hazards are of more immediate concern to investors and are likely to have stronger influence on the entry mode choice in the context of Africa.

In this study, we theorize and test the influences of political hazards on the entry mode choice of MNEs in Africa. Based on prior studies on political hazards (Delios & Henisz, 2000; Henisz & Delios, 2001), we propose that there is a positive relationship between the level of political hazards of a host country and the likelihood of choosing the joint venture mode when investing in that country. Further, we expect this positive relationship to be weakened when MNEs accumulate host country knowledge. Moreover, we extend prior studies by considering whether and how home country governments can help mitigate the host country political hazards and protect their MNEs' FDI there.

All MNEs are exposed to political hazards of a particular host country, but its adverse effect on MNEs may vary by the home countries to which the MNEs belong (Stevens, Xie, & Peng, 2016). This is because a host country government has different relationships with various home country governments. A friendly relationship between home-host country governments can help

mitigate the general host country political hazards, and vice versa (Peng, 2012). Indeed, the relationship between home-host country governments defines the specific investment environment for MNEs from a particular country. This notion is consistent with the two-tier bargaining model developed by Ramamurti (2001) based on his observation of the negotiation between the MNEs' home country governments in developed countries and host country governments in developing countries and the resultant more MNE-friendly investment environments in many developing countries in the 1990s.

Although the important role of home country governments in improving investment environments of MNEs and mitigating political hazards has been proposed in the literature (Cui & Jiang, 2012; Lu, Liu, Wright, & Filatotchev, 2014), few studies have furthered this line of research by investigating the specific mechanisms that home country governments may use and the effectiveness of these mechanisms. Among a variety of instruments (i.e. preferential policy, tax reduction, and guidance service) available to home country governments to support their MNEs in their host countries, foreign aid from home country plays a critical role, especially for investments in developing countries such as those in Africa.

Foreign aid aims to promote economic development and welfare of recipient (often developing) countries (Lancaster, 2007). Foreign aid can help MNEs from donor countries mitigate political hazards through two mechanisms. First, foreign aid helps improve the political relations between two countries and thus reduces the relative level of political hazards faced by MNEs from donor countries. Second, foreign aid helps improve the perception of investors, which boosts the investors' confidence in the political environment of aid recipient countries. Therefore, foreign aid may weaken the positive relationship between the level of political hazards and the likelihood of choosing the joint venture mode.

We undertake this study in the context of Chinese firms' investments in Africa. China overtook the United States as Africa's largest trading partner in 2009 (International Monetary Fund, 2015). The stock of Chinese OFDI in Africa grew from US\$491 million in 2003 to US\$26.2 billion in 2013 (Report on Development of China's Outward Investment and Economic Cooperation, 2014). In addition, Chinese firms have varying experience in investing in Africa, as Africa is the main recipient of foreign aid from China. Thus, China firms' investments in Africa provide a good context to test our hypotheses.

Overall, this study endeavours to make three contributions. First, it provides new insights on the foreign entry mode literature by considering the individual and interactive effects of political hazards, host country experience, and foreign aid. Political hazards and host country experience have been studied in prior studies but not in the context of Africa. Given the rising importance of Africa as an FDI destination and its high level of political instability (Zoogah et al., 2015), our investigation is a timely and much-needed step towards filling this gap in the literature. Second, the consideration of the role of home country governments in reducing the political hazards faced by its MNEs significantly broadens the theoretical framework of entry mode literature which has only examined the role of firm-specific and host country-specific factors. Third, it extends the two-tier bargaining model by identifying foreign aid as a specific mechanism employed by home country governments in the tier-1 negotiation.

Theoretical background and hypotheses

The majority of studies on entry mode have focused on micro-level transactional aspects. Specifically, they are built from the perspective that a firm needs to protect the stream of rents from firm-specific assets by guarding against private expropriation hazards, such as

technological leakage or the hazard of free-riding on brand name or reputation (Delios & Henisz, 2000). In the transaction cost approach, the principal dimension of the resources that affects its susceptibility to private expropriation hazards and its cost of transfer is its degree of specificity to the investing firm. Asset specificity refers to the ease with which an asset can be redeployed to alternative uses and by alternative users without loss of productive value (Williamson, 1975). Under conditions of high asset specificity, a high control mode may be preferred to mitigate the threat of opportunistic behaviour from transaction partners (Brouthers, 2002; Maekelburger et al., 2012). In the context of foreign investment, firms with highly-specific assets are likely to use a wholly-owned mode to fully appropriate the economic rents earned from the assets and to reduce the risk of unwanted dissemination (Teece, 1981).

While the traditional transaction cost analysis provides a parsimonious theoretical explanation of entry mode choice, it focuses on individual economic exchanges to predict the mode choice based on the minimization of transaction costs for that particular exchange (Williamson, 1975). The strategy tripod framework (Meyer & Peng, 2005; Peng, Wang, & Jiang, 2008) has highlighted the importance of considering the influences of institutions on strategic decisions. Peng (2001) and Makino et al. (2004) have both stressed that “countries do matter” in explaining the behaviour of MNEs. Therefore, we need to take into consideration not only the micro-level features of transactions, but also the characteristics of macro-level institutions, such as country-level political environment, in the entry mode decision.

Political environment includes legal framework and its enforcement, property rights and regulatory regimes, and plays an important role in shaping global strategies of MNEs (Meyer, 2001; Meyer et al., 2009). Increases in levels of uncertainty in the political environment of a country deter investments into that country (Henisz & Delios, 2001). When MNEs are uncertain

about the future of regulations, taxations, or macroeconomic policies in host countries, they perceive a high level of political hazards. Coupled with the “liability of foreignness” (Zaheer, 1995), the costs can escalate for successfully understanding and responding to such political instability or uncertainty (Brouthers, 2002; Henisz, 2000). In contrast, when the political environment of a particular host country is supportive and stable, it enhances the survival likelihood of foreign firms in the local market (Zaheer & McEvily, 1999). Thus, the quality—or “beneficence” (Zoogah et al., 2015)—of political environment of a host country, especially in terms of political hazards, will have a profound influence on entry strategies of MNEs (Demirbag, Glaister, & Tatoglu, 2007; Yiu & Makino, 2002).

Political hazards and entry mode

Political hazards are essentially policy instability which happens when political institutions fail to constrain policy makers from changing the status-quo policy regime or policies (Henisz & Delios, 2001). Compared to domestic firms, MNEs are more susceptible to political hazards in host countries. First, as foreign firms, MNEs suffer from high levels of liabilities of foreignness and outsidership. They not only have limited knowledge with local regulative framework and business practice, but also lack local connections as they are treated as outsiders by local networks (Asmussen & Goerzen, 2013; Zaheer, 1995). As such, they are not well informed of possible changes in policies and unable to respond in a timely and effectively manner (Pan et al., 2014). Second, MNEs are usually the targets of policy changes such as nationalism movements. In the policy formation or enforcement process, host country governments tend to protect the benefits of domestic firms at the cost of foreign multinational firms. As outsiders relative to local firms, MNEs face high risks in terms of outright expropriation by local state with coercive power (Demirbag et al., 2007). The literature has provided ample evidence of the “adversarial and

confrontational” events in host countries (Dunning, 1998) and the severe consequences of the host country political hazards (Busse & Hefeker, 2007; Feinberg & Gupta, 2009).

Zoogah et al. (2015) have pointed out that both formal and informal institutions can be the stumbling block to organizational effectiveness in the African context. Our onsite interviews with Chinese executives also confirm the influence of political hazards on their foreign investments.

‘There are three facets of hazards when making investment considerations. The top one is the discontinuity of local government policies, especially for the government procurement or official procurement.’ - From a senior manager, Sumsoar Group in Yiwu, Zhejiang province, China (October 3, 2015)

Confronted with high political hazards and their severe adversarial consequences, MNEs are likely to choose joint venture instead of wholly owned subsidiary for three reasons. First, having joint venture partners allows them to reduce the level of investment in host countries. The less credible commitment by government and the ever-changing regulatory structure in a host country make MNEs face a higher level of risks in their investments (Dunning, 1998; Jiang, Peng, Yang, & Mutlu, 2015). If the adversarial event actually happens, a lower level of investment amount means less loss to the MNEs. Thus MNEs can cut down the loss and retain some flexibility whenever political hazards occur (Yiu & Makino, 2002). Second, having a joint venture with a local firm can help build connections with the local government or powerful stakeholders in the host country. Compared with foreign firms, domestic firms are more likely embedded in the local environments with extensive local connections, including those with governments (Li, Poppo, & Zhou, 2008). Such connections can be used to gather information about potential policy change or lobby governments for policies which are favourable or at least less unfavourable to MNEs

(Slangen & Van Tulder, 2009). Third, equity ownership of local firms can serve as collateral in case local governments are considering any adversarial event. It helps reduce volatility in the political environment because any adversarial policy change will hurt both MNEs and their local partners whose interests are in general in line with those of governments. Therefore, we propose that:

Hypothesis 1: There is a positive relationship between the level of political hazards in a host country and the likelihood of an MNE's entry by a joint venture into that country.

Political hazards and entry mode: the moderating role of host country experience

Although a firm can reduce political hazards by having a joint venture partner in a local market, the level of the firm's dependence on the local partner to reduce political hazards would vary by its prior host country experience. Firms obtain specific knowledge on how to enter and operate in a foreign market through learning by doing in prior investments over time (Johanson & Vahlne, 1977). Such accumulated host country-specific knowledge through prior operations allows firms to improve their understanding of the host country political environment and develop capabilities to mitigate political hazards. When firms have greater levels of host country-specific experience, they are more knowledgeable about how to operate in that country (Lu et al., 2014). Thus, prior host country experience may serve as a substitute for the role of local joint venture partners in helping foreign investors gain access to information about market and nonmarket environments (Luo & Peng, 1999).

In their prior investments in a host country, MNEs may also develop their own local networks with governments, domestic suppliers, and customers (Lu et al., 2014; Schwens et al., 2011). These local connections may provide firms with diverse local knowledge and help them detect, analyse, judge and predict the changes in the identity and the preferences of incumbent

policy makers and the subsequent changes of regulations and laws (Delios & Henisz, 2003). At the same time, MNEs develop context-specific capabilities, which are tailored to the host country's specific economic, political and culture dimensions, to handle the potential instability in the host country's environment (Taussig & Delios, 2014). In doing so, MNEs can not only deepen the understanding of business practice and institutions, but also act more proactively in the unpredictable host country environment and formulate efficient strategies to safeguard against the opportunistic behaviour of host country governments (Delios & Henisz, 2000; Tseng & Lee, 2010). Thus, firms with substantial host country-specific experience will have less need for local joint venture partners and this will weaken the positive relationship between political hazards and the use of the joint venture mode.

In contrast, MNEs with limited host country-specific experience are new to the uncertain environment and have not developed capabilities for gathering and analysing relevant information for investment (Luo, 1999). Under such circumstances, they are more susceptible to the volatility in the political landscape and have more need for local joint venture partners to mitigate their disadvantages over local firms. Hence, we postulate that:

Hypothesis 2: An MNE's host country experience negatively moderates (weakens) the positive relationship between political hazards and the likelihood of the MNE to enter that country by a joint venture.

Political hazards and entry mode: the moderating role of foreign aid

MNEs can mitigate political hazards by negotiating with local governments in host countries by leveraging their ownership advantages such as advanced technology or well-known brands to obtain favourable terms of entry, operations or exit. This is the traditional bargaining model developed in the 1980s based on the experience of MNEs from developed economies (Kobrin,

1987; Lecraw, 1984). However, these MNEs often found that their bargaining power became obsolete after entry because the host country governments can hold MNEs' investments made in host countries as hostages and change the agreed terms. Ramamurti (2001) extended this one-tier bargaining between MNEs and host country governments by incorporating another tier of bargaining: the one between home and host country governments. The effectiveness of the bargaining between MNEs and host country governments depends, to a large extent, on the political relations between home and host country governments. This is because home country governments can increase the bargaining power of MNEs by removing the investment barriers and facilitating to lay the ground for a favourable investment environment. The two-tier bargaining model proposed by Ramamurti (2001) and Li et al. (2013) highlights the important role of home country governments in helping its MNEs mitigate host country political hazards.

Home country governments have a variety of tools to use in their bargaining with host country governments. In this study, we focus on foreign aid and discuss how it can help mitigate host country political hazards and hence moderate the relationship between political hazards and entry mode choice. Foreign aid has often been viewed as an effective vehicle for promoting economic growth in developing countries (Lancaster, 2007). However, recent reviews indicate that a donor's motivation is influenced by its political and strategic considerations both internationally and domestically (Alesina & Dollar, 2000; Lancaster, 2007). A recent example was the Mombasa Port Expansion project in Kenya. The project will construct a new container terminal to create three additional berths. In March 2015, Japan International Cooperation Agency (JICA) signed the agreement with the Kenya Port Authority (KPA) to provide a Japanese official development assistance (ODA) loan of up to 32.116 billion Japanese Yen (US\$275 million) for this project. However, when the Kenyan National Treasury ordered KPA to

introduce new conditions in the bidding documents, Japanese government threatened to cut aid to Kenya (Kalilwa, 2015).

Research relating to motivations for giving aid concedes that aid continues to serve as a form of home country (donor) guarantee for investments in a host country (recipient), and that aid moderates the level of risk perceived by MNEs from the donor country (Asiedu, Jin, & Nandwa, 2009; Kimura & Todo, 2010). Other recent studies on the emergence of China as a major aid donor to Africa conclude that Chinese approach to foreign aid has shifted from one influenced by Cold War ideological and political considerations to one that is more influenced by business strategy (Buckley et al., 2007; Chaponnière, 2009; Cheng & Shi, 2009; Ramasamy, Yeung, & Laforet, 2012; Warmerdam & de Haan, 2011).

The recent literature proposes that an increase in aid improves a host country's credit ratings (Harms and Rauber, 2004), and that aid mitigates the adverse effect of expropriation risk on FDI (Asiedu et al., 2009). On the one hand, the perception of political hazards is often subjective (Kobrin, 1979) or imaginative (Asiedu, 2002). Foreign aid can enhance the information flows from the recipient countries (Blaise, 2005) and thus acts as a vanguard for FDI by MNEs from the donor countries (Kimura & Todo, 2010). For example, Asiedu et al. (2009) propose that although risk negatively impacts FDI, aid alleviates some of the negative influence of risk on FDI. On the other hand, foreign aid can also improve the confidence of foreign investors from the donor country because political relations between the donor and recipient countries are often considered as an important factor in their FDI decisions. This is supported by our interviews with Chinese executives who have invested in Africa.

“Since our Prime Minister Keqiang Li visited Nigeria, many Chinese investors followed him to explore business opportunities in Nigeria. The government relations between China and Nigeria greatly improve our confidence in investing in Nigeria and Africa.”

- From one senior manager, Sumsoar Group in Yiwu, Zhejiang province, China (October 3, 2015).

In line with Asiedu and colleagues (2009), we contend that foreign aid from a donor country to a recipient country can negatively moderate the relationship between political hazards and entry mode choice of MNCs from the donor country to the recipient country. As foreign aid from their home country increases, MNEs will have more confidence to assume higher levels of equity in their investments despite of political hazards in the respective host countries. Thus we have the following hypothesis:

Hypothesis 3: Foreign aid from a home country government to a host country negatively moderates (weakens) the relationship between political hazards and the likelihood of an MNE's entry by a joint venture in that country.

Methodology

Research setting and sample

We implement our study in a sample of listed Chinese firms' investments in Africa. Chinese firms investing in Africa provide an appropriate empirical context to test our hypotheses. First, Chinese FDI in Africa has achieved increasing prominence. The flow of Chinese outward foreign direct investment (OFDI) to Africa has increased from \$391.7 million in 2005 to \$3.20 billion in 2014, with an annual growth ratio of 26.3 percent, and covered 52 of the 56 countries in Africa (Ministry of Commerce, 2015). The countries in which Chinese firms have invested in Africa are

significantly different in terms of legal origin (La Porta et al., 2000), ethnic fractionalization (Easterly & Levine, 1997), type of colonies (Acemoglu, Johnson, & Robinson, 2000), and institutional quality (Hearn, 2015). These differences provide opportunities to explore the influence of institutional environment, such as political hazards, on the entry modes of MNEs (Zoogah et al., 2015).

Second, Africa is becoming an important market to China. The bilateral trade between China and Africa increased from \$5.6 billion in 1999 to over \$200 billion in 2014 (International Monetary Fund, 2015). Many Chinese firms not only exported to Africa, but also invested there. Their varying levels of experience in the host countries in Africa allow us to investigate the moderating effect of host country experience on the relationship between political hazards and entry mode choice.

Third, the Chinese government has placed great emphasis on developing close relationships with African countries and provided significant support for the economic development in Africa (Peng, 2012). African countries' supports such as votes in international political, economic and civil decisions can be crucial for China to achieve its political and diplomatic goals in the world. This dates back to the role that African countries played in supporting China's admission to the United Nations in 1971 (Bräutigam, 2011). In return, the Chinese government provides aid to help Africa countries reduce poverty and build capabilities of economic development. For example, the Chinese government provided a total of \$14.41 billion of foreign aid from 2010 to 2012. Among this, 51 percent went to Africa (Information Office of the State Council, 2014). The prominence of aid from the Chinese government to Africa provides a good opportunity for our study to examine the role of foreign aid in moderating the relationship between political

hazards and entry mode choice. Taken together, Chinese investments in Africa provide an ideal context in which our hypotheses can be empirically tested.

Our sample comprises Chinese firms publicly listed on the Shanghai and Shenzhen stock exchanges during the period from 2000 to 2014 (inclusive). The data collection process included three steps. First, we collected foreign entry events of Chinese OFDI from the Ministry of Commerce of China (MOC). MOC is a major ministry at the central government level promoting and managing Chinese OFDI (Luo, Xue, & Han, 2010). Every new OFDI project conducted by Chinese firms needs to be registered with MOC. This data source provides a brief profile of each OFDI project (e.g., investment location, industry, date of approval, and line of business). We selected entries by Chinese firms into Africa from this database. Second, we matched the foreign entry events with Chinese publicly listed firms to have information on the parent firms. Third, we excluded the following entries from our final sample: (1) foreign entries in the form of representative offices because such entries need very little commitment, (2) projects in tax havens because OFDI to these destinations are driven by tax considerations (Hampton & Christensen, 2002; Lu et al., 2014), and (3) equity ownership by Chinese multinational firms is less than 10% (Cho & Padmanabhan, 2005; Demirbag et al., 2007). The final sample consists of 49 listed Chinese firms and their 110 investments in African countries. We lagged all independent variables by one year for causal inferences.

Dependent variable

The dependent variable, *foreign entry mode choice* dummy, equals to 1 if a sample firm has used the joint venture mode and 0 for wholly owned subsidiary. Following prior studies, we adopted 95% equity ownership as the cut-off point to distinguish between a wholly owned subsidiary and

a joint venture (Brouthers, 2002; Chang, Chung, & Moon, 2013; Chen & Hennart, 2002; Delios & Henisz, 2000; Demirbag et al., 2009; Yu, Lee, & Han, 2015).

Independent variable

For the key independent variable, *political hazards*, in a given host country, we used political constrains index (POLCON) developed by Henisz (2000) which is widely used in international business studies (Delios & Henisz, 2003; Demirbag et al., 2009; Holburn & Zelner, 2010; Jiang et al., 2015; Slangen, 2013). This index estimates the probability of policy change in a specific country in a specific year, given the structure of a nation's political institutions and the preference of actors that inhabit them. The measure of this index is constructed using a spatial model of political interaction based on data on: (1) the number of independent government branches with veto power over policy changes; (2) the homogeneity of the political party composition across different branches; and (3) the heterogeneity of this composition within each legislative branch. The POLCON score is scaled between 0 to 1, with 1 indicating extensive institutional checks and balances (For details about POLCON, see Henisz, 2000). Following Holburn and Zelner (2010), we defined policy hazard for host country j in year t as $PoliticalHazards_{jt} = 1 - POLCON_{jt}$. Thus the higher the level of POLCON scores, the higher the level of political hazards in a given host country.

Moderating variables

In our study, *host country experience* is one of the two moderators. Following previous studies (Barkema, Bell, & Pennings, 1996; Holburn & Zelner, 2010), we operationalized *host country experience* as the number of previous entries into a specific country. *Foreign aid* is the other moderator in our study. Chinese aid data to Africa were drawn from the online database of AidData, collected and published by a group of researchers from the United States and Germany

and supported by World Institute for Development Economics Research of the United Nations University using a media-based data collection approach. The database covers 53 countries during the period from 2000 to 2013. We downloaded the database that contained China's 1955 official aid projects and extracted information about China's annual aid to Africa at the country level. In order to measure foreign aid to a specific country, we first summed up official development assistance data, which are official financing given at concessional rates or grants to developing countries primarily to promote economic development and normal welfare in the recipient, and other official flows such as preferential export credits for each African country for each year. Then, we calculated the stock of foreign aid of each year and used natural logarithm transformation of the variable in our regression models.

Control variables

We included several firm-level control variables that may influence a firm's foreign entry mode choice. Firm size is controlled as larger firms may have sufficient resources to make investment on their own (Maekelburger et al., 2012). We measure *firm size* by the natural logarithm of a firm's total assets (Ang, Benischke, & Doh, 2014). Firms of different ages may act differently in responding to the internationalization strategy (Guillén, 2002; Tseng & Lee, 2010). We controlled for *firm age* which is measured as a firm's founding year subtracted from the focal year. *Intangible assets* are one of the key determinants of entry mode choice as per transaction cost theory. We control for the reputable brands and marketing skills of the investing MNEs. MNEs with more reputable brands and better marketing skills may prefer to exploit them through the wholly owned mode over the joint venture mode (Chen & Hennart, 2002). In line with prior studies, we use MNE's sales expenditures divided by total sales, as a proxy for marketing related intangible assets (Delios & Henisz, 2003; Slangen & Van Tulder, 2009). Government ownership

in a firm can influence the risk preferences of firms as state-controlled firms are more likely to benefit from government support and hence have a higher propensity to invest in risky environment (Cui & Jiang, 2012; Ramasamy et al., 2012). Following Delios et al. (2006) who identified state-owned companies by the ultimate controller of a firm, we measure state ownership as a dummy variable which equals to 1 if a firm's ultimate controlling shareholder is a state entity or owned by a state entity, and 0 otherwise (Meyer et al., 2014). Data on the above control variables is obtained from the China Stock Market and Accounting Research (CSMAR) database and the annual reports of the listed firms.

As prior studies documented that MNEs may invest in Africa for resource-driven considerations (Asiedu, 2006; Bartels, Napolitano, & Tissi, 2014), we controlled for *parent firm industry* and *subsidiary industry*. We constructed two dummies to control for industry effect of parent firm and subsidiary. The dummies equal to 1 if it is a resource-intensive industry and 0 otherwise (Demirbag et al., 2010). Following Gomes-Casseres (1989) resource-intensive industries were identified as food, beverages, textiles, rubber, tobacco, paper, petroleum, and mining. Infrastructure projects count for 37 percent of total investments of Chinese FDI in Africa by the end of 2013 (Report on Development of China's Outward Investment and Economic Cooperation, 2014). Thus, we control for *OFDI type* with a dummy which equals to 1 if the investment is on infrastructure projects and 0 otherwise. We also control for two country-level variables: Host country GDP growth and FDI net flows. GDP growth of host country was used as an indicator of the attractiveness or market potential of a foreign country (López-Duarte & Vidal-Suárez, 2010). The flow of FDI may also affect the openness and attractiveness of host country which will influence the strategic decision of firms (Chan & Makino, 2007). Thus, we include FDI net flows from home country to a specific host country in our model to control this

effect. We log transform the value of FDI net flows from home country to correct for skewed values. Both country-level of variables were constructed from World Bank's database.

As our data span from 2000 to 2014, we need to control for particular events in this period. We employed a dummy which takes the value of 1 if the project is in or after 2008 and 0 before 2008. We chose the year of 2008 because there is a dramatic increase in OFDI made by Chinese firms in 2008. The financial crisis occurred in 2008, which provides an appropriate opportunity for Chinese firms to actively participate in global cooperation and competition (Davies, 2010; Taylor, 2011). The flow of OFDI from China surged to \$55.9 billion, an increase of 111 percent in 2008 compared to the year of 2007 (Report on Development of China's Outward Investment and Economic Cooperation, 2008).

Model estimation

Because our dependent variable, *foreign entry mode choice*, is a dichotomous variable, probit regression is appropriate for our analysis (Delios & Henisz, 2000). The regression coefficients estimate the impact of the independent variables on the probability that the foreign entry mode choice is joint venture rather than wholly owned subsidiary. As our sample is pooled data, the observations are independent across clusters but dependent within groups. This will lead to an underestimation of the true standard errors and inflate the significance tests that are related with the parameter estimates (Greene, 2003). In order to obtain robust estimated standard errors and variance, we follow Slangen and Hennart (2008) and Xu, Pan and Beamish (2004) in accounting for such cluster effects by using clustered standard errors and report the robust standard errors.

Results

Table 1 presents the descriptive statistics and a correlation matrix of all variables. As shown in Table 1, the correlations between our variables ranged from low to medium, suggesting that multicollinearity is not a serious problem. We further verify this by checking the variance inflation factors (VIFs) of all variables in all regression models. They were all well below the threshold of 10 (Hair, Black, Babin, Anderson, & Tatham, 2006; Neter, Kutner, Nachtsheim, & Wasserman, 1996). We mean-center related variables to minimize the problem of potential multicollinearity in testing the two interaction effects.

Table 2 shows the regression results of binary probit regression on the likelihood of the use of the joint venture mode. Model 1 is the baseline model that includes only the control variables. We add two moderating variables in Model 2. Model 3 enters independent variable to test the main effect (H1) of this study. Model 4 and Model 5 separately test each of the two moderating effects (firm's host country specific experience and foreign aid from its home country government) on the relationship between political hazards and entry mode choice. Model 6 presents the results of the full model.

Insert Tables 1 and 2 about here

Hypothesis 1 predicts a positive relationship between the level of political hazards of a host country and the likelihood of entering that country by the joint venture mode. As shown in Model 3 of Table 2, the coefficient of political hazards is positive and marginally significant ($p < 0.1$). Thus the result supports Hypothesis 1. Hypothesis 2 predicts that the positive relationship between political hazards and the use of the joint venture mode will become weaker when firms accumulate host country experience. The coefficient of the interaction term between political

hazards and host country experience (Model 4) is negative and highly significant ($p < 0.01$), providing strong support to Hypothesis 2. Hypothesis 3 states that foreign aid can negatively moderate the positive relationship between political hazards and the likelihood of the use of the joint venture mode. This prediction is strongly supported by the coefficient of the interaction term between political hazards and foreign aid (significant at $p < 0.01$ and negatively signed). The results on the two moderating effects remain robust in the full model which contains all variables and interaction terms.

To gain further insights into these findings, we plotted the related interaction results based on the full model (Model 6 in Table 2). Figure 1 illustrates the interaction between a firm's host country experience and the political hazard in the host country. As shown in Figure 1, the slope is positive when an investing firm has low level of host country experience (one standard deviation below the mean of host country experience). In contrast, the slope becomes negative when an investing firm has high level of host country experience (one standard deviation above the mean of host country experience). This contrast clearly shows that the relationship between political hazards and the joint venture mode becomes less positive (or even negative) when a firm's host country experience increases.

 Insert Figure 1 about here

Figure 2 depicts the interaction between a home country's foreign aid and the political hazard in the host country. As shown in Figure 2, the slope is positive when an investing firm's home country has a low level of foreign aid (one standard deviation below the mean of foreign aid) to its host country. In contrast, the slope becomes negative when an investing firm's home

country has high level of foreign aid (one standard deviation above the mean of foreign aid). The contrast illustrates that the relationship between political hazards and the joint venture mode becomes less positive (or even negative) when the foreign aid from a firm's home country to the host country increases.

Insert Figure 2 about here

Discussion

This study examines the relationship between political hazards and the entry mode choice in the context of Africa where political instability presents substantial challenges to foreign firms. We further consider how this relationship can be moderated by firm-level capability such as an investing firm's host country experience and government-level policy instruments such as foreign aid provided by its home country government to host countries. In a sample of listed Chinese firms' investments in Africa from 2000 to 2014, we find that Chinese firms tend to use the joint venture mode when political hazards are high in a host country. This relationship is weakened when they accumulate host country experience in that country and when Chinese government's foreign aid to that country increases. The findings from this study have implications for both research and practice.

Theoretical contributions

Our findings enrich entry mode literature in three ways. First, this study helps to advance our understanding of foreign entry mode choice by theoretically and empirically examining the moderating role of home country governments. Prior studies in the entry mode literature have only examined the effects of firm-specific and host country-specific factors (Brouthers, 2002; Luo, 2001; Yiu & Makino, 2002; Yu et al., 2015). Some recent studies have started considering the role of home country governments (Cui & Jiang, 2012; Pan et al., 2014; Peng, 2012; Stevens et al., 2016). For example, Cui and Jiang (2012) postulate that the firms with high levels of state ownership will be more inclined to rely on the home government resources, thereby having stronger motivation to choose the joint venture mode so as to conform isomorphic institutional pressures. Similarly, Pan et al. (2014) find that firms with higher levels of state ownership and legislative connections will be less affected by the foreign institutional environment when making ownership decision. However, these studies still stop at treating state ownership or legislative ties as “political factors that are embedded within the firm.” We further these studies by directly examining the political force outside the firm. Our study is in line with Duanmu (2014) who examined the influence of government outside the firm on the level of FDI. Thus, our consideration of the role of home country governments in reducing the political hazards faced by its MNEs significantly contributes to the theoretical framework of the entry mode literature. In our study, the important role of home country governments in reducing the political hazards has been empirically supported by the significant negative moderating effect of home country’s foreign aid on the relationship between political hazards and the use of the joint venture mode. Therefore, future research on entry mode should incorporate the role of home country governments outside the firms in the theoretical framework to provide a more complete picture of the entry mode decision.

Specifically, our identification of foreign aid as a particular mechanism employed by home country governments contributes to the two-tier bargaining model proposed by Ramamurti (2001) and Li et al. (2013). The two-tier bargaining model has been proposed but seldom empirically tested. It theorized the general role played by home country governments in tier-1 negotiation in reducing risks in host country political environment. But it has not theoretically pinpointed or empirically demonstrated the specific instruments home country governments could use. We have theorized in this study how foreign aid could be such instrument and empirically demonstrated its significant role in moderating the relationship between political hazards and entry mode choice (i.e., joint venture vs. wholly owned subsidiary). This is in line with the findings by Li et al. (2013) in their case study of Chinese FDI in African natural resources sector. Li et al., (2013) also argue that the Chinese government represents the collective interests of Chinese MNEs to negotiate with host country governments. We extend their argument and test this in more general industry settings with a comprehensive dataset from a variety of Chinese multinationals. As such, we contribute to the two-tier bargaining model by enriching its theoretical framework and presenting the first evidence how this model works.

Second, the significant individual and interactive effects of political hazards, host country experience, and foreign aid shed new light on entry mode studies. The former two factors, political hazards and host country experience, have been studied in prior studies but not in the context of Africa. The African context meaningfully extends the empirical domain of the literature because Africa is becoming one of the major FDI destinations and yet it has high levels of political instability (Zoogah et al., 2015).

The finding of the positive relationship between political hazards and the use of the joint venture mode provide corroborating evidence on the use of joint ventures to mitigate the political

risks in a host country (Slangen & Van Tulder, 2009; Tseng & Lee, 2010). Further, the contrast between the significant effect of political hazards and the non-significant effect of firm intangible asset (advertising intensity) provides support to our contention that the political hazards are of primary concern in the entry mode decision into African countries. It also suggests the relative importance of the determinants of entry mode can vary by research context. Researchers should contextualize research questions and conceptual models accordingly.

The negative moderating effect of host country experience on the positive relationship between political hazards and the use of joint venture entry mode found in this study is consistent with the findings from prior studies (Delios & Henisz, 2000; Mackelburger et al., 2012), suggesting the substitutive nature of the local knowledge contributed by local partners and accumulated by foreign firms through experience. As a firm gains experience in a host country, it is less dependent on local partners for local knowledge. The strength of this moderating effect in the context of Africa points to the importance of host country experience in highly unstable political environment.

Third, our empirical context of Chinese outward FDI into African countries is of great importance but understudied in the literature. While Africa has drawn attention from investors all around the world, investors often have limited knowledge of this region in terms of political, cultural, social and economic environments. Therefore, there is an urgent need to investigate the mechanisms and strategies for foreign firms to invest and operate successfully in such an important but politically unstable continent. The results from Chinese firms investing in Africa answer the call for more studies on strategies of investing and operating in such “unknown world” (Zoogah et al., 2015).

Practical implications

This research has important practical implications for foreign firms operating in or thinking of entering Africa. Our findings suggest that firms should seriously consider using joint ventures when entering into African countries, especially those with high political hazards. While this general recommendation may hold true for all, firms should evaluate their specific need for local knowledge and connections. If a firm has already gained substantial host country experience, its accumulated local knowledge and established local connections reduce the need for a local joint venture partner. Further, firms should make good use of the support of their home country government. In countries with unstable political environment, good relationship between home-host country governments can be critical in reducing expropriation risk. Therefore, firms should take this into consideration in deciding on where and how to make their investments.

Our findings also have implications for policy makers. The significant moderating role of foreign aid suggests that foreign aid can be used as vanguard for FDI. Policy makers may want to use foreign aid strategically to both guide the outward FDI and protect the interests of their MNEs. Nevertheless, the primary aim of foreign aid is to promote the economic development and welfare of developing countries. The challenge for policy makers is how to use foreign aid to achieve such primary aim and, at the same time, to protect its home MNEs' investment in aid recipient countries.

Limitations

This study has several limitations. First, we only examined one instrument, foreign aid, employed by home country governments in helping mitigate political hazards for its MNEs' FDI in the recipient countries. In reality, there is a variety of tools, such as bilateral agreements and treaties on trade and investment issues, available to home country governments. Future studies could extend our study and compare the relative effectiveness of different tools in mitigating

political hazards. Second, we used Chinese FDI in Africa as our empirical setting. Although this setting is appropriate and important, there are concerns about the generalizability of our findings. While we believe that our theoretical framework can be applied in different settings, this assertion is yet to be tested. Third, we only examined listed firms due to data availability. It will be useful to test this study's models in samples of small- and medium-sized firms or born-global firms as these firms are likely to be more susceptible to political hazards than listed firms that have more resources.

Conclusion

Although Africa is becoming an attractive FDI destination, its heightened political hazards remain a major deterrent to MNEs. This study investigates strategies to reduce this risk in Africa. We make and substantiate the case that joint venture is a preferred entry mode in the presence of high political hazards. Yet, this preference becomes less prominent when a firm accumulates host country experience and when the foreign aid from its home country government to the host country increases. Our findings highlight two-tier (at both firm and government levels) strategies to mitigate political hazards.

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Table 1 Descriptive statistics and correlations

Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13
1.Foreign entry mode choice	0.336	0.475													
2.Firm age	12.109	4.943	0.055												
3.Firm size	23.044	1.633	0.184*	-0.226*											
4.Intangible asset	0.046	0.053	-0.066	-0.111	-0.223*										
5.State ownership	0.655	0.478	-0.009	-0.155	0.529***	-0.261***									
6.Parent firm industry	0.064	0.245	0.130	0.161*	0.137	-0.175*	0.189*								
7.Subsidiary industry	0.345	0.478	-0.072	-0.238*	0.373***	-0.080	0.327***	-0.189*							
8.OFDI type	0.136	0.345	0.054	0.131	-0.117	-0.253***	0.010	0.548***	-0.289***						
9.Host country GDP growth	0.052	0.071	0.049	-0.126	0.078	0.011	-0.070	0.045	-0.063	0.020					
10.FDI net flows from home country	19.468	5.631	0.132	-0.066	0.043	0.065	-0.003	-0.050	-0.047	-0.160	0.062				
11.Time dummy	0.855	0.354	0.021	0.402***	0.175*	-0.304***	-0.029	0.108	-0.188**	0.089	-0.010	0.109			
12. Political hazards	0.681	0.173	0.121	0.140	0.082	-0.190**	0.135	0.099	0.166*	0.088	-0.048	-0.139	-0.019		
13. Host country experience	0.173	0.446	0.026	-0.067	0.071	-0.008	-0.019	-0.018	-0.024	-0.035	-0.139	0.050	0.102	-0.240**	
14. Foreign aid	18.068	5.623	0.066	0.275***	0.217**	-0.148	-0.082	0.127	0.055	-0.026	0.193**	-0.040	0.447***	0.142	0.128

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$; t statistics in parentheses

Table 2 Probit model on the likelihood of entry by joint venture

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Constant	0.542 (0.83)	0.567 (0.82)	0.551 (0.82)	0.506 (0.75)	0.807 (1.20)	0.724 (1.06)
Firm age	0.040 (0.95)	0.040 (0.96)	0.036 (0.86)	0.050 (1.18)	0.044 (1.04)	0.055 (1.31)
Firm size	0.311* (1.95)	0.308* (1.93)	0.322** (1.98)	0.283* (1.75)	0.359** (2.18)	0.318* (1.93)
Intangible asset	-1.567 (-0.58)	-1.533 (-0.57)	-0.774 (-0.28)	-0.783 (-0.30)	-2.133 (-0.66)	-2.113 (-0.71)
State ownership	-0.500 (-1.04)	-0.484 (-1.02)	-0.510 (-1.07)	-0.471 (-0.99)	-0.571 (-1.18)	-0.532 (-1.10)
Parent firm industry	0.363 (0.47)	0.341 (0.44)	0.270 (0.35)	0.399 (0.52)	0.221 (0.28)	0.337 (0.43)
OFDI type	-0.367 (-0.90)	-0.378 (-0.94)	-0.484 (-1.15)	-0.627 (-1.47)	-0.669 (-1.42)	-0.773 (-1.62)
Subsidiary industry	0.120 (0.18)	0.133 (0.20)	0.135 (0.21)	0.102 (0.15)	0.236 (0.35)	0.183 (0.26)
Host country GDP growth	0.231 (0.12)	0.213 (0.12)	0.544 (0.32)	0.133 (0.07)	0.507 (0.29)	0.115 (0.06)
FDI net flows from home country	0.045 (1.61)	0.045 (1.61)	0.053* (1.66)	0.057 (1.57)	0.057* (1.68)	0.061 (1.61)
Time dummy	-0.699 (-1.50)	-0.739 (-1.33)	-0.675 (-1.20)	-0.761 (-1.39)	-0.833 (-1.49)	-0.880 (-1.59)
Host country experience		0.055 (0.15)	0.219 (0.57)	-0.757* (-1.67)	0.096 (0.27)	-0.791* (-1.75)
Foreign aid		0.005 (0.15)	0.0002(0.01)	0.001 (0.03)	-0.006 (-0.21)	-0.004 (-0.13)
Political hazards			1.453* (1.76)	1.051 (1.25)	1.634** (1.96)	1.174 (1.43)
Political hazards × Host country experience				-5.635*** (-2.74)		-5.215*** (-2.64)
Political hazards × Foreign aid					-0.407*** (-2.88)	-0.342*** (-2.67)
Log-L	-63.540	-63.503	-62.119	-58.811	-59.643	-57.044
Pseudo R ²	0.096	0.096	0.116	0.163	0.151	0.188
Correctly classified	70.910	70.910	70.000	72.73	72.73	75.45
Akaike I.C.	149.1	153.0	152.2	147.6	149.3	146.1
BIC	178.8	188.1	190.0	188.1	189.8	189.3

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$; t statistics in parentheses

Figure 1 The moderating role of host country experience on the relationship between political hazards and the joint venture mode

Figure 2 The moderating role of foreign aid on the relationship between political hazards and the joint venture mode

The likelihood
of entry by joint venture

..... Low level of foreign aid

———— High level of foreign aid

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