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   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

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- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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AN UNDERSTANDING OF DUNNING'S OWNERSHIP-LOCATION-INTERNALISATION (OLI) ECLECTIC THEORY OF MULTINATIONAL COMPANIES

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ABSTRACT

Multinational companies that seek to enter foreign markets usually make the strategic choice whether to enter the foreign market through Foreign Direct Investment (FDI), exportation, or joint ventures. The Eclectic Model was formed to incorporate the three different forms of international growth/expansion: Licensing, Exports and Foreign Direct Investment (FDI). This model supports the manager's decisions in choosing appropriate strategies for expansion. The so-called OLI-factors are three categories of advantages, namely the ownership advantages, locational advantages and internalization. A precondition for international activities of a company is the availability of net ownership advantages. These advantages can both be material and immaterial. The corporation should analyze the six decisions used to decide whether a market is suitable, that is, managers should make the correct product choice for the particular market. Through market research they will choose the best market. This articles aims at exposing the understanding of the Dunning's Eclectic theory and its rationale to a multinational corporation. Alongside this the article examines the process of screening foreign markets and also the potential impact of multinational companies on home and host countries.

KEYWORDS
Multinational companies, Foreign Direct Investment (FDI), OLI-factors (ownership, locational and internalization), foreign market, home and host countries.

INTRODUCTION

All organizations have a potential for growth and various strategies to expand and grow internationally are available for them. The only difference that exists is the time and the resources they want to commit in order to reap the benefits of international growth by investing globally. However, what confuses mangers is the strategy to choose, even if they are able to identify a potential opportunistic market, they fail to select an appropriate strategy to implement. Multinational companies that seek to enter foreign markets usually make the strategic choice whether to enter the foreign market through Foreign Direct Investment (FDI), exportation, or joint ventures. Most of them usually prefer FDI compared to other modes of investment such as exportation or licensing (Hill, 2005). This is because of several reasons such as; the high transportation cost on exports, for example, when this cost is put together with production cost it becomes so expensive that it leaves MNC's with the choice of FDI in which there exists market imperfection that leads to the internalization theory, due to strategic rivalry and also due to specific advantage. Dunning (1981) suggested that the choice of entry into the new foreign market depend on ownership advantages, location advantages, and internalization. An MNC can enter foreign market through the export, joint venture (FDI), green-field FDI and brown field FDI.

STATEMENT OF THE PROBLEM

In a business environment that is increasingly global in nature, the questions of how, when, and where a firm chooses to engage in foreign direct investment are important topics for international businesses. They will also have to choose which mode of entry they want to use. This article will give an overview of what the Eclectic Paradigm is and how it relates to foreign direct investment. The eclectic paradigm will enable managers to make informed strategic decisions should their firm choose to engage in foreign direct investment.

OBJECTIVES OF THE STUDY

1. To expose the concepts in Dunning's eclectic theory and relate the concepts with a multinational corporation
2. To explicate the potential impact of multinational companies on home and host countries

SIGNIFICANCE OF THE STUDY

The Eclectic Model was formed to incorporate the three different forms of international growth/expansion: Licensing, Exports and Foreign Direct Investment (FDI). This model supports the manager's decisions in choosing appropriate strategies for expansion that is why proper understanding is needed. The OLI framework is also known as the Eclectic paradigm which was proposed by Dunning (1977, 1980, and 1988). His framework was an extension of the internalization theory which originated from the transaction theory stating that "companies should seek lower costs between handling something internally and contracting another party to hold it for them" (Daniels, Radebaugh, Sullivan, 2001).
Before entering foreign markets, certain decisions needs to be made by managers of these firms; these include; screening the market if the barriers for importation and transportation cost are not high, they should opt for exportation but if they are high they should go ahead and screen the product if it is easy to enter a new market with a specific product then they should go for a joint venture. If they cannot use products to enter the market then they should try and use the internal processes that give the firm competitive advantage to enter a green-field market. If it does not work managers should opt to take control in a brown field investment (Daniels, Radebaugh, Sullivan 2009).

LITERATURE REVIEW

Dunning's (1977, 1980, and 1988) proposed model followed Hymer's (1960) application of industrial organization economics in order to study the investment and international trade. The strong position of this model in economic theory gave a basis for integration of various strategic models related to similar theories and for further development. The Eclectic model was developed with the aim of understanding FDI investments throughout the world.
"The ability of an international firm to correctly select markets for its portfolio of products is paramount to its success. During the process of international market selection (IMS) firms must find markets that offer prospects to grow sales, yet also fit strategically with the firm. Finding these markets is not easy and a number of systematic approaches to IMS have been developed over the years. Upon a review of these efforts, one could conclude that the IMS process has three stages: 1) market screening, 2) market identification and 3) market selection". (Kumar, Stam, & Joachimsthaler, 1993; Anderson & Strandskov, 1998).
Root, (1997) argues that the firm is simply attempting to come up with a list market for further study in the screening phase. In this stage the firms use macro variables with secondary data. A more product specific information is used to even narrow down the screening process in the market identification stage. In the market selection stage, detailed analysis of the remaining markets occurs; quite often primary data is used to predict consumer response to the market offer, specific competitors are identified and gauged and, the home firm's strategy is considered.
There are various criticisms about the effects of globalization in which the foreign ventures of international firms are viewed as negatively disturbing or detrimental to the level of exports, creation of jobs, and stability of wages at home and abroad, an comprehensive review of studies on the effects of foreign

direct investment compliments multinationals with being very much beneficial than damaging for both their home and host countries. According to NBER Working Paper No. 9293, "*Home and Host Country Effects of FDI*", NBER Research Associate Robert Lipsey declares that "there is little evidence that multinationals are guilty of the "many evils that are alleged." (Lipsey, 1994)
Based on the available evidence, "multinational firms transfer managerial practices from their country of origin to their country of operation." (Child *et al*., 2000). Ferner, (1997), attributes this home country effect to the fact that MNCs are entrenched in the business system of their country of origin.

THE RATIONALE OF THE OWNERSHIP-LOCATION-INTERNALISATION (OLI) ECLECTIC THEORY OF MULTINATIONAL COMPANIES

Ownership Advantages are advantages that firms benefit from controlling. Ownership enables organizations to develop competitive advantages hence encouraging them to use these advantages to expand internationally. These will only apply if the organization has internal unique core competencies or resources that build competitive advantage by enabling it compete with local firms in their own environment. Therefore, successful foreign investment depends not only on the organization's possession of internal core competencies and resources, but on how it is able to co-ordinate them to gain a competitive edge over local firms in the region. These may include a strong brand name, physical assets, research and development facilities, innovation and patents as well as other organizational efficiencies such as superior technology based strategic tools or large scale operational advantages. The multinational company should have a unique competitive advantage which will overcome the disadvantages of competing with the local firms in the home country. Location advantages can be two fold. The organization may benefit from location advantages when it is near the market/customer. This will not only allow continuous and steady supply, but will enable it to save on costs like transportation and warehousing, developing cost advantages. Secondly, Firms can also benefit from location advantages when they are nearer to their suppliers of raw materials. This will enable them to reduce on time taken for transportation and will also help maintain quality. However, there are times when foreign investments reap advantages like cheap labor or make the firm visible to scarce immobile resources only accessible with local firms. This will hence lead to FDI being adopted. Location advantages will build an advantage if performing activities will be more profitable in the foreign location as opposed to the organizations home country. These advantages can be as a result of cheaper labor costs, cheaper land space to set up production sites which are closer to input resources, faster transport channels or proximity to a substantial consumer market, access to cheaper skilled labor, cheaper production inputs such as raw materials or favorable governmental regulations to foreign investments and fewer local competitors. The location advantages are important as they help in identifying which countries will become the host countries for the multinational company.
Internalization Advantages are those that the organization must benefit more from engaging a foreign operational structure rather than remain local in order to build. This means that the cost of operating in the home market is much higher than if operations were international. These may include the lower cost of transactions or better operational control systems. Internalization Advantages explain the advantages that an organization obtains from producing their own products rather than through a collaborative arrangement like a joint venture. The essence is that when organizations develop and carry out their own activities, they are able to benefit from learning and development of their core competencies and resources. With this experience and strategic capabilities, they will hence move into foreign markets.
This advantage is related to the ownership advantage. In the words of Ethier (1986), internalization is mainly important. For example, Coca Cola Company is able to internalize due to its ownership of patents and technology for instance. Ownership has to mainly be explored internally than externally. Companies would choose to internalize due to the greater degree of uncertainty. It would occur when the transfer of knowledge occurs. It would also occur due to price mechanism. In the internal market, prices are charged between related parties within the organization whereas external market prices are charged between the buyer and seller. This leads to flexibility as the company itself decides on the prices of goods and services. It depends on the market entry form. With exports and FDI there are likely to be internalization advantages unlike for licensing as there are regulations to be followed as per license agreement.
Exports is the least expensive strategy and hence the most applied by organizations to expand internationally. It is used when barriers to trade are low and where there exists few competitors in the local market. They can use the following methods to export:*Direct Selling:* This involves selling through sales personal, foreign distributors or retailers who are in touch with the customers on a direct basis. An example is Kenafric Industries Limited. It deals in manufacturing Confectionery, Footwear and Stationery. It uses sales personnel present in foreign countries like Uganda and Tanzania to sell its products in those countries. *Indirect Selling:* The organizations, in this approach, export its goods using agencies and parties that specifically deal with exporting. An example is the use of Export Trade companies. *E-commerce:* This method has emerged as a result of increased technology developments, enabling organizations to sell online using websites. A good example is E-bay that sells consumer products directly to the end-users.
The licensing growth strategy enables a company (Licensor) to grant Intellectual rights to another firm (Licensee) for a fixed period of time in exchange of royalty payments. Licensing normally takes place between a foreign firm (Licensor) and a local firm (Licensee). This method is used especially if there exist high barriers to entry in a particular market and when the product has fewer technicalities. (Daniels et al, 2006)
Foreign Direct Investment (FDI) is the most expensive and riskiest out of all the growth strategies. It also requires abundant resources to be invested for the long-term. FDI can be defined as a strategy where firms engage in investing resources in a foreign country. The company that invests using FDI turns into a Multinational Corporation and commits for the long-term in inflexible strategy. FDI is especially beneficial when it touches on the primary activities of the value chain.
FDI's can be divided into three types: *Brownfield*; which requires purchase of existing operators/firms: *Greenfield*; where the firm engages into new investments: *Joint ventures*; where the company participates with another organization to pursue the same goal. (Amadeo, 2012)

TABLE 1: DUNNING'S ECLECTIC PARADIGM

		Categories of advantages		
		Ownership Advantages	Internalization Advantages	Location Advantages
Form of Market Entry.	Licensing	Yes	No	No
	Export	Yes	Yes	No
	FDI	Yes	Yes	Yes

Source: Dunning (1981)

In order to make a clear decision of which strategy to choose, Dunning (1981) developed the above table to display the advantages a company may experience with a particular growth strategy. The presence or absence of these advantages will determine what kind of strategy the firm should consider as most viable. According to this theory, if the firm has ownership advantages, but has no location advantages or internalization advantages, the most appropriate international growth strategy would be licensing. On the other hand, if a firm has both internalization and ownership advantages, it should employ the exporting strategy. Therefore, only if the firm enjoys all three advantages should the option of foreign direct investment be pursued. However, recent technological and globalization effects on internal resources and competencies will shape the strategy of any global growth objectives.
We can therefore conclude as Rugman and Brewer (2001) say, "that when companies want to exploit a firm-specific asset abroad they will more likely invest in own facilities rather than, for example, licensing if transaction costs are high. The more intangible the firm-specific asset is, the greater the incentive for internalization will be. Organizing transactions may be carried out through two methods, the price system or hierarchy. The problem with the price system may

be that some market participants take advantage of measurement difficulties to overprice and/or underperform. To avoid this 'cheating' behavior companies internalize and integrate transactions". (Rugman and Brewer, 2001)

SCREENING FOREIGN MARKETS

The corporation should analyze the six decisions used to decide whether a market is suitable, that is, managers should make the correct product choice for the particular market. Through market research they will choose the best market. They will also have to choose which mode of entry they want to use. They should also make key consideration if they could transfer their corporate DNA. A corporation must position well to win the loyalty of the intended customers. They must also check the rate at which the market expands in order to choose wisely where to trade. They must analyze the political economic trends and if only they are favorable they should take the venture. Industry attractiveness should be "analyzed by the threat of new entrant, the threat of substitute products, rivalry amongst existing competitors, bargaining power of suppliers and bargaining power of the buyer". (Rugman and Collinson, 2009).

When an organization is pursuing a foreign direct investment strategy, it must start by evaluating and judging if the existing internal resources and competencies will provide competitive advantage in the targeted country as well as enable favorable competition to existing local organizations. For example, if there is a monopolistic advantage or the size of competitors already present. The above approach can hence enable companies to screen for potential foreign markets. The choice of this market will depend on whether the organizations will be able to reap the OLI advantages discussed above. This will be determined by the choice of strategy.

POTENTIAL IMPACT OF MULTINATIONAL COMPANIES ON HOME AND HOST COUNTRIES

Internationalization and foreign investment has many positive and negative effects on both home and host countries. Multinationals have positively affected some countries by investing in them, but at the same time have had adverse effect on their own home country.

The information relating to international management advocates that the home country effect has in recent years become even stronger. As such firms operating in more than one country are forced to integrate and effectively co-ordinate their international business activities. Multinational Corporations, as it is argued, will have to stop or discard multi-domestic strategy, which is a combination of a low need for international integration of the business and a high local responsiveness to the local requirements, and instead they will have to increasingly integrate and co-ordinate their business across borders. (Harzing, 2000). This would be easily done through standardization processes achieved either on the basis of home practices or on some form of global best practice recommendations. "International management structures, financial control mechanisms, expatriates in key positions and written guidelines are among the options for firms seeking to achieve international integration." (Ferner, 2000; Harzing, 1999). Edwards and Ferner, (2000) add that "it can be expected that the home country effect is strongest in firms that originate in a dominant economy, namely the USA today or Japan a decade ago."

Although the home country effect proposes that the management and employment relations of foreign affiliates are displayed on those of their country-of-origin, positing the host country effect assumes that they are also influenced by their country-of-operation (Ferner 1997, Rosenzweig and Nohria, 1994). The extent to which the host country has an effect depends on two factors. Firstly, the institutional distance between country-of-operation and country-of-origin is important. The more institutionally different the two are, the easier it is to identify a host country effect. Secondly, the strength of national institutional regulation is important. MNCs are under more pressure to comply in more tightly regulated business systems than in weaker institutional environments. Nevertheless, research by Muller (1998), Royle (1998) Tempel (2001) and Wever (1995) on American and British MNCs in Germany shows that even in strong institutional environments there is some room for maneuver.

Whether a transfer of practices between the parent company and the foreign subsidiaries occurs does not entirely depend on the host/home country effect, but also on the strategic role of the subsidiary (Gupta and Govindarajan, 1991), the method of affiliate establishment (Taylor *et al*., 1996) and power relations (Ferner, 2000). Particularly important for the argument pursued here is the type of practice to be diffused. Some, such as those in the area of ER, are more difficult to transfer, as in many countries these are relatively tightly regulated. Nevertheless, ER is also an area where corporate executives might have strong views about certain principles such as management's 'right to manage', which could provide an incentive for standardisation.

CONCLUSION NAD RECOMMENDATIONS

FDI is visible at every front. It is, however, discouraged as a result of developed perceptions by the host governments. Due to these perceptions, governments may engage in creating regulations that restrict FDI. Overall, John in his OLI model supports the FDI decision and has provided us with the frameworks and theory as to why FDI should be chosen. As competition goes global and companies search for new opportunities in foreign market, increase in FDI is definite. FDI not only opens up a market for new products but enables the host countries to grow as well. Hence FDI must be encouraged. However, host countries need to maintain a level of control over the FDI so as to prevent any dominance or depletion of resources by the foreigners and to make it a win-win strategy. The so-called OLI-factors are three categories of advantages, namely the *ownership advantages*, *locational advantages* and *internalization*. A precondition for international activities of a company is the availability of *net ownership advantages*. These advantages can both be material and immaterial. The term *net ownership advantages* is used to express the advantages that a company has in foreign and unknown markets. Eclectic theory suggests that by dynamizing the paradigm, and widening it to embrace asset-augmenting foreign direct investment and MNE activity it may still claim to be the dominant paradigm explaining the extent and pattern of the foreign value added activities of firms in a globalizing, knowledge intensive and alliance based market economy.(Bartlett, & Beamish, 2011). As the international business environment became increasingly complex and sophisticated, companies developed a much richer rationale for their worldwide operations. Scale economies, ballooning R&D investments, and shortening product life cycles has transformed many industries into global rather than national structures. They have made worldwide scope of activities not a matter of choice, but an essential prerequisite for companies to survive in those businesses.

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