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A Review of the Determinants of Outward Foreign Direct Investment (FDI): From the Perspective of the Eclectic Paradigm

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Abstract: *The Eclectic (OLI) Paradigm provides a conceptual framework that offers a comprehensive explanation of the underlying dynamics of foreign direct investment (FDI). It posits that the primary motivations for FDI can be broadly classified into three categories: market-seeking, efficiency-seeking, and resource-seeking. These three advantages inherent to the home countries serve to determine their respective locational advantages, thus influencing the market selection of foreign investments by multinational enterprises (MNEs). Furthermore, the institutional factors also impact the decisions of investors with regard to their investments, as these factors serve to determine whether or not the foreign investment environment can be considered safe and stable. The present study thus seeks to examine the factors influencing foreign direct investment (FDI) in accordance with the Eclectic (OLI) Paradigm. This article aims to provide a comprehensive analysis of the determinants of foreign investment, with the ultimate objective of informing decision-makers.*

Keywords: *The Eclectic (OLI) Paradigm, The Foreign Direct Investments (FDI), A Review*

1. Introduction

In economic terms, foreign direct investment (FDI) refers to a specific type of investment behaviour. It is characterized by the objective of a resident entity in one economy, known as the direct investor, acquiring a continuous interest in an enterprise based in another economy, the direct investment enterprise. Foreign direct investment (FDI) represents a long-term relationship between direct investors and direct investment enterprises, characterized by a significant (or potential) influence by the investors on the management of the latter [1]. The disparities in production factors across diverse capital markets serve to establish the existence of comparative advantages in market competition [2]. The attainment of such comparative advantages through a firm's production, which is focused on the utilization of heterogeneous and immobile production factors (such as natural resources, labour, and technology) that are distributed unevenly across countries [3], represents a crucial aspect of market competition. As observed by Barney in 1991[4] when a firm implements a value-creating strategy that is not concurrently practiced by its rivals, the firm attains a competitive edge. Consequently, in the context of globalization, which entails a reduction in trade restrictions and greater international economic integration, corporations have expanded their manufacturing activities abroad to access resources unavailable in domestic markets. This strategy, known as foreign direct investment (FDI), enables them to gain a competitive edge and promote their business operations. In essence, foreign direct investment (FDI) serves to stimulate economic growth, generate additional employment opportunities and encourage the transfer of managerial and technical expertise. Furthermore, it fosters greater trade opportunities [5]. In a concise manner, the fundamental objective of foreign direct investment (FDI) is to secure competitive advantages with a view to facilitating business expansion through multinational transactions.

2. The underlying motives for overseas foreign direct investment (OFDI)

Dunning developed the Ownership, Location and Internalization (OLI) paradigm in 2001, also known as the Eclectic Paradigm [6]. Eden and Dai in 2010[7] pointed out that the three elements (O, L and I) in the eclectic paradigm are three necessary advantages for the generation of OFDI. Dunning[6] ascribed the ownership and location advantages “related to the way the firms organized the generation and use of the resources and capabilities within their jurisdiction and those they could access in different locations.” For this reason, Dunning[6] argued that an important part of fully understanding the extent and pattern of

foreign value-added activities by firms is to explain why firms choose to generate or exploit the "ownership" benefits internally rather than selling or earning them in the open market. Furthermore, all the I-specific variables are associated with the costs and benefits of different modalities of coordinating various economic activities. In OLI paradigm, Dunning[6] explained that the generation of foreign investment activities is the configuration of three sets of forces: firms' ownership of internationally competitive advantages; the extent of firms' decision to locate abroad for these investments; and the extent of firms' internalizing markets to generate and/or capitalize on their advantages. The eclectic paradigm answers the question of why and where the firms choose to invest in foreign markets[8]: First, the eclectic paradigm demonstrates that the primary motivation (the "why") of international production for firms (or, more specifically, outward foreign investment) is to seek and own competitive advantages. These advantages are limited or unavailable in domestic markets and must be sought in foreign markets. To put it another way, FDI represents a strategy through which firms can gain the competitive advantages that are otherwise unavailable to competitors through transnational investment activities. In this vein, Dunning[6] underscored that the significance of each of the three advantages (O, L, and I), and the configuration among them, differs across countries. This also elucidates the fundamental cause of outbound foreign investments. Second, Dunning[9] delineated the three principal forms of foreign direct investment (FDI): market-seeking FDI, resource-seeking FDI, and efficiency-seeking FDI. Therefore, in particular, the objective of firms investing abroad is to gain competitive advantages in production and operation resulting from the three forms of outward FDI. The specific strengths inherent to these three aspects, as possessed by the host country, serve to determine its own location advantages and, in turn, whether or not home multinational enterprises (MNEs) will engage in foreign investment behaviors. Thus, the triumvirate variables of the eclectic paradigm contribute to an explanation of the factors that affect international business activities, particularly in the context of foreign direct investment.

In relation to the three forms of foreign direct investment (FDI), the objective of market-seeking FDI is to expand foreign markets in the host countries, thereby increasing the market share of the domestic country in question. Of greater significance is the contribution of this phenomenon to the generation of new job opportunities and the considerable advancement of economic growth. Additionally, there is an improvement in the market position[10][11][12][5][13][14]. In terms of resource-seeking, the objective is to obtain resources that are not available in domestic markets or to acquire specific resources at a lower cost than in home countries, particularly in the case of natural and energy resources[15][16]. In the context of efficiency-seeking, the objective is to produce and obtain cost-effective products[15][17].

Moreover, the institutional context plays a crucial role in shaping the patterns of outward foreign direct investment (OFDI). The institutional environment of the host country serves as a key determinant in whether foreign investments are perceived as being safe, stable, and effective. As Kostova and Zaheer[18] have previously emphasized, multinational enterprises require a certain degree of institutional legitimacy in order to ensure their survival and continued development within the increasingly intricate international business environment. This is due to the inherent nature of multinational enterprises, which are embedded within foreign institutional environments and therefore require a degree of adaptation in order to attain the requisite level of legitimacy[19]. Fig 1 presents the theoretical framework that underpins this article.

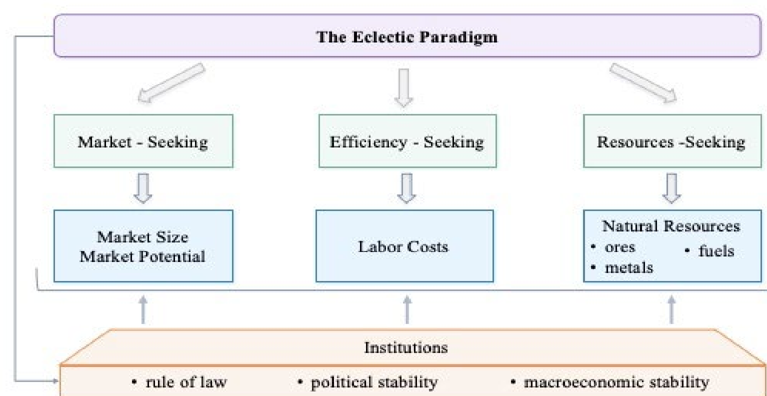

Fig. 1: The Theoretical Framework of OLI Paradigm

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3. Key Factors for Promoting OFDI

In light of the tripartite typology of foreign direct investment (FDI) proposed by Dunning[9], an extensive body of empirical literature has been dedicated to the examination of the underlying factors driving overseas foreign direct investment (OFDI) under the umbrella of market-seeking, efficiency-seeking, and resource-seeking motives.

In terms of market-seeking FDI, Dunning[9] posited that market-seeking FDI can be defined as import-substituting foreign investment. Market size and other market characteristics are regarded as crucial elements that can shape the market advantages of the host country, enabling it to satisfy domestic production and economic growth objectives[9]. Consequently, in the pursuit of market-oriented foreign investments, host market characteristics represent a pivotal dimension for investors to consider when determining whether or not to invest abroad. KIM and RHE[20] proposed that the size of the host market exerts a positive and significant impact on South Korean overseas direct investments (OFDI). Similarly, De Beule and Van Den Bulcke[21] demonstrated that the effect of the host market size on international investment was positive and significant in both Chinese and Indian OFDI cases. However, a study by Stoian and Filippaios[22] indicated that market size had a negative impact in the case of Greek outward foreign direct investment (OFDI). Lim[23] proposed that market growth is an essential indicator of market characteristics, and that it is positively correlated with foreign investment. This is because rapid economic growth creates more opportunities for generating profits than slow economic growth. Nevertheless, Okafor[24] discovered that market growth was not a significant determinant of US OFDI.

The second essential motive of outbound foreign direct investment (FDI) in the OLI paradigm is the pursuit of efficiency. Görg and Wakelin[25] proposed that labour costs were inversely and significantly correlated with US outward foreign direct investment (OFDI). Takagi and Shi[26] demonstrated that labour costs exhibited a negative and significant correlation with Japanese foreign investments. Additionally, Hatzius[27] indicated that elevated host labour costs deterred outward foreign direct investment (OFDI) flows from the UK and Germany.

The third major motive of foreign investments, as defined by the eclectic paradigm, is the pursuit of resources. Dunning[9] conceptualized resource-seeking foreign direct investment (FDI) as a supply-oriented form of overseas investment. Host countries can attract foreign investment by offering incentives to invest overseas, for example, in natural resources[9]. Natural resources constitute an indispensable basis for national wealth across the globe[28]. In their 2010 study, Kalotay and Sulstarova[29] discovered that the natural resources present in the host country had a positive and statistically significant impact on Russian outbound foreign direct investment (OFDI). The findings of Chiappini and Viaud[30] indicate that the natural resource endowments of the host country exert a positive yet uncertain influence on Japanese outbound foreign direct investment (OFDI). Conversely, Camarero, Moliner, and Tamarit[31] suggest that the impact of natural resources on Japanese OFDI is only discernible in developed countries.

In terms of the institutional factors, the establishment of a sound institutional environment has the capacity to attract greater levels of foreign direct investment. This is facilitated by a number of interrelated factors including, but not limited to, the protection of intellectual property rights, political stability, a reduced incidence of corruption, and a greater degree of regulatory certainty[32] [33]. Conversely, the presence of a poor quality legal system increases the probability that the profits and assets of investing firms will be expropriated, which in turn acts as an effective deterrent to foreign investment. Cieślik et al.[34] revealed that rule of law was an important positive factor for British OFDI in Europe. The study of Chiappini et al.[35] also found a positive and significant relationship between the host rule of law and Japanese OFDI. In the case of China, Jadhav and Katti[36] found a positive and significant effect of the host rule of law on OFDI of BRICS economies. However, in the study of Nguyen and Doan[37], they indicated that there was no relationship between the host rule of law and China's OFDI. In addition, political stability is another important element related to institutional environment. According to Mudambi and Navarra[38], the importance of institutions in the international business field based on the fact that institutions reflect the major immobile factors in a globalized market, and the factors of production, legal, political and administrative systems are generally the internationally immobile framework whose costs determine the international attractiveness in transnational economic activities. Camarero et al.[39] revealed that political stability was positively and significantly associated with German foreign investments in Latin American countries. However, Lucke and Eichler[40] found that political stability was negatively and significantly correlated with foreign investments in developed countries, while had no important influence on foreign investments in developing and transition countries. In the case of China, Lv and Spigarelli[41] found a positive and significant correlation between the host political stability and China's OFDI in European countries.

4. Conclusion

The objective of this study is to identify the principal factors that influence the decisions to engage in outward foreign direct investment (FDI), as elucidated by the Eclectic (OLI) Paradigm. The eclectic paradigm offers a comprehensive framework for analyzing the behaviour of foreign investments. In accordance with the OLI paradigm, the market-seeking motivation, efficiency-seeking motivation, and resource-seeking motivation are regarded as the fundamental drivers of outbound foreign investment. An expanded OLI framework highlights the significance of institutions in the context of foreign direct investment (FDI). A robust and well-functioning institutional environment is instrumental in ensuring the security and efficacy of FDI. The eclectic paradigm provides a synthesis of the foundational principles that underpin outward FDI and offers a robust scientific foundation for understanding the underlying drivers of overseas direct investments. It is crucial to acknowledge that the eclectic paradigm is inherently context-specific. Consequently, the policies enacted by government entities, the manner in which activities are organized, and the strategies pursued by firms can potentially influence the OLI configuration. Additionally, the factors in the framework cannot be discussed in separate terms; rather, they must be discussed in terms of the overall performance of the model within the specific context[6][22].

The present article reviews the influential factors of outward FDI as they have been investigated by scholars in extant literature from the perspective of the eclectic paradigm. To summarize, in consideration of the present empirical evidence pertaining to market-oriented foreign investment, the market size and the market potential emerge as the primary factors that elucidate the conduct of international investments. In the context of efficiency-oriented foreign investment, the primary objective for foreign investors is to identify locations where labour costs are low. A reduction in labour costs in the host country provides investors with a competitive advantage, encouraging them to make foreign investments. With regard to foreign investments motivated by the desire to access resources, natural resources such as ores, metals and fuels are particularly attractive to foreign investors. In addition, the institutional conditions, including the rule of law, political stability and macroeconomic stability, are crucial in determining whether institutions are conducive to or detrimental to FDI performance.

This article contributes to the existing literature on the determinants of outbound foreign direct investments (FDI) by offering an integrated insight into this phenomenon under the theoretical framework of the eclectic (OLI) paradigm. It is hoped that this insight will assist decision-makers in developing an improved understanding of the behaviors of outward foreign direct investments (FDI).

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