Theoretical and Applied Economics
Volume XVIII (2011), No. 11(564), pp. 35-42

Brief Reflections on the Development of the FDI Theory

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Abstract. *In this essay, we intend to review the theory of the FDI, since its origins to the present days, focusing on its corner stones. We present the FDI theory through the lens of the strategic management and try to bring to the forefront the main contributions to this framework. At the same time, we underline the scholars' frequent return to the "springs" of the FDI theory, either those generated by Hymer or the internalization theory or the OLI paradigm, in order to consolidate the theoretical FDI construction.*

Keywords: FDI; MNE; strategic management; FSA-CSA matrix; OLI paradigm; LLL model.

JEL Codes: F21, F23, F59.
REL Code:10F.

More than half a century before, some academics started to search answers at questions like: Which are the intrinsic characteristics of the multinational enterprises (MNE)?[(1)] Which are the motivations for the extension of the activities of corporations beyond the borders of the country of origin? Where and how do these companies realize their expansion? Is there a critical mass of assets (tangibles and intangibles) of a company or an initial moment t_0 when a company becomes a potential MNE? As scholars found empirically or theoretically substantiated answers at these questions, the theory of international affairs and foreign direct investment (FDI) started to get a definite shape. Shortly named as the theory of the FDI or the theory of the MNE, this is an independent research field and answers today much more questions than initially. It has, like its object of study itself, the MNE, variable and dynamic borders and interact with other research fields such as: international trade, strategic management, financial management, theory of the entrepreneurship and of the firm, the network theory and even the new institutional economics.

The Canadian economist Stephen Herbert Hymer (1934-1974) is among the first theoreticians of the FDI, alongside Edith Penrose and John H. Dunning. He is even considered by some authors, like Christos N. Pitelis, „the father-figure of the theory of the MNE" (Pitelis, 2006, p. 3), which explained the MNEs' motivations for internalization. In his PhD thesis from 1960, Hymer showed that the main function of the FDI is, together with that of exploiting the monopolist advantages and diversifying the risks that of eluding the structural failures of the market, and the MNEs are the "creatures of market imperfections". Nevertheless, Hymer doesn't make the distinction between the structural imperfections of the market and the failures determined by the transaction costs, thus overlooking the *coasian discourse* (Dunning, Rugman, 1985, p. 229). In his opinion, the natural reaction of the MNEs at the market imperfections is the internalization of the market and the development and exploitation of the specific advantages (*firm specific advantages, FSAs*), through strategies that represent nowadays the main instrument of the strategic management. In the light of these arguments, the FDI represents rather a strategic decision at company level that a financial one, the latter being related to the differential of the interest rates at global level (Dunning, Rugman, 1985, p. 230, Kindleberger, 1987, p. 24).

Starting from Hymer's PhD thesis, it was outlined a school of thought having as axis the FDI theory, centred at the University of Reading and based on the analysis of the FDI through the lens of the strategic management. This point of view is most clearly reflected by John H. Dunning: "the modern MNE is rather a vehicle for the transfer of the entrepreneurial talent than of financial resources" (Dunning, Rowan, 1970, p. 321). Among the exponents of this school of thought, with or without direct affiliation, we mention: John H. Dunning, Alan Rugman, Mark Casson, Peter J. Buckley, Rajneesh Narula, Alain Verbeke, Richard E. Caves, Jean François Hennart, David John Teece. More recently, it emerged another school of thought related to the FDI theory, based predominantly on the financial management and represented by scholars such as: Alan C. Shapiro, John R. Graham, Campbell R. Harvey, Geert Bekaert, Costea Munteanu and Alexandra Horobeț.

Returning to the FDI theory which incorporates the strategic management we must underline that, from this perspective, the companies that are active beyond the national borders operate in a way that replaces different functions of the market with internal transactions, intra-firm, every time the cost of the internal transactions is lower that that of the market exchanges. This is the essence of the internalization theory, which was conceptualized by Peter J. Buckley and Mark C. Casson in 1976 in the paper "The Future of Multinational Enterprise", starting from Hymer's thesis. The two scholars demonstrate that the MNE organises a set of activities at the internal level, so that it could develop and exploit the FSAs. According to this theory, each type of market imperfection can generate pressures on the company so that it should internalize. The same idea, that the MNE can replace the market, has been developed by Oliver Williamson in 1975, completely independently from the research activities undertook by Buckley and Casson (Rugman, Verbeke, 2008). In subsequent papers, Buckley and Casson underline that internalization, as general principle that explains the borders of the MNE, starts from the premise of the rational choice. However, the authors emphasize that in spite of the MNE's objective of profit maximization, the rational behaviour is not "necessarily selfish" (Buckley, Casson, 2009, pp. 1566, 1568).

In the early '80s, two new framework-concepts crystallized in the FDI theory. One is that developed by Alan Rugman: matrix of *firm specific advantages – country specific advantages* (FSA-CSA) at the MNE level (Rugman, 1981). He underlines that, on the one hand, one of the company's motivations for going abroad is turning to good account its FSA. The company specific benefits mean the company's property, *id est*: technologies, knowledge, managerial or marketing abilities etc. On the other hand, the second reason is given by the host country specific benefits, for instance: natural resources, the quality and size of the labour force, cultural factors, tariff and non-tariff barriers, public policies etc. But this matrix has been shaded by the other framework concept, which has dominated the FDI theory for over 30 years and was initiated by John Dunning: the „eclectic" paradigm of the international output OLI – ownership, location and internalization (Dunning, 1981). According to this paradigm, FDI are motivated by three advantages of:

ownership, location and internalization. Between the matrix FSA-CSA and the paradigm OLI there is the following correspondence: FSA=O, and CSA=L, I being in fact the mechanism of tracing the borders of the MNE, based on the company specific advantages and the host-country specific benefits.

Based on this, the FDI typology was gradually defined, having as correspondent four major reasons for MNE to internationalize through FDI: investments in search of resources (natural or cheap and/or highly qualified labour force), investments looking for markets (and for avoiding the trade barriers on those markets), investments searching for effectiveness and investments looking for strategic assets (or *created*, which is the main source of the companies' competitiveness and belongs to the knowledge economy and creative economy) (Dunning, 1993, UNCTAD, 1998, pp. 184-189, OECD, 2002, pp. 39-41). As a matter of fact, starting from the '90s, the interest of the economists concentrated more and more on the companies' competitiveness (Porter, 1990).

Starting with the '80s it was outlined another research direction in the field of FDI, namely related to the effects of the FDI flows, primarily at host countries level and afterwards at home countries level. This direction was reflected by a myriad of studies on this subject (e.g. Lipsey, 2002). If initially these studies were pre-eminently centred upon the analysis of the role of the inward FDI for host countries, subsequently the balance was inclined in the favour of studies examining the impact of the outward FDI on the home countries. The explanation for this change is given by the motivations of such studies. In the former case, the objective was to convince the host countries authorities about the positive role of the FDI upon the national economy, and, as a direct consequence, the necessity for the economic liberalization and the adoption of a permissive legal framework related to the FDI. In the latter case, such studies were located in home countries, most of them developed ones and confronted with a major macroeconomic imbalance on the labour market – the unemployment. The goal of such studies was to obtain a negative correlation between the outward FDI and the own unemployment rate. The problematic of the FDI, alike at host countries and home countries level continues to represent a "hot" topic on the international agenda.

More recently, in the '2000s, the academic discourse related to the FDI is characterized by two distinct features:

(1) In contrast with the previous period, when starting with Dunning (1958), the studies focused on the FDI analysis at the level of the developed economies, the last decade was characterized by an afflux of analyses focussing on FDI attracted by and originating in the emerging economies (Mathews, 2002, 2006, Buckley, 2010). Even the theoretical discourse highlights conceptual frameworks specific to

this group of economies (Mathews, 2002, 2006). John A. Mathews proposes a complementary model to the *OLI paradigm*, adapted to the level of MNEs from the emerging economies: LLL (linkage, leverage and learning). Mathews (2006d) underlines the following aspect: the fact that MNEs from the emerging economies (especially from Brazil, the Russian Federation, India and China) are the new entrants on the international markets may be, at the same time, a benefit for them, by the access to advanced technology (by imitation), and, based on this, the reduction of property gaps against MNEs in the developed countries. As a matter of fact, this approach is similar to "the evolutionist process" described by Lall (2000) and based on "the technological learning" (Nelson, 2004). Dunning et al. (2008) recognized that emerging MNEs are short of the "O" component (ownership or property benefits), but this doesn't mean that such benefits are absent. While MNEs in the developed countries make use of FSA based on assets, such as technologies, brands and other intellectual property rights, MNEs from the emerging economies resort to networks, relationships and organization structure (UNCTAD, 2006).

(2) Also at theoretical level, in the last decade one can remark the scholars' frequent return to the "springs" of the FDI theory, either those generated by Hymer or the internalization theory or the OLI paradigm, in order to consolidate the theoretical FDI construction (Dunning, 2001a, 2001b, 2003, 2008, Rugman, 2008, Dunning, Pitelis, 2008, Buckley, Casson, 2009, Dunning, Lundan, 2010). For instance, Dunning and Lundan (2010) focus on a new element of the OLI paradigm, namely the institutional advantages, both endogenous and exogenous, that represent the *key of the successfully regeneration of the ownership advantages* (Oi).

As a conclusion, the economists' interest for the FDI theory hasn't lost its intensity since its launch, more than half a century before, especially as the MNEs from the emerging economies, particularly from Brazil, the Russian Federation, India and China are nowadays active players in the field of the FDI.

Acknowledgements

This article benefited of financial support through the project "Post-Doctoral Studies in Economics: programme of continuous training for the elite researchers – SPODE", financial agreement no. POSDRU/89/1.5/S/61755, project financed through the European Social Fund of the Sectoral Operational Programme Human Resources Development 2007-2013.

Note

(1) The United Nations Conference on Trade and Development (UNCTAD) uses the acronym TNC – transnational corporations – instead of MNE.

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