## CHAPTER 2

# Foreign direct investment – concepts and explanations

While the discipline of international business has long had its distinct academic identity, the discussion as to its essence and focal research questions has still remained inconclusive [Griffith, Cavusgil & Shenkar 2008; Peng 2004; Shenkar 2004]. Buckley [2002] argued that three major areas have preoccupied scholars in this field. The first one was related to the flows of foreign direct investment (FDI) predominantly at the macroeconomic level and developed until the 1970s. The second one, thriving particularly in the 1970s up to the 1990s, was concerned with the explanation of existence, strategy and organisation of the multinational enterprises (MNEs). Finally, the stream starting in the mid 1980s has been concerned with "understanding and predicting the development of the internationalisation of firms and the new developments of globalization" [*ibidem*, p. 365]. Daniels and Radebaugh [2001, p. 3–4] summarise the core of international business as "all commercial transactions – private or governmental – between two or more countries." They point to the fact that these transactions involve modes of business which are different than those at a purely domestic level, such as exports or FDI, and that these choices are influenced by the external environment, which becomes diverse due to its international character.

The aforementioned evolution of research interests of international business indicates that this field tackles both macro- and microeconomic questions. Gorynia [2012] argues that if international economic activity can be analysed from the perspective of both economics and management then most macro-level approaches are of economic character, while micro-level analyses have predominantly adopted the view of management sciences. Regardless of the adopted denomination of the discipline, a holistic approach should consider many intersec-

tions which exist between macro- and micro-level variables. Thus, the next section clarifies the notion of FDI, which is a crucial phenomenon at country level, regional or industry level, as well as firm level. In the subsequent section, a review of theories explaining FDI is presented. Since the subsequent chapters are devoted to the strategies and performance of multinational firms, selected macroeconomic theories are only signalled in this volume, while the chapter is predominantly devoted to microeconomic and management-oriented concepts pertaining to FDI.

## 2.1. FDI definition

According to the benchmark definition of the OECD [2008a, p. 48], FDI "reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor." The notion of lasting interest implies that there is a long-term relationship between the said two companies, as well as significant influence on the management of the foreign company. The OECD assumes a threshold of direct or indirect ownership of at least 10% of capital (or of voting power) in order to define lasting interest. Based on this criterion, FDI can be distinguished from portfolio investments, i.e. cross-border capital transfers driven by interest-rate- and risk-balancing premises, without exerting any meaningful influence on the decisions of the foreign company [Holtbrügge & Welge 2010].

In order to classify FDI relationships, UNCTAD [2012, p. 3] distinguishes between subsidiaries (incorporated enterprises in the host country in which a direct investor holds more than 50% of its voting power), associates (incorporated enterprises in the host country in which the investor owns between 10–50%) and branches, which include wholly or jointly owned unincorporated enterprises in the host country The latter can represent "(i) a permanent establishment or office of the foreign investor; (ii) an unincorporated partnership or joint venture between the foreign direct investor and one or more third parties; (iii) land, structures (...); or (iv) mobile equipment (such as ships, aircraft, gas- or oil-drilling rigs) operating within a country, other than that of the foreign investor, for at least one year" [UNCTAD 2012, p. 3]. UNCTAD jointly refers to them as foreign affiliates [ibidem]. The notion of FDI does not only embrace a first-time purchase of shares in a foreign entity, but also subsequent transactions between the parent firm and its foreign affiliate, including the increase in the shares held by the parent, credits between the two companies, as well as the profits generated by the affiliate and reinvested by its parent [Jost 1997].

At the macroeconomic level, depending on the direction of FDI activities in a given country, outward FDI and inward FDI can be distinguished [Kutschker & Schmid 2008]. In terms of possible approaches to measuring this phenomenon, FDI can be analysed from the perspective of FDI stocks calculated on the basis of balance sheets of foreign affiliates or, alternatively, that of FDI flows which capture cross-border transactions from the balance of payments [Deutsche Bundesbank 2013]. However, both approaches to measuring may be burdened with certain limitations. As Kutschker and Schmid [2008] emphasise, a variety of aspects can differ across countries:

- data collection methods, information scope and periods under study;
- threshold value for capital share that distinguishes FDI from speculative investments (10% or higher);
- type of financial transactions considered as part of FDI;
- minimal transaction values above which such deals are recorded in FDI statistics.

Furthermore, Beugelsdijk et al. [2011] argue that FDI stocks do not accurately reflect the actual value created by affiliates in the foreign country for a number of reasons. Firstly, some FDI projects are not undertaken with the purpose of generating value in the host countries, e.g. if they are predominantly used as export platforms. Secondly, a significant proportion of foreign affiliate financing can be raised externally, e.g. from foreign banks. Thirdly, FDI stocks do not adequately reflect the contribution of human capital to foreign operations. In a similar vein, FDI flows can distort the actual image of affiliates involved in actual operational activities, since they include intra-corporate flows of funds among units of a multinational corporation, also called "capital in transit" [Zimny 2011].

Since this book adopts a firm-level perspective, FDI is considered as an element of firm internationalisation, which involves capital transfer to foreign markets [Zentes, Swoboda & Schramm-Klein 2010]. Its forms include greenfield investments and acquisitions [Rymarczyk 2012], while according to the criterion of ownership, wholly-owned subsidiaries or joint ventures can be identified in case of greenfield investments, and minority stakes or full-acquisitions in case of acquisitions [Kutschker & Schmid 2008].[5]

## 2.2. Theoretical concepts explaining FDI

In the context of the present volume related to strategies and performance outcomes of Polish multinationals, it is relevant to review the conceptual foundations

[5] See section 3.1.1.4 for a review of FDI modes and their determinants.

of FDI decisions and their possible relationships with firm performance.[6] FDI cannot be analysed in isolation from the internationalisation process of the firm of which it makes part. Therefore, the inclusion of the process determinants provides a collection of important variables which provide context for FDI decisions and affect their success. Moreover, the distinction between macro- and micro-level concepts explaining FDI, frequently found in literature of international business, loses on relevance if one assumes that FDI behaviour of firms is affected by different variables that make part of theoretical concepts rooted in different academic traditions. Accordingly, such a sharp distinction is both impossible and unnecessary, as it is in the case of the distinction between international management and international economics.

The ensuing sections provide a mosaic of different theoretical approaches which identify specific determinants of FDI. When comparing and combining theories to increase the understanding of the FDI phenomenon, it is important to be aware of differences in the underlying assumptions of these concepts, the key variables and the predicted interrelationships between them, or the level of analysis which a particular theory can be applied to. One can note that the limitations of one constitute, broadly speaking, the strengths of another. Therefore, it is not appropriate to criticise specific theories for their intentionally narrow focus, since it is the latter that allows exploring the phenomenon under study in more depth. Hence, a holistic approach combining several complementary and compatible concepts could enable more complete explanations of FDI behaviour without excessively inflating the single approaches and risking the reduction of their normative value. Therefore the sections below present a number of particular approaches, while the last one, Dunning's eclectic framework, displays the highest integrative potential, combining some of the statements of other discussed theories.

### 2.2.1. Classification approaches

Apart from the distinction between macro- and microeconomic theories of FDI, widespread in international business scholarship [Misala 2003; Pilarska 2005], different authors have proposed approaches to classifying FDI theories [see e.g. Agarwal 1980]. Holtbrügge and Welge [2010] note that theoretical concepts can be divided into static and dynamic, the former remaining focused on single internationalisation decisions, while the latter embracing internationalisation as a pro-

[6] The present chapter merely outlines certain concepts, to the extent that they are relevant for this study. For a detailed review of theories devoted to FDI, see for instance Gorynia [2007], Rymarczyk [2012], Shenkar [2008], or Zorska [1998].

cess.[7] At the same time they argue that FDI theories fall into two distinct research traditions: economic and behavioural. According to Calvet [1981], FDI theories either build on the theory of the market or the theory of the firm. In turn, Tahir [2003] divides leading FDI theories into the market imperfection paradigm, behaviour paradigm, environment paradigm and market failure paradigm.

This plurality of approaches, each of which is based on different conceptual assumptions, is further acknowledged by Kutschker and Schmid [2008], who argue that FDI is not only subject to explanations within concepts explicitly devoted to it, but also to broader concepts pertaining to firm internationalisation and those explaining different internationalisation forms (both at a macro- and microeconomic level).[8]

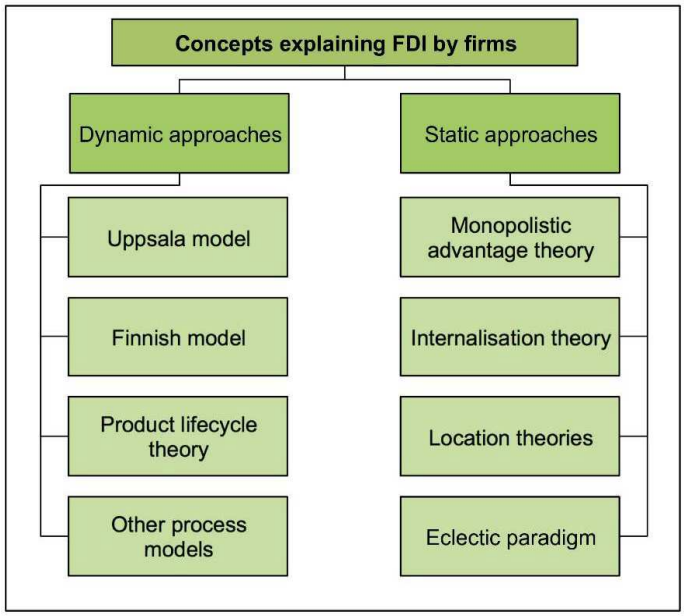


**Figure 2.** Overview of selected theoretical concepts explaining FDI

Source: own work.

The below sections focus on micro-level (firm-level) theoretical concepts (see Figure 2), however it must be stressed that macro-level theories have played

[7] For the notion of process in strategic management, see Bamberger and Capallo [2003].

[8] For a different approach to classifying FDI theories, borrowed from strategic management, see Trąpczyński [2014b].

a crucial role in explaining foreign trade and FDI, including the early absolute advantage theory (A. Smith), comparative advantage theory (D. Ricardo) or the factor proportion theory (E. Heckscher & B. Ohlin) [Rymarczyk 2004]. Other approaches to international trade include the non-availability approach of Kravis [1956], Posner's [1961] technological gap theory or Linder's [1961] demand structure hypothesis. Among theories explicitly devoted to explaining the FDI phenomenon, a part of early concepts focused on capital market-related explanations, attributing the growth of FDI particularly to the comparison between the expected return on domestic and foreign investments [Heidhues 1969], the value of national currencies [Aliber 1971] or the motive of international risk diversification [Rugman 1975, 1976, 1977]. A distinct group of concepts, including notably the model of Kojima and Ozawa [1985] and the investment development path [Dunning 1986; Dunning & Narula 2002], relates the evolution of FDI inflows to and outflows from a given country to its economic development. Another explanation is provided by the theory of oligopolistic behaviour [Knickerbocker 1973], according to which FDI results from a reaction to investments undertaken by competitors in oligopolistic industries.

### 2.2.2. Process approaches

Process models in international business have sought to describe or explain the foreign expansion process, FDI being one of its stages.[9] A number of process models has been developed, whose common denominator is the assumption that firms start internationalising their activity with operating modes requiring the lowest commitment of resources and then gradually increase this commitment [Leblanc 1994; Edvardsson, Edvinsson & Nyström 1993]. Thereby, the progression along the sequence of operating modes is driven by the learning process related with innovation adoption, i.e. internationalisation can be regarded as (strategic and organisational) innovation to the firm [Andersen 1993]. These models are centred around export entry modes, thus they do not contribute significantly to the analysis of FDI [see e.g. Bilkey & Tesar 1977; Cavusgil 1984; Reid 1981]. Moreover, they remain mostly descriptive, without explicitly addressing the actual mechanisms of foreign expansion. The selected approaches discussed below attempt to provide explanations of the progression of internationalisation strategies, including notably FDI, along different paths.

[9] The notion of process refers to changes in the internationalisation of the firm. Another significance of process pertains to the sum of activities within organisations that lead to foreign expansion decisions, in particular to FDI [see e.g. Aharoni 1999; Buckley, Devinney & Louviere 2007; Larimo 1995].

#### 2.2.2.1. Uppsala model

Nordic researchers considered internationalisation as a gradual process driven by an interplay between the development of knowledge about foreign markets and operations on the one hand, and an increasing commitment of resources on the other [Johanson & Vahlne 1990, 2009]. The approach is rooted in behavioural theory, whereby internationalisation is regarded as a result of a series of managerial decisions [Johanson & Vahlne 1977]. The internationalisation mechanism includes state aspects and change aspects (see Figure 3):

- the former are the resource commitment[10] to foreign markets and the knowledge[11] about foreign markets and operations. Market commitment and market knowledge are supposed to affect decisions leading to further commitment and the manner in which present operations are carried out;
- change aspects are related to decisions about resource commitments and the performance of extant business activities. Commitment decisions and current activities affect the level of market knowledge and resource commitments, and so on [Johanson & Vahlne 1990].

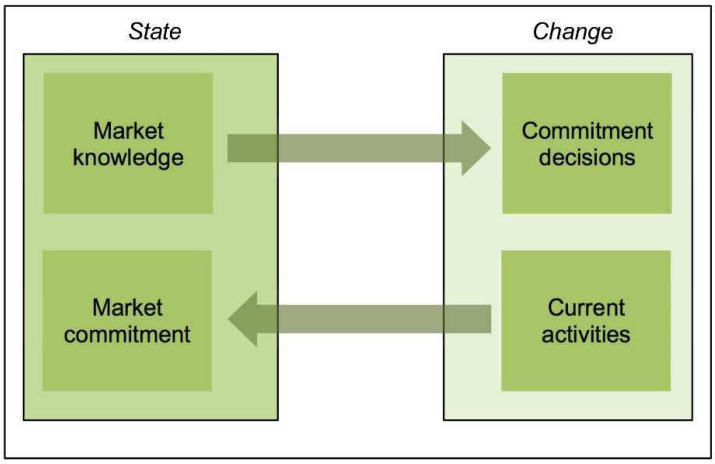


**Figure 3.** The internationalisation mechanism

Source: adapted from Johanson & Valhne [2009, p. 1412].

[10] Johanson and Vahlne [2009, p. 1412] define commitment as "the product of the size of the investment times its degree of inflexibility."

[11] Thereby, they refer to a Penrosian understanding of knowledge, with objective knowledge that can be taught and experiential knowledge, which can be developed through own experience.

An important tenet of the Uppsala model is that the perception of foreign market opportunities and challenges is affected by experiential knowledge, which helps to reduce uncertainty. Johanson and Vahlne [1977] also distinguish between general and market-specific knowledge, the first one referring to overall management practices or customer characteristics, regardless of location, while the second one being more strongly affected by national culture, local business environment and individual customers. The lack of general internationalisation knowledge has been argued to afflict foreign business and foreign institutional knowledge while deficiencies in the latter type of knowledge can afflict further internationalisation [Eriksson et al. 1997, 2001].

The internationalisation patterns can be traced back along two dimensions. The first one, called the *establishment chain*, refers to the operating modes within one host country. Accordingly, firms pass from no regular export activities, through exports via agents, sales subsidiaries and manufacturing subsidiaries [Johanson & Wiedersheim-Paul 1975]. The sequence of a firm's engagement in the foreign market corresponds to a rising degree of resource commitment and exposure to local market conditions. Secondly, firms enter foreign markets according to the *psychic distance chain*, whereby host countries with successively higher differences in language, culture, political systems, etc. are selected. The notion of psychic distance is inherently related to that of the liability of foreignness, i.e. the costs of doing business abroad that result in a competitive disadvantage for an MNE affiliate [Zaheer 1995; Zaheer & Mosakowski 1997]. It refers to all factors which might affect cross-border operations by disturbing the flow of information between the firm and the market.

The Uppsala model has been an influential concept in international business literature. Nonetheless, it has also been subject to multi-faceted criticism. In contrast to the linear character of the process perspective, empirical evidence shows that the actually observed paths might often be irregular.[12] For instance, the "3E" model of Kutschker [1996, 2002] posits that the internationalisation process consists of international evolution, international episodes and international epochs. International evolution reflects the incremental perspective in internationalisation theory and research, whereby the foreign expansion process occurs gradually, in small steps, yet almost permanently and frequently as a result of ad hoc decisions [Kutschker, Bäurle and Schmid 1997a,b]. Conversely, international episodes remind that the process may also occur in a more abrupt manner, whereby single events can dramatically change a firm's international footprint.

In a similar vein, the "GAINS" – Paradigm by Macharzina and Engelhard [1991] that since organisational complexity can be represented by a limited num-

[12] See for instance Buckley [1982], Turnbull [1987], or Van de Ven [1992].

ber of internally consistent organisational archetypes (or "gestalts"), there are no pre-determined stages in the internationalisation process. Instead, the authors suggest that archetypes of internationalisation stages exist depending on constellations of environmental, structural and strategy variables, which may allow to predict some internationalisation phenomena based on the description of the firm along those variables.

Furthermore, the decreasing relevance of national borders due to trade liberalisation and information revolution, and on the other hand the shortening of product life-cycles, rising R&D expenditures and rapid dispersion of information technology, add to factors accounting for increased dynamics of the international environment [Fletcher 2001]. Thus, the deterministic character of the stage sequence has recently been questioned by developments including the leapfrogging of intermediate stages [Bell 1995; Chetty & Blankenburg-Holm 2000], as well as the emergence of international new ventures [e.g. Acedo & Jones 2007; Andersson & Florén 2008; McDougall & Oviatt 2000], born globals [e.g. Freeman & Cavusgil 1984], or re-internationalisation processes [Welch & Welch 2009]. Moreover, the Uppsala model has been criticised for not taking into account all relevant market entry modes [Vissak 2010].

The original explanations of the internationalisation patterns in themselves were also subject to criticisms. It has been argued that the development of electronic business makes the concept of psychic distance less relevant [Axinn & Matthyssens 2002]. Also, it has been doubted whether the very notion of psychic distance can equally refer to all internationalising firms at the same internationalisation stage to the same extent, regardless of such firm-level characteristics as firm size or experience [Langhoff 1997]. Also, while the concept of distance in the genuine process model has been applied to the home-host-country relationship, Hutzschenreuter & Voll [2008] suggest that the effect of distance becomes relevant when comparing the distance between a newly entered and a previously entered market closest to it.

One of the significant determinants of firm internationalisation is the industry in which a firm operates. Vahlne and Nordström [1993] argue that sequential paths are more typical of firms with mostly domestic, limited experience and operating in industries with a predominantly domestic competition. A more regional or global experience, given the same industry sector, is expected to accelerate the internationalisation process. In terms of industry influence, also Bell, Crick and Young [2004] found important differences between the internationalisation processes of knowledge-intensive and traditional manufacturing SMEs, the latter being involved in foreign markets from the very beginning of their operations, relying on foreign networks to a larger extent, entering a larger number of export markets with new "global offerings."

To a certain extent, the above criticisms seem not be legitimate as Johanson and Vahlne [1990] themselves later explain that the stage sequence does not necessarily hold for firms with larger resources, or for stable, homogeneous market conditions. Also, in cases of considerable experience in markets with similar conditions, for instance in turbulent environments of transition economies, firms are more likely to engage more resources than those without such experience [Johanson & Johanson 2006].

#### 2.2.2.2. Finnish model

While being less popular, the Finnish model of firm internationalisation addresses several of the aforementioned weaknesses of the Uppsala model at the conceptual and operational level. Welch and Luostarinen [1988, p. 47] note that a "sequential, cumulative process of internationalization does not necessarily mean some smooth, immutable paths of development." The authors distinguish the following dynamic factors affecting internationalisation patterns:

- resource availability, which can hinder internationalisation, but this constraint can also change in time;
- knowledge development through actual experience of foreign expansion, which is a relevant factor in explaining the mostly evolutionary patterns of foreign expansion;
- communication networks, which can act both as a barrier to entering foreign markets or as an expansion catalyst at later stages;
- risk and uncertainty, explaining the initial choice of culturally closer locations;
- control over foreign markets instead of relying on intermediation, as the company's foreign market knowledge increases and raises the concern of appropriately exploiting foreign market potential;
- commitment of management to developing international strategy.

Moreover, internationalisation is said to be affected by situational factors, such as government policies or intermediary actions. The consideration of a broader spectrum of dynamic factors is also reflected by less deterministic internationalisation paths. In relation to direct undertaking of FDI in foreign markets, without preceding this move with exports, Welch and Luostarinen [1988] acknowledge that the increasing wave of acquisitions causes firms to short-circuit gradual expansion patterns. Moreover, even if FDI is preceded by other non-equity operation modes, the actual paths can be irregular and vary across host countries, depending on emergent opportunities or threats. An important argument here is that a part of the contradictory empirical evidence against the gradual expansion in individual

markets can be explained by the experience gained in other market entries, which reduces the uncertainty that usually restricts resource commitment.

Last but not least, the Finnish model explicitly acknowledges the fact that internationalisation does not only occur along the establishment and psychic distance chain, but it involves other dimensions. Most notably, internationalisation concerns the deepening and diversification of the firm's international offering, both in terms of product line extension or providing more complex product packages. The dimension of personnel is a less evident indicator of internationalisation, however not less important, as the increasing international mindset of the management team increases further commitment to foreign expansion. The dimension of organisational structure reflects the fact the rising capability of the firm to cope with the increase in international operations complexity. Finally the dimension of finance reflects the increasing range of finance sources as the firm internationalises. At the same time, the establishment chains considered in this model involve both outward and inward international activities, such as imports or subcontracting for foreign firms. The psychic distance component of the Uppsala model is both specified and enriched here, including political, economic, cultural or physical distance [Welch & Luostarinen 1988].

#### 2.2.2.3. International product cycle concept

The international product cycle approach developed in the context of firm internationalisation by Vernon [1966, 1979] places particular emphasis on the geographical patterns of internationalisation and the changing role of production location as the product matures. The underlying assumptions of the model are that the production enables economies of scale, while consumption preferences are similar in different countries, although their evolution is delayed in time as a function of the level of economic development.

In the new product phase, a given product is developed and produced usually in an advanced economy (in economic and technological terms). While prices are initially high due to limited production volume, exports begin due to foreign demand [Vernon 1966]. In the mature product phase, due to the rising competition and pressure on lower prices, production tends to be shifted to cheaper locations thus resulting in FDI. Due to demand structure similarity, these locations are usually still within the same economic category, i.e. developed countries. In the standardised product stage, the production processes are unified, requiring less skilled labour. Therefore, production is increasingly relocated to emerging markets, accompanied by exports to developed countries, including the country of origin.

However, the approach does not specify the source of technological advantages of the firms starting a product cycle [Dunning 1988b], nor the specific

location patterns within the broad country categories [Kutschker & Schmid 2008]. Moreover, the same globalisation-related limitation as in the case of the Uppsala model pertains to the irregular geographical expansion patterns of many contemporary born globals. Nevertheless, Vernon [1979] later claimed a continued relevance of the approach, particularly in relation to moderately internationalised firms operating in high-tech sectors.

### 2.2.3. Microeconomic FDI theories

Apart from the aforementioned theoretical concepts related to firm internationalisation, whereby FDI is one of the possible operating modes, there have been approaches explaining the rationale for the existence of MNEs, as well as the determinants of their scope. In doing so, these theories have sought to deliver explanations of necessary conditions and motives for undertaking FDI and of their geographical patterns.

#### 2.2.3.1. Monopolistic advantage theory

The theory of the monopolistic advantage of Hymer [1976], also developed by Kindleberger [1969, 1971] and Caves [1971], can be seen as a part of the so called market imperfections paradigm [Calvet 1981]. Accordingly, in contrast to the perfectly competitive model of neoclassical economics, market imperfections provide the rationale for FDI. Kindleberger [1969] identified imperfections in goods markets (such as product differentiation, monopoly power in certain markets); imperfections in factor markets (such as patented or publically unavailable technology, favourable access to capital, brand equity, superior management skills); size advantages (such as economies of scale, vertical integration); government-imposed disruptions (such as tariff walls).

It is out of market imperfections that monopolistic advantages of some firms can arise. Hymer [1976] argued that the focal motives of FDI pertain to the willingness to control foreign operations and to the exploitation of monopolistic advantages. The former is related to the influence on foreign operations and reduction of international competition (especially by international acquisitions).[13] The latter underlines the importance of firm-specific advantages in foreign markets as a prerequisite for overcoming barriers to international operations [Hymer 1976]. MNEs can arguably be in a better position to overcome the barriers to entry

[13] More specifically, control refers to the use of assets deployed abroad and transferred from the parent firm so as to minimise risks and achieve monopolistic power [Dunning & Rugman 1985].

than domestic newcomers entering a given industry Caves [1971]. Specifically, MNEs can benefit from their international configuration of value chains to match domestic rivals by exploiting scale economies. Likewise, product differentiation (arising from a history of buyer preferences, patenting of product features such as design, or control over favourable distribution channels) or capital required for investment projects, are more likely to be found in firms having large international operations.

Nevertheless, while MNEs do have advantages over local competitors in foreign markets in overcoming entry barriers, they have to incur costs related to crossing national boundaries. These additional barriers are often called the liability of foreignness [Zaheer 1995] and arise out of the information disadvantage of foreign firms related to differences in economic, political, legal, cultural or social aspects of the environment, information and communication costs, or wrong information interpretation [Zeng et al. 2013]. These differences in barriers to entry faced by domestic firms entering an industry and established international firms entering a foreign market contribute to explaining patterns of foreign investment and business performance [Caves 1971].

However, Teece [2006] criticised Hymer for neglecting the relevance of transaction costs minimisation, as well as not specifying the sources of an MNE's monopolistic advantage.[14] Scholars have more recently sought to shed more light on the role of firm-specific advantages (FSAs) in the context of MNEs. A particular emphasis on the exploitation of a distinct competitive advantage in the form of unique assets is made by Teece [2006], who sees it as a source of quasi-rents of MNEs. In his dynamic capability approach, he goes a step further in specifying the unique assets which are a source of competitive advantage, differentiating between factors of production (inputs available in disaggregated form in factor markets); resources (hardly imitable and transferable firm-specific assets); organisational routines or competences (such as systems integration, quality, miniaturisation); core competences (related to the fundamental business of the firm and compared to its competitors); dynamic capabilities (the ability to integrate external and internal assets to respond to external changes); and products (final goods and services manufactured by using the possessed competencies) [Teece, Pisano & Shuen 1997].

#### 2.2.3.2. Internalisation theory

Another theoretical concept explaining the establishment and operations of MNEs is the internalisation theory [Rugman & Verbeke 2004, 2008]. In grounding the

[14] The shortcomings of this approach are addressed by theories reviewed in the subsequent sections.

theoretical reasoning on efficiency-oriented premises, it stipulates that MNEs internalise certain activities (i.e. engage in FDI) rather than carrying them out via arm's length transactions. Thereby, the logic of transaction cost economics is transferred to international business theory. Transactions occur when a good or a service is transferred over a technically separable frontier [Williamson 1990]. The transaction cost theory is based upon three behavioural assumptions. First, transaction participants show a bounded rationality, since they only have limited access to information and a limited capacity for processing information [Verbeke & Yuan 2005]. Second, opportunistic behaviour of transaction partners at the expense of the other party is assumed. Third, it is supposed that actors are risk-neutral and act on the basis of the expected value of action alternatives [Williamson 1985].

Transaction costs are typically divided into ex-ante costs (related to information and transaction party search, negotiation and contract preparation costs) and ex-post costs (related to contract monitoring, conflict management and contract execution) [Erlei & Jost 2001]. The level of these costs is affected by three transaction characteristics: specificity of investments made in the relationship with the partner, uncertainty related to future conditions of the transaction and to a partner's opportunistic behaviour, as well as the frequency of transactions [Wolf 2005].[15] In the choice between transaction modes, including the market, hierarchy (or internal organisation), or hybrid arrangements (such as long-term contracts with adaptation and security clauses), the ultimate efficiency criterion is the sum of all transaction and production costs [Williamson 1986]. Hence, the most cost-efficient solution is selected based upon an analysis of both characteristics of the transaction itself and the institutional arrangements.[16] However, while in transaction cost economics the analytical focus is laid on the micro-level of transaction characteristics, the internalisation theory [Buckley & Casson 1976, 1998; Teece 1986] is centred around the market for know-how. The underlying assumption thereof is that the international market for technological knowledge is imperfect [Buckley & Casson 1998]. In the context of multinational enterprises, there is an additional risk related to property rights dissipation or license abuse [Dunning 1988b]. Moreover, the market can not in all cases assess the benefits and costs of a particular transaction, which accrue to one of the contracting parties, but are

[15] While the increase of the first two characteristics raises transaction costs, the increase of the third one has an opposite effect.

[16] For instance, given a low uncertainty or low transaction-specific investments, the market with its high incentive intensity and competition mechanism appears to be more cost-efficient than an internal organisation of the transaction. As the uncertainty and investments necessary for the transaction rise, the propensity to engage in contracts with security clauses also rises. At higher levels of uncertainty, and thus the threat of partner opportunistic behaviour, the internal organisation of transactions may be the optimal solution [Williamson 1975].

external to the transaction. Thirdly, if the market size is insufficient, firms may not be able to realise economies of scale, scope and coordination in different functional areas. As a result of market imperfections, firm-specific knowledge would not be sold on the market at all or at its actual value, which makes the use of the market impossible or costly [Hennart 2010]. Hence, an MNE can be understood as an international, internal market for intermediate goods in which the MNE decreases transaction costs by acquiring complementary assets in different locations and by establishing integrated operations within parent control [Hennart 1986].

Buckley [2009] summarises the benefits of internalising an imperfect or, in extreme cases, non-existent market, mentioning the coordination of multistage process in which time lags exist but futures markets are lacking, the discriminatory pricing in internal markets which allows efficient exploitation of market power, bilateral concentration of market power which eliminates instability, the removal of inequalities of knowledge between buyer, as well as internal transfer pricing that reduces tax liability on international transactions. These advantages, however, must be able to offset the costs of internalisation, which include higher resource costs if one external market is replaced by several internal markets, communication costs, or costs of managing the complexity of multi-country operations.

Scholars developing the concept of internalisation have made several references to its application to foreign market entry mode choice.[17] Rugman and Verbeke [1992] argue that internalisation advantages pertain to the benefits related to given entry modes (such as exports, licensing, or FDI) when operating in foreign markets. In terms of geographic patterns of FDI, Rugman and Verbeke [2004] suggest that the Uppsala model and the internalisation theory may actually be closer to each other than it is usually suggested. Based on the trend of regional concentration of Triad-country MNEs, they argue that the value of MNEs' FSAs may be limited outside of their home region, regardless of the mode via which they are being transferred to the foreign market.[18]

#### 2.2.3.3. Location theories

The choice of location can have consequences for the performance of foreign operations [Brouthers et al. 2009; Chan, Makino & Isobe 2010; Davidson 1980; Gammeltoft, Pradhan & Goldstein 2010; Goerzen & Beamish 2003]. Location theories of international business, which explain the "where" – component of FDI,

[17] One of the pioneers of applying the transaction cost logic to entry mode decisions were Anderson and Gatignon [1986].

[18] In fact, their resources are not sufficient to overcome the inter-regional liability of foreignness.

*de facto* derive from their counterparts in the domestic context [Misala 2003].[19] The roots of conventional location theory, which sought to explain the determinants of concentration of economic activity in certain areas, can be traced back to the "classical tradition" developed in Germany by von Thünen [1826] or Weber [1909]. According to the former concept, a basic determinant of location of agricultural cultivation is the parcel rent, which decreases concentrically from the agglomeration towards the countryside [Cieślik 2005]. This concept was extended and transposed to the industry context by the latter one, which introduced the term of agglomeration advantages, understood as combinations of natural resources, labour and capital minimising production and transport costs [Misala 2003]. The neoclassical urban and regional economics further developed the concept of externalities related to the spatial concentration of economic activity.[20] The new economic geography withdraws from the neoclassical assumptions of traditional trade theory, assuming imperfect competition and scale economies of firms [Krugman 1998].[21] In the international business context, location was central to theoretical discussions of FDI in the 1960s, while for the subsequent two decades this rather macroeconomic emphasis shifted to microeconomic questions related to the organisation of MNEs. Yet, the changes in the economic environment, including the relevance of knowledge in value creation and the interconnectedness of operations in an increasingly globalised economy, have brought the location factor back into focus. Location is a central variable in a series of theoretical concepts related to FDI. Dunning [2000] asserts that international business research, as well as a wealth of empirical studies on the determinants of FDI and its spatial distribution, have extended (rather than replaced) traditional location theories in order to embrace the specificity of cross-border operations.

Holtbrügge and Welge [2010] broadly discuss the "location theory of firm internationalisation" as a set of location factors relevant to FDI location decisions: market factors (e.g. market size and growth); cost factors (e.g. wage differentials and tax advantages); resource-based factors (e.g. access to natural resources or skilled labour); government incentives (e.g. tax exemptions or subventions); and political and legal factors (e.g. legal stability, political risks). As there is no single

[19] A detailed review of conventional location theories can be found e.g. in Cieślik [2005] or Misala [2003].

[20] Marshall [1890] identified three sources of externalities affecting the spatial concentration of business, which are the availability of skilled labour, the existence of specialised suppliers of goods and services, as well as information flows and knowledge spillovers among firms. Quoted after Cieślik [2005], p. 115–116.

[21] In the local concentration of economic activity, a key role is attributed to pecuniary externalities, which are treated as an outcome of market transactions, while technological spillovers are treated as exogenous, albeit relevant in some sectors [Cieślik 2005].

location theory, there is also no finite "catalogue" of location variables [Kutschker & Schmid 2008]. Contemporary concepts related to international distribution of firm activity suggest that factor endowments of host countries still remain an attracting force in international location decisions of firms, although this role is decreasing. Porter [1990a] argues an important location variable relates to the quality of business environment, which increases firm productivity. Accordingly, this task is fulfilled by clusters, understood as groupings of firms in a particular sector in a given location. They enhance firm productivity owing to a better access to specialised inputs and information, as well as intensifying complementary exchanges between firms and increasing performance incentives. Thus, the presence in specific locations is becoming increasingly relevant for MNEs for the accumulation of knowledge, e.g. via the allocation of R&D activities in technologically sophisticated locations [Cantwell & Narula 2001; Kuemmerle 1999].

An important contribution to understanding the international business environment has been provided by the institutional theory [Bevan, Estrin & Meyer 2004; Marinova, Child & Marinov 2012; Obłój 2014]. "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" [North 2011, p. 3]. In other words, institutions devise a structure which reduces uncertainty by limiting the set of choices made by individuals. In Scott's [1995, p. 33] terms, institutions are "regulative, normative, and cognitive structures and activities that provide stability and meaning to social behavior." Institutional frameworks can be divided into formal and informal constraints [North 1991]. Formal constraints include political rules, judicial decisions, and economic contracts. Informal constraints, on the other hand, comprise socially sanctioned norms of behaviour, which are embedded in culture and ideology.[22]

A different classification, albeit reconcilable with the former (see Table 1), has been popularised by Scott [2001]. It distinguishes three pillars of institutions. The regulative pillar refers to the formal rules and regulations as sanctioned by a state, largely corresponding to North's [2011] formal institutions. The normative pillar pertains to values (conceptions of the preferred or the desirable) and norms (legitimate means to pursue ends). The cultural-cognitive pillar embraces the beliefs and value system of a society [Gaur & Lu 2007]. Finally, the said institutions can also be divided into external and internal institutions, which both affect firm strategies [Oliver 1991, 1997]. The former embrace regulatory structures, laws, courts, interest groups or public opinion in general. The latter focus on the institutionalised practices and norms inside organisations.

[22] North [2011] suggests that in situations where formal constraints fail, informal constraints will act to reduce uncertainty and provide a reference frame to organisations.

**Table 1.** Dimensions of institutions

| Degree of formality [North 2011] | Examples | Supportive Pillars [Scott 2001] |
|---|---|---|
| Formal institutions | *Laws*<br>*Regulations*<br>*Rules* | Regulative (coercive) |
| Informal institutions | *Norms*<br>*Cultures*<br>*Ethics* | Normative<br><br>Cultural-cognitive |

Source: updated from Peng et al. [2009, p. 64].

The effect of institutional factors at the level of locations for FDI can be regarded from two different viewpoints. The stream of new institutional economics, focused predominantly on economic efficiency, refers to the impact of country-level institutions on economic activity [North 2011]. Institutions are shaped to an important extent by the state, particularly through the support of efficient property rights [Arslan 2011]. On the other hand, informal institutions play an equally important role in shaping the business environment, in that social relations and the cultural context may even restrict the success of economic reforms and limit economic performance [Chung & Beamish 2005]. Dunning [2005] recognised that the extent and quality of a nation's institutions and its institutional infrastructure are increasingly becoming a critical determinant of the successful deployment of the firms' ownership advantages and thus an important consideration in FDI location choice by MNEs. In general, a lower level of host-country institutional hostility, restrictiveness and instability attract higher FDI [see e.g. Globerman & Shapiro 2003; Habib & Zurawicki 2002; Rodriguez, Uhlenbruck & Eden 2005].[23]

Another perspective in international business, based on organisational analysis, is focused predominantly on achieving legitimacy within the host-country environment or of the parent firm. Accordingly, firms adopt organisational structures, processes and strategies, which help them to cope with expectations formulated by their external or internal environment (DiMaggio & Powell 1983]. The institutionalisation process leads to the elimination of behaviour which does not conform with norms regarded as legitimate, which leads to the uniformisation of firm strategies within the same institutional environment [Oliver 1991]. The applications of this line of theoretical reasoning to FDI include the process of attaining legitimacy by foreign subsidiaries vis-à-vis their parents and the host-country environment [e.g. Kostova & Zaheer 1999], host-country selection and the choice

[23] Compare Cuervo-Cazurra [2008].

of market entry strategies [e.g. Xu & Shenkar 2002] or affiliate staffing [e.g. Xu, Pan & Beamish 2004].

#### 2.2.3.4. The eclectic paradigm

##### 2.2.3.4.1. The OLI advantages

The eclectic paradigm (OLI) remains the dominant approach to MNE activities since its explanatory value is higher than that of the sum of the individual theories which it integrates [Eden 2003; Eden & Dai 2010]. The eclectic paradigm has evolved over the years (see Table 2) in line with both significant changes in the world economy and thus MNE activities, and the criticisms that it received from proponents of other theoretical perspectives [Cantwell & Narula 2001]. The fundamental argumentation of Dunning's approach is that a firm engages in FDI, given the fulfilment of three conditions [Dunning 1981]. First, firms must possess ownership (O) advantages compared to incumbents in foreign markets. These frequently comprise intangible assets, which are specific or exclusive to the firm. If the previous condition is satisfied, it must be more profitable to the firm to use the said ownership advantages on its own rather than externalising them via contractual agreements with external parties (e.g. licensing) – in other words there must be internalisation (I) advantages. Given the fulfilment of the above two criteria, it must be more beneficial to the firm to use these advantages in combination with certain input factors in the foreign market (location or L-advantages); otherwise exports would be the preferable way of serving foreign markets.

The possession of O-advantages has influence on *which* firms will enter a given foreign market. L-advantages aim to explain *where* FDI will occur, depending on specific endowments of host countries. Finally, for a given location and firm with particular resources, the internalisation advantages determine whether FDI is preferable over a contractual exploitation of the possessed assets, thus answering the question *how* the said firm advantages should be used [Dunning 1980]. However, as Dunning [2001] underlines, the specific configuration of the three categories of advantages is highly context-dependent, and can be affected by factors on the macro-, meso- and micro-level. While firms are heterogeneous in terms of ownership advantages, which makes some of them sufficiently capable of undertaking foreign expansion, the extent of market failure which determines the existence of internalisation advantages will depend on the industry sector and on the given host-country. Location advantages will not only differ objectively, but the perception of the same host-country conditions might differ between several firms, even from the same industry.

In an early version of his approach, Dunning [1979] distinguished between three categories of firm advantages: those conceptually close to monopolistic advantages and independent of multinationality, those related to the size and age of the firm (vis-à-vis) newcomers to an industry, and those related specifically to multinationality (see Table 2). Later on, Dunning [1988b] regrouped the first category of his original O-advantages as "property right and/or intangible asset advantages" or Oa (related to structural market imperfections), while two other categories as "advantages of common governance" or Ot. In order to mark the distinction between Ot-advantages and I-advantages, Dunning labels the former as the *capability* to internalise markets, while the latter as the *willingness* to do so.

**Table 2.** OLI-advantages in Dunning's eclectic paradigm – a summary

| **Ownership advantages (advantages of enterprises of one nationality, or affiliates of same, over those of another)** | |
|---|---|
| **Independent of multinationality** | *Those due mainly to size and established position, product or process diversification, ability to take advantage of division of labour and specialisation; monopoly power, better resource capacity and usage.*<br>*Proprietary technology, trade marks.*<br>*Production management, organisational, marketing systems, R&D capacity, "bank" of human capital and experience.*<br>*Exclusive or favoured access to inputs, e.g. labour, natural resources, finance, information.*<br>*Ability to obtain inputs on favoured terms (due to e.g. size of monopsonistic influence).*<br>*Exclusive or favoured access to product markets.*<br>*Government protection (e.g. control on market entry).* |
| **Which branch plants of established enterprises may enjoy over *de novo* firms** | *Access to capacity (administrative, managerial, R&D, marketing, etc.) of parent company at favoured prices.*<br>*Economies of joint supply (not only in production, but in purchasing, marketing, finance, etc., arrangements).* |
| **Arising due to multinationality** | *Multinationality enhances above advantages by offering wider opportunities.*<br>*More favoured access to and/or better knowledge about information, inputs, markets.*<br>*Ability to take advantage of international differences in factor endowments, markets. Ability to diversify risks, e.g. in different currency areas, and to exploit differences in capitalisation ratios.* |

| Internalisation Advantages (i.e. to protect against or exploit market failure) | |
|---|---|
| *Avoidance of transaction and negotiating costs.*<br>*To avoid costs of enforcing property rights.*<br>*Buyer uncertainty [about nature & value of inputs (e.g. technology) being sold].*<br>*Where market does not permit price discrimination.*<br>*Need of seller to protect quality of products.*<br>*To capture economies of interdependent activities.* | *To compensate for absence of futures markets.*<br>*To avoid or exploit Government intervention (e.g. quotas, tariffs, price controls, tax differences etc).*<br>*To control supplies and conditions of sale of inputs (including technology).*<br>*To control market outlets (including those which might be used by competitors).*<br>*To be able to engage in practices e.g. cross-subsidisation, predatory pricing etc. as a competitive (or anti-competitive) strategy.* |
| **Location Specific Variables (these may favour home or host countries)** | |
| *Spatial distribution of natural and created resource endowments and markets.*<br>*Input prices, quality and productivity, e.g. labour, energy, materials, components, semi-finished goods.*<br>*International transport and communications costs.*<br>*Investment incentives and disincentives (including performance requirements, etc)*<br>*Artificial barriers (e.g. import controls) to trade in goods.* | *Infrastructure provisions (commercial, legal, educational, transport and communication).*<br>*Psychic distance (language, cultural, business, customs, etc, differences).*<br>*Economies of centralisation of R & D production and marketing.*<br>*Economic system and policies of government; the institutional framework for resource allocation.* |

Source: adapted from Dunning [1979, p. 276; 1981, p. 80–81; 1988b, p. 48].

Dunning [1979] argues that the differences in production functions, scale economies and product differentiation are not country-specific in their origin and their use, but firm-specific. In fact, a part of ownership advantages are transferrable across borders, a tendency which increases with the degree of a firm's multinationality. On the contrary, MNEs can also profit from comparative advantages of host countries [Kutschker & Schmid 2008]. Yet, Dunning does not underscore the role home countries in foreign expansion, either. The extent and intensity of MNE activity is regarded as a function of their O-advantages, which, in turn, are largely a function of their home-country L-advantages [Narula & Nguyen 2011]. In fact, large internal markets may give rise to large firms able to realise economies of scale, while the quality of educational, training or R&D facilities affect the management and organisational expertise or the technology-based assets of domestic firms. In a similar vein, the level of consumer incomes, demand elasticity and preferences are related to firms' product differentiation or marketing economies [Dunning 1981].

#### 2.2.3.4.2. Institution-based view and the OLI paradigm

Based on a macro-level approach to institutions by North [2011], and applying them to the micro-level context, Dunning and Lundan [2008b] argue that formal and informal institutions as the "rules of the game" are crucial to understanding interactions between the MNE and its environment. Linking the concept of OLI variables to that of institutions, they argue that the I-advantages are in themselves institutional, as they address alternative modes of exploiting or acquiring O-advantages [Dunning & Lundan 2008a]. Conversely, in regard to O-advantages they call for a conceptual differentiation between Oa- and Oi-advantages. Lundan [2010, p. 55] defines institutional advantages (Oi) as the "formal and informal institutions that govern the value-added processes within the firm, and between the firm and its stakeholders." These include codes of conduct, norms, and corporate culture, as well as appropriate incentive systems and appraisal. While Oa focus on market power and efficiency, and Ot on the organisational effectiveness of the MNE, Oi relate to legitimacy and trust resulting from non-market effectiveness. These firm-specific norms and organisational practices can depend on the macro-level institutions of their home countries and can be transferred (and adapted) to foreign subsidiaries [Dunning and Lundan 2008b]. In turn, the institutionally-related location advantages (Li) are likely to vary between countries, particularly those at various economic and institutional development levels. They comprise the institutional infrastructure which is critical to stimulating both inward and outward FDI [Dunning & Zhang 2008]. Dunning [2006b] underlines that different measures of institutional development and social capital, such as market liberalisation, corruption level, educational system, protection of intellectual property rights, or more active competitiveness-oriented policies, are becoming focal in decisions related to FDI locations.

#### 2.2.3.4.3. Critical remarks and extensions

Frequent criticisms of the eclectic approach have been related to its integrative character. In fact, Rugman [2010] notes that O-advantages – contrary to the FSAs discussed in the internalisation theory – combine both intangible assets of the firm and more country-level factors, such as the institutional environment or industry structure, thus blurring the boundary between ownership and location factors. Moreover, I-advantages appear to be strongly linked to O-advantages, since the very possession of intangible assets is an instance of replacing the market. This argument particularly refers to the conceptual difficulty in distinguishing Ot- from I-advantages [da Silva Lopes 2010]. Furthermore, it is suggested that certain Ot-advantages could be reclassified as L-advantages, e.g. operational flexibility or information about product markets in the host country. Thus, Rugman and

Verbeke [2009, p. 163] argue that there is "little value in distinguishing between the O and I aspects of FSAs (...)," and "(...) O and I, in practice, are integrated features of FSA management within the MNE, that cannot be decoupled in strategic decision making." Also the proponents of strategic management concepts have suggested the need for conceptual modifications of the OLI paradigm, so as to increase its explanatory capacity at the microeconomic level. First, it has been suggested that the typology of O-advantages ought to better reflect the origins of profitability and growth of firms. Da Silva Lopes [2010] proposes to distinguish between:

- general ownership advantages ($O_g$), specific to the country or industry of the firm, such as cultural, legal and institutional environment, labour and natural resources, and capital markets;
- firm-specific ownership advantages ($O_f$), independent of single product lines, such as marketing knowledge and distribution networks;
- product-specific ownership advantages ($O_p$), including intellectual property protection and the ability to innovate and differentiate products.

Moreover, an implicit assumption of IB theories is that O-advantages originate within the parent firm and are exploited abroad, or their pool within parent possession is enhanced through strategic asset-seeking FDI. Madhok and Phene [2001] remind that firm-specific advantages evolve with both environmental evolution and the managerial adaptation within the firm which external changes induce, whereby a crucial O-advantage is to manage foreign subsidiaries in order to benefit from their initiatives and leverage local opportunities.

## 2.3. Practical implications of theoretical concepts

According to the motto that "there is nothing so practical as a good theory[24]," a question arises to what extent the aforementioned theoretical concepts explaining FDI behaviour from different perspectives can inform managerial decisions and economic policy. Before these questions can be answered based on empirical evidence from Polish multinationals,[25] this section aims to briefly evaluate the theories discussed above from the perspective of their applicability to economic reality.

Starting with the Uppsala model, as it was indicated earlier the original concept arose from a limited empirical basis. Hence, it is characterised by an excessive determinism of mode and location sequences, especially leaving out such

[24] K. Lewin quoted after Wolf [1973, p. 325].
[25] See Chapter 4.

phenomena as early or fast internationalisation. It can be argued that its applicability is limited predominantly to early-stage internationalisation of the firm and of its home economy. Moreover, no specification of motives for switches in subsequent internationalisation modes is provided by the model, limiting its concrete normative statements. However, the concept draws managerial attention to the relevance of experiential learning in firm expansion, as well as cooperation of internationalising firms with their foreign and domestic customers and competitions in order to alter or accelerate internationalisation paths. From the point of view of economic policy, the role of governments to support firms in their internationalisation, which includes FDI projects, relates to the provision of complex information on foreign markets to exporters and foreign direct investors by dedicated agencies, as well as creation of cooperation platforms for internationalising firms.

In a similar vein, the Finnish model provides no specification of motives for switches in subsequent internationalisation modes. Moreover, its normative character in relation to the product or organisational structure dimensions is limited. Nonetheless, it reminds that firm internationalisation should be holistically measured in different dimensions and also draws the attention to the interrelatedness of different decision aspects. Based on this concept, managers should facilitate the transfer of best practices between foreign markets in order to make subsequent expansion steps more effective. At the same time, firm internationalisation can be promoted by the provision of risk-reducing support measures, including credit or loan guarantees.

In turn, the aforementioned international product lifecycle theory, while presenting a simplified and arguably outdated image of reality, encourages the adoption of a lifecycle-oriented choice of internationalisation forms and foreign locations by companies. The resulting implication for policy-making pertains to adjusting the measures for both attracting and stimulating FDI to the development level of the economy, particularly in terms of the types of value added and industry sectors of FDI projects which receive certain forms of government support. On the other hand, the monopolistic advantage theory, while showing no consideration to resource augmentation by expanding abroad, which can also be a relevant expansion motive in the case of emerging multinationals,[26] nor considering the applicability and value of firm resources to foreign market contexts, it certainly does draw managerial attention to the creation and protection of firm-specific advantages as crucial asset in firm internationalisation. Moreover, it is also based on a concept that is relevant from managerial viewpoint, i.e. the barriers to entering a foreign market, which can be particularly true for firms which are still at a nascent stage of their international operations. Following this line of reasoning, the

[26] See Chapter 4.

support for firms' internationalisation by the state should be oriented at developing their resource pool and improving the overall conditions in which firms can enhance their competitiveness, rather than focusing merely on dedicated financial and non-financial tools supporting concrete expansion steps.

Further, internalisation theory, while remaining broad in its statements as to what can actually be internalised and neglecting the diversity of motives that can lead to this process, reminds managers that the choice of an optimal internationalisation form depends, *ceteris paribus*, on transaction and coordination costs. Accordingly, the process of facilitating both outward and inward FDI to a given country should rely on the design and implementation of policies aimed at minimising transaction costs, hence – again – not focused merely on investment transactions, but creating a supportive business environment in general. The role of the business environment is also raised in the group of location theories, which in themselves do not allow any specific recommendations due to their rather broad character. However, an implication of location theory, which is reflected by managerial decisions related to market choice is the use of comparative advantages of specific countries in allocating modules of international value chains. Again, the role of home- and host-country governments should focus on developing a country's particular comparative advantage and both absorbing and generating investments of the type which is best suited to the country's competitive profile at present and in the future. At this juncture, the institution-based view provides a narrower focus on formal and informal institutions as the "rules of the game," drawing attention to the conformity and potential conflicts between rules and behaviour norms of the home country, host country, and the foreign affiliate of a multinational company. These considerations should play an important role in selecting locations for foreign operations. Countries should therefore be active in shaping the rules of the game to facilitate firm operations. The eclectic paradigm (OLI) combines many of the above insights due to its holistic character. While it shows some conceptual overlaps between variable categories (O and I; I and L), as it was discussed before, and devotes only little attention to firm strategy, it posits that the choice of internationalisation form depends on the specific constellation of OLI advantages. Accordingly, managerial decisions related to location and mode choice decisions should be regarded as interrelated.