Unfolding the eclectic umbrella

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Abstract
On several occasions John Dunning has described his eclectic paradigm (the OLI framework) as an envelope or an umbrella. This is now becoming a widely accepted standard conception. On this background it seems reasonable to rise two questions. Who or what is under the umbrella, and which function does the umbrella supply. The article suggests that the umbrella as suggested by Dunning is largely a cover for anything that at the macro or meso level contributes to explaining the international location of production (or, even broader, business activities). The article further attempts to give the umbrella concept a meaning and use at the micro (or firm) level arguing that the three factors – O, L and I – may be ordered in six causal sequences. It shows that each of the sequences coincides with a well known theory of internationalisation, and that the umbrella thus conceived does in fact cover basically existing business theory on internationalisation of the firm.

Background

It is not the purpose of the present article to evaluate the eclectic paradigm as such, nor to go into the development over time. It is well known that over the past 35 years it has moved considerably, from the early mark 1, Eden (2003). It is assumed that the reader is informed about the basic features of the paradigm.

Dunning explicitly relates his paradigm to three basic questions: the *why*, the *where* and the *how* of international business activities, Dunning (1981, 1988). One may reasonably observe that the third question – the how – is somewhat subdued, since the main interest of Dunning and his co-workers is the establishment across borders in the shape of Foreign Direct Investments (FDI). Other forms of internationalisation are touched upon, but FDI lies at the heart of the eclectic paradigm.

The paradigm addresses the three – or two – basic questions at three analytical levels – the macro, the meso and the industrial level. Following Eden (2003) it may reasonably be stated that the success of the eclectic framework increases with the unit of analysis. It has proved useful and fruitful in explaining the structure of international production, both from a longitudinal perspective, Dunning (1988, chapter 3), and from a cross-geographical one. The latter one emphasising the consequences of localisation from trade barriers, including regionalisation, and other market imperfections.

The eclectic paradigm has proved useful also at the industry level, e.g. in explaining the role of MNC in relation to (changes in) production patterns of the industry across the globe. It may be seen as either complementary or in competition with theories of industrial clustering such as Porter (1990). It may als be a useful tool in explaining the various industrial configurations covered by Porter (1980, 1986), such as fragmented vs. concentrated industries.

The weakest point remains the micro – or firm – level. It has not become obvious how O variables relate to firm behaviour or configuration – or performance for that matter. Nor has the paradigm contributed to the individual company´s choice of location. One remedy may be to supplement the OLI thinking with some sort of sorting mechanism, the simplest one being NPV calculations. Finally there is no hint of the ex post perspective: once established as an FDI, does the foreign operation perform satisfactorily – or even optimally.

The purpose of this article, thus, is to combine the observation that the eclectic paradigm seemingly does not perform satisfactorily at the micro level with the frequently argued view that the paradigm is – or functions as – an envelope or *umbrella*. It may not be particularly clear what the two expressions refer to, but a guess may be the "big tent" suggested by Dunning (2000): OLI is wide and broad and deep enough to embrace all other theories of international business. Thus each of them becomes – or is reduced to – an OLI subset.

A corollary may be that the eclectic paradigm includes everything and (at firm level) explains nothing and implies that the paradigme should be checked for relevance and possibly redundance. While competing IB theories flourish, the paradigm is probably much less endangered by redundance at the meso and macro levels. This is strictly in agreement with the original intension of OLI, viz. to explain international production and not individual company behaviour.

Addressing the micro level, *how* do we get on from the somewhat sweeping statement that OLI is an umbrella of IB theories? Dunning´s own arguments draw on postulates such as OLI is more valuable than the (sum of?) otherwise competing theories, or that OLI is relevant because it deals with essential questions in IB.

In order to get beyond, let us introduce the concept of *logical OLI sequence*. In the eclectic paradigm, the three dimensions – O, L and I – are juxtaposed and presented as necessary (*not* sufficient conditions to be met in order for a FDI to materialise. Let us instead introduce the three dimensions as a set of (six) alternative sequences. One of the three being the prime mover of internationalisation that spills over into a second one which activates the third of them. Logically this approach supplies us with six distinctive sequences:

O → I → I

O → L → L

I → O → L

I → L → O

L → I → O

L → O → I

The obvious question to ask, of course, is whether any business philosophy would be detectable under each of the six cases. We should be aware that further combinations are possible, for instance location may be explained by the combined arguments of O and I factors. Similarly a combination of O and L actors may explain internalisation, or a combination of L and I factors may be the explanation of building O (firm competences).

OI → L

OL → I

LI → O

Similarly, from a purely logical point it is possible that the company´s Ownership advantages will simultaneously decide where and how to internationalise, or I factors may be seen as a driving force which leads to both building of O and location decisions at the same time. Finally the location motive may be so powerful that it is the driver of building O factors in combination with internalisation.

O → IL

I → OL

L → IO

The remaining part of the article addresses these configureations in order to reveal possible categories of business thinking (strategy or business modelling) in each case, and when possible relate to existing IB theory.

Some interpretations

O → I → L

Business behaviour or theoretical approaches building on this sequence takes the starting point in Ownership advantages. These, according to the eclectic paradigm may be of the asset type or the transactional type. Both relate to the abilities of the company and span a wide variety of possible advantages. To mention only a few, the O may be exclusive access to particular inputs, patents or routines that provide the firm with a particular competitive power. Or it may be the ability to handle a variety of related problems drawing on knowledge that has been accumulated in the firm – market research of models of international management.

Such ownership advantages are internalised in the company and not licensed off or sold at other firms. If, further, the company has valuable resources which may be harmed by externalisation, it has to cross borders to save international customers by way of FDI operations. In some cases a resource rich firm will be approached from outside, or see opportunities in a foreign market, and in response set up a subsidiary to serve the particular foreign customer segment(s).

In many cases there may be spill-back, so that new experiences in foreign market expand the resource base of the firm. This, however, is not the place to take up more complex recursive modelling of business processes.

In literature the resource based view (RBV) reflects the sequential logic of this image. Resources are accumulated and expanded, also across borders in new figurations of business activities and resource combinations. Authors in this approach include Wernerfelt, Grant, Barney and others. It appears most likely that this sequence exists in practical business life as well as in IB literature.

In recent years, not least the international service sector has been subjected to investigation according to this sequential logic, vide Strandskov and Pedersen (2007).

O → L → I

Here the starting point is once again the O variables – the same set as indicated in the previous case. The variables are, in the shape of services or products transferred to customers across national borders. As relations grow stronger, and the market share increases, the market will be served by more committed operational modes, such as contractual cooperation or ultimately by production in foreign business units, after FDI has taken place.

As experience in the given market is accumulated, and more experiments are carried out, the exporting company reacts to gradually reduced perceived risk by embarking on more committed entry modes.

In IB literature this sequence fits to the so-called Uppsala model (Johanson and Vahlne 1977, 1990) in which the interchange of stock variables and flow variables determine the expansion path of the firm. (Figure???). The theoretical argument leads to (1) markets being served in order of increasing “psychic distance”, and (2) the conventional sequence which indicates that foreign markets are served by more and more committed operational modes as time passes by and experience is accumulated.

The Uppsala model is one of several “stage models” which define FDI as the most advanced and committed way of serving international markets. In an OLI context it certainly contributes to answer questions related to the “who”, “when”, “shy” and “how” of international operations, and thus supplies the eclectic paradigm with a managerial underpinning.

I → O → L

Starting in the realm of internalisation gives a totally different taste of business than starting in the O section. Internalising O variables in the business environment has a distinct entrepreneurial twist – competitiveness is not “inherited”, it is *built*.

Again the time factor takes importance, as building O advantages takes time, unless the builder is a powerful corporation venturing into a new business area. Internationalisation by a FDI will take place once the strength of the firm is sufficient to mount entry barriers in a foreign market, and the driving I factors “automatically” spill over into committed market entry, or FDI. The business logic is straightforward – if it is a necessity to protect O advantages by internalising them, the pattern will not be changed by moving to a lesser known market, but rather reinforced.

In literature this business model is found in Buckley and Casson (1985) where internalisation is the driving force behind FDI. Like with the other theoretical models, the argument is more differentiated than that, but the basic business logic is the I-O-L sequence. At the extreme, this view boils down to viewing O advantages as the sum of historical internationalisation acts, and the crossing of borders leading to international location as a calculatory question of minimising transaction costs.

I → L → O

A wish to acquire competences or resources – O advantages – in possession of a foreign company in many cases leads to a merger or take-over. In a world characterised by overwhelming global information levels and time-based competition, more and more necessary and complementary resources will be spotted, that are in possession of foreign companies.

A wish to internalise such resources will lead to border crossing operations, and once internalised the added competences will strengthen the ownership advantages of the acquiring firm. It makes an interesting addition to conventional FDI thinking that overseas direct investment may be directed towards the input side, even if this kind of reasoning is not far off Dunning (1988) that emphasises among others the resource seeking motive of FDI. It goes for oil companies looking for raw oil just as well as for resource seeking directed towards the process or managerial processes of another firm.

In literature this sequence reflects the line of thinking in the so-called resource dependency theory (Pfeffer and Salancik 1978) which emphasises how companies must constantly be on outlook for ways of supplying indigenous resources with complimentary ones in the hand of other firms.

L → O → I

In recent years the concepts of industrial districts and industrial clustering have assumed new importance in business literature, but the thinking has been around since the days of Alfred Marshall who enquired into the concept of districts. According to this line of reasoning, more or less arbitrary an industry shoots up in a certain geographic area and grows in competitiveness. The theme has been prominent in the "new economic geography" where clustering plays a key role. Gradually the local firms build ownership advantages, sometimes by extreme specialisation inside the cluster, and in turn the cluster competitiveness attracts FDI from foreign firms with a wish to tap into the pool of knowledge and competences that has developed in the cluster.

One among many examples is the location of fast-moving Indian wind turbine producer Suzlon in Aarhus, Denmark. The business unit is a global centre with the aim to transmit the knowledge from the Danish wind turbine hub throughout Suzlon´s organisation. Even if this sequence resembles the resource dependence theory, it is obvious that the logic is quite different – setting up a new business unit may or may not be a question of take-overs, but L is the driving force, not I.

L → I →O

Again, location is the driving force, but not necessarily due to agglomeration or cluster arguments. Often business people state something like "If you can handle the American market, you can handle any market". L factors in this case will act as a magnet that attracts foreign FDI which in turn assume importance as a strategic business unit (Ghoshal and Bartlett 1988), where new or superior competencies (O advantages) ae developed and transferred to other corporate business units, be it marketing, research or logistic skills.

Traditional location theory may yield some theoretical support for this behaviour, but the diamond concept, Porter (1990), also provides a degree of immediate persuasion. If attracted to a foreign market, it seems quite likely that the investor will locate in the vicinity of the factors that make the country attractive – i. e. close to an industrial cluster. Route 126 in the Boston area or Philadelphia for pharmaceutical industry, or Hollywood for entertainment companies are appropriate cases.

The difference, concerning industrial clusters, between this sequence and the previous one may seem small or non-existent, and one may suggest that in both cases L → (IO), but from a business view there may be a world of difference between "searching for the O" that certainly is hidden in the cluster, and the wish to tap into it actively by establishing and FDI, i. e. by internalising operations in the heart of the cluster. The distinction should be maintained.

An alternative interpretation of this case would be given by the *transaction cost* approach, Williamson (1975, 1985…). The theory takes the individual transaction as the unit of analysis, and thus identifies the maximum efficient mode of entry on a case-by-case method. The theory assumes that independently of the choice *ceteris* is *paribus*. Choosing the efficient mode implies that transaction costs are minimised. This might bring a specialised kind of ownership advantage such as optimising the market entry mode. In a broader perspective one may argue that this leads to a capacity for optimising the international organisation structure, including finding the right roles to play in the corporation for each business unit. It may then be argued, without full conviction, that L → I…. is in a sense followed by …I → O.

For all the brilliant economic reasoning embedded in the transaction cost approach, it may not really measure up to a place under the OLI umbrella.

Further elaborations

It would seem that causality of the three eclectic dimensions – O, L and I – does open for a workable definition of an "eclectic umbrella", and that the interpretation of the concept does indeed in a systematic way lead to a business related as well as theoretically related context. The umbrella may be represented as in figure 1 below.

When organised this way, the umbrella might give rise to further questions, e.g. does it open for a business – or, MNC – understanding that goes beyond the competing theories such as stage models, resource based theories etc.? Here the simple but penetrating triplet (OLI) might carry beyond individual theories and towards a typology of MNC. The six revealed theoretical approaches could be combined in groups of two in altogether six different ways. The six combinations tell as many different stories about strategic thrust and business modelling.

A combination of the resource dependency thinking and the resource based view materialises in the sense that location is derived from the aim to develop resources inside the firm. One may talk of a resource driven business model – or strategy – where *location is derived* from ownership and internalisation considerations.

A combination of the resource based view and the Uppsala model shares the dominant feature that focus is internal to the firm. Accumulation of knowledge, resources or competences is the driving force. The business model relates to modern concepts like the learning firm or the knowledge driven form, even if strategies in agreement with resource dependency to some extent may be included in this model.

Figure 1. The eclectic umbrella unfolded.

Resource dependency
I-O-L

Resource based view
O-I-L

Resource driven
Strategy, IO-L

Aggressive interna-
Lisation, I-OL

Internal focus
O-IL

Entrepreneur
Ship, I-L-O

Uppsala
O-L-I

External focus,
LI-O

Derived interna-
lisation, OL-I

Location drive
L-IO

Diamond model
L-I-O

Economic geography
L-O-I

Combining the Uppsala model with the new economic geography, i. e. OL → I, shares the view that internalisation is derived from other factors. Ony a sufficient combination of ownership and location advantages will lead to internationalisation. The traditional term, *the reluctant MNC*, may be appropriate to characterise this particular perspective.

The new geography and Porter´s diamond have the common ground that localisation is important, and a driver. Admittedly, none of the approaches are really company oriented, but both of them offer a reasonable context for understanding a company strategy: MNCs looking for locations that may add to their competitiveness will be sensitive and maybe even *footloose* in the hunt for advantageous localisation.

The entrepreneurial approach shares with the diamond the point that external factors over time are decisive for building competitiveness. The entrepreneurial thinking may focus on business opportunities in general, while the diamond philosophy is directed more towards a particular location as supplier of competitive advantage. While entrepreneurship as a model may be more customer oriented, the diamond thinking appears to be more network oriented.

Finally, the resource dependency theory and the entrepreneurial thinking share the opinion that internalisation is the crucial factor in shaping company strength. Both of them see the acquisition and the internalisation of resources as essential – thus the common determination: aggressive internalisation.

Conclusions

The understanding of the eclectic paradigm as an “umbrella” appears more justified after the above analysis. Adding causality to the OLI dimensions reveals that OLI is indeed an “umbrella” that spans most of to-day´s business thinking, as well as most of current IB theorising. The fall-out of the transaction cost theory would seem to be a minor problem in the context.

Figure 1 illustrates that there may indeed be fruitful ways of linking existing theories, as they may be grouped in pairs that between them identify a current way of formulating strategies and business models. Strategy and business modelling in practice is a far-spanning endeavour, and the models defined all would seem to be existing in business reality. It may be an exciting exercise to move deeper into the six suggested strategy domains in figure 1.

One further off-spring of the argument is that we may obtain a different – and from an OLI point of view a far more satisfying – classification of MNC based on causality of the three eclectic dimensions. What is the strategic direction of the companies? What are the driver(s) in the business models they set up, and what are the goals?

It is our belief that the introduction of causality in OLI will open for new vistas linking the eclectic paradigm more firmly to the micro level which has so far been the weakest spot in the framework. As causality is a component in most business thinking as well as in most theories, the paradigm may assumed increased theoretical contents as well as an increased use as a tool for multinational business.