

# Benefits of the eclectic paradigm



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The usefulness of the eclectic paradigm as a framework for combining and relating alternative theories of international business, and in coping with changes over time in the practice of international business

## 1. Introduction

The eclectic paradigm, namely the OLI paradigm was put together by the economist John Henry Dunning (1927-2009) in the late 1970's. Dunning's early research focused on American owned affiliates in the UK and their higher productivity compared to their local competitors. He wondered how and why these firms were able to compete locally with indigenous UK firms and started to raise questions about the advantages of multinational firms as an outcome of their activities abroad. He identified certain firm specific advantages and also advantages derived from the country of origin (Dunning, 2001). These are first two components of the later assembled paradigm, the O which refers to Ownership advantages and the L which refers to locational advantages. These early works and the early identification of the O and L and their mutual interaction are initially reflected in the book *American Investment in British Manufacturing Industry* (Dunning, 1958). This stream of research continued through the 1960's when Dunning was working on American firms in Europe.

Later during the 1970s, influenced by Buckley and Casson, Dunning started to address transaction cost explanations in an internationalization perspective (the I component of the paradigm) in addition to the previously identified O and L advantages. He was concerned about why firms decided to generate and exploit their specific advantages internally rather than through the open market forces. This broadened his perspective and articulated more

clearly the early view he had on the O and L components. And by the time he was putting together the rest of the paradigm at the end of the 1970's, he looked back to the 50's and 60's and the theories of Vernon, Hymer and others and interpreted them from within this framework and elaborated on how their ideas were expressed from the eclectic paradigm. Intellectually, he brought everything together, not just contemporary but also past theories, bringing all these explanations together in some sort of rubric that allows to connect them.

Since then, the eclectic paradigm's simplicity and yet its thoroughness smoothly integrates international business theories and allows researchers from different fields and disciplines to systematically explain the growth of multinational activity (Cantwell and Narula, 2001).

## 2. The Eclectic Paradigm Revisited

The eclectic paradigm itself is not an explanation of the MNC rather it helps explain the level, determinants and patterns of the foreign value added activities (international production) of firms, and or countries. The paradigm offers a framework from which an explanation can be obtained. It is not itself a predicting theory but it is a way of connecting different theories which can be then used to help understand different types of foreign production according to their specific contexts and motivations (Dunning, 2001).

The Eclectic Paradigm and its OLI components have gone through different revisions and are defined as follows:

O: Ownership advantages. These are firm net competitive advantages that companies from one country possess over those firms from other countries when servicing a specific market.

L: Location advantages. The degree to which companies decide to locate abroad value added activities. These value added activities can be the result of internalizing.

I: Internalization. The degree to which companies add value to their output by identifying as more profitable to internalize the generation and exploitation of their ownership advantages rather than through the open market.

(Dunning, 2000, 2001; Ietto-Gillies, 2012)

An interesting aspect of the OLI elements is that they are not independent from each other but that they interact. For example, the value added activities generated by locational advantages feed back to the O advantages. That is why an often misunderstood and controversial element is the O, because of the fact that it is called ownership, scholars like Rugman relate it only to firm specific advantages. However, the O also refers to advantages that come from the institutions of the country of origin (home country). In other words, what Dunning (2001) initially meant by (O) Ownership referred to the nationality of ownership as opposed to the ownership of assets by a firm. It was later on that Dunning acknowledged and expanded the Ownership advantages to include firm specific and other types of advantages such as the ones resulting from engaging in foreign production. Another reason why this is so important is because it does not

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necessarily imply that the MNE has to be legally defined by the ownership of assets, but if instead there is an international business network that is not entirely owned, it could still be consistent with the notion of capabilities generated within such a network associated with firms of a certain nationality of origin. On the other hand the L element has to do with host country advantages and it is just not necessary to compare the host with the home but different host countries with one another in determining where the firm goes to produce.

### 3. OLI: Combining and relating IB theories

The eclectic paradigm comes from other international business theories which are themselves influenced by economic and organizational theories. The paradigm draws from theories of the individual firm such transaction cost economics (internalization) and market power theories and their relationship with markets and integrates them with macroeconomic approaches to foreign production such as the product lifecycle theory (Cantwell and Narula, 2001). This encompassing aspect of the paradigm has brought many criticisms, one of the most popular ones calls it a “ *shopping list of variables* ”. Dunning (2001) responded to this criticism by clarifying that each variable of the paradigm is constructed based on well-known and accepted economic and organizational theories. In addition, he clarifies that the objective of the paradigm was not to explain all kinds of international production but to offer a framework that helps organize a methodology that can lead to a better explanation of different kinds of foreign production.

Vernon’s product lifecycle theory is the most inherently dynamic or evolutionary in character of all the theoretical approaches of the paradigm.

Hymer's market power and Buckley and Casson internalization theories were limited to the period in which they were writing about them, during which an evolutionary perspective of the MNE was not yet explored. On the other hand the product life cycle theory was contemporaneous to the conditions of the 1960's and therefore Dunning included this evolutionary character in the paradigm. This became an important part of the paradigm in the sense that it gave it an evolutionary and dynamic perspective on how firms grow over time, which is an integral part of the way the eclectic paradigm should be interpreted and used (Dunning, 2001).

In addition, from an evolutionary approach, the Eclectic Paradigm's internalization advantages are attributable to the conditions of improved organizational learning and technology creation, rather than to the conditions for a more efficient cost-minimizing organization of an established set of transactions. This opens up the possibilities of alliances in order to increase ownership advantages through cooperation. This takes the paradigm beyond a basic transactions costs perspective and expands the types of ownership advantages, from advantages in line with Bain -which assumes advantages to exist before going abroad- to cooperative and interdependent generated ones (Tolentino, 2001).

#### 4. The Future of the Eclectic Paradigm in IB

The eclectic paradigm has not only faced criticisms but also faces the challenges of an increasingly changing international business environment due to globalization and technological advances. In the last decades MNC activity has increased both in extent, intensity and form. There is also

increased global interconnectedness and interdependence which makes inter firm alliances more common and necessary (Cantwell and Narula, 2001). R&D is more complex and costly also increasing the way it is undertaken. Asset exploiting FDI is still present but asset augmenting and knowledge seeking FDI are increasingly important. All of this has created new ways of performing cross border activities and different strategies that MNCs use to pursue them.

Additionally, the field of IB has also evolved. It has moved from a market driven view to a more knowledge driven one. Moreover, the level of analysis has changed as well. In the 1990's there was a shift from the macro level approach in which countries were the unit of analysis to a more micro approach with the firm as the unit of analysis. Lately the field is going even more micro by also paying increasing attention to behavioral (individual) considerations and therefore allowing it to use the individual as the unit of analysis. Actually nowadays, the direction of the field International Business studies is becoming more multilevel in character, allowing for different levels of analysis including the countries, firms and individuals. The field has also become more interdisciplinary by drawing from other disciplines such as sociology, anthropology, biology, geography and history. Therefore taking in to account all these changes the following question arises:

*Is the eclectic paradigm going to hold with the external changes related to globalization, technological change and the new directions in the field of international business?*

I believe it will. So far the paradigm has held for the last two decades (since the 1980's) and it seems to be getting stronger as a guiding framework in international business studies. All its components are articulated in a way that allow all the aforementioned changes. For example the Ownership component has always been relational in character and has included different interactions and levels of analysis (Ietto-Gillies, 2012). Therefore this does not present a threat to the paradigm but it actually increases its relevance because it allows for multilevel analysis by combining the different units and elements of analysis and allowing them to interact. And even though there are not many discussions of the eclectic paradigm today, the paradigm is increasingly relevant now in relation to where the international business field is going.

Additionally, the paradigm has successfully embraced phenomena such as Alliance Capitalism, technological accumulation, international networks and dynamic capabilities, by which firms cooperate and mutually increase their ownership advantages. These are areas of research that according to the critics are not addressed by the paradigm. Moreover, the Location element of the paradigm increases in importance in the sense that subsidiary location has become important because they are embedded in their foreign locations and can benefit from their networks and national innovation systems and therefore adding value to the MNC.

On the other hand, dynamic capabilities are created not just within firms but by interacting or cooperating with other firms and actors (Knowledge enhancing technological dynamism) and they become part of the O advantages. These ownership advantages also come from the interaction



with locations with which initial 'O' advantages are crucial for the development of absorptive capacity. Dunning argues that capabilities or ownership advantages are a condition for internalizing. This is a dynamic view in which advantages are an evolutionary concept.

Critics say that some strategic considerations may not be covered by the OLI and that routines and processes should be added (OLMA). However, even though the paradigm does not specifically address routines and processes it addresses the ownership advantages that may result from them. Every day problem solving activities create unique core capabilities that are idiosyncratic of each firm, therefore giving them or enhancing existing 'O' advantages. This means that the OLI paradigm still holds for strategy considerations, especially in terms of capability development (in terms of O). Also in some way in 'L' with economies of location and experiences of location. Finally also with the interaction between O and L which creates a complex interaction at different levels and interactions. For example in the case of subsidiaries, competence creating subsidiaries actually enhance Ownership advantages therefore giving strength to the argument that O advantages are not only originated in the MNE's home country but also arise in subsidiaries as well.

Today we can apply this also to international business networks, so rather than a legal definition of the firm, the MNE per se, the OLI paradigm can be used as a method to analyze international business networks and also the MNE firm as a strategic coordinator of such networks. In other words the subject area moves on but the paradigm remains relevant, partly because of the degree of flexibility which is built in some of these characteristics,

especially in the Ownership advantages, which is by the way, the most important component of the paradigm, because it is the one that ties everything together, since it is the properties of learning that define the location or the transactional network basis of the firm.

## 5. Conclusions

The objective of the eclectic paradigm is not to explain the multinational firm but the level and pattern of foreign value added activities of firms. It helps explain not only the initial act of foreign production but also its growth. The eclectic paradigm overcomes the limitations of partial theories of international production and provides a holistic framework in which existing alternative and complementary theories of international production coexist (Tolentino, 2001).

In the international business field a systemic approach is now more needed than ever, in addition it must be inherently interdisciplinary. At the beginning the eclectic paradigm had a more descriptive approach. It was originally developed by integrating some international business theories that come mainly from economics. Theory of trade in Vernon's case, theory of the firm of the industry in Hymer's case and again theory of the firm in Buckley and Casson's case. Nowadays it is relevant to combine theories taken from different disciplines. Different ways to think about the world, new perspectives. That is why a systemic approach is needed. The eclectic paradigm is now it is an umbrella that handles a range of theories, a framework that enables the understanding of how these theories are tied and work together. Therefore what is happening is that the discipline is moving away from some of the earlier theories that were essentially theories

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of discrete individual choice, such as whether to export or not, or whether or not to locate production abroad, and in the case of having located production abroad, whether to license to an independent firm or produce internally with through a subsidiary. Those were firm level choice decisions, but if instead a system is wanted and the knowledge on how it evolves through time. Therefore the eclectic framework is precisely the right way to approach a complex system, because a paradigm like the eclectic paradigm provides a broader context, providing progressive interaction between different factors and actors giving it present and future relevance.

## 6. References

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