Determinants of Foreign Direct Investment and the Advantages Theory: A Literature Review and Future Research Agenda

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ABSTRACT

This study reviews three classic international business theories and some related empirical studies to identify the gaps in the literature and suggest future research directions. In international business studies, most analyses on the determinants of FDI are centered on three concepts of firm-specific, internalization, and location advantages according to the monopolistic advantage theory, internalization theory, and OLI paradigm. These three advantages determine whether a firm will internationalize, how it will enter foreign markets, where it will locate in the host country, and how it will perform in a foreign market. However, These theories are set up with the premise of firm-specific advantages and cannot be used to explain the phenomenon of emerging market multinational enterprises, which have emerged in large numbers in recent years. Simultaneously, these theories, which focus on manufacturing, need to be used to explain the internationalization of the service industry in-depth and with greater relevance.

KEYWORDS

Firm-Specific Advantage, Foreign Direct Investment, Internalization Theory, Multinational Corporation, OLI Paradigm

INTRODUCTION

After World War II, due to the rapid growth of multinational corporations (MNCs), the international business (IB) theory related to MNCs began to develop gradually. Core theories in the field of IB analyze the overseas activities of enterprises. The development of related theories can be traced back to Hymer’s doctoral dissertation titled, “The International Operations of National Firms: A Study of Direct Foreign Investment” in 1960, when he was at the Massachusetts Institute of Technology in the United States (US). He proposed the monopolistic advantage theory (MAT) in a dissertation published in 1976. Before the MAT, the international trade theory (ITT)—with the factor endowment theory as its core—was primarily employed to explain the behaviors of enterprises concerning foreign direct investments (FDIs). According to ITT, factor endowments determine the FDI behaviors of enterprises. Therefore, countries with capital shortages exhibit high-interest rates and vice versa, resulting in capital flows from countries with sufficient capital to those that lack it (MacDougall, 1960).
From 1914 to 1956, Hymer (1960) confirmed that US MNCs were generally concentrated in several industries that were insensitive to fluctuations in interest rates. Furthermore, most MNCs raised funds in the capital market of the host countries. This result revealed severe flaws in the perspective of capital arbitrage for explaining the FDI behaviors of MNCs and the need to establish new theories to better explain FDIs by burgeoning MNCs. As espoused in his doctoral dissertation, Hymer conducted an in-depth analysis of the factors behind the formation of MNCs based on his question “why do FDIs occur?”

Following Hymer (1960), Buckley & Casson (1976), Dunning (1977), and other scholars have also explained the internationalization behaviors of firms. Due to the background at the time, most theoretical studies and theories in the analytical framework were based on firms in developed countries, especially manufacturing firms, explaining their internationalization behavior in detail. However, since the 21st century, with the deepening of economic globalization, internationalization behaviors are no longer limited to firms in developed regions, as many firms in emerging markets have also started their internationalization. In addition, the booming internationalization of the service industry has become a hot topic in recent years. It seems that part of these changes cannot be explained by the existing IB theory.

This study thus used the pioneering results of Hymer (1960) as the starting point to review and clarify the MAT, internalization theory, and OLI paradigm by reviewing the literature on the relationships between the motivation of firm internationalization and three types of advantages: firm-specific advantages, internalization-incentive advantages, and location-specific advantages. This study also reviews the empirical literature and related studies in seven major IB journals from 1972 to 2022 and identifies new themes from the latest studies that can provide scope for future research (Journal of International Business Studies, International Business Review, Journal of World Business, Review of World Economics, International Marketing Review, Journal of International Management, and Management International Review). In addition, several other representative studies are cited in this paper. This study thus provides a comprehensive understanding of IB research to date and, to some extent, predicts the direction of future research. Furthermore, it provides practical insights on the internationalization of enterprises.

LITERATURE REVIEW

Monopolistic Advantage Theory by Hymer (1960)

Hymer has proposed that the formation of MNCs—the primary motivation for conducting FDIs—is to “control” local business activities for two reasons. The first is the removal of conflict. When enterprises from various countries compete in an imperfect market, foreign ownership of and control over local business activities eliminates cross-border competition and forms an international oligopoly, monopolizing the profits generated by foreign businesses. The second relates to comparative advantages. Enterprises generally encounter three disadvantageous situations during their overseas development: (i) MNCs face additional costs to obtain information that they are unfamiliar with, for instance, regarding the local economy, legislations, and business practices; (ii) they are accorded differential treatment; and (iii) exchange rate risks. Hence, MNCs must benefit from specific advantages to overcome these unfavorable conditions when competing with local enterprises.

Hymer proposes four advantages based on the findings of Bain (1956): (i) the ability to obtain factors of production at low costs, (ii) knowledge of achieving efficient production, (iii) excellent distribution capabilities, and (iv) the ability to differentiate themselves from competitors. Enterprises with these advantages may enjoy the exclusive benefits of launching overseas business activities. Numerous scholars have adopted Hymer’s proposed advantages, proposing theories on MNCs. These were termed monopolistic advantages by Hymer’s tutor, Kindleberger (1969), firm-specific advantages...
(FSAs) by Buckley & Casson (1976), ownership-specific advantages by Dunning (1977), and firm-specific assets by Rugman (1980). This study collectively refers to these various terms as FSAs.

Hymer’s insights have served as the basis for new theoretical paradigms of MNCs, with FSAs used as the core concept in subsequent studies on MNCs. Table 1 summarizes the representative studies (Horst, 1972; Blomstrom & Lipsy, 1986; Lall, 1986; Grubaugh, 1987; Horaguchi, 1992; Kotha et al., 2001; Trevino & Grosse, 2002; Tseng et al., 2007; Raff & Ryan, 2008; Lee & Rugman, 2012; Kirca et al., 2016; Tashman et al., 2019). The MAT that FSAs, which could be firm size, research and development (R&D) intensity, or advertising intensity, among others, promote firms to internationalize or help them improve their performance overseas and are well supported by these empirical studies.

MAT, as the first theory to explain the internationalization behaviors of firms, has not only made a significant contribution to the development of IB theory, but also provides important insights into the practice and application of internationalization. For example, if a firm is deciding whether to internationalize, it needs to determine whether it has FSAs and whether these can overcome the various disadvantages in overseas markets. If a company does not have sufficient FSAs, it needs to carefully consider whether it should start an international business. At this time, it is more important for enterprises to consider how to build advantages, such as developing differentiated products by

Table 1. FSAs and the internationalization of enterprises

<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Year</th>
<th>Research subject</th>
<th>Research method</th>
<th>Major discovery on FSAs as a factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Horst</td>
<td>1972</td>
<td>US manufacturing MNCs</td>
<td>OLS regression</td>
<td>The larger the enterprise size, the stronger its propensity for FDIs. However, advertising, R&amp;D intensities, and interest rates do not impact FDIs.</td>
</tr>
<tr>
<td>Blomstrom &amp; Lipsy</td>
<td>1986</td>
<td>US and Swedish MNCs</td>
<td>OLS regression</td>
<td>Domestic sales and total assets promote FDIs. The capital-labor ratio, advertising, and R&amp;D intensities have no impact on FDIs.</td>
</tr>
<tr>
<td>Lal</td>
<td>1986</td>
<td>Indian MNCs</td>
<td>Probit regression</td>
<td>FDIs are promoted by gross sales, the capital-output ratio, and import dependency ratio for raw materials but are inversely correlated with the export ratio. Advertising and R&amp;D expenses have no impact on FDIs.</td>
</tr>
<tr>
<td>Grubaugh</td>
<td>1987</td>
<td>US manufacturing MNCs</td>
<td>Logit regression</td>
<td>Total assets, R&amp;D intensity, and product differentiation promote FDIs. Advertising and labor intensities have no impact on FDIs.</td>
</tr>
<tr>
<td>Horaguchi</td>
<td>1992</td>
<td>Japanese manufacturing MNCs</td>
<td>OLS &amp; GLS regressions</td>
<td>FDIs are promoted by enterprise size, equity capital ratio, R&amp;D intensity, and the number of directors. Advertising intensity and employees’ length of service have no impact on FDIs.</td>
</tr>
<tr>
<td>Kotha et al.</td>
<td>2001</td>
<td>US internet MNCs</td>
<td>Regression</td>
<td>FDIs are promoted by enterprise reputation and website traffic, but R&amp;D intensity has no impact on FDIs.</td>
</tr>
<tr>
<td>Trevino &amp; Grosse</td>
<td>2002</td>
<td>MNCs with manufacturing activities in the US</td>
<td>Regression</td>
<td>The propensity for FDIs increase when an enterprise has strong R&amp;D intensities, managers with international experience, and profitability.</td>
</tr>
<tr>
<td>Tseng et al.</td>
<td>2007</td>
<td>US manufacturing MNCs</td>
<td>OLS regression</td>
<td>R&amp;D, marketing intensities, and enterprise size have persistent effects on FDIs, whereas enterprise age only affects FDIs in the initial stage.</td>
</tr>
<tr>
<td>Raff &amp; Ryan</td>
<td>2008</td>
<td>Japanese manufacturing MNCs</td>
<td>Cox regression</td>
<td>Total factor productivity significantly promotes FDIs at the initial and later stages. Enterprise size has no significant impact on FDIs in the initial stage but promotes it in later stages. R&amp;D intensity and export ratio have the opposite effect: these promote FDIs initially but have no significant impact in later stages.</td>
</tr>
<tr>
<td>Lee &amp; Rugman</td>
<td>2012</td>
<td>Korean MNCs</td>
<td>FGLS regression</td>
<td>R&amp;D intensity and marketing capabilities affect MNCs’ performance in a non-linear and U-shaped manner. In addition, there is a curvilinear and U-shaped relationship between the two constructs due to the impacts of the home region and origin of inward FDIs.</td>
</tr>
<tr>
<td>Kirca et al.</td>
<td>2016</td>
<td>Indian MNCs</td>
<td>GEE regression</td>
<td>The performance of manufacturing MNCs depends on their technical assets. Service MNCs’ success in international markets depends more on their marketing assets.</td>
</tr>
<tr>
<td>Tashman et al.</td>
<td>2019</td>
<td>US top movie studios</td>
<td>Dynamic panel regression</td>
<td>Blockbuster production intensities promote the internationalization of movie studios and their performance.</td>
</tr>
</tbody>
</table>

* Source(s): Compiled by the authors.
strengthening investment in R&D or strengthening investment in advertising to improve their brand awareness. These have important practical significance for enterprise internationalization.

**Internalization Theory by Buckley & Casson (1976)**

The concept of internalization has very early origins that can be traced back to the article, “The Nature of the Firm,” published by Nobel Prize winner Coase (1937). Transactional costs have been used to explain why enterprises exist. Coase argues that various costs arise during transactions in the external markets, including exploratory costs of identifying and investigating competitors and costs of negotiating transactions and supervising the execution and fulfillment of contracts. However, these costs can be saved if transactions in the external markets are transformed into enterprises’ internal transactions. In other words, enterprises are formed when the transactional market costs are higher than the internal management and coordination costs. Enterprises exist to save on transactional market costs by substituting costlier market transactions with less-costly intra-company transactions.

The internalization theory was developed based on the core concepts proposed by Hymer (1960), who suggested that in the face of structural market failures, it was more profitable for enterprises to undergo internalization and tap their monopolistic advantages rather than engaging in market transactions. This result implies that the internalization of enterprises is a substitution for the market. Many scholars after Hymer have contributed to the internalization theory of MNCs. They include McManus (1972), Swedenborg (1979), Rugman (1981) of the “Reading school” (because he was a scholar from the University of Reading in the UK), Hennart (1982), and Buckley & Casson (1976), who have published the landmark book, *Future of the multinational enterprise*.

The starting point of Buckley & Casson’s (1976) internalization theory is that MNCs result from imperfections of the external markets. Market imperfections in the internalization theory do not refer to economies of scale, oligopoly, or tariff barriers. However, they relate to increases in enterprises’ transactional costs in the market due to the failure of specific markets, the unique nature of specific products, or monopolistic powers. This theory relies on three basic assumptions: (i) when operating in an imperfect market, enterprises pursue profit maximization; (ii) when the market for production factors (especially intermediate products) is imperfect, an enterprise can unify its management of business activities and replace the external market with an internal market; and (iii) MNCs are formed when internalization crosses national boundaries. In other words, this theory holds that profit maximization cannot be guaranteed if an enterprise’s intermediate products—such as semi-finished products, process technologies, marketing expertise, management experience, and personnel training—are traded through external markets, which are inherently imperfect.

To resolve suboptimal allocation efficiencies of internal resources and contradictions in the external markets, an enterprise must use FDIs to expand the scope of its production and management entities and form its own integrated space and internal exchange system. By doing so, a firm may transform open transactions in the external markets into internal market transactions. Internalized transactions minimize transaction costs for buyers and sellers, increasing their understanding of product quality and pricing. Information, knowledge, and technology are fully utilized, reducing trading risks and maximizing profits. In other words, the purpose of establishing overseas subsidiaries is to create an internal market between the parent company and its subsidiaries to facilitate the trading of intermediate products.

Hymer (1960), Kindleberger (1969), and Caves (1971, 1982) have focused their theories on imperfections in the market for the final products. In contrast, the “Reading school” theory regards internalization of the markets for intermediate products as the core element for explaining FDIs and the existence of MNCs. Intermediate products are knowledge-based and include technologies, production expertise, branding, and other intangible assets. Hence, MNCs exist because of their efficiency rather than the monopolistic advantages emphasized by Hymer (1960), especially their ability to reduce transactional costs in cross-border transfers of intermediate goods. Rugman (1980, 1981) refers to internalization theory as the general theory of MNCs. He further emphasizes that MNCs should enter
overseas markets as sole proprietorships because this form of complete internalization can better maintain and protect their specific advantages.

However, in addition to the fully internalized form of sole proprietorship, there is also non-fully internalized joint venture as an entry mode for MNCs in overseas markets. Dunning (1977) has argued that the degree of internalization depends on an enterprise’s specific advantages: the more significant its specific advantages, the greater its motivation for internalization (MI). Anderson & Gatignon (1986) have proposed several methods for enterprises to enter overseas markets: sole proprietorship and majority, equal, or minority stakes. The most suitable entry method for an enterprise depends on its asset specificity. A sole proprietorship is required when the asset specificity is relatively high, but the inherent risk is not warranted with a low–medium asset specificity level.

For many empirical studies, FSAs represent the central theme when choosing between a sole proprietorship or a joint venture (with or without a complete internal market, respectively). Some representative studies are reported in Table 2 (Gatignon & Anderson, 1988; Hennart, 1991; Erramilli & Rao, 1993; Hasegawa, 1998; Makino & Neupert, 2000; Brouthers, 2002; Brouthers & Brouthers, 2003; Chiao et al., 2010; Wooster et al., 2016). Most findings in Table 2 support Dunning’s (1977) and Anderson & Gatignon’s (1986) assertions of internalization advantage, that is, the stronger a firm’s motivation to internalize when one of its FSAs is strong, the more inclined it is to use wholly-owned subsidiaries to enter foreign markets.

### Table 2. FSAs, MI, and forms of overseas subsidiaries

<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Year</th>
<th>Research subject</th>
<th>Research method</th>
<th>Major discovery on MI as a factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gatignon &amp; Anderson</td>
<td>1988</td>
<td>US manufacturing MNCs</td>
<td>Logistic regression</td>
<td>The higher the R&amp;D, advertising intensities, and international experience of MNCs, the stronger their propensity to set up wholly-owned subsidiaries.</td>
</tr>
<tr>
<td>Hennart</td>
<td>1991</td>
<td>Manufacturing subsidiaries of Japanese MNCs in the US</td>
<td>Logistic regression</td>
<td>The greater the MNCs’ experience with operating in the host country, the stronger their propensity to set up wholly-owned subsidiaries. R&amp;D and advertising intensities do not impact their methods of entering overseas markets.</td>
</tr>
<tr>
<td>Erramilli &amp; Rao</td>
<td>1993</td>
<td>US service MNCs</td>
<td>Logistic regression</td>
<td>The larger the MNCs’ scale and the higher their level of asset specificity, the stronger their propensity to choose the sole proprietorship entry mode.</td>
</tr>
<tr>
<td>Hasegawa</td>
<td>1998</td>
<td>Japanese MNCs</td>
<td>Logistic regression</td>
<td>The higher the MNCs’ R&amp;D intensity, the stronger their propensity to set up subsidiaries through joint ventures instead of wholly-owned subsidiaries.</td>
</tr>
<tr>
<td>Makino &amp; Neupert</td>
<td>2000</td>
<td>Manufacturing subsidiaries of US MNCs in Japan</td>
<td>Logistic regression</td>
<td>MNCs with high R&amp;D intensities tend to choose the form of wholly-owned subsidiaries instead of joint ventures.</td>
</tr>
<tr>
<td>Brouthers</td>
<td>2002</td>
<td>European MNCs</td>
<td>Logistic regression</td>
<td>Enterprise size, R&amp;D intensity, and experience with overseas expansion do not impact how MNCs’ subsidiaries enter the market.</td>
</tr>
<tr>
<td>Brouthers &amp; Brouthers</td>
<td>2003</td>
<td>Western European MNCs operating in Central and Eastern Europe</td>
<td>Logistic regression</td>
<td>For the service industry, the greater the asset specificity, enterprise size, and local operating experience, the stronger the propensity to set up wholly-owned subsidiaries. For the manufacturing industry, asset specificity, and enterprise size do not impact the subsidiaries’ market entry method. However, the greater the local operating experience, the stronger the propensity to set up wholly-owned subsidiaries.</td>
</tr>
<tr>
<td>Chiao et al.</td>
<td>2010</td>
<td>Taiwanese manufacturing MNCs in China</td>
<td>Logistic regression</td>
<td>The greater the MNCs’ asset specificity, R&amp;D capability, and international experience, the stronger their propensity to choose sole proprietorships as the market entry method.</td>
</tr>
<tr>
<td>Wooster et al.</td>
<td>2016</td>
<td>Subsidiaries of US MNCs in Latin America</td>
<td>Probit regression</td>
<td>The greater the MNCs’ advertising intensity, the stronger their propensity to set up sole proprietorships. The larger the MNCs’ scale, the stronger their tendency to enter joint ventures instead. The results also show that R&amp;D intensity does not impact the subsidiaries’ market entry method.</td>
</tr>
</tbody>
</table>

* Source(s): Compiled by the authors.
If MAT provides practical application and reference for companies to determine whether they fulfil the conditions for internationalization, then internalization theory and related studies provide insights into the mode of setting up overseas subsidiaries. When MNCs have sufficient FSAs, it seems more reasonable to enter a market in a fully internalized way (i.e., in the form of sole proprietorship) to protect and monopolize this advantage to the fullest extent and reap its benefits. Conversely, if the FSAs owned by MNCs are not sufficient, these firms need to cooperate with local enterprises to strengthen their FSAs and it is a better choice to enter the market in a non-internalized way (i.e., through a joint venture).

**OLI Paradigm by Dunning (1977)**

Following internalization theory, Dunning (1977, 1988, 1993), the representative author of the “Reading school,” has stated that many theories on MNCs proposed before the 1970s are too unidimensional in explaining the behaviors of MNCs and lack comprehensiveness and universality. Hence, he integrates the best of various economic and FDI theories and proposes the famous eclectic or ownership–location–internalization (OLI) paradigm. This paradigm provides a unified framework to research MNCs and explain their behaviors.

The OLI paradigm by Dunning (1977, 1988, 1993) proposes that for an enterprise to become internationalized, it must concurrently possess the following advantages: (i) ownership-specific advantages (O-advantages), (ii) location-specific advantages (L-advantages), and (iii) internalization-incentive advantages (I-advantages). The original text reads as follows.

The paradigm asserts that, at any given moment of time, this will be determined by the configuration of three sets of forces:

1. The (net) competitive advantages, which firms of one nationality possess over those of another in supplying any particular market or set of markets. These advantages may arise either from the firm’s privileged ownership of, or access to, a set of income-generating assets, or from their ability to co-ordinate these assets with other assets across national boundaries in a way that benefits them relative to their competitors, or potential competitors.
2. The extent to which firms perceive it to be in their best interests to internalize the markets for the generation and/or the use of these assets; and by so doing add value to them.
3. The extent to which firms choose to locate these value-adding activities outside their national boundaries.

O-advantages incorporate the concept of FSAs proposed by Hymer, namely, the unique advantages of an enterprise, including those based on asset and transactional ownership. Benefits from asset ownership refer to tangible assets (production equipment, production plants, funds, energy, and raw materials) and intangible assets (patents, proprietary technologies, trademarks, goodwill, capabilities at technological development and innovation, management, and marketing techniques). Advantages from transactional ownership are obtained when a firm operates transnationally on a global scale, deploys various resources rationally, and avoids multiple risks, comprehensively reducing its transactional costs. Dunning (1981) argues that an enterprise must exhibit the O-advantages mentioned above before conducting FDIs. However, these advantages do not necessarily translate into FDIs. In other words, O-advantages are necessary but not sufficient conditions for driving an enterprise’s FDI behaviors. When an enterprise exhibits O-advantages but no I- and L-advantages, feasible ways to realize its advantages include domestic production, export sales, or licensing.

The proposition of internalization by Buckley & Casson (1976) is incorporated in I-advantages, which refer to the abilities of an enterprise possessing specific ownership advantages to retain those advantages internally, preventing the imperfect external market from affecting its interests. Cost savings
are more significant for internal than external market transactions, especially for technological and knowledge products whose values are difficult to determine. Furthermore, internalization gathers all aspects of transaction activities under the enterprise’s unified management, stabilizing production, sales, and resource allocation. Consequently, all the firms’ specific advantages can be fully exploited. However, like O-advantages, I-advantages are necessary but not sufficient conditions for conducting FDIs. An enterprise with both O- and I-advantages need not necessarily choose to conduct FDIs because it can expand its scale of domestic production for export purposes (Dunning 1981).

Dunning proposes L-advantages based on the theory of industrial location. This concept refers to the favorability of a specific foreign market to an enterprise’s production and operation in terms of its market environment compared with the home country. In other words, the investment environment factors of the host country may provide it with advantages, which include foreign investment policies, economic development level, market size, infrastructure, resource endowment, labor force, and costs. A foreign market with such a favorable environment is desirable to the enterprise for its multinational operations.

In summary, the combination of the three advantages explains whether MNCs exhibit advantages for FDIs and enables them to choose their method of international marketing (Table 3). Specifically, an enterprise with only O-advantages will choose technology authorization. If a firm exhibits both O- and I-advantages, it will choose export; only when it exhibits all three advantages will the firm choose FDIs. Thus, L-advantages play a crucial role in whether enterprises conduct FDIs.

Dunning (1998) further proposes that MNCs look for L-advantages that complement their O-advantages. Their global competitive advantages may be strengthened through interactions between local learning and overseas participants (i.e., two-way spillover and knowledge flow). Research on the host country’s L-advantages has gradually expanded after the OLI paradigm was introduced. Table 4 summarizes some representative studies (Davidson, 1980; Culem, 1988; Loree & Guisinger, 1995; Chen, 1997; Billington, 1999; Cheng & Kwan, 2000; Noorbakhsh et al., 2001; Na & Lightfoot, 2006; Du et al., 2008; Kolstad & Villanger, 2008; Ramasamy et al., 2012; Jindra et al., 2016; Belkhodja et al., 2017; Economou et al., 2017; Kumari & Sharma, 2017; Kurtović et al., 2020). The results of these empirical studies invariably support the role of L-advantages in the OLI paradigm, that is, companies entering overseas markets are influenced by a certain type of local L-advantages, and the stronger the L-advantages of a region are, the more likely it is to attract foreign investment.

The OLI paradigm, as a comprehensive analysis framework for MNCs’ actions, has practical significance in the application management of enterprises, in addition to being the inspiration for MAT and internalization theory, which is reflected in the overseas site selection of enterprises. After deciding to enter overseas markets, enterprises need to analyze whether the various elements of the host country’s investment environment are in line with their interests, in addition to focusing on their own FSAs. For example, if a company needs to obtain lower production costs overseas, it needs to focus on cheap labor availability in the region; however, if the goal is to obtain a new market, it needs focus on the economic scale of the region. Generally, companies can gain more benefits by taking advantage of the host country’s location factors.

<table>
<thead>
<tr>
<th>Route of servicing market</th>
<th>O-advantages</th>
<th>I-advantages</th>
<th>L-advantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDIs</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Trade in goods and services</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Contractual resource transfers</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

* Source(s): Dunning (1988)
<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Year</th>
<th>Research subject</th>
<th>Research method</th>
<th>Major discovery on L-advantages as a factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Davidson</td>
<td>1980</td>
<td>US manufacturing MNCs</td>
<td>Multivariate testing</td>
<td>Previous experience in the host country increases the MNCs’ FDIs in that country. In addition, enterprises with no international experience are more likely to choose similar neighboring markets.</td>
</tr>
<tr>
<td>Culem</td>
<td>1988</td>
<td>Two-way FDIs between six industrialized countries</td>
<td>OLS and GLS regressions</td>
<td>Market size, growth rate, labor cost, and trade flows significantly impact FDIs.</td>
</tr>
<tr>
<td>Loree &amp; Guisinger</td>
<td>1995</td>
<td>US MNCs</td>
<td>Regression</td>
<td>Political stability and good infrastructure have positive impacts on MNCs’ locational choices.</td>
</tr>
<tr>
<td>Chen</td>
<td>1997</td>
<td>FDIs in 29 regions of China</td>
<td>Panel data regression</td>
<td>GDP, per capita GDP, FDI accumulation, traffic density, and regional policies positively impact locational choice for FDIs. Wage costs have a negative effect on FDIs.</td>
</tr>
<tr>
<td>Billington</td>
<td>1999</td>
<td>FDIs in seven industrialized countries and 11 UK territories</td>
<td>Regression</td>
<td>At the country level, the analysis shows that market size, unemployment rate, import level, corporate tax, and interest rate of the host country are essential factors in determining location. At the regional level, the crucial elements are population density, unit labor cost, and unemployment rate.</td>
</tr>
<tr>
<td>Cheng &amp; Kwan</td>
<td>2000</td>
<td>FDIs in 29 regions of China</td>
<td>GMM estimation</td>
<td>Huge market size, good infrastructure, and preferential policies positively impact FDIs, whereas wage costs have a negative effect.</td>
</tr>
<tr>
<td>Noorbakhsh et al.</td>
<td>2001</td>
<td>FDIs in 36 developing countries in Africa, Asia, and Latin America</td>
<td>Panel data regression</td>
<td>Factors such as previous FDIs, GDP growth rate, and human capital positively impact FDI inflows. The importance of human capital increases over time.</td>
</tr>
<tr>
<td>Na &amp; Lightfoot</td>
<td>2006</td>
<td>FDIs in 30 regions of China</td>
<td>OLS regression</td>
<td>GDP and labor quality positively impact FDI inflows. The proportion of state-owned enterprises in the region harms FDIs.</td>
</tr>
<tr>
<td>Du et al.</td>
<td>2008</td>
<td>US MNCs</td>
<td>Conditional logistic regression</td>
<td>Protection of intellectual property, industrial agglomeration, infrastructure, and education positively impact MNCs’ location choices. Government intervention and labor costs have adverse effects.</td>
</tr>
<tr>
<td>Kolstad &amp; Villanger</td>
<td>2008</td>
<td>FDIs in 57 countries around the world</td>
<td>Panel data regression</td>
<td>Per capita GDP, FDIs in manufacturing, and the levels of democracy and institutionalization have crucial impacts on FDIs in the service industry.</td>
</tr>
<tr>
<td>Ramasamy et al.</td>
<td>2012</td>
<td>Chinese MNCs</td>
<td>Poisson model and negative binomial models</td>
<td>Natural resources and the political environment affect locational choice by state-owned enterprises. Private enterprises are more concerned about market size.</td>
</tr>
<tr>
<td>Jindra et al.</td>
<td>2016</td>
<td>Emerging market multinational enterprises (EMNEs) in the European Union</td>
<td>CLM regression</td>
<td>EMNEs’ locational choice is positively affected by the economies of agglomeration and knowledge externalities.</td>
</tr>
<tr>
<td>Kumari &amp; Sharma</td>
<td>2017</td>
<td>FDIs in 20 developing countries in South, East, and Southeast Asia</td>
<td>Fixed effect estimation</td>
<td>Market size, trade openness, interest rate, and human capital positively impact FDI inflows.</td>
</tr>
<tr>
<td>Economou et al.</td>
<td>2017</td>
<td>FDIs in 24 OECD countries and 22 non-OECD countries</td>
<td>Fixed effect and dynamic panel estimations</td>
<td>Previous FDIs and market size have significant and positive impacts on the FDI inflows to OECD and non-OECD countries. Additionally, FDI inflows to OECD countries are affected by the share of gross capital formation. FDI inflows to non-OECD countries are affected by factors such as political stability and labor costs.</td>
</tr>
<tr>
<td>Belkhodja et al.</td>
<td>2017</td>
<td>Foreign-invested manufacturing enterprises in China</td>
<td>Logistic regression</td>
<td>Educational level, infrastructure, and intellectual property protection positively impact the locational choice for FDIs.</td>
</tr>
<tr>
<td>Kurtović et al.</td>
<td>2020</td>
<td>FDIs in six countries in the Western Balkans</td>
<td>GMM regression</td>
<td>Factors such as per capita GDP, GDP growth rate, urbanization rate, and the agglomeration and system of the service industry positively impact the locational choice for FDIs.</td>
</tr>
</tbody>
</table>

* Source(s): Compiled by the authors.
FUTURE DIRECTIONS

After reviewing classic IB theories, we propose that future research should focus on two aspects. The first is the rise in EMNEs. Classic IB theories on MNCs address enterprises in the world’s most developed regions. These enterprises typically own intangible assets (such as brands and technologies), allowing them to outperform competitors worldwide. The reviewed empirical studies on MAT and internalization theory also reveal that most of the literature has used multinational firms in developed countries as the subject of study. The increasing number of EMNEs has triggered widespread concern in academic circles in recent years. According to statistics from UNCTAD (2015), nine out of the 20 largest outward FDI countries are from emerging markets. Given this phenomenon, some scholars have stated the need to re-examine and re-evaluate the existing theories on MNCs (Meyer & Thaijongrak, 2013; Bruhn et al., 2016; Paul & Feliciano-Cestero, 2021), as classic theories cannot fully explain the emergence of EMNEs. For example, classic theories hold that FSAs are a prerequisite for the internationalization of enterprises. Hence, enterprises without FSAs may not out-compete local enterprises in foreign markets. However, many EMNEs do not exhibit FSAs in the traditional sense (Cuervo-Cazurra, 2012; Luo & Tung, 2018). These enterprises’ foreign investments are not limited to economic systems with a similar or lower level of development but also enter advanced economies. This process of “reverse foreign investments” has led to the classic theories of MNCs being questioned. A few questions arise: Do enterprises need FSAs for internationalization? Why may EMNEs internationalize despite not possessing FSAs? Hernandez & Guillén (2018) argue that although research findings on EMNEs differ from those in developed countries, scholars who have uncovered these differences do not imply that the classic theories should be abandoned. The framework of these studies remains based on traditional theories for hypotheses testing and validation. A universal theoretical and analytical framework is needed to explain the internationalization of EMNEs.

This study argues that it is essential for companies in both developed and emerging markets to have FSAs when competing in unfamiliar overseas markets. While firms in developed regions already have developed FSAs before entering foreign markets, firms in emerging markets are likely to build them after entering foreign markets by absorbing and learning local knowledge, intelligence, and technology. Therefore, rather than discussing whether emerging EMNEs need FSAs, future research could focus on how EMNEs can quickly and effectively build FSAs after entering foreign markets. Current research on this issue is in its infancy and still lacking.

The second aspect is the main reason(s) for the internationalization of the service industry. Hymer’s MAT and Dunning’s OLI paradigms have emerged in the era of unprecedented growth of manufacturing MNCs from the 1950s to 1980s. One question naturally arises: Are these theories that adopt manufacturing MNCs as the primary research subject suitable for explaining the behaviors of service MNCs? Some IB researchers hold a favorable position on this question (Weinstein, 1977; Boddewyn et al., 1986; Terpstra & Yu, 1988; Agaewal & Ramaswami, 1992). They contend that classic theories on MNCs in the manufacturing industry may be extended to analyze the behaviors of MNCs in the service industry. In his book, Multinational enterprises, and the growth of services: Some conceptual and theoretical issues, Dunning (1989) reiterates that the basic framework of the OLI paradigm is fully applicable to explaining MNCs in the service industry.

In contrast, some researchers who address the behaviors of service MNCs are doubtful and argue for the need to revise existing theories on MNCs (Enderwick, 1989; Erramilli, 1990, 1991; Erramilli & Rao, 1990, 1993). For example, Enderwick (1989) believes that many sectors in the service industry involve low technical complexities, making it difficult to specify the FSAs of the related enterprises. Furthermore, many non-equity arrangements (e.g., licensing, management contracts, and franchising) are based on market exchanges and have implications for the internalization theory.

Unlike the manufacturing industry, the service industry has the following characteristics: (i) intangibility (services are invisible behaviors that cannot be seen or touched until they have been purchased), (ii) inseparability (the production and consumption of services co-occur), (iii) heterogeneity
(the quality of the service provided varies with the service provider), and (iv) perishability (the service ceases to exist once it has been provided and cannot be stored) (Zeithaml et al., 1985; Edgett & Parkinson, 1993; Lovelock & Gummesson, 2004; Moeller, 2010). However, the impact of these characteristics on the internationalization of enterprises in the service industry remains unclear.

Finally, this study argues that the study of internationalization in the service industry needs to be broken down by industry. There are service sector industries that are less technically complex in terms of knowledge, such as hotels, restaurants, and retail, whereas others are more technically complex, such as consulting, software development, and scientific research. The differences in technical and knowledge complexity lead to different internationalization behaviors (e.g., whether equity or non-equity arrangements should be used or what FSAs are required). The existing theoretical framework requires supplementation and revision through additional research on service MNCs to answer this question.

CONCLUSION

Theories on MNCs have been developed for more than 60 years since Hymer proposed his MAT. This study analyzed the impacts of FSAs and I- and L-advantages on MNCs’ behaviors by reviewing the classic IB literature, including MAT, internalization theory, and OLI paradigm, and some related empirical studies. Hymer’s MAT holds that FSAs are necessary and sufficient conditions for the existence of MNCs. These specific advantages are derived from superior production technologies, imperfect input markets, and first-mover advantages. Due to such benefits, enterprises may overcome the liability of foreignness and out-compete local enterprises in the host country, gaining profits in transnational operations.

Buckley and Casson’s internalization theory analyzes enterprises’ motivation for internationalization from the perspective of transactional costs. Under imperfect markets, MNCs tend to set up overseas subsidiaries and make internal transfers of intermediate products (especially knowledge products). Overall profits are maximized by substituting the external market with an internal market. The stronger an enterprise’s FSAs, the greater its tendency to build internal markets for exploiting and maintaining these advantages, and the greater its incentive for internalization. Following internalization theory, Dunning extracted the best from various then-prevailing IB theories and proposed the OLI paradigm. He contends that if an enterprise exhibits the two necessary conditions of FSAs and I-advantages and displays L-advantages in a particular host country, it has the necessary and sufficient conditions for conducting FDIs.

The above-mentioned theories have contributed significantly to explaining the internationalization behaviors of enterprises and have become the classic theories for analyzing MNCs. However, these theories are premised on FSAs, which cannot fully explain the emergence of EMNEs. Furthermore, these theories have emerged during the wave of internationalization of enterprises in the manufacturing industry. Therefore, an additional in-depth analysis of the internationalization of enterprises in the service industry seems necessary.

CONFLICT OF INTEREST

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