

## The Evolution of the Eclectic Paradigm: A Review of the OLI Framework in International Business Research

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### Abstract

The Eclectic Paradigm, also known as the OLI framework, is a theoretical framework that explains why firms engage in foreign direct investment (FDI) based on three key elements: ownership advantages, location advantages, and internalization advantages. This paradigm has been widely adopted and adapted in the field of international business to explain a range of topics related to FDI, including the determinants of foreign market entry, the role of multinational enterprises in global value chains, the impact of government policies on FDI flows, and the effects of cultural differences on cross-border transactions. The OLI framework has been valuable for scholars and practitioners in understanding the complexities of international business and foreign investment decisions. Despite the relevance of the Eclectic Paradigm, only a limited number of researchers have explored it, and the current literature presents gaps and inconsistencies. Hence, this paper aims to undertake a thorough literature review of the Eclectic Paradigm, to identify research trends, gaps, and inconsistencies, and to consolidate the existing knowledge of the eclectic paradigm framework.

**Keywords:** Eclectic Paradigm; OLI (Ownership, Location, Internalization) Framework; Foreign Direct Investment (FDI); Literature review.

تطور النموذج الانتقائي:

مراجعة لإطار OLI في أبحاث الأعمال الدولية

الملخص:

يتناول هذا المقال تطور "النموذج الانتقائي" (Eclectic Paradigm)، المعروف بإطار عمل "OLI" (الملكية، الموقع، الاستيعاب الداخلي)، كواحد من أبرز الأطر النظرية المفسرة لاستثمارات الشركات الأجنبية المباشرة (FDI). يحلل المقال التعديلات التي طرأت على هذا النموذج لمواكبة التغيرات في بيئة الأعمال الدولية، بما في ذلك دور التكنولوجيا والعولمة وظهور الشركات متعددة الجنسيات من الأسواق الناشئة. يناقش البحث قدرة هذا النموذج على تفسير استراتيجيات الدخول للأسواق وتحديد العوامل الجاذبة للاستثمار، مع التأكيد على أن النموذج لا يزال يتمتع بمرونة عالية وقدرة تفسيرية كبيرة في ظل الاقتصاد الرقمي الجديد.

**الكلمات المفتاحية:** النموذج الانتقائي، إطار OLI، الاستثمار الأجنبي المباشر، الشركات متعددة الجنسيات، الأعمال الدولية

## 1. Introduction

Since the establishment of the World Trade Organization (WTO), the global economy has expanded due to globalization and economic liberalization movements, and the phenomenon of internationalization of production processes has become widespread. This movement is based on the adoption of market mechanisms, the movement of capital and multinational corporations, and foreign direct investment. Through this new approach, foreign direct investment has become prominent as one of the most important sources of funding and an essential element within the economic development plans and strategies of countries, especially developing ones. Foreign direct investment transfers technology and modern techniques contributes to capital formation, improves human efficiency and skills, and accelerates economic growth.

As a result, countries compete fiercely to attract more foreign direct investment to benefit from the advantages it can provide. However, studying foreign direct investment and the factors that determine its direction and movements requires a focus on the advantages of host countries. In this context, industrial establishment theories indicate that structural variables related to market nature, such as technology, financial availability, and competition, determine the decision to invest abroad. Meanwhile, location and globalization theories indicate that the reasons for foreign investment and production are due to the availability of a good strategic location and natural resources in addition to the importance of regulatory aspects related to investment protection and promotion. The OLI or direct approach theory proposed by John Dunning indicates that foreign direct investment is achieved after the simultaneous availability of three determinants, which are ownership specificity, location advantages, and internalization advantages.

## **2. The origins of the eclectic theory**

### **2.1. John Dunning, founder of the eclectic theory**

The eclectic theory, or as it was originally called the eclectic theory, was presented by John Dunning at a conference in Stockholm in 1976. This theory was the result of his doctoral thesis in the mid-1950s.

Dunning refers to research conducted by authors such as Rostas (1948) and Frankel (1955), who determined that labor productivity in the American manufacturing industry operating in the UK showed weaknesses ranging from two to five times compared to the British industry. This phenomenon raised some critical questions, such as: Was the productivity difference a result of the superior and local resources of the United States or was it due to the efficiency of American managers? Was this productivity difference a reflection of the superiority of original and non-transferable resources of the US economy, or was it because of the more efficient methods used by American managers in harnessing and organizing these resources?

Dunning assumed that if the performance of US companies in the UK was good, then the performance of US companies should be much better than their local competitors. Later, he identified this phenomenon as the "ownership advantage" (O advantages), where it was assumed that productivity differences depended on intangible assets that were not transferable to foreign companies. However, he found that US companies in the UK were not better than their UK competitors, and at the same time were poorer than American companies. This phenomenon results from the non-transferable influence of the US economy, and Dunning called it the location-specific component (L advantages) for any productivity differences.

Dunning presented his research paper at the Nobel Conference in 1976 in Stockholm on the international location of economic activity, where he focused on the fact that the economic area of a country takes the value of the produced output within national borders independently of the ownership of the producing firms.

## 2.2. The Eclectic Paradigm in Hill's Perspective

The framework presented by Hill et al. (1990) aims to enrich current interpretations of entry mode selection rather than replacing them. It combines not only environmental and operational cost considerations but also the global strategic goals in the Eclectic theory of variables affecting the entry mode decision. This allows for considering each entry decision not in isolation, but in relation to its strategic impact on the network of multinational company operations. For managers, this eclectic theory offers many advantages. For one, it can help executive managers identify those factors and issues that must be considered when reviewing different entry situations. Another related and important benefit of the framework is that it can help highlight the potential and actual contradictions that exist when looking at the diverse variables collectively. This eclectic framework can be useful in identifying the possible trade-offs among various considerations, not only in understanding benefits but also in assessing the potential costs associated with adopting a particular entry mode decision. This clarifies the strategic dilemmas management must deal with that may be solved through omission.

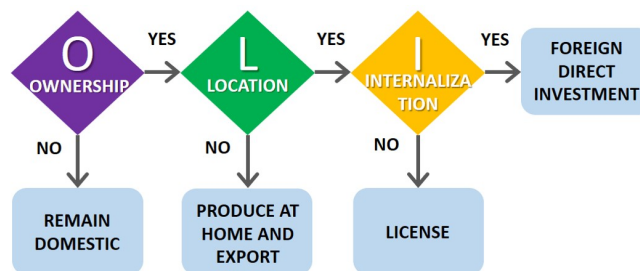
The eclectic paradigm takes a comprehensive approach to examining the complete relationships and interactions of the different components of the business. This model provides a strategy for expanding operations through a foreign direct investment to determine whether a particular approach provides greater overall value than other local or international options available for producing goods or services. Experimental studies that explicitly adopt the eclectic paradigm as a theoretical framework primarily seek to explain the choice between two different alternatives for the situation (Davidson and McFretidge, 1985; Caves, 1982), which are considered to enable researchers to create new predictors for predicting entry mode choice (Anderson, 1997). Meanwhile, the authors summarized in the table the main scientific contributions of the market entry style, typically associated with the factors and variables that influence the market entry mode choice.

### 3. Determinants of Foreign Direct Investment according to the Eclectic paradigm

According to Dunning, companies choose foreign direct investment when they can assemble the elements of the OLI model, which consist of:

- Owning and exploiting ownership advantages "O" in host countries for foreign direct investment.
- The necessity of selecting a good location "L" with the elements necessary to achieve the foreign investment process abroad.
- The priority of using internal exploitation of ownership advantages "I" to internationalize production.

Based on this paradigm, a company must possess all three advantages to effectively participate in FDI. If any of these advantages are absent, the focal company may consider employing an alternative entry-mode strategy. The figure below illustrates each of the three advantages.



**Eclectic paradigm framework (Root, 1994)**

Therefore, companies can penetrate foreign markets through foreign direct investment if the aforementioned elements (OLI) are available. If the location elements "L" are not available while the advantages "O" and "I" remain, the company resorts to exporting or opening agencies to distribute its products. If the company only possesses ownership advantages "O", it resorts to selling licenses and entering into contracts and agreements with local companies to exploit these advantages in its domestic markets. The following table (Table 1) illustrates the different entry modes into foreign markets according to the nature of the available capabilities.

**Table 1: Forms of entry into foreign markets according to the nature of available capabilities (Al-Bendari, 2012)**

Advantage Entry mode	Ownership	Location	Internalization
Foreign Direct Investment (FDI)	Available	Available	Available
Exporting	Available	Not Available	Available
Licensing	Available	Not Available	Not Available

The table shows the different forms of entry into foreign markets and how the choice of one form over the other depends on the costs and capabilities of the foreign company, as well as the compatibility with the investment environment. Exporting represents the various operations through which goods and services flow beyond borders to penetrate foreign markets, deepening the exporting company's knowledge and experience and increasing its administrative and marketing efficiency in the field of international business. This is why companies resort to exporting to reduce fixed costs unrelated to production volume but to fixed asset costs such as available services for production operations, buildings, etc.

**4. Understanding the Eclectic Paradigm and international production methods.**

In order to understand the theory of the eclectic paradigm and the process of selecting among the different methods of international production, we can ask the following question: In which investment environment does a company choose direct foreign investment instead of exporting and licensing to local companies?

To answer this question, Hirsch conducted a study in 1976 on the problem of localizing the production of a certain commodity abroad, largely based on the

specific production costs for choosing between the alternatives available for foreign direct investment in the context of a specific model for two countries, as follows (Nassour, 2014):

The original country is symbolized by A and the host country by B, and  $P_a$  and  $P_b$  represent production costs in each country, respectively. Trade costs in the local market are symbolized by  $M_d$ , and export trade costs or marketing and sales costs are symbolized by  $M_x$ .  $K$  is related to the company's specific advantage, such as a particular technological or commercial managerial knowledge accumulated through previous investments in research and development (R&D) and advertising, where this advantage gives the winning company a temporary monopoly in a certain part of the market while at the same time representing a cost for competing companies. When the company abandons its patent, this advantage becomes a cost for the risk associated with imitation, which leads to the company losing this advantage.

$M$  represents the positive difference between the cost of trading per unit sold in exports and that sold in the local market, where the cost includes the various barriers to exchange (transportation, customs rights, communications, etc.), and is assumed to be positively correlated with  $K$ .  $C$  represents the surplus cost of monitoring and coordinating external operations and activities compared to those internal or local, such that it is expected and assumed that  $C$  is positively correlated with  $M$ ,  $P_b$ ,  $P_a$ , and  $K$ . It is also assumed in this model that demands growth for the commodity in country B may require the completion of a new production unit or branch based on the assumption that demand is not affected.

Where:

- $P_a + M$ : Export cost from country A to country B.
- $P_b + K$ : Cost of relinquishing production license for the benefit of a company in country B.
- $P_b + c$ : Cost of settling in country B.

Where each of these variables is supposed to have positive values, and based on the above, this situation reveals the decision rules imposed on country A's company as follows:

- **Export to country B if:**

$$\left\{ \begin{array}{l} P_b + K > P_a + M \\ P_b + c > P_a + M \end{array} \right.$$

In this case, the company chooses to export if supplying country B's market is less costly than localization or giving up the patent.

- **Investing in country B if:**

$$\left\{ \begin{array}{l} P_b + K > P_b + c \\ P_a + M > P_b + c \end{array} \right.$$

The company chooses direct investment by establishing a production branch in the market of country B, as the investment process is profitable and more beneficial than producing in country B by a local company or a licensee and more beneficial than producing in country A and exporting to country B.

- **Abandonment of the exploitation license for one of the companies in country B if:**

$$\left\{ \begin{array}{l} P_b + c > P_b + k \\ P_a + M > P_b + k \end{array} \right.$$

The company prefers to relinquish the exploitation license to a local company in country B due to the high costs of exporting and settling. According to Hirsch, exporting abroad may be a sound decision if the revenues cover research and development costs compared to foreign direct investment. The latter may be a sound choice if the revenues exceed export operations and the risks are low.

More recent research in international business confirms that multinational enterprises increasingly rely on complex global value chains, knowledge-intensive assets, and digital coordination mechanisms, which reinforce the relevance of the

eclectic paradigm in explaining modern patterns of international production and FDI decisions (Narula & Dunning, 2010; Rugman & Verbeke, 2022; UNCTAD, 2023). In this context, firms evaluate not only production costs but also innovation ecosystems, institutional quality, and strategic access to regional markets when determining the optimal mode of international expansion.

### 5. Main proposals for the eclectic paradigm

The main proposal of the eclectic paradigm addresses several important aspects in determining the size and pattern of international production. These aspects depend on companies' competitive advantages and ability to absorb markets and generate assets, as well as determine the location of these activities outside their national borders. These include:

**Competitive advantages:** Determining the size and pattern of international production depends primarily on the competitive advantages of national companies that enable them to outperform other companies in the global market. These competitive advantages may be due to company ownership, access to income-generating assets, or unique company ownership.

**Companies' ability to absorb markets and generate assets:** This proposal is related to the ability of companies to integrate with international markets and generate the necessary assets to meet international needs.

**Determining** the location of activities: This proposal indicates that companies need to determine the location of their activities outside their home country. Geographic location can significantly affect production costs and access to global markets and suppliers.

**Context:** This proposal indicates that the importance associated with competitive advantages and determining the location of activities will vary depending on the context, including different industries, regions, and countries.

In general, the eclectic paradigm helps identify the best ways to achieve international growth by analyzing various variables and identifying the factors influencing commercial and investment decisions.

## 6. Considerations for attracting foreign direct investments

Attracting foreign direct investments (FDIs) is one of the most important issues for many countries, especially developing ones, due to the benefits that can be achieved. To achieve maximum benefit from these investments and ensure their compatibility with the investment environment in the host countries, the following points should be considered:

### **First: The importance of foreign direct investments**

The importance of foreign direct investments for the economies of host countries is diverse, including:

The foreign direct investment provides countries with the financial resources they need to meet their development plans and is an effective tool in making host countries more ambitious about their strategic goals.

FDIs facilitate the movement of capital to productive sectors in host countries, thus reducing the domestic financing gap resulting from the low local savings rate (Belaid Belhouj, 2002).

FDIs are a solution to many negative phenomena, especially brain drain, capital flight, and unemployment, by achieving economic benefits for workers, primarily in terms of higher wages and increased productivity, training workers in advanced technical methods, and benefiting from them in increasing production efficiency.

FDIs contribute to filling many of the major gaps in a country's economy, including:

The foreign exchange gap is necessary to import machinery, equipment, and technical expertise needed for development processes.

The technology gap to meet the needs of developing countries for technical expertise, organizational, and marketing skills.

The gap between general revenues and expenditures, where FDIs lead to host countries receiving new revenues in the form of customs duties and taxes on profits, increase their spending capacity and contributes to filling the revenue gap they face.

Foreign investment plays a significant role in stimulating economic growth by providing additional capital, management skills, and advanced technology that contribute to developing new industries and expanding existing ones.

**Second: Factors that attract foreign direct investments**

Several factors attract foreign direct investments, including:

**Stable political and economic environment:** Investors prefer countries with stable political systems, low levels of corruption, and a stable macroeconomic environment, which guarantees the continuity of investment operations and the ability to achieve high returns.

**Infrastructure:** Good infrastructure, including transport networks, telecommunications, and power supply, is essential for foreign investors, who need reliable and efficient infrastructure to operate effectively.

**Skilled workforce:** Countries with a skilled and educated workforce with advanced technical skills are attractive to investors who need a qualified workforce to operate effectively and efficiently.

**Investment incentives:** Governments that provide investment incentives such as tax holidays, duty-free imports of capital goods, and exemptions from withholding taxes, and other investment incentives, are attractive to foreign investors.

**Access to markets:** Countries with access to large markets, such as regional or international markets, are attractive to foreign investors because they provide access to a large customer base and increase the potential for profitability.

**Legal and regulatory framework:** A transparent and efficient legal and regulatory framework that protects investors' rights and ensures the smooth flow of capital and profits is essential for attracting foreign investment.

**7. Summary of Gaps in the Literature on Market Entry Methods in the Eclectic paradigm**

Although the eclectic paradigm (OLI framework) has had a major influence on international business theory, it has also been the subject of numerous critiques and

scholarly debates. In this regard, Dunning (2000) discussed several criticisms of the eclectic paradigm in his work “The Eclectic Paradigm as an Envelope for Economic and Business Theories of MNE Activity.” While the paradigm has been widely adopted to explain the internationalization of multinational enterprises (MNEs), several limitations have been identified in the literature.

One criticism concerns the lack of strong empirical validation. Some scholars argue that the eclectic paradigm functions more as a conceptual framework integrating multiple theories rather than as a fully testable empirical model. Although many empirical studies have attempted to test elements of the OLI framework, critics suggest that the relationships among ownership, location, and internalization advantages are sometimes difficult to operationalize and measure (Narula & Dunning, 2010; Rugman & Verbeke, 2022).

Another criticism relates to the strong emphasis on ownership advantages. The eclectic paradigm highlights firm-specific assets—such as proprietary technology, brand reputation, and managerial capabilities—as central drivers of international expansion. However, some scholars argue that this emphasis may underestimate the importance of location-specific capabilities, institutional factors, and absorptive capacity in host countries, especially in emerging markets (Cantwell, Dunning & Lundan, 2010; Meyer & Peng, 2016).

A further limitation concerns the applicability of the model to emerging and developing economies. The original formulation of the eclectic paradigm was largely developed based on multinational enterprises from advanced economies. Consequently, critics argue that the framework may not fully capture the dynamics of internationalization in environments characterized by institutional instability, imperfect markets, or weak regulatory structures (Peng, Wang & Jiang, 2008; Meyer & Peng, 2016).

The eclectic paradigm has also been criticized for lacking a dynamic perspective. Some researchers suggest that the framework does not sufficiently capture how ownership, location, and internalization advantages evolve over time as firms gain

experience, develop new capabilities, or respond to technological change and globalization (Narula, 2018; Verbeke & Kano, 2016).

Another important critique concerns the limited integration of the eclectic paradigm with other theoretical perspectives. Scholars have argued that the model should be more closely connected with complementary frameworks such as transaction cost economics, the resource-based view, and institutional theory, which provide additional insights into firms' internationalization decisions (Rugman & Verbeke, 2022; Peng et al., 2008).

Beyond the theoretical critiques of the eclectic paradigm, the literature on market entry modes has also identified several research gaps. For example, recent studies have highlighted that much of the existing research focuses primarily on large multinational corporations, while relatively less attention has been paid to small and medium-sized enterprises (SMEs) and their internationalization strategies (Paul & Rosado-Serrano, 2019).

A second gap concerns the limited number of studies examining the decision-making processes behind market entry choices. Understanding how firms evaluate and select entry modes—such as exporting, licensing, joint ventures, or foreign direct investment—remains an important research area. Investigating these processes can provide deeper theoretical insights into how firms select international locations and entry strategies (Canabal & White, 2008; Hennart & Slangen, 2015).

A third gap relates to the need for greater theoretical integration in market entry research. Since no single theory fully explains the complexity of entry mode decisions, scholars have suggested combining multiple theoretical perspectives to provide a more comprehensive explanation of firms' internationalization behavior (Canabal & White, 2008; Verbeke & Kano, 2016). Integrating frameworks such as the eclectic paradigm, institutional theory, and the resource-based view can significantly improve the explanatory power of research on international market entry strategies.

In conclusion, while the eclectic paradigm remains one of the most influential frameworks in international business research, it continues to evolve in response to new empirical evidence and theoretical developments. The criticisms discussed above highlight the need for ongoing refinement, empirical testing, and integration with complementary theoretical perspectives in order to strengthen its ability to explain multinational enterprise behavior in an increasingly complex global environment.

### **Conclusion**

The Eclectic Paradigm (OLI framework) remains one of the most influential theoretical models for explaining the internationalization of firms and the determinants of foreign direct investment. By integrating ownership, location, and internalization advantages, the model provides a comprehensive explanation of why multinational enterprises choose to expand internationally and how they select among different market entry modes such as exporting, licensing, or foreign direct investment.

The literature reviewed in this study confirms the continued relevance of the OLI framework in understanding multinational enterprise behavior and international production patterns. However, several limitations have also been identified, including difficulties in empirical measurement, an overemphasis on ownership advantages, and limited integration with other theoretical perspectives. Moreover, much of the existing research focuses on large multinational corporations, leaving important gaps in understanding the internationalization strategies of firms from emerging economies and small and medium-sized enterprises.

Despite these limitations, the eclectic paradigm continues to serve as a valuable analytical framework for international business research. Future studies should focus on integrating complementary theories, expanding empirical applications in diverse economic contexts, and examining how technological change and globalization dynamics influence firms' international investment decisions.

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