The Universal Model of theories determining FDI revisited

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Abstract: The paper refers to ‘a theoretical model’ created by Bitzenis (2003), named Universal Model, that incorporates most of the Foreign Direct Investment (FDI) theories. What derives from the literature review is the comprehension of the relativity of each theory; there is no FDI theory that dominates the decision-making process of multinationals (MNEs) regarding FDI. Economists, MNEs and entrepreneurs may have a decisive interest in countries that open their economies aimed at attracting significant FDI inflows as a final goal. The investment opportunities appeared in various countries differ from time to time even in the same country diachronically.

Keywords: FDI; foreign direct investment; Universal Model; multinationals; incentives; barriers; OLI; ownership-location-internalisation; determinants; transition economies; planned economy; Bulgaria.


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1 Introduction

The structure and nature of international markets are not static in any way, especially in the last three decades that have been dominated by rapid developments in technology. The deep appreciation of knowledge as a profit-making asset for business transactions (intellectual capital) has turned the world economy in a somewhat different direction. Some of the indicators of the transformation of the global perspective of business operations are the following:

- The intensive globalisation of the economic activity and the gradual deterioration of trade and investment barriers.
- The significant development of technology dealing with transportation and communication.
- The growth of the service sector, especially the industries dealing with knowledge and information.
- The rapid growth of a new generation of technology.
- The response of state authorities to the changing circumstances, in the form of modifications of strategies, policies and regulations. In some cases, the incentives provided by governments in the form of subsidies, tax holidays, and so on has been accurately described by Dunning (1980, 2000a) as ‘locational tournaments’ attracting an increasing amount of investors.
- The increasing role of the physical and human infrastructure and that of the macroeconomic environment and the institutional framework in the choice of a host country.
- The appreciation of being part of a geographical network, which assists the establishment of the notion that the presence of other foreign investors is preferable if not essential.
- The significant amount of strategic asset seeking.
- The emergence of an economic community that shows tendency for collaboration among the significant holders of wealth for the purpose of achieving their goals (‘alliance’ capitalism; Dunning 1977, 1998, 2003a, 2003b) underlined by the increasing tendency of firms towards cross-border alliances.
- The statistical results of analysing world trade operations. For example, the activity of multinationals (MNEs) and their subsidiaries in 1997 exceeded the activity of world trade by 27%.

Nevertheless, there are still advantages that are concentrated in certain geographical areas and that constitute incentives for MNEs to invest in that given location (Bitzenis, 2003).
2 The Universal Model

Although the physical factors of production are more mobile than ever, the little remaining boundaries to the mobility of country-specific factors and their non-availability in other locations, as well as the transportation costs, which may be very high in some cases, also constrain the mobility of intangible assets. These assets are very mobile and in the globalisation era travel with the speed of the communication networks, whose realisation require the use of immobile tangible assets (Dunning, 1998). The rapid technological changes and the overwhelming urge of intangible assets for mobility may, some day, impose the total mobility of assets that constrains them (consider gardens and hydroelectric units in Sahara and summer resorts in the North Pole, all products of the achieved mobility of climate, water and fertile earth).

The changes observed in the last decades certainly have a significant growth rate, much larger than that of the past. Respective changes are likely to occur in much larger growth rate in the years to come. These changes will cause many static theories on Foreign Direct Investment (FDI), and on other economic aspects, to become obsolete. For example, consider how the theory of Aliber (1970) on FDI as a way of exploiting the differences in exchange rates will apply after the monetary unification of the countries of the European Union.

This potential for growth of the global market along with the consideration that each theory applies to a limited number of sectors, and that a given firm may be served by different theories in different time periods, has motivated us to connect the main aspects of the dominant theories in one Universal Model. This model hardly contains any new considerations, just another point of view of the existing theories. All the operations have one main purpose and that is profit. Profit can be either long term or short term and direct or indirect, and it may be achieved through many channels, but still remains the higher purpose behind the actions of all enterprises. Based on this notion, all theories that analyse why companies undertake FDI or under what circumstances they should undertake FDI have deep consideration of profit. This model connects all the FDI theories under the consideration of the way they assure profit for the company. The Universal Model is not used as a whole, but encourages the use of the ‘Branch(es)’ of the 9 ‘Routes’ of profit that better fits the profile and priorities of each separate company. It is subject to change, as some theories become obsolete and as new parameters enter the perpetual equation of the world economy. The main benefit of this model is that it presents a wide ‘picture’ of the effects that a potential FDI project may have on a company and of the potential gains a firm will derive from it. The necessary assumptions of econometrics that some variables remain stable or do not affect the model are not necessary in qualitative survey analysis since a complete view of the market provides both companies and theorists with a deeper appreciation of the situation in question.

The observation that investment motives, which host countries offer in order to receive FDI inflows, and investment opportunities for MNE companies differ throughout time led to the conclusion that theoretical approaches of FDI fail to follow the development of the phenomenon of globalisation. This particular finding led to the configuration of an innovative methodological composition, the Universal Model (Bitzenis, 2003). Thus, the MNEs prefer to invest in specific countries and not in all, even if all of them ‘participate’ in the globalisation procedure, liberalise their economies and open their borders to FDI.
2.1 Reasons, incentives, motives, possibilities and opportunities for FDI

Based on Dunning (1988) and Bitzenis (2009), we can outline the motives for FDI according to their content:

1 Market seekers
   - influenced by the size of the market of the host country
   - prospects of the host country for market growth
   - the host country is a new market for the MNE to expand its operations.

2 Market seekers from a strategic point of view
   - meeting the local needs and tastes of the host market
   - there is a lack of local competition in a host country
   - there is a local (host) unsatisfied demand for products
   - an MNE acquires the assets of a local company in a host country (through a joint venture or a merger and acquisition (M&A))
   - an MNE may decide to substitute prior trade relationships with a country by undertaking local production in order to avoid trade barriers
   - if a company finds it profitable to expand, either vertically or horizontally, it may look for opportunities abroad and thereby expand through FDI.

3 Factor seekers
   - availability of natural resources
   - exploiting managerial, organisational, marketing and entrepreneurial advantages existing in the host country
   - access to high technology
   - low cost of acquiring and using raw materials and human resources in the host country.

4 Efficiency seekers
   - economies of scale
   - economies of scope
   - risk diversification.

5 Locational seekers
   - climate and infrastructure in the host country
   - geographical proximity
   - cultural closeness
   - cultural and psychic distance between home and host country.
6 Exploiting ownership advantages
   • strong brand name
   • product innovation
   • know-how
   • marketing expertise
   • existing business links
   • multinationality.

7 Seeker of financial aspects
   • tax relief or other financial incentives.

   • Political reasons
     • existence of ethnic minorities
     • special government treatment for a company due to a specific ‘nationality’ of the foreign firm
     • discrimination of companies coming from a specific country.
   
   • Others (e.g., overcoming imperfections). In general, motives may be derived from the need to overcome market imperfections. Thus, there might be several solutions to overcome these imperfections and this produces many investment opportunities (an MNE may avoid searching and negotiating costs of acquiring raw materials from other companies by moving to vertical integration).

However, we can argue that a lot of examples of FDI could fit in more than one of the above categories.

Moreover, as outlined by Bitzenis (2009) and Bitzenis and Szamosi (2009), the motives of FDI can be categorised according to their source of creation into the following groups:

   • incentives offered directly by the host government (e.g., financial incentives, tax reliefs)
   
   • motives ‘derived’ from the host market or the host country or were given indirectly by the government or ‘derived’ from the passive behaviour of the host market (e.g., climate, market size, raw materials, lack of local competition, political and macroeconomic stability, stable legal framework, transparency, liberalisation and unsatisfied local demand)
   
   • motives that are coming from the interrelation of the home and host country—motives that can only be connected with the MNE, its origin country and the host country (e.g., geographical proximity, cultural closeness, historical and trade links)
   
   • internal incentives owned and ‘provided’ by the MNEs (strong brand name, experience, know-how and expertise)
   
   • motives/incentives that have been created by an external event (from outside the host country) or by global market pressures or even are derived from exogenous reasons
outside the host market (war, globalisation pressures, home country is too saturated, collapse of the communist regime and transition).

Below, the main categories of motives are analysed in greater detail. More specifically:

1. **Market hunters** may proceed to FDI for the following reasons:
   - The *size of the market* of the host country is one of the major factors (if not the most important) that an MNE takes into consideration in the decision-making process of FDI.
   - The prospects of the host country for *market growth* are also a very important factor and along with the market size they are the most frequently considered. All empirical studies have supported that these are the main determinants of FDI (Benacek et al., 2000).
   - An MNE is profit oriented and in order to generate more profit, it is constantly seeking for *new markets* to expand its operations. This process aims at increasing the company’s market share in the host country.

2. **Market hunters from a strategic point of view** may proceed to FDI for the following reasons:
   - When an MNE realises that there is *lack of local competition* in a host country, it will try to exploit the opportunity.
   - According to the *product cycle theory*, when a product is losing market share in the home country, the company starts searching for other markets elsewhere to introduce the product.
   - If the company’s market share, because of either increased production cost or low product quality (low competitiveness of the product), is gradually but dramatically reduced, the company will turn to another market, sometimes abandoning the home market as a way to stay in business (*a way to survive*).
   - In a similar manner, *competitive pressures* in home country that lead to the reduction of the company’s market share in the home country may lead the company to try to substitute the lost market share with participation in a foreign market.
   - When a company is not strong enough to become an MNE but spots an opportunity in a neighbouring country, which is within the company’s capabilities, then the former company undertakes FDI *just to become an MNE firm* (for marketing reasons for the home country – reputation). This is the case of most Greek investments in the Balkans.
   - Some companies realise that their presence in a given market may assist their efforts of *meeting the local needs and tastes* of that market since the direct contact will provide them with more adequate information.
   - When the company realises that its production line has potentials, but the home *market is too saturated* to allow it to exploit those potentials, the company may seek for a new market outside the national borders of the home country.
• Alternatively, an MNE may be motivated to undertake an FDI project in a host market when there is a local (host) unsatisfied demand for its products.

• In some cases, companies undertake strategic moves in response to the actions or expected actions of competing firms of the same or a related industry. Many theories have studied such cases. In many cases, investment moves aim at thwarting a competitor.

• When a competitor enters a foreign market, the company follows its ‘market leader’ in order to prevent the competitor from acquiring a significant share and dominating the foreign market (follow the leader) (Knickerbocker, 1973; Flowers, 1976). In many cases, this strategy brings losses in the first years for the company that follows and even for the leader, but they both still persist in order to prevent the ‘leader’ from being the only company to establish brand recognition in the host country.

• Many firms also follow their competitors in order to exploit the latter’s experiences by following their successful steps and avoiding their mistakes (follow the competition).

• Firms in financial industry such as banks and insurance companies follow their clients in the host country in order
  • not to allow their clients to hire a local firm or another MNE that might, in time, take up their operations in the home country, as well
  • to exploit the ready-to-use clients in foreign markets.

• For firms that utilise raw materials that are supplied only by a given number of suppliers, an FDI project may come by the suppliers that open the way for the firm to follow (follow the supplier).

• The growing trend of globalisation exerts pressure on companies to undertake FDI in many countries in order to secure their physical presence in most of them and establish themselves as economic giants. In many cases, the selection of the region is done according to the ‘fashion trend’ of the time that points out which regions are profitable or offers investment and privatisation opportunities (e.g., Central and South America, Asia, Central and Eastern Europe and Commonwealth of Independent States (CIS)).

• Moreover, firms may acquire assets (by making a joint venture or a M&A, etc.) from a local company in a host country for
  • increasing market shares’ purposes in the global market, or
  • decreasing global competition (become a global leader) in the specific industry/sector (decrease competition or weaken the competition), or
  • for a geographical dispersion of knowledge-based assets from foreign locations.

• A company may decide to undertake FDI if it finds a market where no foreign company from the same industry has any operations (First mover advantage).
• When a foreign competitor ‘invades’ a company’s home market, the former ‘steals’ some of its market share that the company hopes to replace by entering the competitor’s home market (defensive/counterattack). When the competitor’s move is predicted by the home company, it ‘attacks’ the competitor’s home market first in order to cause problems in the competitor’s market share (offensive/attack).

• An MNE may decide to substitute prior trade relationships with a country by undertaking local production in order to avoid trade barriers. If a company finds it profitable to expand, either vertically or horizontally, it may look for opportunities abroad, so it expands through FDI.

3 Factor hunters

• A company may seek either factors unavailable in the home country or ways to minimise factor costs (availability of natural resources).

• Exploiting managerial, organisational, marketing and entrepreneurial advantages, technological skills, labour skills (of the host country), access to high technology, etc.

• There are companies that seek the location that offers the optimum production factors that are necessary for their operation. The factors that dominate production are the ones that determine their choice of location. The companies might look for:
  • A skilled, educated and preferably low-cost labour force.
  • A semi/unskilled low-cost labour force.
  • Availability of natural resources and an adequate labour force.
  • Low cost of raw materials—inexpensive land (the low cost of acquiring and using raw materials and human resources).
  • Companies that focus on intensive production search for a cheap labour force.
  • By creating an export base, the MNE focuses on minimising the production cost with the intention to re-export raw material, products and other resources back in home country; in this way, the company is a factor hunter.

4 Efficiency hunters

• When companies own certain assets that are mobile and transferable at a low cost, such as technology and R&D findings, they may choose to create subsidiaries either local or, usually, foreign in order to achieve economies of scale by distributing the fixed costs of obtaining such assets.

• When companies are focused on achieving economies of scope, they need larger markets in order to supply significant quantities of their diversified goods or services. These products or services are offered in order to cover more of the consumer needs.

• Many companies create foreign subsidiaries either by multi-sourcing (many production sites in different countries) or by participating in many other
companies in related industries in order to diversify the risk of operating by having alternative production sites in times when a certain industry or location experiences difficulties.

- Multi-sourcing is also efficient for vertically integrated companies, which operate at many production stages, that may exploit the factor endowments of each country by assigning each stage to the country that most efficiently provides the dominant production factors of the given stage of production.

- Companies diversify their product lines either to secure the survival of their products in different markets or to meet the needs and tastes of the host market.

- Just like factor hunters search for cost minimising, efficiency hunters search for managerial expertise, new and advanced technology, common governance, arbitrage of currency, cost and entrepreneurship for efficiency maximising. Synergistic economies and geographical concentration (agglomeration) may also constitute reasons for FDI.

5 Locational hunters

- The specific climate of a region may attract the kind of companies that can exploit this climate, like hotel chains or farming companies.

- The openness of a country is one of the major factors that may attract foreign investors and led the author to the argument about fashion trends of MNEs in investment locations in different time periods. This occurs because during a certain time period, a country or a few neighbouring countries or a whole region (e.g., CIS, Central and Eastern Europe, North America) open their borders, liberalise and stabilise their economies and proceed to mass (large-scale) privatisation programs of their previously state-owned enterprises. They also give incentives for FDI inflows in order to support their macroeconomic development.

- Many companies recognise an opportunity to exploit the cultural closeness of their country with another country by providing products for the host market similar to the products provided in the home market or according to their tastes, needs and mentality.

- Cultural distance may also be exploited by an MNE that introduces a totally unfamiliar product in a host country that might attract customers by raising their curiosity or their admiration for the foreign culture. In most cases, geographical distance goes hand in hand with cultural differences, and especially in Central and Eastern European countries, there is a trend of mimicry of the Western civilisation.

- Although the advanced infrastructure in the host country is a factor that encourages FDI decisions, lack of infrastructure in certain sectors may encourage a company to undertake FDI in order to provide infrastructure for the sector in need (telecommunication or other service activities).

- Historical links between the home and the host country may encourage FDI decisions.
• Geographical proximity plays an important role in the choice of location since there are low transportation costs and sufficient information on the country’s conditions and investing opportunities.

• Economic, social, financial and political stability is also considered as a factor encouraging investment by MNEs. Any instability in the above sectors increases the risk of the investment project.

• Companies that face difficulties in their home market when trying to reduce production cost may undertake an FDI project in order to create an export base in the host country either to exploit trade agreements with surrounding countries or free trade zones, or to use the host country as a link to other neighbouring countries.

6 Exploiting the Ownership advantages

• Companies that hold advanced technology, a strong brand name, product innovation, know-how, marketing expertise or high managerial skills, all of which allow them to dominate the local market, may eventually feel the need to exploit these advantages abroad.

• Past trade relations or existing business links provide the company with an advantage that may lead to a successful investment. If an MNE with prior trade relationships with a country spots favourable conditions for local production or unfavourable conditions to trade, it may undertake FDI that might substitute or complement trade.

• Companies that have gained experience by investing in many countries hold the characteristic of multinationality, which gives them the advantage to better recognise business opportunities and undertake investments.

• Familiarity of the MNE regarding local (host) tastes, needs, customs and language is an element that helps in the decision of undertaking an FDI project.

• Exploiting existing favourable terms of obtaining inputs.

• Exploiting agreements with local firms and friendly relationships with host governments.

• Exploiting ‘influences’ derived from MNE’s strong name-firm size.

• Exploiting advantages by creating synergistic economies, common governance etc.

7 Hunters of financial aspects

• Empirical studies have shown that tax reliefs are a factor of minor importance in the investment decision (Bitzenis and Szamosi, 2009). The author’s prior findings have also confirmed this (Bitzenis, 2009). However, small companies from countries close to the host market do consider them either when transferring the whole production site or part of the production site or when creating an export base. Tax reliefs or other incentives may be given by a host government in order to promote economic growth in the host country (macroeconomic development).
Some countries provide incentives for the establishment and operation of offshore companies that are trivially taxed due to discriminatory tax policies.

A method for reduction of the taxation of both the subsidiary and the mother company is the transfer pricing. This method allows the company to manipulate the financial results and may be an incentive for internalisation of operations in another country.

The existence of double-taxation avoidance may be a way for a company to choose among different countries that present similar investment opportunities in a specific region. The existence of double taxation is a burden on the financial result unless it can be overcome by finding methods of not declaring profits. The above reasons belong to the smaller category of taxation minimisation or avoidance and that is a very important group of incentives for an MNE.

In a world with fluctuating exchange rates, it is sensible for companies to consider the currency differences, either waiting for the currency to strengthen or looking for locations where the acquisitions in the home country are major investing opportunities (because of a very weak local currency). Companies from countries with a strong currency have the opportunity to arbitrage the currency easier.

State-owned enterprises offered for privatisation especially in Central and Eastern European countries have difficulties in valuation methods of assets offered, which are usually overvalued. Also, the investors seek lower privatisation offers in order to cover the cost of the risk of failure, thus sometimes interesting and profitable offers may arise.

Subsidies and grants that are provided either by the home country or by wider organisations like the EU to companies that undertake FDI in specific regions aiming at the economic development of those regions constitute incentives for FDI. Availability of cheap local (host) financing of FDI projects (whole or partial) is also a major financial incentive for FDI (exploiting interest rate differentials).

**Political reasons**

Both home and host countries and firms may have political reasons for supporting or discouraging FDI. The host country may need FDI in order to support economic growth, decrease unemployment, balance the deficits and generally gain from FDI spillovers. These political reasons are apparent by the governmental intervention in the form of subsidies and other incentives (Sergi, 2004). This intervention negatively affects free competition, and that is why the EU is considering the general abolishment of government or EU grants inside the Union.

Sometimes, the decision of the host government to allow or discourage a foreign company to acquire a formerly state-owned firm might depend on the ‘nationality’ of the foreign firm. This decision is also taken for political reasons
• There are cases when the home country provides mainly financial incentives to local companies in order to invest in a specific country in which there are ethnic minorities.

• Also, home country may prefer to dominate economically the host country and/or influence the local political decisions, demonstrating its influence through the presence of many companies from the home country.

9 Overcoming imperfections

• In general, the incentives demonstrated by Universal Model are derived from the need to overcome market imperfections. Thus, there might be other solutions (other investment opportunities) for the same imperfections that may produce many other incentives. Some of the well-known imperfections are the following:

  • many theories of FDI have studied the transaction costs or the market imperfections and argue that FDI may be undertaken in order to minimise or avoid them.
  
  • to avoid searching and negotiating costs of acquiring raw materials (vertical integration in a host country)
  
  • to avoid cost of introducing or breaking a contract of licensing
  
  • to control the quality and the price of the product
  
  • to retain ownership of the monopolistic-ownership advantages
  
  • to avoid lags, delays and lacks of inputs.

2.2 Obstacles, Barriers, disincentives for FDI

As outlined by Bitzenis (2009), the obstacles/constraints of FDI can be categorised according to their source of creation into the following groups:

1 country/geographical/location constraints (geographical distance from the West, lack of raw materials/natural resources, high crime rate (also high economic crime rate), social instability, lack of security, absence of tourist opportunities (absence of sea, mountains, landscapes, mild climate), etc.)

2 business environment (market) constraints (bureaucracy, corruption, briberies, lack of entrepreneurship, lack of managerial skills, lack of skilled labour force, high competition, problems in cooperation with local citizens (problematic joint ventures), social instability (strikes), technological backwardness, low labour productivity, etc.)

3 legal constraints (unstable legal framework, constant changes of laws, lack of laws, uncertain or imprecise property rights, lack of enforcement of the laws, discrimination in the enforcement of the laws, etc.)

4 taxation constraints (high taxation, high VAT, constraints regarding the repatriation of profits, etc.)

5 political/government constraints (political and government instability, high government intervention, blockage of fund transfers, takeovers, slow pace/progress
in the transition process, government inability and government unwillingness for successful reforms, etc.)

6 macroeconomic constraints (exchange rate volatility, high inflation, low per-capita income, etc.)

7 infrastructure constraints (technological backwardness, lack of infrastructure – such as telecommunications, roads, networks, internet, lack of financial intermediaries, etc.)

8 cultural constraints (unawareness of business mentality of local people, cultural consideration constraints, citizens are sceptic of foreign investors, privatisation and consumption, as well as unwilling to buy foreign products, etc.)

9 religion constraints (Indian people do not consume beef (cows are considered to be holly animals), Muslims do not eat pork, Muslims do not ask for loans (avoidance to pay interest rates because of their religion’s belief))

10 environmental constraints (can be either legal constraints that determine specific functions of production (e.g., health and safety, – product safety laws)); social constraints that determine tastes and buying patterns of consumers (e.g., healthy foods); or ecological constraints that determine the necessary conditions of avoiding aspects of pollution

11 external constraints (war, domino effect of an economic crisis, etc.)

12 others (lack of future prospects for market/economic growth, disintegrated economy, lack of participation in regional initiatives, international organisations and Unions (such as IMF, OECD, NATO, EU, EMU), lack of favourable bilateral treaties, lack of financial incentives, etc.).

If a country does not have regulations allowing the repatriation of profits, then FDI is discouraged. All the Central and East European (CEE) countries, except for Hungary, at the beginning of the transition had limitations in the repatriation of profits (either a specific percentage in the class of 10–20% of profits or in relation with the availability of foreign exchange). Partial or even full liberalisation of the repatriation of profits was later established first in Poland, Czechoslovakia and later in the remaining CEE countries. However, the author’s research demonstrates that investors find ways to overcome this barrier (Bitzenis, 2006b). For example, in the early years of transition in Bulgaria, only the initial volume of the investment was allowed to be repatriated, according to the law. Knowing that, investors overvalued the machinery they transferred to the foreign subsidiary in order to repatriate the future profits.

If the host country in question lacks local managerial skills or natural resources or some other factor that a company is looking for in that particular host country, or if the above factors are available but at high prices, then the company that needs these factors may not invest in this country for the above reasons.

If the country has a high crime rate or the state cannot sufficiently protect the investors from illegal actions or organised crime, then the company will not feel safe in investing in this country.

If the banking system or the financial intermediaries-stock market or other transaction services-are not capable of handling big companies efficiently, then the transaction costs are very high and the financing of the companies becomes very difficult.
When a country lacks favourable bilateral treaties, subsidies, low-cost privatisation opportunities, favourable tax policies etc., then the country does not offer incentives for FDI on its own. Instead, the MNE must be in search for some other country advantages in order to invest in the specific country.

The culture and the local behaviour regarding consumption attitudes, labour attitudes and productivity may be a barrier if it is negative towards the company. Especially in the former communist countries, where the mentality of people evolved through years of state domination, the attitude is against excess consumption, privatisation and foreigners, in general. The corporate culture is also quite passive in the sense that employment security, low targets of state-owned companies, and low motivation of employees during the communist years resulted in workers having a very low productivity rate. Another grave investment barrier in the former communist countries is the power and complexity of the state bureaucracy that dominated the country for many years.

The low per-capita income and the negative consumers’ consumption patterns (low tendency in consumption) certainly discourage a company from investing in a country. The low per-capita income may be the result of previous economic crisis, devaluations of the local currency, high inflation rates and the low economic development of the country. As mentioned above, consumption patterns in former communist countries are low not only due to the low income but due to the negative attitude of people towards excess consumption.

Low levels of technological development and low levels of infrastructure may prove discouraging for companies, especially those for which technology and infrastructure are of major significance for the production or for the operation of the company, in general (see also Figure 1).

**Figure 1**  The universal model of theories determining FDI

Source: Bitzenis (2003)
3 Determinants of FDI

From a theoretical point of view, we can divide the determinants of FDI into motives, sources of creation and obstacles/constraints. The various perspectives provide a solid overview of the relative options available to those seeking investment opportunities. The motives seek to explain the rationale for those seeking opportunities, the sources of creation help us understand the leverage being employed and the obstacles/constraints outline the possible hindrances to investment.

Generally, investors prefer sound macroeconomic fundamentals (stable exchange rate, low inflation and sustained growth), the availability of infrastructure, a stable and favourable tax regime and stable institutional and regulatory factors and policies, while at the same time, they also mention the importance of free trade agreements and regional trade integration schemes. It is also worth noting that most investors rate the availability of infrastructure (electricity, water, transportation links and telecommunication) as more important in influencing FDI location decisions than the costs involved in their investment projects.

One of the most important factors a company considers before undertaking FDI is minimising investment risk. When a country has an unstable legal system (i.e., regulations change often), lacks appropriate laws and insufficiently enforces the ones it does have, the risk increases. From the macroeconomic point of view, if the exchange rate is volatile and the country suffers macroeconomic instability (inflation) – and from the political point of view, if the country suffers from political instability or social instability (e.g., high labour unrest and strikes) – the risk of investing in this country is also increased. Especially in transition economies, when the transition process is delayed (unclear property rights, delays in restitution, low progress in privatisation, banking reform and liberalisation, existence of Mafia, nomenclature, corruption, briberies, bureaucracy, etc.), the economic and political instability is enforced, and the risk again increases. Moreover, a significant number of investors observe that recent financial crises have highlighted the underlying risks of investing in emerging and transition markets, and there is a need for paying greater attention to issues relating to political and macroeconomic stability, the legal framework, corruption and bureaucracy (Benacek et al., 2000; Bitzenis, 2006b; Jun and Singh, 1996; Lankes and Venables, 1997; Bitzenis and Szamosi, 2009).

Behind the overall conclusion that several factors are important (or unimportant) as motives or barriers, we argue in this paper that there are still other factors that could also play an important role in perceiving motives and obstacles of FDI from a company’s point of view:

- the country of origin of investors together with the size of the investing company and the size of the country of origin, as well as expectations of the company regarding the market share that it will obtain
- the sector (industry) of the investing company
- the strategic plans of the investing company (which markets to serve, etc.).

The influence of investor origin has been examined by several researchers who concluded that it plays an important role in determining FDI (e.g., Andersen, 1994; Sass, 1996). Considering a company from Germany and another company from Greece, both trying to
invest in Bulgaria, there are lower expectations for profits and market share for the Greek company, which, according to the world economic standards, is a small company coming from a weak economy. The Greek enterprise considers more significantly the market size of Bulgaria (Bulgaria is ‘another Greece’ based on population). Conversely and for the opposite reasons, the German company, which prefers to invest in Bulgaria, has higher expectations. Also, if the investing company comes from a country with a relatively cheap labour force such as Romania, the factor-relative labour costs in Albania or in Bulgaria will not be so important as it will be for some investors from western Europe where these costs are higher (Bitzenis, 2006a). Furthermore, small companies may be satisfied with a very small market share in a host market. Along the same lines, a company may perceive as significant the market size of a host country smaller than its home country, if there is an opportunity for obtaining a large enough market share. In this way, the company could reach a higher absolute number of customers in the host country than in the home country owing to the significant market share.

Multinational companies from different sectors/industries perceive motives and barriers in a particular host country in different ways. The lack of infrastructure in the telecommunication industry, for an investing company in the specific sector, may be perceived as an incentive for the company to enter in that country. However, the same lack of infrastructure will be an obstacle for other companies that belong to the services sector (e.g., the banks). Similarly, low labour cost is an incentive for labour-intensive industries (e.g., textile companies). However, this is not a major incentive for banks, since they prefer a skilled labour force and managerial skills and are more indifferent to the cost of labour, which does not affect significantly the total cost of the offering product. Similarly, market size may be an important incentive factor for some companies but not for others. A company that produces luxury products cannot perceive as a decisive factor a country with a huge population and low per-capita income. The actual market for such a company could even be a very small country with a high per-capita income and market share potential (Bitzenis, 2009; Bitzenis and Szamosi, 2009).

The strategy of an investing company basically differentiates companies upon considering the importance of motives and barriers. For companies that invest in a host country in order to create an export base, and thus are mainly interested in the production costs, the most important FDI motive could be the low labour or raw material costs. Conversely, an investing company with a strategy for selling and serving the foreign (local) market may perceive market size, GDP per capita or market growth as the most important motives for FDI (Benacek et al., 2000; Lankes and Venables, 1997; Pye, 1998).

From an empirical point of view, Benacek et al. (2000) concluded that econometric evidence supports the findings of survey studies, and they also added that taken individually, certain research may suggest misleading conclusions. They claim, for example, that a study in Central and Eastern Europe that excludes Hungary and the Czech Republic may conclude that political and economic stability is not a very important issue to investors. A study, however, that does include Hungary and the Czech Republic may indicate that their relative political and economic stability can help explain why such a large share of investment in the transition economies has been directed towards these two countries. This rationale would also support the notion, however, that to minimise potential biases, multi-country FDI studies need to take into account similarities in country development, stability and market size and comparable sample sizes from the countries included. Another approach is to undertake individual country studies and then do comparisons between the countries as opposed to ‘grouping’ them. More often than
not, in the literature, there is a disproportional participation of companies among countries that may infer misleading conclusions, and there are also multi-country studies in which there are no similarities among countries such as similar levels of development, market size and stability. Thus, a study that includes a group of countries from the ex-Yugoslavian region (Slovenia, former Yugoslav Republic of Macedonia [FYROM], Croatia, Serbia and Bosnia) may conclude that there is lack of infrastructure as FDI barrier, or weak economic development although such a thing is not necessarily true in Croatia and especially in Slovenia, and it is more representative of the situation in FYROM, Serbia and Bosnia (Bitzenis and Szamosi, 2009).

Dunning used his expertise and knowledge of the field to develop what he has sometimes called a ‘systemic theory’ or a ‘paradigm’. He tried to explain the range of the Multinational companies’s activities – trade, licensing and FDI – and proposed a framework for the analysis of three kinds of advantages to investors (Dunning, 1977, 1980): ownership, location and internalisation (advantages). Dunning’s ‘eclectic’ theory was criticised as nothing more than a “shopping list of variables” (Dunning, 2000a) to which he replied that his approach must not be seen as a theory but rather as a ‘system’ or a ‘paradigm’, i.e., as an umbrella for a variety of theoretical approaches (Dunning, 2000b).

The findings supporting fast economic growth as a determinant of M&A activity (Chen and Findlay, 2003; Dunning, 2003a) are based on Dunning’s Ownership-Location-Internalisation (OLI) paradigm. However, it is important to note that economic perspectives such as transaction cost economics and the OLI framework provide limited insights for the M&A implementation processes (Shimizu et al., 2004).

In order to encompass the role of networks and informal institutions, the Universal Model is not limited within the conceptual barriers of the OLI paradigm. Neglected findings for the determinants of equity-based modes of foreign entry, even by the evolved OLI framework (Dunning, 2003b), can ‘coexist’ within the unifying framework of the Universal Model. These are, for example, imitation in terms of ‘follow the leader/supplier’ hypothesis (Graebner and Eisenhardt, 2004; Yang and Hyland, 2006), informal institutions in terms of culture (di Giovanni, 2005; Stahl and Voigt, 2008) and geographical proximity for monitoring the subsidiary (Head and Ries, 2005; Lehto, 2006).

4 The Universal Model revisited

What derives from the literature review from 1937 up to 2010 is the comprehension of the relativity of each theory; there is no theory that dominates the decision-making process of MNEs regarding FDI. After the consideration of the FDI theories, the author made an attempt to present, in the simplest possible way, the incentives, motives, reasons, possibilities, opportunities, externalities and imperfections that an MNE considers before the decision of FDI. A company, when considering FDI, tries to exploit or overcome any factor that has stimulated or motivated its management to proceed in investing in a foreign country. Moreover, the barriers, which discourage an FDI decision, are in fact the other side of the same coin, meaning that the negative side of an incentive constitutes a barrier.

Some of the theories presented may be viewed as static, while others may be considered dynamic. The static theories studied only the factors that lead to the decision
The Universal Model of theories determining FDI revisited

The overall character of this paper and the desire of the author are to argue that no theory is general by itself. On the other hand, a model like the one the author proposes (Universal Model), which includes the bulk of the dominating theories on FDI determinants, may provide a more general approach of the subject. One must consider that the market conditions are always changing and the changing character of the boundaries, the globalisation, the European Union etc. will definitely create new challenges and opportunities for a company seeking value-adding activities internationally, in ways different from the ones studied up to now. This model may be expanded with every new theory developed that derives from the above changes. As the authors of the above theories concluded on reasons why a company may undertake FDI by examining certain subjects (countries, incentives, barriers) in certain time periods, the author of this paper, studying all those FDI and new trade theories, creating a questionnaire and studying almost 64 foreign companies operating in Bulgaria in the time period 1989–1999 (Bitzenis, 2003), ended up with two conclusions:

- no theory can be general and that led to the creation of the model that includes them all
- in the case of Bulgaria (as well as any country examined in a certain time period), only a part of the model is appropriate for application.

These considerations led to an additional conclusion. Since every country offers different motives and incentives for investment and has different obstacles and barriers that are all submitted to considerable changes through time, the MNEs choose the country that maximises the possibility of success for their investment plan. Even when two countries hold the same properties, an MNE bases its investment decision on evaluation of all factors in relation with its corporate priorities and needs. The choice of the appropriate ‘branch’ of the model, which is suitable for application in a certain case, requires examination from the side of the country, the MNE and/or the industry, and always in relation with the time period. In order to conclude on the most applicable theory for a country on a given period of time, one should turn to the analysis of empirical (survey and/or econometric) research results.

The opportunities presented in various countries are not equal in value throughout the world. There is an openness of the borders, abolition of currency restrictions, liberalisation of trade and prices and technological and transportation advances, all of which facilitate decisions for FDI and create opportunities for efficient, less risky and less costly FDI projects. On the other hand, FDI inflows and outflows by MNEs and the consequent direct and indirect effects of FDI on the host economies may be viewed as a vehicle of globalisation (WIR, 1998, p.97). There are many countries that have opened up their economies to trade and have been receiving FDI inflows; however, the share of FDI is not equal in all countries and the FDI inflows in less-developing or poor countries show little growth or no growth at all. Indicatively, although the Asian region is quite attractive for foreign investors, there are countries from this region that receive insignificant FDI and others that receive a great percentage of the regional FDI. For example in 1998, China received (US$ 45 billion) the 52.9% of the total FDI into
developing countries (Yeung and Dicken, 2000, p.228). It is more accurate to claim that in the case of FDI inflows, there is internationalisation rather than globalisation in the activities of MNEs, aiming at maximising their profits, gaining new markets, taking advantage of cheap resources, increasing their market share etc. Even large corporations, although regarded to be at the heart of the global economy, remain overwhelmingly domestic (or national) companies, largely oriented to their home countries (constrained by home countries’ rules and regulations) and maintaining the centralised control of their operations in their home country. They may extent their activities mainly to neighbouring countries in order to maximise their profits and minimise their costs. It is true that around 1/3 of the world trade is intra-firm trade, which incorporates even third-world countries or countries from pacific region in the world trade. Still not all countries are parameters in this equation, and the statistical data manifest the huge differences in FDI inflows in different parts of the world.

The MNEs are interested in searching markets that fulfil their investment plans. They carry out extensive market research before they reach a decision and focus their interest on the profitability of their decision. They are working towards finding countries that fulfil their goals. A great deal of MNEs’ decisions in making FDI depend on their willingness to participate in countries that exist in different geographical and strategic positions. It is not possible that all countries around the world offer the same opportunities and the same conditions for an MNE to act, at the same time. Consequently, the interest of MNEs is not concentrated in one part of the world constantly, but follows opportunities in different places (Latin America, the UK and Ireland, Spain and Greece, Eastern Europe, CIS, SE Asia etc.) at different periods of time, according to the circumstances. On the other hand, each country offers different comparative, locational advantages, and incentives for FDI. The MNEs evaluate these incentives and select the most appropriate countries for their investments. Derived from the worldwide statistical information, there may be countries with near to zero FDI inflows and simultaneously others that hold a great percentage of the total amount of FDI inflows.

An MNE’s choice of the direction of FDI is very much affected by the stage of development of any group of countries or a whole region, which may initiate a transition to a market economy, through privatisation programs and their offers, or may go through other stages, which create opportunities for FDI. One may say that each time period creates trends for investing in different groups/regions of developing economies that provide opportunities (Central America, South America, SE Asia, CEE region). One may also argue that the fact that an economy needs financial and technical support for the transition to a market economy is what generates the opportunities and interest for FDI inflows.

4.1 Criticism of Dunning’s eclectic paradigm

The differentiation of the Universal Model from the eclectic paradigm (Dunning, 2000a) of international production lies in the fact that the first presents more endogenous variables than the second one and consequently, recognises as investment occasions of the host countries’ variables (institutional and not) that are not included in the analysis of cross-correlation of OLI advantages.

Dunning’s ‘eclectic’ theory was criticised as nothing more than a “shopping list of variables” (Dunning, 2000a) to which he replied that his approach must not be seen as a
The Universal Model of theories determining FDI revisited

369

theory but rather as a ‘system’ or a ‘paradigm’, i.e., as an umbrella for a variety of theoretical approaches (Dunning, 2000b).

The eclectic paradigm (Dunning), as all theories that aim in the interpretation of international business activity, is based on the way of acquisition, creation and exploitation of financial elements (assets). In the case in question, the term financial element (asset) includes, “the reserve of resources and possibilities that the enterprises have access or have in their possession, and that are capable to increase and create income” (Dunning, 2003a, p.14). The financial elements (assets) that interest the international production activity are distinguished (Dunning, 2002b) in:

- those that enterprises have under their possession
- those that enterprises may not possess, but have access to, and finally
- those that are related with the administration that determines the output of the above two.

In conclusion, the eclectic paradigm (Dunning) proposes that the cross-border activity of MNE enterprises depends (Dunning, 2003a) on:

- the availability of financial elements (assets) that lead to advantages of property
- the availability of financial elements (assets), the access or acquisition of which leads to ownership advantages and consequently the enterprises’ need for expansion in order to explore advantages of locality
- the capability of enterprises to internalise their financial elements (assets) that produce advantages of locality.

5 Conclusions

We have analysed the Universal Model, which we strongly believe that incorporates most of the theories determining FDI. What derives from the literature review from 1937 up to 2010 is the comprehension of the relativity of each theory; there is no theory that dominates the decision-making process of MNEs regarding FDI. The investment opportunities presented in various countries are not equal in value throughout the world, and they differ from time to time even in the same country. In the globalisation era, countries open their economies and target their efforts towards stabilising and liberalising their macroeconomic environment through the use of different policies and sequential paths, having as a final goal the transition to a sound market economy aimed by the attraction of significant FDI inflows.

Regarding FDI, the constant increase of MNEs will facilitate a constant increase in the FDI volume invested in host countries; still the distribution is bound to be unequal due to the limited opportunities in each country. If a country seizes to offer opportunities, how can one oblige uniform FDI, in high-risk environments, in the name of globalisation?
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References


