OLI

Idea In Short

An eclectic paradigm, also known as the ownership, location, internalization [OLI] model or OLI framework, is a three-tiered evaluation framework that companies can follow when attempting to determine if it is beneficial to pursue foreign direct investment [FDI].

Eclectic paradigm a.k.a the OLI framework assumes that institutions will avoid transactions in the open market if the cost of completing the same actions internally, or in-house, carries a lower price. It is based on internalization theory and was first expounded upon in 1979 by the scholar John H. Dunning. Nowadays, companies are increasingly expanding their operations beyond their national borders by relocating certain value chain activities abroad. Companies have several motivations to do so. First, they may seek such natural or strategic resources as physical, financial, technological or human resources that are more attractive abroad. In other cases, the company may simply seek new customers. It may sell more products and services in the international markets than at home. Finally, companies seek ways to increase efficiency to create scale and cost economies. Regardless of the benefits, these companies need a holistic approach to international expansion. Companies can choose from a wide variety of entry-mode strategies when expanding abroad. Each approach has its own merits and de-merits. Some of the popular approaches are exports, licenses, franchise, strategic alliances, joint ventures, acquisition, and greenfield investments. Joint ventures, acquisition, and greenfield investments require significant cash outlay and large equity investments. Therefore, these vehicles are considered forms of Foreign Direct Investments [FDI]. The OLI paradigm, also known as the eclectic paradigm, helps identify the best option by excluding some of the available strategic alternatives. OLI is an acronym for Ownership-, Location- and Internalization- advantage. According to this paradigm, a company needs all three advantages to successfully engage in FDI. A company should employ a different market entry strategy if one or more of these advantages are absent.

Ownership advantage

First, a company needs an ownership advantage to overcome the liability of foreignness. The liability of foreignness is the inherent disadvantage that foreign firms experience in host countries because of their non-native status. These disadvantages vary from simply not speaking the local language to having limited knowledge on the local customer demands. Ownership advantages include proprietary information and various ownership rights of a company. Brand, copyright, trademark or patent rights, and the use and skills internally available are factors that offer a company this advantage. Hence, ownership advantages are typically considered intangible. These advantages should be valuable, rare, hard-to-imitate, and organizationally embedded. In other words, the resource should be so valuable that a company can derive a competitive advantage over foreign rivals. Therefore, companies should appraise whether they have a certain competitive advantage that they can transfer abroad to offset their liability of foreignness. For example, these could be a strong brand name with a great reputation, unique technological capabilities or huge economies of scale.

Location advantage

Location advantage is the second necessary advantage. Considering liability of foreignness, host countries must offer compelling advantages to make internationalization worthwhile to undertake FDI. These advantages can be simply geographical or exist because of the cheap raw materials, low wages, skilled labour force, special taxes, lack of tariffs, etc. Companies should assess whether there is a comparative advantage to performing specific functions within a particular nation. Often, these considerations depend on resources' costs and availability. Furthermore, the attributes vary among the chosen locations. Usually, location advantage refers to natural or manufactured resources. Either way, these resources are generally immobile and require a partnership with a foreign investor in the target location to utilize them to their fullest potential. Porter's Diamond model is a great tool to determine these location advantages. Companies should question whether there are any location advantages the target market offers. On a negative outcome, the management is wise to keep production at home and export products instead. This assumes a demand for the company's products and services in the international market. However, upon a positive outcome, the company might pursue certain value chain activities abroad through licensing, franchising or through FDI.

Internalization advantage

Finally, internalization advantages signal when it is better for an organization to produce a

particular product in-house against contracting with a 3rd party. At times, companies may find it more cost-effective to operate from a different market location while keeping production in-house. If a company decides to outsource production, it may require negotiating partnerships with local suppliers. However, taking an outsourcing route only makes financial sense if the contracting company can comply with the company‘s policies, standards and quality requirements at a significantly lower cost. Alternatively, the foreign partner can offer insights into the local market or even more skilled employees who can make a better product that the company lacks. Joint ventures with local partners, acquiring existing local companies, or starting from scratch through a greenfield investment are appropriate internationalization strategies that a company could pursue.

Summary

After answering these three questions with the aid of the OLI paradigm, you should be able to at least exclude some entry-mode strategies. When a company deems that its assessments are positive, it might be a good option to engage in FDI and control production activities. In case of difficulties between acquiring an existing foreign company or partnering with a local player through a strategic alliance, additional strategic analyses help.