

Motives Underlying Foreign Direct Investments: A Primer

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Abstract In this work it is contended the idea that, even though FDI has been at the centre of the analysis for a long time, economic literature has not still adopted a unified framework for the investigation of the issue at stake. Indeed, despite some important exceptions, above all Dunning [29], motivations have been highly disregarded from the current analysis. We put forward the idea that motives underlying what we have called a “cherry picking” activity must be considered essential cause they shape and direct the different alternatives available to the firm. Moreover, a well structured motive-based taxonomy concerning FDI decision is presented, composed by three main parts: (i) resource seeking, (ii) market seeking and (iii) non-marketable asset seeking. Finally, the effects of a set of factors on FDI decision are taken into account. We start by pointing out that empirical literature has found seemingly contradictory results on the effects of several variables on inward/outward FDI decisions. Indeed, it is shown that useful insights can be drawn from our taxonomy taking a closer look at the empirical literature dealing with factors affecting FDI decision.

Keywords FDI determinants; FDI motives; taxonomy; foreign direct investments

1 Introduction

In economic theory the topic of Foreign Direct Investments (henceforth FDI) has been deeply investigated under many perspectives, generating different streams of literature. Nevertheless, a unified framework analysing primitive motives underlying FDI decision is still missing. Indeed, the literature is still quite fragmented given the particular area of interest researchers are involved in. Obviously, there have been some works which have tried to provide a satisfactory taxonomy aimed at guiding researchers under a unified framework. Among the others, Dunning [29] contribution is worth mentioning because it constitutes the starting point for all following elaborations on this issue. Notwithstanding, much confusion remains in the way in which the topic is approached, especially to conduct empirical testing of hypothesis.

For all of the above mentioned reasons, we put forward a taxonomy of motives underpinning the decision for a firm to grasp an opportunity outside its home country. We show that two main logical steps are envisaged and that the final outcome of the decision process is not necessarily FDI. Moreover, even when this is the case, we identify factors influencing this particular choice among the relevant alternatives, together with factors influencing the decision to localize the process in a particular country.

The paper is structured as follows. Firstly we discuss the logical framework at the base of firm's general decision of carrying out an international strategy and we stress how this process will not necessarily result in a FDI.

Then we put forward the idea that motives underlying what we have called a “cherry picking” activity must be considered essential cause they shape and direct the different alternatives available to the firm.

Afterwards, a critical review of the literature on FDI motivations is presented. In particular, we stress the absence of a clear-cut treatment given that motives have been mainly examined by different streams of the literature in a heterogeneous way.

Furthermore we present a well structured motive-based taxonomy concerning FDI decision, composed by three main parts: (i) resource seeking, (ii) market seeking and (iii) non-marketable asset seeking. The effects of a set of factors on FDI decision is taken into account. We start by pointing out that empirical literature has found seemingly contradictory results on the effects of several variables on inward/outward FDI decisions. We show that their analysis under the lens of our taxonomy contributes to reduce consistently these contradictory outcomes.

Finally, conclusions and suggestions is put forward for further directions of enquiry.

2 A Useful Logical Framework for the Analysis of Firms' International Strategies

In the present section we suggest a decomposition into well defined logical steps dealing with

firms' decisions involved in carrying out an international “strategy”. As argued in what follows, these “strategies” could eventually end up with FDI, but they could also have a different result (e.g. joint venture or exports), which is affected by several factors.

To start with, it is worth stressing that the logical steps we will identify can be effectively reversed at times, other times be co-existing or even lacking, but, as we will argue, they should be kept analytically distinct, and this because the factors influencing them are usually different and with diverse impacts.

Firms' decision making process involved in carrying out an “international strategy” can be fruitfully viewed as follows.

First of all, firms identify an opportunity which can be grasped outside the home country. Indeed, in order to possibly being grasped via a FDI, such opportunity must possess some transnational feature, and this is a necessary condition for starting a decision process which can eventually result in a FDI. Thus, for instance, think a firm that decides to reduce production costs taking advantage of low cost foreign work or to expand its market by selling its own products abroad. It is worth noting that the act of catching the opportunity is the final aim of firm's actions and this primordial motive shapes the patterns of the decision and the effects it has on both the host and home countries.

Having identified the opportunity, a twofold decision is logically implied in the “cherry picking” strategy:

(1) Choice among the relevant alternatives: A first choice has to be made among a set of relevant alternatives. These are all the different means the firm has on hand to seize the opportunity and they strongly depend on the kind of opportunity the firm deals with. Thus, for instance, FDI, exports and patent licenses are all alternative ways to take advantage of a foreign market. On the contrary, when a firm wants to take advantage of low cost foreign labour, it can resort either to FDI or to international outsourcing. Moreover, the motives underlying the process determine also the factors which in turn have an impact on the outcome of the selection among the relevant alternative means. Given that one of such alternatives is always a FDI and that we are interested in studying the factors making firms choosing FDI, we decided to call these factors internalization determinants.¹

(2) Location choice: There is a second choice involved in the “cherry picking” strategy, i.e. the choice related to the location. Thus, for instance, when a firm decides to resort to FDI in order to take advantage of a foreign market, the problem of choosing the host country might be still unsolved. Indeed, the firm can actually invest in a country which is different from the market it wants to exploit, as in the case of “export platform” FDI [34]. Moreover, the factors affecting such location choice, the so called location determinants, strongly depends on the kind of opportunity the firm deals with.

So far, we have described the process as made up of two logically distinct steps. Nevertheless, we are aware of the fact that such steps, with the related determinants, may be not temporally separated, but co-exist and/or influence each other.

3 Motives as the Real Building Block of FDI Decision

The logical framework put forward in the previous section reveals the importance of understanding which are the motives underlying FDI for the analysis of their determinants and their effects, in terms of productivity spillover, international trade patterns and so on. Indeed, following the above line of reasoning, FDI is just the observable possible outcome of the “cherry picking” process previously described, which is triggered and shaped by the “cherry”, i.e. the opportunity the firm wants to grasp.

Thus, FDI can be fruitfully viewed as one of the alternative means available to the firm for picking up a particular opportunity and, more precisely, for acquiring an internationally non transferable “foreign asset” in an indirect way.²

The non internationally transferable foreign asset we are talking about could be: labour or another natural resource; a market, considered as an asset in itself - the Smithian “vent for surpluses” -; another asset, such as firm-specific knowledge or organizational models.

1 We have drawn this term from the theory of the firm, even though we do not use it with the same meaning. As a matter of fact, we are not referring in a strict sense to the way the firm chooses its boundaries (make or buy decision) as it is usually done in most studies (e.g. [23] and [71]) and, especially in the description of Dunning's OLI paradigm. Instead, our purpose is only that of taking into consideration all other possible alternatives that a firm may have in getting access to another country.

2 The “non transferability” feature can be interpreted in either absolute terms or relative ones. The latter refers to a foreign asset which results as non transferable at prevalent conditions.

We will go back to these issues later, what is important to stress now is that a systemic treatment of the motives of FDI is needed because they turn out to affect:

(2) FDI determinants. ¹In particular, they affect:

a. The set of the “means” available to the firm that are alternative to FDI;

b. *Internalization determinants*, i.e. factors influencing the probability of choosing the FDI among the set of alternative means;²

c. *Location determinants*, that is the factors affecting the choice of the country in which the firm actually invests.

Effects of FDI in both *host* and *home* country. In particular, as we will argue later, the motives turns out to affect the levels and patterns of international trade, the FDI contribution to economic development and the amount and direction of productivity and knowledge spillovers.

Studying FDI determinants without taking into account motivations can lead to estimates that are either non significant or highly-dependent on the sample of countries that have been chosen. This can happen because a particular typology of FDI is prominent in some countries while lacking in others.

In order to shed some light on the topic, one should recognize that, first of all, any classification put forward for the FDI is useful only whether it is based on the underpinning motivations, because they influence directly both the determinants and the effects on home and host countries; second, one should clearly distinguish between internalization and location determinants.

4 A Critical Review of the Literature on FDI Motivations

When a firm invests abroad is actually pursuing a set of different aims and, for this reason, motivations are certainly not unique. This is why the issue of FDI motivations has not been usually treated as a separate field of study, on the contrary, it has crossed different streams of the economic literature, such as international business, international trade models and the theory of the firm. Moreover, motivations are subject to changes as time passes because they are dependent upon the structure of the firm and of the characteristics of the host countries where the firm invests.

The most cited taxonomy of FDI motivations is the one proposed by Dunning [29]. It is possible to consider this study as the starting point of our analysis. Before describing this taxonomy, it should be pointed out that it is built upon the OLI paradigm [31], that explains why (*Ownership advantage*) and how (*Internalization advantage*) a firm decides to become a multinational and where (*Location advantage*) it is more likely to invest.³

The taxonomy is made up of four categories:

(1) *Resource seeking*: in this category the main aim of the MNEs is that of acquiring particular types of resources that they are not available at home (like natural resources or raw materials) or that are available at a lower cost (such as unskilled labour that is offered at a cheaper price with respect to the home country);

(2) *Market seeking*: in this case MNEs invest in a foreign country to exploit the possibilities granted by markets of greater dimensions. Various reasons (besides that of searching and exploiting new markets) lead to this choice by the MNEs: to follow suppliers or customers that have built foreign production facilities, to adapt goods to local needs or tastes and to save the cost of serving a market from distance. In recent times it is becoming important also to have a physical presence on the market to discourage potential competitors from occupying that market.

These two types of motivations are the most cited and debated in the relevant literature; in particular with regard to international trade models that try to formalize the OLI paradigm, they are defined respectively as *vertical* and *horizontal* FDI. In the latter case the early model is by Markusen [58]. In particular, FDI are motivated by the will of avoiding transportations and trade costs (acting with

1 In line with the past literature, determinants can be treated as “factors that drive FDI behavior” [13]. Nevertheless, it should be stressed that the real driver of FDI is linked to the motives underpinning the decision and that the FDI is used to reach a particular aim.

2 Even when the same alternative is selected for two different order of reasons, factors influencing the choice of this specific alternative are different in this case as well. Indeed, the underpinning motivations have a different impact on either the direction or the characteristic of the same chosen alternative.

3 The *ownership advantage* can be considered as the mobile asset (e.g. a patent or a trademark) that a firm must own or control in order to exploit it; the *location advantage* consists in exploiting this asset abroad in addition to, or instead of in the firm's home country; finally, the *internalization advantage* consists in the power to control the asset's exploitation itself, rather than contracting out use of the asset to an independent foreign firm.

export substituting motives) or by tariff jumping motives. In particular, the firm has to decide whether the costs are higher by setting up a foreign plant or serving the market by exporting.¹

On the other hand, vertical FDI, as considered in the early model by Helpman [46], aim at relocating part of the production chain abroad allowing MNEs because of the lower cost of production factors available in the host country (see, among the others, [66]).

In both cases, motivations are mainly overlapping with those identified by Dunning, even though they are modelled only from the point of view of the costs differences between the country of origin and the receiving country.

- *Efficiency seeking*: they are considered to occur especially in two occasions: in the first case firms “take advantage of differences in the availability and costs of traditional factor endowments in different countries”, while in the second one they “take advantage of the economies of scale and scope and of differences in consumer tastes and supply capabilities” [29]

Other authors have made use of this category by just referring to the blurred definition given by Dunning, without trying to better specify it and, instead, using different dimensions of it. For some of them (e.g. [33],[63]), this category is overlapping or very close with the case of resource seeking, because it is described to happen only as a way to fragment production, thus gaining from the cheap cost of labour in less developed countries. Other authors (e.g. [8],[17],[75]) instead underline the possible gain of common dispersed activities by exploiting economies of scale and scope due to the fact that the multinational enterprise (henceforth MNE) is able to diversify its asset. It is important to underline that both uses of the initial Dunning's definition do not add further motivations to those already identified in the market or resource seeking FDI.

All these three groups of motivations are considered to serve the primary objective of generating economic rents through the exploitation of some firm specific assets. They are usually technological assets generated through R&D investments that the headquarters of the MNE transfer to the subsidiaries to contribute to its exploitation in a foreign market ([18],[64]). For these reasons they are usually identified in the literature as *asset exploiting FDI* [60].²

- *Strategic asset seeking*: the last category Dunning singles out may be considered as separate because, in this case, the purpose of the investment is that of acquiring and complement a new technological base rather than exploiting the existing assets.

The main point to stress with regard to this last category is that it does not fit well with the OLI paradigm that Dunning proposed [31], because here the motivations of the firm investing abroad are that of gaining access to knowledge or competences that are not inside the firm. It follows that in the building of the OLI paradigm, motivations are not considered but they are *ex-post* determined.

Moreover, Dunning mainly describes various situations in which strategic considerations are the dominant motives for FDI, rather than of purely asset seeking motives confirming that this is a sort of residual category.³

As a matter of fact, unlike the previous three categories, the type of motivations just described in the distinction made by Cantwell and Mudambi [20] are grouped under the heading of *asset seeking FDI*.⁴

In recent times, much of the literature has given many contributions to understand FDI asset seeking hypothesis by getting off a new stream of literature. It is motivated by the trend of MNEs to establish internal and external networks for innovation [77] which are characterized by different levels of territorial and social embeddedness, by proving that the way to think about MNEs has changed passing from a centralized vertical organization to a decentralized more flexible structure.

This literature may be divided into two parts: the first examines the international location of R&D that is motivated by several issues ([21], [19]). As Kumar [53] argues, in particular to support foreign

1 The theory of horizontal FDI has been subsequently developed by many authors (see, for instance, [47],[14],[55],[56]).

2 These types of FDI have also been identified with different names such as *home base exploiting* [52], or *competence exploiting* [20].

3 Dunning describes other minor motives for a firm to engage in FDI that he is not able to insert in any of the four categories previously described. They are divided into three groups: *escape investments*, that is investments made “to escape restrictive legislation or macro-organizational policies by home governments”, *support investment*, needed to “support activities of the rest of the enterprise of which they are part” [29], and *passive investments*, that is investments which are closer to portfolio investments, although sharing with FDI some character of active involvement in firm management.

4 This kind of FDI is also called *home-base augmenting* [52] or *competence creating* [20].

production by adaptation to host country markets but most of all to tap into the capabilities available in host countries by locating subsidiaries close to the leading centres of research and innovation ([64], [62]), thus benefiting from localized knowledge spillovers. The second strand of literature refers to those papers that try to demonstrate that the possibility of absorbing technology may be important for firms which do not have an initial advantage, in this way disregarding the basis upon which the OLI paradigm is built. This is examined in some theoretical papers where the case of multinational “without advantages” are examined ([37], [65]). On the other hand, only Bjorvatn and Eckel [10] consider the entry strategy of both the lagging and the leading firm by using strategic considerations close to those used by Dunning. Even from the empirical point of view, there is a growing econometric evidence that accounts for the asset-seeking hypothesis ([50], [61], [69]), who make a comparison between sectoral R&D intensity of home countries with respect to host countries to account for the hypothesis of technology sourcing.

The second strand of literature that considers FDI motivations mainly deal with spillovers. In this case spillovers should be considered as the external effects caused to local firms by the presence of a MNE in the same or in a different sector. In particular, FDI motivations are considered only with regard to the two broad categories of asset exploiting and asset seeking. These studies are carried out by Driffield and Love [28]. They try to distinguish the technology exploiting and the technology sourcing hypothesis by using sectoral R&D intensity to consider whether this may have some influences on the host countries spillover effect. Driffield and Love [27] also proposes a FDI taxonomy trying to disentangle the broad category of asset exploiting and asset seeking motivations. They combine two different sets of issues: technology differences (measured by R&D intensity differentials) and factor costs differences (measured by unit of labour). In this respect it is crucial to consider the fact that the efficiency seeking motives are caused by the low cost labour of the host country while the R&D differential is in favour of the host country, thus putting into light the fact that it may be considered like a resource seeking FDI.

The last stream of literature taking into consideration FDI motivations is related to the variables of location choice of MNEs, that are also called FDI determinants. The issue of FDI motivations is examined ex-post by considering whether certain country characteristics may be related to the attraction of FDI characterized by particular motivations. For example, as it is pointed out in some papers ([14], [57]), a rise in market dimension is associated with a rise in FDI inflows that are considered to be market seeking. This type of reasoning is built up even in the case of resource seeking [22] or in the case of efficiency or asset seeking FDI [63]. In this last case it should be noted that the need for local skills is growing together with complementary factors of production or business related services such as, for example, the access to local finance. This is a proof of the fact that MNEs are now based on a different structure that has influences on their motives.

Finally, it is crucial to point out that in Dunning's reasoning, motivations for investing abroad follow the building of the OLI paradigm, in this way posing some problems when he defines the categories inside the taxonomy. It means that not all motivations, and especially the asset seeking ones, may well fit into the paradigm that remains unchanged.

5 A Modified Motivation-based Classification of FDI

Given the analysis carried out in the previous section, we notice out this particularly partial way of explaining the motivations at the basis of the choice of the MNE when investing in a particular country. To the best of our knowledge, the analysis carried out by Dunning [29] is the only one proposed in the literature and for this reason it is our starting point. However, we also have to stress that our analysis is not based on the OLI paradigm as it is done in the Dunning's analysis; instead, we propose a modified taxonomy by describing the motivations in the light of the logical steps into which the MNE decision is divided (see table 1).

Table 2 Motivation-based Classification of FDI

Motive	General Definition	Relevant Alternatives	Internalisation Determinants	Localisation Determinants
Resource seeking (RS)	FDI is taken to acquire particular and specific resources at a lower cost than could be obtained in the home country	International Outsourcing International Trade	Asset Specificity (+) Uncertainty(+) Asset Intangibility(+) Asset Complementarity (+)	Real cost of the resource (-) Absolute scarcity of the resource (+) Relative productivity of the resource (+)
Market seeking (MS)	FDI is taken to exploit a foreign market which is of some appeal to the firm, by supplying either the market of the host country (host-market FDI) or that of adjacent ones (export-platform FDI)	Exports Licenses	Policy Barriers (+) Transportation/Communication Costs(+) Ease of Imitation(-) Degree of Patentability (mixed)	<u>Host-Market FDI</u> Absolute market size(+) Growth rate of the market(+) Absolute advantage(+) Comparative advantage(+) <u>Export-Platform FDI</u> Differences in norms and regulations(+) Labour costs differentials(+)
Non-marketable asset seeking (NMA)	FDI is taken to acquire assets which are not directly transferable through market transactions	Joint Venture Acquisition of Core Personnel	Degree of competition into the market(+) Degree of transferability of knowledge through direct contact(-) Extent of organisational capabilities (+)	Basic and advanced infrastructure(+) Degree of closeness of the technological frontier between home and host country (+)

Resource seeking

Following Dunning [29] and Dunning [32], one of the motives for a firm to actually engage in FDI activity can go under the heading of *resource seeking*. As Dunning [29] himself puts it, this should include all the cases where enterprises are “prompted to invest abroad to acquire particular and specific resources at a lower real cost than could be obtained in their home country (if, indeed, they are obtainable at all).” ([29], p.56).

Unlike Dunning, we use the term resource to refer to natural scarce resources and labour, both unskilled and skilled, whereas in Dunning [29] the term is referred to natural resources, unskilled labour and technological and managerial capabilities. It is important to grasp such differences.

On the one side, we do not include technological and managerial capabilities. As we will see later, for the present aim such assets should be more properly viewed as non marketable assets, because they are relevant in affecting FDI decisions to the extent to which they cannot be directly transferred by means of market transactions.

On the other side, we include skilled labour in the present category. Indeed, although FDI aiming at acquiring human capital are usually considered asset seeking FDI [77], and thus analysed in relative isolation, we believe that the fact that the skills of workers can be, although partially, the object of market contracts leads to analogies with the other cases under the present heading.

In fact, although the cases of skilled-labour seeking FDI can actually show peculiar features in the degree and patterns of productivity spillover they produce, they show instead characteristics which are quite similar to those of the remaining cases of this category with respect to the relevant alternatives as well as the internalization and location determinants.

As for the set of alternative strategies the firm can actually follow, this does not change when the resource to exploit is a natural physical resource or unskilled labour, or when it is instead skilled labour. Indeed, in both cases, instead of engaging in a FDI, the firm can decide to resort to *international*

outsourcing or, to the extent to which the result of such activities takes the form of internationally tradable goods and services, simply resort to *international trade*.¹

The analogies still remains with respect to what we called internalization determinants. Indeed, in all the resource seeking strategies, no matter if the resource at stake is actually a natural one or skilled/unskilled labour, the factors affecting firms' decision to resort to either outsourcing or FDI are mainly those shaping the boundaries of the firm, that is those influencing the Make or Buy decision.

In this respect, the results achieved within the theory of the firm turn out to be particularly useful. We mainly refer to the *transaction costs theory* ([74], [73], [72]) and the *theory of property rights and incomplete contracts* ([42], [44], [43]).

Thus, for instance, according to the former theory the boundaries of the firms, and thus in the present context the decision to resort to outsourcing instead of FDI, are mainly affected by the intensity of the so called *hold-up problem* and the level of conflict among transactors. In particular, there should be a negative correlation between the lack of fungibility of assets (*asset specificity*), and the expected level of outsourcing. Moreover, when present together with specificity, uncertainty is another factor negatively correlated with outsourcing.² In addition, one should take into account the interrelation of each transaction with all the other exchanges. And, finally, transaction costs are usually assumed to be positively related with asset intangibility and this is therefore another factor influencing outsourcing decisions [41].

According to the theory of property rights and incomplete contracts, firms instead arise because contracts do

not provide for every possible situation and the ex post allocation of power (or control) associated with ownership, the so-called *residual control rights*, is therefore important; and firms are in fact the product of a process of optimal allocation of these residual rights.³ Within this framework, the conclusion is that we should expect no monotonic relation between transaction costs and vertical integration degree, but there should be a positive relation only between asset complementarity and vertical integration.⁴

Finally, also with respect to what we called location determinants the similarities among all the cases of resource seeking FDI as previously defined are quite marked. In all such cases, there should be seemingly a negative correlation between the country actually chosen for the FDI and the real cost (gross of duties and tariffs) of the resource the firm is interested in; a positive correlation between the former country and the absolute scarcity of the resource on a global scale; and a positive correlation between the country and the relative productivity of the resource.

Market seeking

A second motive concerning the decision for a MNE to engage in FDI activity goes under the heading of *market seeking*. As previously discussed, this topic has been diffusely ascertained by the literature so far (see Section 0). The main aim of market seeking FDI is to exploit a foreign market

1 The term *outsourcing* has been used by economist with slightly different meanings. Someone [68] uses it mainly referring to *international partnerships*, thus assuming a minimum level of relation durability. Some others utilize it in all the cases in which firms resort to foreign markets to acquire intermediate inputs [36]. In this case the term is therefore just a synonym of international trade in intermediate inputs. Finally, some other economists [9] uses the term outsourcing only referring to the cases in which what it is actually outsourced is service provision. Sometimes the term is used as a synonym of *delocalisation* or *off-shoring*, especially within the international trade literature ([48], [39]). Drawing on, among the others, Amiti and Wei [1], the meaning of outsourcing we decided to stick here delimits it with respect to, on the one side, delocalisation or off-shoring, on the other side, vertical FDI. In particular, we use delocalisation [54] or off-shoring for referring to the international fragmentation of production stages, being it due to international outsourcing or *vertical FDI*. In the latter case, the production stage goes outside the country but still remains within the boundaries of the firm, whereas in the former it crosses both the national and the firm boundaries.

2 As noted by Gonzalez, Arrunada et al. [41], if no specificity exists, there is no conclusive argument to expect a definite correlation between uncertainty and outsourcing in the transaction costs theory.

3 In particular, this theory assumes that: contracts are incomplete and this in turn generates costs associated with ex post inefficiencies, re-negotiations and specific investments in firm relationships; assets are specific; there are variables that, though observable, are not verifiable from outsiders; property rights give residual rights of control on assets, both material and immaterial, but not on human resources. For a systematic treatment of the theory see, for instance, Hart [43].

4 There is a recent interesting empirical application by Feenstra and Hanson [35] that seems to find some evidence supporting the existence of a relation between firm outsourcing and contractual incompleteness in the case of delocalization in China.

which is of some appeal to the firm, in particular by supplying the market of the host country, or that of adjacent ones, with goods and services.

The main problem underpinning this kind of FDI motive refers to the fact that foreign market to be exploited is not necessarily the market where FDI takes place. Indeed, the FDI can be either in a direct form or in an indirect one. In the first case, the firm is interested in the exploitation of the market of the country hosting the FDI while, in the second case, the country where the FDI is directed is just a “platform” from which it is possible to export to the surrounding area.

This distinction between exploitation of the host country and what in the literature are called *export-platform FDI* [34] is very important and it must be kept in mind both in the remainder of the present section and when we will discuss findings of the empirical literature (see Section 0). In particular, this distinction will be put into practice when the definition of localization determinants is put forward.

Under market seeking, the main internalization determinants driving the decision of MNE to carry out FDI, instead of other alternative strategies for “picking up the cherry”, can be divided in two main sets of factors: (i) factors influencing the ability of the MNE to export goods and services (the issue of tradability); (ii) factors affecting the extent of appropriability of the results of the production process.

The first set of factors relate to particular characteristics of the goods and services, all those that can compromise the possibility of internationally trading them, as well as to all the different costs that hinder trade, hence influencing the degree of tradability of final products.¹ According to the classical model of Buckley and Casson [15], exports imply lower fixed costs and higher variable costs compared to FDI. In general, although the typologies of trade costs are numerous,² in this section we will concentrate just on some of them, which are deemed as particularly important for the issue at stake, that is *policy barriers* and *transportation/communication costs*.

As for the former, these are all the restrictions that the foreign market is likely to impose on its own imports. The typologies of restrictions available can be distinguished in two main parts. On the one hand, there are direct import restrictions which act on the overall volume of imports of the host country. Among these, we find tariffs, import quotas, voluntary export restraints, local content requirements, red-tape barriers and national procurement. On the other hand, we have indirect import restrictions which are put in action by fostering the overall volume of exports of the host country. In particular, the means available are principally exports subsidies and export credit subsidies.

All of the above mentioned restrictions are positively correlated with the likelihood of the MNE to take the decision to carry out market-based FDI. In particular, MNE is likely to decide for FDI as a mean to “jump” over the restrictions imposed on imports by the host country.

As for transport costs instead, they can be decomposed in direct and indirect ones. The former refers to freight charges and relative insurance on the shipment. The latter one include holding cost, inventory cost and preparation cost. While transportation costs have a significant impact on the level of tradability of goods, communication costs impact more the extent of tradability of services [25]. Nevertheless, both of them are positively correlated with the decision to carry out a market-based FDI. As an example, think to a MNE facing the decision either to take out an FDI or exporting the products directly to the host country. In case the costs of delivering the product raise, the MNE is more likely to invest directly into the country via FDI.

The second set of internalization determinants pertains instead to factor influencing the extent of appropriability of the results of the production process, that is *easiness of imitation* and *patentability* issues.

The former refer to the set of factors influencing the extent of appropriability of the results of the production process. As long as factors other than patent - such as secrecy, the importance of complementary investments, lead-time and a steeper learning curve - are able to protect the technology employed by MNE from easy and quick imitation, the firm is more likely to invest directly into the host country.

Easiness of imitation is in turn influenced by the degree of patentability of a given invention. Both international and national regulations,³ together with the efficiency of the patent office, are all factors

1 In general, trade costs can be broadly defined as “all costs incurred in getting a good to a final user other than the marginal cost of producing the good itself ([2], p.691)”.

2 For an exhaustive list refer to Anderson and Wincoop [2].

3 The most important changes in international regulations approved in the last 30 years are: Bayh Dole Act (1980), patentability of new technologies such as software and life sciences discoveries, decrease of the

impacting directly on the possibility for the MNE to patent a technology in the host country. The level of appropriability patent assures grants the MNE with a temporary monopolistic advantage over competitors in the host market, advantage spurring the firm to invest directly in the host market. Nevertheless, the same firm faces a somewhat different opportunity, that is the possibility to license the patented technology. In this case, the firm might decide for an alternative strategy other than FDI, that is profiting from licenses' revenues. The direction of the effect on FDI decision is thus negative. Indeed, the streams of profits coming from licenses are negatively correlated with market-based FDI. We can conclude that the overall effect is mixed, depending on which of the two effects - positive for the monopolistic advantage in the host country and negative for the streams of profits from licenses - overcomes the other.

Once the first step of the decision process is carried out, that is a market-seeking FDI is chosen as the appropriate mean to pick up the opportunity arisen in a foreign country, then the choice of a location is the subsequent logical step to be accomplished. When the main aim of the MNE is to enter into the foreign market, location determinants should be distinguished between whether they pertain to the decision to enter exactly the market where FDI is done and whether the host country is seen more as an export platform for the markets of neighbouring countries.

In the first case, a factor driving localization choices is the size of the host country market. In other situations the growth rate of the market is more important than the absolute size. Other important factors are the presence and intensity both of absolute and comparative advantages. All of these factors affect positively the decision to localize the market based FDI in the host country.

In the second case, differential in characteristics of host country compared to neighbouring ones are the essential factors influencing the decision to direct the FDI in the host country and use it as an export platform. Among the others, differences in norms and regulations, together with those in labour costs are worth stressing.

Non marketable asset seeking

The last main aim for a firm to engage in FDI activity is the acquisition of assets which are not directly transferable through market transactions. Such assets are characterized by the possibility of being exploited only inside the country or in the "local" context where they are created. Indeed, when this characteristic is taken to the extreme, if the firm is willing to access this asset, it is forced to invest in the host country through FDI.¹

To start with, they can be constituted by *agglomeration economies*: in this case, the fact of being close to other firm may play its role in the FDI localization. In particular, besides the possibility of better linkages with suppliers and customers and the presence of a valuable market of specialized labour, technological spillover effects that may be grasped by the MNEs invite them to locate close to cluster of firms. This possibility has been explored by a large strand of literature (even though with different approaches) that underlines how this mechanism occurs (e.g. [70], [45], [5]), and the importance of agglomerations have been carried out also in the new economic geography [51]. In this sense, FDI and agglomeration economies have already been linked in the previous literature but it is not well pointed out that the possibility of replicating the same agglomeration economies across borders is not feasible because spillovers are extremely dependent upon the "local" context.

Second, they can be related to learning aspects and, in particular, that of having access to the firm organizational capabilities. The latter can be considered a "sticky" resource because they lie in the particular expertise and organizing principles of a firm. They are generated inside the firm and due to the high degree of tacitness it is difficult to communicate and to transfer them especially by market means (e.g. [76]).

In the same way, the presence of valuable technological knowledge that is built using some local specific competencies that are not reproducible in a different setting can actually represent something that would be lost if transferred across borders. For these reasons, the complexity of the technology embedded in the local context needs close contacts with the owners of the technological base in order to

patentability requirement and higher protection accorded in courts.

¹ It is worth noting that the characteristic of non transferability we are referring to can be related to both inner features of the asset as well as institutional and normative context. Just to give an example, we may cite the case of Protected Designation of Origin (PDO). It is a term used to describe foodstuffs that are produced, prepared and processed in a given location using specific local know-how. The final goods cannot be compared to the same final goods eventually produced with the same characteristics in another country, because the context in which they would be produced is obviously different.

start a process of technological accumulation.

As for the possible strategies which are alternatives to FDI in this case, they are mainly Joint Venture (henceforth JV) and acquisition of core personnel. As for the former, MNEs might enter into partnerships with firms to have direct access, exploit and absorb the asset into their own production processes. Indeed, JVs give greater opportunity for technological collaboration and technological exchange. The other possibility for MNEs is to try to have access to the core personnel of the local firm given that what is mostly needed for the MNE is not only the local context where the asset is produced, but the people who have competence on the production process of the asset.

With regard to the internalization determinants, establishing a JV will be less likely when the degree of competition in the market is particularly high. As a matter of fact, when the market is highly competitive the possibility for the firm to have access to the specific asset considered will be more difficult if the firm with which an alliance is established is in direct competition with the MNEs itself or with other firms that are part of the local market. This is essentially because the valuable asset will not be easily disclosed to competitors. On the other side, the greater is the degree of transferability of knowledge through direct contact, the higher will be the possibility that the MNE will enter into the market with a JV.

The second alternative considered above is the international acquisition of the core personnel. In this case, the point is that the higher the degree of organizational capabilities inside human resources, the higher is the probability for the MNE to resort to FDI. The explanation lies in the fact that, if the competitive advantage of the firm is not embedded in some key people, but it is instead diffused in the firm's overall organizing procedure, in order to get the assets it would be better to acquire the firm through a M&A rather than trying to capture the key personnel.

Finally, as for the location determinants, in this case MNEs will choose the location according to variables mainly related to the local infrastructure: this aspect is important from many perspectives because we are not referring only to basic infrastructure (such as a reliable transport system), but also to scientific and high technological infrastructure (like high-quality telecommunication). In particular, the linkages between the scientific infrastructure and the market are of crucial importance. For example if there is a higher university-industry relationship it means that firms may have a large educated and high-qualified pool of workforce to employ that will be able to incorporate valuable organizational capabilities. Possessing such type of workforce becomes central for firms' competitiveness in a globalized economy.

Another crucial variable is the degree of closeness with regard to the technological frontier between the sender and the receiving country. It means that MNEs will choose the country on the base of the need of having access to assets of the same (or close) technological level. In this way, it will be easier to insert them into the production process of the MNEs.

Even in this case, there are some complementary resources like the access to local markets that are crucial to exploit resources that are non tradable and should be produced and sold in the same place.

Other motives for FDI

What remains to prove is that our classification of the motives underlying FDI is indeed exhaustive, i.e. it exhausts the motivations for a firm to engage in a FDI, or at least that the motives not included are indeed residual and do not therefore alter the overall figure. In so doing, in Section 0 we will analyse what can be considered the "residual motives" of FDI, whereas in Section 0 we discuss the reasons why we decided not to follow Dunning [29] taxonomy, thus considering as separate items neither *efficiency seeking FDI* nor *strategic asset seeking FDI*.

Residual motives

With respect to the residual motives, we think the only cases that cannot be subsumed in any of the items of our taxonomy are *support investments*, as Dunning [29] terms them, that is FDI whose purpose is mainly "to support the activities of the rest of the enterprise of which they are part." ([29], p.61). These are investments which are highly complementary to other kinds of FDI or outsourcing decisions and, given their inner ancillary nature, they share the character of the main activity they serve. Examples of support investments are trade-related investments of MNEs, that is investments done to manage trade related activities of the firm in the host country, such as the purchasing of intermediate inputs in case of resource seeking strategies. They can also equally serve a market seeking strategy by helping managing the relevant information and the network of clients in the market of destination.

Apart from this typology, we believe there are no other residual motives left aside, although we should admit that, given the absence of a clear cut division between FDI and *portfolio investments*, there could be situations in which the latter share some features with the former. However, we think that in

these cases the short term perspective with which such investments are done tends to prevail. First of all, no FDI is actually involved in operations of financial coverage. Second, in all the cases in which, in trying to gain from short and medium term asset appreciation, the acquired firms are actively managed by their “new” owners,¹ although this can alter the impact in terms of productivity spillovers, there is no relevant change with respect to the determinants, which remains those pertaining to portfolio investments.

It is worth finally noting that the problem of distinguishing FDI in a proper sense from speculative foreign investments in real estate, i.e. investments done to gain from the appreciation in land and property prices, is instead mainly related to statistical problems. Indeed, although in theory these investments are no FDI because of their short term perspective, they are nevertheless included in direct investments in national accounts data and cannot be easily distinguished.

What remains outside?

We now describe why we have left out some of the categories identified in the Dunning's taxonomy: first of all, we do not make use of the efficiency seeking category. It should be noted that, to the purpose of the logical framework that we identified, efficiency seeking FDI do not represent another mean to reach the goal of exploiting an opportunities that is present in another country. Dunning [29] in his categorization and in other subsequent studies ([32], [30]), justifies the presence of this category by having in mind the theory of the firm, according to which, a firm will invest abroad through FDI even though an identical firm, fulfilling the same functions, is present there because administrative costs will be much lower. With reference to our logical process, motivations for FDI do not change. As a matter of fact, as pointed out in the previous sections, efficiency seeking FDI are sometime identified under the label of market or resource seeking, especially when carrying out empirical applications. The category of efficiency seeking should be discriminating only on the possibility of doing outsourcing instead of FDI, that is an internalization choice.

With reference to the category of asset seeking hypothesis, we do not take it into consideration because in the Dunning reasoning it is considered as a category that contains all the other motivations that are not possible to explain through the framework of the OLI paradigm. The asset the firm is seeking are not properly identified and most of all it is considered that it will take benefits for the advancement of the international competitiveness of the firm. This last issue as well as the strategic motivations identified may well be present even in other categories, and especially according to our working hypothesis they are the prerequisite of all FDI decision. This is due to the fact that a FDI is done when there is an opportunity to pick up and when there is an asset to gain that for the firm is not available at home. Dunning [32] and Dunning [30] acknowledge the multiple changes the MNEs activities have undergone due to globalization of economic activity that have force them to rise their asset augmenting activities, especially with regard to assets characterized by high knowledge intensity. However, he does not consider this to be a motive that may generate FDI. This mode of investing abroad can only be chosen by a firm that already owns some specific valuable assets that constitute its advantage.

6 FDI Decision as Influenced by Motivations: for the Sake of Clarity

In this part we take into consideration some of the most important topics that have been treated in the empirical literature dealing with FDI determinants.

Our starting point is the review by Blonigen [13] who considers the effects of a set of factors, investigated by the empirical literature, on the extent and direction of FDI. In particular, he addresses the effects of exchange rates, trade flows, trade barriers and taxes. We add up to this list by considering two main factors that have drawn the attention of the empirical literature in recent years, that is institutions and Localised Knowledge Spillovers (henceforth LKSs). In particular, the aim of the analysis we carry out is that of using our revised taxonomy of FDI motivations to be able to better clarify the direction of the effects produced by a certain determinant on the choice and the level of FDI according to the areas identified above (see table 2). As a matter of fact, up to now, no clear-cut results have been reached with regard to this issue. We will point out that by identifying FDI on the basis of their driving motivations will improve our understanding of the direction and extent of the final effect.

Exchange rates are surely one the most studied determinants affecting the decision to carry out FDI. Indeed, FDI can be conceived as a transfer of capital and, along that, it can be considered as a choice between expected returns of different decisions of investment. Three different issues have been taken

1 These cases are termed *passive investments* by Dunning [29].

into account by the existing literature.

As for the extent of exchange rate *volatility*, both positive ([24], [40]) and negative effects ([67], [6]) have been found, thus pointing out a blurred effect of exchange rate volatility on FDI decision.

Notwithstanding, through the lens of our taxonomy, it is possible to get more precise insights on the grounds of different motivations underpinning FDI decision. When FDI is resource driven, we expect a positive relationship between exchange rate volatility and FDI to arise. In this case, outsourcing is the relevant alternative to the RS FDI and, given that it comprises the trade of intermediate goods, FDI option will be preferred, because the price of buying intermediate goods will be higher in the case of outsourcing rather than get them through the parent company.

Instead, in the case of MS FDI, the effect is again positive given that the available alternative is to export goods whose prices are surrounded by increasing uncertainty due to exchange rate fluctuation. This means that FDI will be preferred cause they consist of transfers internal to the firm and, for this reason, more protected against the volatility of the currency.

As far as NMAS FDI is concerned, following option theory the choice of investing through FDI will be procrastinated because the firm will have more opportunities to get higher profits in the future. This yields a negative relationship between volatility and FDI [16].

As for the *level of the exchange rate*,¹ the current literature usually identifies a positive relationship between depreciation of the local currency and FDI ([38], [49], [4]).

In this case we need to differentiate between localization and internalization determinants. With regard to RS, the effect is positive because it will be more difficult for the firm to import if the exchange rate depreciates. In the case of MS, the most important point is that the effect on the internalization determinant is positive due to the fact that an increase in the exchange rate decreases the cost of acquiring an asset abroad and, at the same time, decreases the nominal profit gained by the FDI activity.

Nevertheless, reasoning in terms of relevant alternatives, a positive effect, mediated by exports, arises.

Indeed, an increase in exchange rate leads to a decrease in exports, thus reducing the number of available alternatives and hence increasing likelihood of FDI. As to what concern the effect on the localization determinant we should make a distinction between perfect and imperfect capital market. In the former case, the effect is null because there are no possibilities of taking advantage of internal prices, while in the second case we expect a positive effect because, in the case of FDI, the firm may act through prices in order to rise nominal profits. The resulting effect is positive. In the case of NMAS, the effect is positive because, in the short run, the price of the asset the firm is trying to get access is decreasing and it is convenient not to delay its acquisition. This last effect has been named by the empirical literature as “fire sale” effect [12].

Some of the literature ([16], [40]) has shown, especially from the theoretical point of view, that an increase in the *expected exchange rate* may lead to a current reduction of the amount of FDI undertaken.

However, this effect is based on firm-level characteristics. According to our taxonomy, this effect will be very negative when the choice is between trade and FDI (MS) given that spot contracts are the norm; when the choice is between outsourcing and FDI (RS) the effect is less negative, because of the existence of long-term contracts. This is likely to induce an increase in exports, thus reducing FDI.

As to what concern localization determinants, once FDI is chosen as the relevant strategy, expected exchange rates do not impact on the level of the FDI cause all the transfers are made internally to the firm. This is the case for RS FDI and MS FDI; as regards NMAS, it should be pointed out that the effect is negative because an expected “fire sale” effect is likely to arise.

Trade effects²: with reference to trade effects, by using different measures of trade protection the emerging literature (e.g. [11]) has reached only blurred or at least positive results, that is moderately confirming tariff-jumping hypothesis. However, as considered even by [13], these results are due to the fact that this type of literature has not considered trade effects of FDI that are closely linked with FDI motivations. It should be underlined that, in this case, the choice of serving the foreign market through FDI has already been taken. This is the reason why the effect is only with reference to the localization choice. Our classification reveals a null effect only in the case of NMAS. This may be explained by the fact that the goods do not pass through the market and so they are insensitive to trade protection. In the

1 The level of the exchange rate is here conceived as the host country currency over the home country currency.

2 Under this heading we consider trade costs principally.

case of MS the result is negative because trade and FDI may be considered as substitute while in the case of RS the effect is positive because it implies a flow of goods between the two countries that are sensitive to higher trade costs.

Institutions: with regard to the macro area of institutions it can be divided in two big areas, those relative to social and political issues (such as bureaucracy, corruption, infrastructure) and those relative to the technological environment (such as the patentability issues like IPRs).

Most of the recent literature (e.g. [7]) reveals that good institutions are the driving force of increasing FDI inflows.

The first point to be considered are related to *infrastructure*, which includes for example transports and ICTs. In the case of RS, we should point out that the decision about carrying out an FDI has no influence on the alternatives because outsourcing is influenced by this variable in the same way. However, with regard to the amount of FDI the sign of the effect it will certainly be positive as found by previous literature: the same effect (with regard to location determinants) can be found even in the case of MS and the case of NMAS. In particular, in the latter case, the internalization determinant is positive because FDI is certainly preferred to acquisition of core personnel if better infrastructure is present. The same holds in the former case, investing in the host country through FDI will be preferred to exports because of the possibility of reaping an higher market share.

Then, under the heading of *enforcement of law*, we can find issues such as corruption and bureaucracy. As already underlined, previous literature found a positive sign concerning both the amount and location of FDI, this is confirmed in our taxonomy in all three cases. As regards internalization determinant, the effect is null even in this case as far as the RS is concerned, for the same motivations explained above.

Instead, pertaining to *IPRs'* issues the effect is more complicated. Even at the theoretical level there is no agreement on which is the best regime for IPRs in order to attract FDI (e.g. [59]). There, it is pointed out that both a strong and a weak IPRs regime may encourage a firm to serve a foreign country through FDI. In the case of strong IPRs, the firm is more sure that its asset will not be spread out and, for this reason, FDI should grow. However, due to the fact that it is now easier to protect the valuable asset it may also be the case that FDI is displaced by export or licensing. In the same way, in the case of weak IPRs, FDI may grow because the firm now needs to protect its assets through internalization.

With regard to our classification, in the case of RS we expect a mild negative effect because the higher codifiability will lead the outsourcee to better master the phase of the production process of its own competency. That is why we expect the level of outsourcing to rise and that of FDI to decrease. In the case of MS, we are likely to obtain a mixed result because, if we consider the alternative to licensing, we may have both decreasing FDI due to the higher convenience for the firm to profit from license revenues and increasing FDI due to the better protection the firm will get in the host country market against its competitors. However, with regard to the option of exports, an increase in the degree of patentability is likely to induce an increase in the level of FDI because FDI spillovers are hurting less firm's profits thanks to the higher level of protection.

In the case of NMAS, we assume that in the host country there is a non-transferable asset we are interested in. Let's assume further that this asset refers, for example, to a production process that, although not entirely transferable through the market, is at least partially patented by some local firms. An increase in the degree of patentability in the host market will discourage, at least partially, the willingness of the firm to conduct FDI instead of relying on different relevant alternatives to acquire the asset (acquisition of core personnel and/or joint ventures).

As for trade protection, we consider both tariff and non-tariff trade barriers.²

Considering RS FDI, the effect should be positive, because acting on internal prices MNEs can build a more favourable setting, thus more than offsetting the negative sign due to the tariffs imposed on goods' re-import.

In the case of MS, we expect a positive sign because of the tariff-jumping hypothesis; it means that the MNE will build the foreign affiliate in order to avoid the higher price of serving the foreign market

1 Usually IPRs include also issues such as copyrights, trademarks, industrial secrecy, while here we focus only on patents.

2 Non-tariff barriers are, for example, particular standards to be met on the characteristics of imported goods or other "red tape" barriers. In the case of non-tariff barriers the empirical studies investigating their effect on FDI decision are very limited due data constraints.

through exports.¹

Instead in the case of NMAS the effect is null because higher tariff barriers do not have influences on the price of the resource the firm is looking for.

The last determinant taken into consideration pertains to the issue of the localized knowledge spillovers.

This literature ([3], [26]) considers that a firm localizing in a cluster might be characterised by increasing returns to scale deriving from the knowledge ability to spill over from the surrounding firms and/or other organisations (e.g Universities and research centres). However, this particular location may lead both to technological and pecuniary externalities as well as to higher competition. Which of the two effects is going to prevail is not clear.

According to our taxonomy, in the case of RS we expect a null effect because the firm located in the home country will rely on the firm that, inside the cluster, is able to produce intermediate goods in the better way. This means that the firm has no need of investing via FDI.

In the case of MS, the effect is positive because the firm has higher possibilities of rising its productivity (through spillover effect) and, thus, of selling higher amount of goods in the local market. In the case of NMAS, the effect is again positive because, through an FDI a firm can get more of the resource it needs and, in this way, it can rise its productivity.

Table 3 Factors Influencing FDI Decision Classified According to Motivations

		Resource seeking	Market seeking	Non-marketable asset seeking
Exchange rates	Volatility	+	+	-
	Level of exchange rate	Internalisation Determinants (ID): = Localisation Determinants (LD): +	ID: + LD: +	+
	Expected exchange rate	ID: - LD: =	-	-
Trade effects		+	-	=
Institutions	Infrastructure	ID: = LD: +	ID: + LD: +	+
	Enforcement of law	+	+	ID: + LD: +
	Degree of patentability	-	mixed	-
Trade protection		+	+	=
Localised knowledge spillovers		=	+	+

7 Conclusions

FDI has been at the centre of the analysis of economic literature since a long time. Nevertheless, economic science has not put in place a unified framework for the investigation of the issue at stake. Indeed, quite recently some sort of taxonomy has been put forward [29] but, to us, this has been partial and not always able to grasp the effect that we deem as essential in the study of FDI, that is underpinning motivations.

Indeed, as we demonstrated, motivations have been disregarded by the most part of the different literature streams in economics, which has been mainly concentrating on issues specific to it.

Along the paper, we have put forward the idea that motivations are at the core of the FDI decision and that FDI is only one of the different relevant alternatives available to grasp an opportunity arising in a foreign country. Moreover, the relationship between motivations and the set of alternatives means by

¹ However, in the case of MS as export platform we should consider the fact that exporting to third countries the final or intermediate goods produced by affiliates will be higher, thus reducing FDI as far as this motivation is concerned.

which opportunity can be seized is presented. According to that, we have shown how various factors shape the different set of available alternatives and that, among them, what we named internalization determinants affect the decision for an FDI strategy. Finally, another set of factors, namely localization determinants, influence the localization of the FDI.

On the grounds of the logical framework summarized above, we put forward a motivation-based classification for FDI, distinguishing among three main motives: resource seeking, market seeking and non-marketable asset seeking.

Finally, we draw useful insights from our taxonomy taking a closer look at the empirical literature dealing with factors affecting FDI decision. It is the case that empirical literature has found seemingly contradictory results on the effects of several variables on inward/outward FDI decisions. We show that contradictory outcomes can be consistently reduced thanks to the implementation of our classification which draw the attention on motivations and on the effects that the latter have on subsequent decisions pertaining to FDI.

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