A CRITICAL ASSESSMENT OF THE ECLECTIC THEORY OF THE MULTINATIONAL ENTERPRISE

Masahiko Itaki*
Ritsumeikan University

Abstract. The paper critically deals with the eclectic theory of the multinational enterprise. It examines, firstly, the theoretical redundancy of the ‘ownership advantage’; secondly, the inseparability of the ‘ownership advantage’ from the ‘location advantage’; thirdly, the conceptual ambiguity of the ‘location advantage’; and, lastly, possible methodological dangers of a multi-factor analysis under the three headings of the eclectic theory.

INTRODUCTION

It is true of everything that the first steps are both the most important and the most difficult. To begin with, theorization consists of a set of definitions of concepts. The basic concepts underlying the eclectic theory of the multinational enterprise (MNE) are currently being criticized by the internalization theorists, in that the ‘ownership advantage’ is ‘double counting,’ that is, the internalization and location factors are necessary and sufficient to explain the existence and growth of the MNE. The controversy seems to require a thorough examination of the concept of the ‘ownership advantage’. However, the examination should extend further afield. Our objective in this paper is to assess critically the three basic concepts in the eclectic theory, i.e., the ‘ownership advantage,’ the ‘internalization advantage,’ and the ‘location advantage’ and to suggest the beginnings of an alternative framework to deal with the MNE and FDI (i.e., foreign direct investment).

REDUNDANCY OF THE ‘OWNERSHIP ADVANTAGE’

Some Features of the Eclectic Theory

First of all, we must set up the target of our examination. The eclectic theory, Mark I, as advocated by Dunning is as follows [Dunning 1981:79]:

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*Masahiko Itaki was a Visiting Research Fellow, Department of Economics, University of Reading, and now is Lecturer, Faculty of International Relations, Ritsumeikan University, Kyoto, Japan.

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1. It (i.e., the firm) possesses net ownership advantages vis-à-vis firms of other nationalities in serving particular markets. These ownership advantages largely take the form of the possession of intangible assets, that are, at least for a period of time, exclusive or specific to the firm possessing them.

2. Assuming condition 1 is satisfied, it must be more beneficial to the enterprise possessing these advantages to use them itself rather than to sell or lease them to foreign firms, that is, for it to internalize its advantages through an extension of its own activities rather than externalize them through licensing and similar contracts with independent firms.

3. Assuming conditions 1 and 2 are satisfied, it must be profitable for the enterprise to utilize these advantages in conjunction with at least some factor inputs (including natural resources) outside its home country; otherwise foreign markets would be served entirely by exports and domestic markets by domestic production.

Four features of the eclectic theory should be noted here, as far as they are concerned with our argument. Firstly, needless to say, the concept of the advantage is a relative concept; i.e., advantage of a firm vis-à-vis the others tautologically means their disadvantage vis-à-vis the firm. The advantage is understood from the viewpoint of economic competitiveness and profitability, and thus it takes the form of an economic asset whether tangible or intangible. Thus, the asset value is measured by capitalizing the stream of expected future earnings by means of the rate of return. Secondly, the concept of internalization is interpreted as internalization of an ‘ownership advantage’ rather than that of an imperfect market. Thirdly, the existence per se of the ‘ownership advantage’ has nothing to do with the internalization; thus, the ‘ownership advantage’ is logically independent of the ‘internalization advantage.’ Finally, the ‘ownership advantage’ is logically independent of the ‘location advantage;’ thus, the ‘ownership advantage’ can be measured without referring to location factors.

The Logic of the Internalization Theory

Let us focus on the second and third features and compare them with the basic logic of the internalization theory. The distinctive feature of the internalization theory is its recognition that the firm is an economic institution, the objective of which is to maximize profit (i.e., super-normal profit in the Marshallian sense) in the world of market imperfections. The firm attempts to maximize its revenue and minimize its costs: the firm maximizes its organizational benefits after remunerating all the factors of production, R&D, marketing, and management.

Firstly, if arm’s-length markets are inefficient and incur huge transaction costs, the firm would replace them with its unified ownership and control