Chapter 2
Internationalization, Sustainability, and Capacity-based Motives of Foreign Direct Investment: A Conceptual Framework

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ABSTRACT

Researchers have studied foreign direct investment (FDI) from various perspectives, and noted the motives of FDI depend predominantly on disadvantages in home countries or advantages in host countries. However, little is known about how investors avail themselves of such advantages. The purpose of this chapter is to offer guidelines to investors to make effective FDI decisions and maintain sustainable international expansions in the post-pandemic era. Via a conceptual review of the extant literature, the authors elaborate on the motives of FDI from the perspective of the capacities of investors and provide a nuanced understanding of how they can make better investment decisions based on both the lacks and capacities. The authors develop a framework elucidating that the motives of FDI can be determined by a firm's level of technology and absorptive capacity. The framework will help investors to find cross-border partners to collaborate with, increase resilience, and deal with post-pandemic recovery.

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INTRODUCTION

The COVID-19 pandemic has severely affected the global economy and the flows of FDI. The pandemic is expected to have a negative impact on the global Foreign Direct Investment (FDI) flows, causing a fall of more than 30% even under the most optimistic scenario, as observed by the Organization for Economic Cooperation and Development (OECD). The pandemic is going to affect both the inward and outward flows of FDI (Fang et al., 2021; Fu et al., 2021). However, the extent of the impact will depend not only on the public health and economic policy responses but also on the capacity of the investors. Even though the pandemic has significantly altered the trajectories of economies and altered the strategies of MNEs (Hitt et al., 2021), FDI can play important role in supporting economies during and after the pandemic by creating linkages between local and foreign firms and facilitating the transfer of advanced knowledge and technology.

The literature on FDI focuses predominantly on the investment a country receives. From the recipient's perspective, researchers often link FDI with long-term economic development, attributing it to the knowledge and technology transfer, of a country (Borensztein, 1998; Djulius, 2017; Grossman & Helpman, 1993; Keller, 2010; Lall & Narula, 2004; Ritchie, 2002). When a firm establishes its business activities in a location, it gets into business and establishes different relationships with other local firms. Such intra-industry and inter-industry relationships stimulate knowledge transfer among firms, but the extent may differ depending on the types of relationships of firms. By encouraging foreign investors to invest, host countries hope to catalyze technology transfer in local firms since FDI is associated with the existence of intangible assets of foreign investors (Blomstrom & Kokko, 1999).

At the same time, making FDI can have a beneficial impact on economic development by easing some limitations in the home country such as technological and financial constraints, capability bottlenecks, and resource shortages (Knoerich, 2017). Due to the pandemic, the map of countries' proximity to the global distribution of knowledge, markets, and resources is likely to change (Hitt et al., 2021). In the changing circumstances, FDI can be a strategy to catch up with development in terms of acquiring knowledge and technology, improving production processes, developing managerial skills, and being a part of a business network. The process will eventually foster competitiveness. Similarly, firms have different reasons for investing abroad such as lower cost of production, lower tax rate or no tax, higher profit, access to new markets, access to a new business network, and so on (Caves & Caves, 1996). According to the literature, firms' primary motives to make FDI are to seek natural resources, new markets, efficiency, or strategic assets depending on firms' motives and capabilities (Dunning & Lundan, 2008).

However, researchers, predominantly, focus on the lack of firms to understand the motive of FDI, but they ignore the fact that the capabilities of firms can also play a crucial role in making FDI decisions. For example, the low absorptive capacity of investors can limit the positive effects of FDI in home countries. Therefore, it is important to understand the role of capabilities because the extant literature on FDI points out that firms benefit from making FDI but does not explain how such benefits are realized. For example, firms conduct FDI when they possess unique capabilities, or firms may decide to expand in search of new capabilities that are not available in the home country or market (Cantwell, 1989). A firm can take different measures to protect its unique capabilities while making FDI. However, making FDI does not guarantee that the firm will be able to access new technology available in host countries.

Johanson and Vahlne (1977) explained that a lack of knowledge about the foreign market is an important obstacle to operating in a foreign market, but such knowledge can be obtained mainly through operations abroad. Such a notion indicates the possibility of knowledge transfer between home country

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