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The Evolution of Theories of MNEs: Minimizing the Liability of Foreignness through Globally Intelligent Subunits

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Abstract

This paper reviews the typology of the evolution of theories of multinational enterprises (MNEs) within the past century. Looking back at historical events and the development of theories of multinational enterprises (MNEs), we see that wartime economies contributed significantly to economic and social distress. Postwar devastation brought about technological setbacks. This paper observes the importance of technology and knowledge as the fundamental elements that revived the world's economic state and firms' competitive advantage. Through the acquisition and integration of technology and knowledge, the infrastructure for foreign direct investments created economic stabilization and reduced technological stagnation. This paper provides a conceptual framework that suggests that in order for MNEs to sustain profitability and competitive advantage and to survive, they must capitalize on foreign investments abroad. However, investing in an overseas market creates unfamiliarity that can be costly. This is known as the "liability of foreignness." Therefore, this paper provides six criteria for MNEs to consider in minimizing the liability of foreignness. It also introduces the concept of "global intelligence," defined as creating foreign subunits that are dynamically capable of intellectual understanding of the global economic, political, and cultural requirements of a foreign market. These requirements may include sensing, seizing, and transforming information in order to be aware of a country's policies, trade regulations, and language, as well as geographic and resource acuity. Finally, the paper suggests that the combination of these six criteria and "global intelligence" may drive MNEs' performance by overcoming the costs of doing business abroad, creating "globally intelligent subunits" within the home country and exporting them to a host-country market.

Keywords: competitive advantage, foreign direct investment, global intelligence, host country, knowledge, liability of foreignness, multinational enterprise

1. Introduction

The past century witnessed devastation unlike any other, with two world wars spanning over ten years, three months and fifteen days, causing the loss of nearly 70 million lives and a disturbing U.S. $2.3 billion in military spending. As a result, technology was at an all-time low causing economic and technological stagnation. However, the world witnessed a new light coming through economic integration and technological advancement through the revolution of information technology, the fall of communism and Marxist economies in 1989, the creation of the World Trade Organization (WTO) in 1994, and the contribution of evolutionary theories of multinational enterprises (Sachs, 1999). This study reviews the typology of the evolutionary theories of multinational enterprises within the past century and provides a better understanding of how interacting factors can influence the behavior of firms.

This paper considers that as technology and knowledge have become copiously accessible, firms have become less unique. In that, MNEs now share similar processes, routines, and innovative ideas. This begs the question: what makes one MNE relatively distinctive when compared with others? This paper suggests that as the home market becomes increasingly competitive, MNEs begin to expand outside their national boundaries in hopes to sustain their competitive edge. Since MNEs are potentially opportunistic in becoming global, a new direction for firms to leverage competitiveness seems to come through the acquisition of information and mastery of host-country requirements. In doing this, MNEs are able to better assimilate to a foreign environment, thus reducing costs of doing business abroad. This paper explores the liability of foreignness associated to foreign direct investment activities and how MNEs can minimize their costs of doing business abroad.

Going back to people know-how and engaging in the acquisition of information related to foreign policies, regulatory traits, and the economic, political and cultural landscape. This study provides a conceptual framework that suggests MNEs couple their firm-specific capabilities with host-country requirements by creating 'globally intelligent subunits' that are made up of individuals who possess "global intelligence." Global intelligence, coined in this paper, refers to MNEs' ability to acquire host-country information and synthesize that information according to six criteria in order to match them with firms' capabilities, which can be used to assimilate to the host-country's market while minimizing costs associated with unfamiliarity. This in turn will allow MNEs to limit the cost of foreignness and gain competitive advantage against both domestic and international competitors within the host-country market. This paper argues that the future of MNEs' competitive advantage relies on firms' dynamic capability to create 'globally intelligent subunits' within their home country and export them to foreign markets.

The paper begins by briefly reviewing the typology of the evolutionary theories of multinational enterprises. Important historical events within the past century and shifts in theory caused by a shift in the dynamic arena of firms are explored. Next, it presents liability of foreignness as a means for MNEs to sustain superior firm performance by overcoming the costs of doing business abroad. Finally, the paper suggests ways to minimize the liability of foreignness by considering six criteria related to costs of unfamiliarity and the creation and exportation of "globally intelligent subunits".

2. Typology of the Evolution of Theories of MNEs

In this section, we take a look at the way theories of multinational enterprises have evolved over the span of 100 years, taking into consideration factors that have ultimately shifted one theory of MNEs to the next. These shifts include wartime economies and political and social underpinnings. In this paper, we acknowledge that the contribution of these theories together forms the basis of this conceptual paper, which suggests MNEs' future for competitive advantage lies in the dynamic combination of existing theories, but utilized differently.

We begin with the classical economist, Adam Smith (1776), and his seminal work *Wealth of Nations*, which contributed to the ideology that became the fundamental foundation of the international economy in Western Europe. Although the international economy began slowly in that region, it emphasized that the idea of division of labor would create a massive surplus that would fuel technological innovation, leading to greater efficiencies. According to Smith (1776), the real measure of the wealth of a nation is through the accumulation of capital labor, through the creation of goods and services within the nation. Thus, the concept of gross domestic product (GDP) was first introduced, which today remains a central indicator of a nation's wealth. Smith (1776) added that the "the invisible hand" allowed the economic system to regulate maximum efficiency but that unfair regulation of monopolies and tax preferences would create an imbalance within the economy. His theory would lead to an industrial revolution from 1780 to 1820, which was accelerated by 1900 when an introduction of innovative methods and new sources of energy helped mechanize activities that potentially increased productivity without detracting from ongoing production. However, nearly a century after his work, Karl Marx (1867), revised Smith's theory, stating that the value of human labor was the predominant factor driving the two economic exchange functions, buying inputs and selling them to other firms, government, and consumers (Dunning, 2003; Sachs & Warner, 1995). Marxist economies, a capitalist theory that spread across the world, promoted rapid economic growth and industrialization outside of Europe and North America following the adoption of capitalist institutions, free trade, and lowered costs of transportation (through the invention of the railway) (Sachs & Warner, 1995).

However, the unprecedented First World War would unfortunately paralyze the emerging global capitalist system for more than half a century. The aftermath of the harsh four-year war left a weakened economic state amongst capitalist economies, both financially and politically, leaving behind trade and financial imbalances that posed instabilities throughout the 1920s. This financial instability, coupled by the failure of the gold standard, worsened the economic state and led to the Great Depression in 1929. It lasted for nearly ten years. (Sachs & Warner, 1995; Kindleberger, 1973).

The economic turmoil from postwar dislocations lasted until 1936. However, a breakthrough in the modern economy came from theorist Ronald Coase in his pivotal 1937 paper titled "The Nature of the Firm." His work would become the first to question "why do firms exist and what determines the scale and scope of firms," revealing a serious gap in the traditional theory of firm and market organization. Coase (1937, p. 388) introduced the concept of transaction costs, which suggests alternative methods of coordinating costs of production. Coase's theory was short-lived, following the Second World War in 1939, which lasted for another six years, ending in

1945 when the Axis powers gave their unconditional surrender.

As any wartime conditions would, the Second World War left the world with chronic economic and political consequences. It crippled Europe's powers' ability to maintain their empires, and thus from 1940s to the 1980s many of their colonial states became independent and applied their own economic regime that led back to capitalism. By the 1960s, technology and economic conditions were back to what they were after the First World War. With the tired technology of the 1930s and limited economic activity, countries' economies were becoming direr. Hence, a shift toward foreign exchange would soon surface as a solution to create the emergence of economic stabilization. The introduction of the International Monetary Fund (IMF) in 1944 would provide a framework for 44 countries to partake in economic cooperation to avoid competitive devaluations by establishing convertible currencies.

Although Coase's (1937) theory shared the significant perspective of transaction cost theory, the limitations of firms' ability to add value, knowledge, or technology in a time that needed economic reform would hinder their chances of achieving economic growth and competitive advantage. Hence, the Neo-Coasian doctrine received criticism due to the small overlap between transaction cost and value-added maximizing approaches (Dunning, 2003). However, between the end of the 1950s and early 1970s, economic and organizational theorists (Penrose, 1959; Hymer, 1960; Williamson, 1981; Buckley & Casson, 1976; Teece, 1988) theorized that market internalization by firms would ultimately change the economic state of postwar devastation by focusing on market imperfections. This is apparent when the limitations in Coase's (1937) theory led to the great work of Buckley and Casson (1976) titled *The Future of the Multinational Enterprise*. According to Buckley and Casson (1976), there were five elements that would lead to the rapid growth of MNE activity: (1) an increase in demand for technologically-based products; (2) efficiency and economies of scale from knowledge-based production activities; (3) difficulties related to the organization of knowledge; (4) lower international communication costs; and (5) increased opportunities for tax reduction through transfer pricing.

To overcome postwar economies, Europe, North America, and Japan needed to the reintroduce foreign exchange. This would help importation of foreign technology and capital resources used in the production of manufactured goods primarily for agriculture and mining (Sachs, 1999). Their continuous theoretical developments contributed to foreign direct approaches and value-added theories that have shaped our modern economic system (Hymer, 1960; Williamson, 1981; Buckley & Casson, 1976). This was evident by the 1970s, when the tripartite alliance consisting of Europe, the USA, and Japan began to see rapid economic growth through international trade and market internalization. By the 1990s, the outcome would lead to lower trade barriers and culminate in international trade and monetary unions within European and North American countries The emergence of foreign trade led to the rise of a successful market economy, one that included a regulated institution that oversaw currency conversion for international trade and common standards for commercial- and market-based transactions (Sachs & Warner, 1995; Sachs, 1999).

Between 1982 and 1995, market internalization theories focused on value-adding perspectives that highlighted knowledge as a public good that can be easily transmitted across national boundaries. These theories would later contribute to MNEs' ability to transfer and receive knowledge, enabling them to open and operate a network of foreign subunits internationally (Buckley & Casson, 1976; Kogut & Zander, 2003). Through the acquisition of knowledge of firms and foreign markets, theorists (Wernerfelt, 1984, Barney, 1986; Dunning, 1988; Teece, 1988; Oviatt & McDougall, 1994) began to assess what makes some firms more competitive than other firms. They looked into firms' capabilities and heterogeneity that highlighted the dynamic complexity of a firm beyond its mere structure. Theories like resource-based view (RBV), dynamic capabilities, and eclectic paradigm would harness multinational enterprises' ability to emphasize the interplay of firm-specific advantages and host-country features, enabling MNEs to sustain global economic advancement and competitive advantage (Barney, 1986; Dunning, 1988; Teece, 1988; Oviatt & McDougall, 1994).

With the revolution of information technology, the fall of communism and Marxist economies in 1989, the existence of the World Trade Organization (WTO) in 1994, and the contribution of evolutionary theories of the multinational enterprise, the world witnessed for the first time a remarkable increase in economic integration after nearly eight decades and two world wars (Sachs, 1999). Figure 1 illustrates the specific references to typologies of the evolution of theories of multinational enterprises over the span of a hundred years and the historical events that have shaped the existence and shift of these theories.

Looking back at historical events and the development of theories of the multinational enterprise, we recognize that wartime economies contributed to significant economic and social distress. More than that, postwar devastation would also bring about technological setbacks. This paper observes the importance of technology and knowledge as the fundamental elements that would revive the world’s economic state. Through the acquisition and integration of technology and knowledge, the infrastructure for foreign direct investments were created. This allowed countries to engage in operations beyond national boundaries through the establishment of convertible currencies, common commercial trade laws, and market-based transactions (Sachs & Warner, 1995, Sachs, 1999).

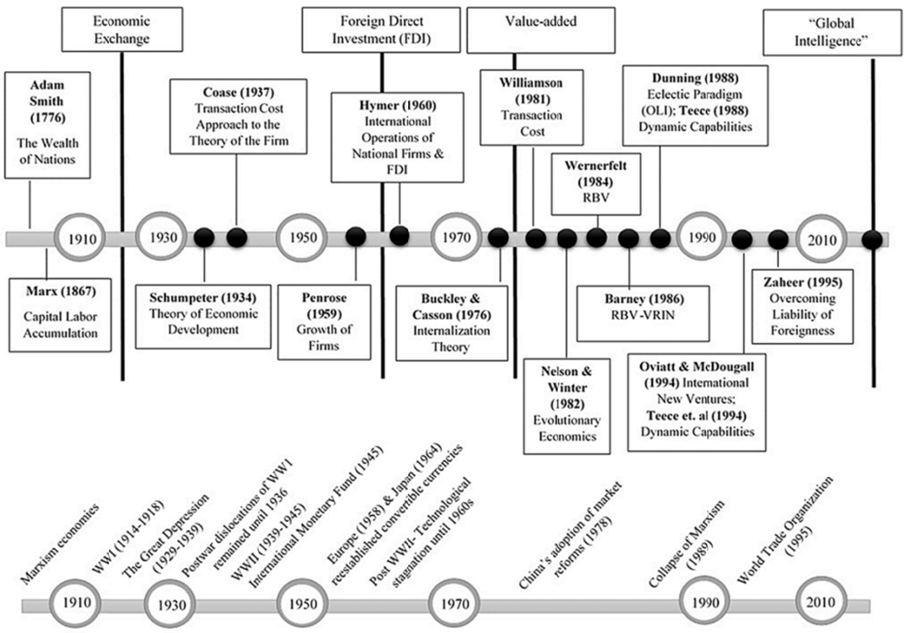

Figure 1. Typologies of the evolution of theories of multinational enterprises and historical world events over a span of a hundred years

Adapted from “Some antecedents of internalization theory,” by Dunning, J, H. 2003, Journal of International Business Studies, 34, 108-115. Copyright 2003 by Palgrave Macmillan Ltd.

Hence, this paper suggests that the elements that overcame the world’s most devastating economic collapse could also be the same elements that MNEs use to champion competitive advantage. However, since technology and knowledge have become copiously accessible in today’s world, firms have become less unique. Therefore, in sustaining competitive advantage, firms must be able to utilize the right theories, the right methods, and the right timing. This paper suggests “global intelligence” as the answer to sustaining superior firm performance and competitive advantage by minimizing the costs of doing business abroad. Global intelligence here is defined as a state of intellectual understanding of the global economic, political, and cultural characteristics of a foreign country that enable MNEs to overcome the costs of unfamiliarity. It is a concept that encompasses the need to minimize the liability of foreignness through the conceptualization of existing theories and the assessment of six criteria considerations made famous by Stephen Hymer (1960). Through the integration of these two concepts, MNEs will able to create “globally intelligent subunits” within their home country and export them to host-country markets abroad.

3. Liability of Foreignness

The seminal work of economist Stephen Hymer (1960) published in 1976 provides a compelling analysis of multinational enterprises and foreign direct investments in a time when cross-border activities were becoming exceedingly significant. His work on the “liability of foreignness” provided the central assumption that would lead to many extensions of multinational enterprise theories (Buckley & Casson, 1976; Dunning, 1977; Hennart, 1982). Hymer (1960) defined “liability of foreignness” as the costs of doing business abroad. Kindleberger (1969) and Mezias (2000) define the liability of foreignness as the disadvantage of bearing additional costs and denial of access to host-country resources, which are enjoyed exclusively by domestic firms. The theory proposes that multinational enterprises face additional costs due to the “foreignness” of a country’s policies, regulatory traits, economic, political, and cultural differences (Hymer, 1976; Sethi & Guisinger, 2002; Mezias, 2000; Calhoun, 2002). Amongst other factors, he also suggests that MNEs face coordination difficulties across significant geographic distance that impact costs sustained to foreign MNEs. Hence, foreign firms are less likely to perform robustly when compared with their indigenous counterparts.

According to Zaheer (1995, p. 343), there are four costs in particular that MNE subunits are often subject to bear in an overseas market: "(1) costs directly associated with the degree of spatial distance (distance and or time zones) such as the costs of travel, transportation, and coordination costs between home country and host-country; (2) firm-specific costs based on a particular company's unfamiliarity with and lack of roots in a local environment; (3) costs resulting from the host-country environment, such as the lack of legitimacy and citizenship of foreign firms and economic nationalism of domestic firms; (4) costs from the home country environment, such as the restrictions or regulations on importing high-technology assets to certain countries imposed on U.S.-owned MNEs." Hymer (1960) suggests that MNEs can minimize these costs of competition between foreign and enterprises from other countries through the control of firm-specific advantages. This control of an MNE's knowledge, skills, and abilities of host-country requirements set it apart from international and domestic firms within an overseas market, consequently minimizing the MNE's "liability of foreignness."

Factors that influence these costs are varied amongst MNEs, according to the firm's socio-cultural similarities, industry standing, and firm-specific advantages relative to the host-country firms. In this context, it should be recognized that the liability of foreignness and the costs associated with being "foreign" can affect MNEs' profitability and survival within the host-country market (Zaheer, 1995). The next section describes the ways MNEs can minimize the liability of foreignness into six significant criteria.

3.1 Minimizing the Liability of Foreignness

As multinational enterprises face competitive market pressures, they become more inclined to expand outside their national boundaries and explore opportunities through foreign investments abroad. This provides MNEs an alternative way to improve firm efficiencies and manage the costs of operations. Consequently, investing abroad allows MNEs to design their growth strategies in order sustain their competitive edge (Hashim, 2012).

However, moving abroad can entail significant risks and costs to multinational enterprises. If handled erroneously, it can affect a firm's profitability and effectiveness. Therefore, this paper suggests six criteria that MNEs should consider in abating their firm of their liability of foreignness:

1. Firm-specific advantages vs. isomorphism (adaptation vs. adoption). Drawing from foreign direct investment theories and resource-based view approaches (Hymer, 1960, 1976; Buckley & Casson, 1976; Dunning, 1977, 1988; Hennart, 1982; Wernerfelt, 1984; Barney, 1991), these theorists have argued that MNEs can overcome liability of foreignness by drawing on pre-existing capabilities and relying less on creating new ones in foreign subunits (Kogut & Zander, 1996). These existing capabilities are referred to as firm-specific advantages, usually in the form of managerial capabilities, economies of scale, or providing differentiated products and brand names. However, minimizing the cost of liability weighs more heavily on the practice of managerial capabilities such as the ability to transfer technology, knowledge, and organizational practices across unfamiliar territory (Barlett & Ghoshal, 1986; Kogut, 1993). On the other hand, institutional and organizational theorists (DiMaggio & Powell, 1983, 1991; Zucker, 1988; Rosenzweig & Nohria, 1994, Rosenzweig & Singh, 1991) argue that MNEs will attempt to become isomorphic in an effort to mimic local firms' practices that have been proven successful in order to meet the demands of local host-country requirements, thus giving up their existing capabilities for new local ones. The more pertinent question is how MNEs choose which of the two approaches suit them best. Do they import firm-specific advantages, or do they mimic domestic firms' success? The findings in literature suggest that the choice of approach derives from the MNE's level of capability relative to the host-country firms (Zaheer, 1995).

2. Fully foreign subunits vs. local subunits (parent enterprise vs. local centralization). Another way of minimizing the liability of foreignness is choosing whether to become a fully foreign subunit driven by the parent enterprise or to become a local subunit with sovereignty to act like a domestic firm. MNEs that possess economies of scale, differentiated products, or advanced technology are more likely to apply fully-foreign subunits, importing their capabilities because they are more able to capitalize on distance-related costs. Meanwhile, MNEs that possess capabilities less firm than local firms are more likely to be provided full autonomy from parent enterprises in order to maintain competitiveness (Zaheer, 1995; Bartlett & Ghoshal, 1989). Therefore, MNEs that are looking to expand abroad must first determine their firms' capabilities relative to their potential foreign market in order to decide whether a fully foreign or local subunit is most suitable.

3. Vertical vs. horizontal expansion. The decision to engage in vertical or horizontal expansion is closely influenced by the MNE's comparative advantage and production factors. MNEs that engage in vertical expansion

most commonly possess a comparative advantage within the host-country market relative to the costs of factors of production, namely land, labor, and capital (Guillen & Garcia-Canal, 2009). Theorist Coase (1937) suggests that MNEs vertically expand in order to spread the marginal costs by internalizing production and outsourcing costs within the market. In doing this, MNEs are able to expand and integrate many activities along the value chain, thus creating market power with the host-country market (Bain, 1956, 1959). For foreign MNEs, this approach seems to be more profitable in regards to the slow but yielding ability to gain market recognition. Horizontal expansion is a corporate growth into more than one industry across varying businesses. This is possibly more pragmatic for MNEs that have an existing or established facility abroad, because they can internally diversify their operations without having to bear the costs of transaction (Williamson, 1975). This serves the MNEs better in exploiting market opportunities while maintaining production in the parent-home country. Horizontal expansion is relevant to MNEs that are influenced by high distance-related costs such as transportation costs, fluctuant currency exchange rates, or that face stringent protection barriers to entry (Guillen & Garcia-Canal, 2009).

4. Psychic distance vs. physical distance. According to the Uppsala model, MNEs may begin to expand their businesses abroad by associating themselves with shared values and expectations of the host-country. Countries that share a similar language, culture, economic, and political system with foreign MNEs are more likely to find those same MNEs investing within their market. This is typically understandable, since people like what they know. Using the Uppsala model, MNEs are able to venture into foreign countries that are seemingly closer to their home market, thus reducing the firms' perceived risk of failure and reduced market uncertainties and allowing MNEs to build on their experiential knowledge of the host-country's environment and later expand at a more distant market. This is commonly referred to as psychic distance (Johanson & Vahlne, 1990, 1997). For example, Rangan and Drummond (2004) provide evidence that prior historical and linguistic ties between Europe and Brazil allow European MNEs to outperform American-based MNEs in Brazil. However, this is only true when European MNEs have similar or more firm-specific advantages than American MNEs.

This brings us to the second point: physical distance. MNEs from developed countries that possess firm-specific advantages are more likely to expand regardless of "psychic distance." Since they possess economies of scale, brand, or differentiated products, and technological advances, they capitalize by investing in emerging countries regardless of physical distance to their home country. In regards to the cultural aspect, they may mimic certain practices in order to respond to "localization." In order to minimize liability of foreignness, MNEs must evaluate their mode of entry, whether it be to leverage cultural similarities or firm-specific advantages in emerging countries (Hymer, 1960; DiMaggio & Powell, 1983, 1991; Rosenzweig & Singh, 1991; Dunning, 1998; Guillen & Garcia-Canal, 2009).

5. Upstream vs. downstream activities. According to Porter (1986) and Defever (2006), identifying MNEs' involvement within a foreign environment can minimize the costs of foreignness by linking the type of activities conducted to the resources to which they are related. Thus, whether MNEs create products (upstream activities) or sell and provide services (downstream activities), they are able to adhere to costs directly related to the purpose of their foreign subunits and cut unnecessary ones. For instance, MNEs that engage in upstream activities typically create backward linkages that strengthen their relationship with the supplier. This enables MNEs to more easily access sources of raw materials. On the other hand, MNEs that engage in downstream activities typically have forward linkages that will enrich their relationship with the distributor or agent, allowing MNEs to reduce uncertainty within the host-country market (Hashim, 2012).

6. Emerging vs. established MNEs. MNES looking to expand abroad must consider the differences between emerging and established multinationals and which end they are on. MNEs that have relatively fewer economic and technological advancements are more likely to compete in countries that are less developed, and vice versa (Hashim, 2012; Ramamurti, 2008). This suggests that although emerging MNEs possess competitive firm capabilities, it may not be enough to compete in highly developed countries due to insufficient financial and technological advances relative to host-country firms (Barnard, 2010; Ravamurti, 2008). However, this is quite the opposite with developed countries. Internalization theorists (Coase, 1937; Hymer, 1960; Dunning, 1998; Porter, 1986; Defever, 2006; Guillen & Garcia-Canal, 2009) suggest that MNEs from industrialized developed countries are able to competitively compete with host-country firms because they possess more capable resources, financial, and technological advancements than indigenous firms.

These six criteria provide MNEs with an overall insight on how firms can leverage information that will help them minimize liability of foreignness when expanding beyond national boundaries. Evaluating each criteria and selecting which best suits them can support MNEs' ability to design "globally intelligent subunits" that are able to act as transnational entities that combine both global integration and domestic responsiveness in order to consolidate economic returns and sustain competitive advantage (Bartlett & Ghoshal, 1989; Doz & Prahalad, 1984; Prahalad & Doz, 1987). The next section discusses the ways MNEs can achieve this.

3.2 Creating Globally Intelligent Subunits

Foreign subunits are only foreign when they invest in a country of which they have no knowledge. Previous studies and historical evidence presented in this paper have addressed the importance of acquiring knowledge of host-country requirements but more importantly how to coordinate that knowledge effectively through a network of units. Knowledge-sharing about external environmental conditions can allow MNEs to cooperate and transfer knowledge between parent and foreign subunits more effectively than other firms, whether it be within the home country or abroad (Bartlett & Ghoshal, 1989; Birkinshaw & Morrison, 1995; Gates & Egelhoff, 1986; Gupta, 1987; Roth, Schweiger, & Morrison, 1991; Kogut & Zander, 2003).

Thus, competitive advantage can be leveraged when MNEs are able to design a transnational strategy that incorporates both knowledge about firm-specific advantages and host-country requirements relative to the six criteria of minimizing liability of foreignness presented in the previous section. This paper suggests that MNEs that are likely to expand and invest in foreign countries may benefit from sensing, seizing, and transforming information of that foreign country by embedding it within subunits in their home country prior to its exportation to a foreign environment (Buckley & Casson, 1976; Caves, 1982; Dunning, 1977; Hennart, 1982; Barney, 1991; Winter, 1991).

The design and creation of a globally intelligent subunit consists of human capital that is able to create a fully functional subunit infrastructure and acquire information and technological resources. For the most part, they act as an "incubated subunit" conceived in the home country, which consists of the right people, the right methods, and the right environment. The "right" people that make up this globally intelligent subunit are those who possess the managerial experience and organizational capabilities of working within an international presence. With that being said, they need to possess the following five types of experience: (1) experience in designing a transnational organizational structure that adheres to parent firm objectives while responding to local operational procedures; (2) experience dealing and engaging with host-country shareholders; (3) experience in minimizing liability of foreignness through cultural engagement and language fluency; (4) experience in improving the degree of MNEs' local citizenship within the host-country; and (5) experience in managing both home country and host-country human resource activities such as recruitment, training, and development, compensation and incentives, as well as dismissal (Kostova & Roth, 2003; Szulanski, 1996).

The objective of hiring the right people is to create a strategic link between the parent firm's needs and that of the host country. By understanding or having similar values and objectives, these globally intelligent subunits are able to minimize the costs of communication while operating abroad. Therefore, these subunits will become an efficient and effective means of establishing the process of global integration and assimilation within the host country (Gupta & Govindarajan, 1991; Roth & Morrison, 1992). Through the acquisition of human capital that possesses managerial experience and capabilities, MNEs are able to minimize liability of foreignness by avoiding regulatory complications and domestic firm hostility that would incur costs of deterrence (Eisenhardt & Behnam, 1995; Roth & Morrison, 1992).

4. Discussion

The past century has seen a dramatic transformation, from once an economic and social ruin, the world has since embraced technology, knowledge and with that wheeled stabilization through economic integration from foreign direct investment activities. This paper highlights how interacting factors such as economic, political, societal and technological developments have shaped the theories of multinational enterprises that we use today. As a result, MNEs have become more dynamic and competitive.

There has been vast literature on foreign direct investment and how it has the potential to give firms the boost that it needs to sustain competitive advantage against its rivals. However, there have been limited studies addressing the liability of foreignness that MNEs potentially face once they have established their subsidiaries abroad. This paper provides evidence from literature that proves liability of foreignness can amount to significant risks for MNEs which include the inherent costs of transferring technology and knowledge across national boundaries and the survival of subsidiaries within a foreign market. This study does not imply that all MNEs that approach foreign direct investment activities abroad are doomed to fail, rather it caveats MNES about the potential risks and provides them with a conceptual framework that allows practitioners to minimize the liability of foreignness. By considering six specific criteria mentioned in the literature, MNEs are able to create incubated subunits that match their firms' specific advantages with foreign market requirements. This transnational strategy will help MNEs assimilate to foreign markets more seamlessly, thus, minimizing the costs of doing business abroad. Basically, what this paper is essentially doing is providing both researchers and practitioners the building blocks to create an artificial unit that consists of “what we know” and bringing it to the unknown. By controlling “what we know”, we are minimizing the risks of “what we don’t know”.

This conceptual paper is delimited by several elements. First, this paper only provides one dimension of the whole reality. This is delimiting because it is a conceptual framework that presumes in an idealistic world, MNEs have the available resources and understanding of how to create “globally intelligent subunits”. Not only is it an expensive and time consuming undertaking, it is based on the overwhelming idea that MNEs are able to gather true host-country information about the foreign market. A second limitation was that not all the literature on the topic was not explored. Other name worthy theorists and their works were not included due to time constraints. Thus, limiting the overall perspective of the evolutionary timeline of multinational enterprises. This conceptual paper has its analytic restraints. For example, it lacks empirical evidence and measurement methods.

However, this paper provides a stepping stone for future researchers to develop the appropriate measurement methods to test the theory of minimizing liability of foreignness following the six criteria provided in this paper. In addition, researchers should identify what types of factors influence the assimilation process of “globally intelligent subunits” in foreign markets. Finally, experimental research should be conducted to test whether this framework is valid across an international context.

5. Conclusion

This study establishes that as home markets become increasingly competitive, multinational enterprises are inclined to seek opportunities beyond national borders. Therefore, we will see more MNEs investing in business abroad. In the attempts to expand MNEs’ growth strategies, profitability, and survival, these firms face liability of foreignness: the apparent costs of doing business abroad. Studies suggest that most MNEs will consider several criteria in the practice of minimizing these costs of unfamiliarity. MNEs that consider these six criteria are able to match their firm-specific advantages to the development of “globally intelligent subunits” contracted to partake in the assimilation process of foreign firms in an overseas market. This study provides multinational firms with a model that enables them to assess their firms’ capabilities, which will influence how well MNEs establish “globally intelligent subunits” that can minimize costs of foreignness and effectively implement organizational practices abroad.

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