



# Market expansion versus cost reduction: a financial analysis of foreign direct investment advantages for multinational enterprises

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## Abstract

By testing a large sample of US-based multinational enterprises (MNEs), we attempt to microscope the relations between FDI advantages and excess market value created thereby. Two most commonly pursued FDI advantages—market expansion and cost reduction—come under the analysis. We find that the overseas divisions of US-based MNEs have significant market expansion advantage over the domestic divisions, but do not have significant cost reduction advantage. The cross-sectional variation in excess market value of US-based MNEs finds an explanation in the market expansion advantage when firm equity risk is held constant, but it cannot be explained by the cross-sectional variation in the cost reduction advantage. Given the result of our study, we also deliberate on the relations of FDI advantages with the degree of international involvement by MNEs. © 2002 Elsevier Science B.V. All rights reserved.

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## 1. Introduction

Owing to a rapid pace of economic globalization over the last two decades, foreign direct investment (FDI) has become a popular vehicle by which firms achieve their strategic objectives. The worldwide FDI flows have amazingly grown from US\$ 46 billion in 1980 to US\$ 644 billion in 1998 (World Bank, 1999). In this process, multinational enterprises (MNEs) are particularly active in generating excess values through FDI. As claimed, it is in

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