International Business Review 17 (2008) 630–641

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

Finance-specific factors as drivers of cross-border investment—An empirical investigation

Jens Forssbæck [a,b], Lars Oxelheim [a,c,*]

[a] Lund Institute of Economic Research, P.O. Box 7080, 220 07 Lund, Sweden
[b] Center for Law, Economics and Financial Institutions, Copenhagen Business School, Copenhagen, Denmark
[c] The Research Institute of Industrial Economics, P.O. Box 55665, 102 15 Stockholm, Sweden

A R T I C L E I N F O

Article history:
Received 16 January 2008
Received in revised form
16 August 2008
Accepted 22 September 2008

JEL classification:
E22
F21
F23
L23

Keywords:
Cost of capital
Cross-border acquisitions
FDI
Financial strategy
Financial variables
OLI

A B S T R A C T

In this paper we empirically test the role of firm-specific financial characteristics as drivers of international investment and production. We hypothesize that financial strength generates advantages that can be exploited through cross-border investment activity. The hypothesis is tested in a series of binary-response models, using a sample of 1379 European non-financial firms' international acquisitions. Controlling for traditional firm- and target-country-specific foreign direct investment (FDI) determinants, we find strong evidence that financial factors play a significant role in explaining cross-border investment. We conclude that without explicit consideration of the financial dimension, firms' FDI decisions cannot be properly understood.

1. Introduction

Several theories and research traditions have contributed to understanding the determinants behind a firm's decision to undertake foreign direct investment (FDI). One common element in these different, but often overlapping, theories is that they focus on real side factors, whereas the financial side of the firm is ignored, or allotted a menial role for the FDI decision. This in turn may reflect a relatively small role for finance within international business theory more broadly (as noted at a general level by, e.g., Agmon, 2006)—possibly due to a tradition of (implicitly) assuming that finance essentially "follows fundamentals". Indeed, Dunning (1993), for instance, discusses a "financial asset advantage" that concerns "firms' superior knowledge of, and access to foreign sources of capital", but essentially finds this advantage to be a by-product of the size, efficiency and knowledge of the multinational firms.

Contrasting this view, in a conceptual paper, Oxelheim, Randøy, and Stonehill (2001) argue that a firm's financial characteristics are not merely by-products of its competitive strength but constitute a distinct set of explanatory variables.

* Corresponding author at: Lund Institute of Economic Research, P.O. Box 7080, 220 07 LUND, Sweden. Tel.: +46 46 222 87 44; fax: +46 46 222 44 37.
E-mail addresses: jens.forssbaeck@fek.lu.se (J. Forssbæck), lars.oxelheim@fek.lu.se, lars.oxelheim@ifn.se (L. Oxelheim).

0969-5931/$ - see front matter
doi:10.1016/j.ibusrev.2008.09.001

By having a superior financial strategy a firm is able to minimize its cost and maximize its availability of capital relative to its competitors, both domestic and foreign. By lowering the discount factor of any investment, such a financial advantage increases the firm's likelihood of engaging in FDI.

The present paper brings this argument to the data. As point of departure, we have chosen to focus on the ownership–location–internalization (OLI) framework (Dunning, 1977) since, in its ambition of being all-inclusive, it provides a list of ''standard'' FDI determinants against which we can test the added explanatory value from including financial factors. We thus construct a number of firm-level financial characteristics ranging from simple cost of capital and creditworthiness measures to outright financial strategies such as listing the firm's equity on large and competitive foreign stock exchanges. We then use binary-response models to test if the included financial variables significantly influence a firm's propensity to undertake FDI, next to a set of traditional FDI determinants suggested by OLI. As far as we are aware, this is the first paper to empirically test the role of firm-level financial factors within a ''full-fledged'' OLI framework.

The results, based on a sample of 1379 European non-financial firms' cross-border acquisitions in a total of 44 target markets, show a strongly significant explanatory power of a number of financial characteristics and of financial strategies undertaken in a period of up to 60 months prior to the investment. These results give a clear indication of the important role played by finance-specific factors and support the notion that firms can create ownership advantages by adopting strategies to improve their financial strength.

The article is organized in the following way. The next section summarizes the argument for including finance-specific factors in the OLI framework. In Section 3 the empirical models and testing methodology are explained. We then present definitions of the variables used and the dataset. In Section 5, the results are presented and discussed. In the final section we summarize our findings and provide concluding remarks.

2. Financial determinants of FDI and the OLI paradigm

The basic underlying logic for the inclusion of financial factors in any model proposing to explain FDI is that a firm's cost of and access to capital matter for its ability and propensity to undertake foreign investment. Hence, strategies aimed at lowering the cost and/or increasing the availability of funds—i.e., creating a financial advantage—will improve a firm's likelihood undertaking FDI.

However, in efficient and internationally integrated financial markets, no firm has a financial advantage over another, since all firms have equal access to finance at equal (risk-adjusted) cost. Arguing for a finance-FDI effect thus requires an assumption of imperfect capital markets that are at least partially internationally segmented. While the theories underpinning the OLI paradigm (especially internalization theory) largely build on imperfections in goods markets, the effects of financial market imperfections have received less attention. To the extent that they have been acknowledged, they have been discussed as sources of locational advantages or—in a strategic context—as potential sources of opportunistic, ''reactive'' managerial behaviour (Aliber, 1970; Dunning, 1993; Kogut & Kulatilaka, 1994). Oxelheim et al. (2001), by contrast, emphasize to the role of ''proactive'' financial strategies and the potential of such strategies to generate *ownership* advantages.

The basic tenet of an ownership advantage is that to undertake FDI, a firm must have developed firm-specific characteristics that enable it to be competitive in the home market. The assumption is that these characteristics are transferable abroad and of such magnitude that they may compensate for the extra costs and barriers that are associated with doing business abroad. Ownership advantages may include various economies of scale and scope (such as size, market power, and economies of multi-plant structures), a superior technology, or other types of proprietary knowledge, such as managerial and marketing expertise.

A low cost and high availability of capital may thus be categorized as a ''traditional'' ownership advantage insofar as large, research-intensive MNCs reside in countries with liquid, efficient, and integrated financial markets. But as pointed out by Oxelheim et al. (2001) this is not necessarily true for MNCs resident elsewhere or for firms in general. For such a firm, a conscious strategy aimed at improving its financial strength may materialize in an ownership advantage. Therefore, given (partial) segmentation and remaining home bias in world capital markets, there are benefits to be reaped from ''proactive'' financial strategies such as, e.g., cross-listing in a more liquid stock market (Foerster & Karolyi, 1999; Miller, 1999; Pagano, Röell, & Zechner, 2002; Sundaram & Logue, 1996; Tolmunen & Torstila, 2005), foreign issues of equity and/or debt (Modén & Oxelheim, 1997), and ''bonding'' strategies to reduce information asymmetries (Oxelheim & Randøy, 2003).

Following this argument, financial advantages may be important for all firms but should be particularly important to MNCs resident in small industrial or emerging market countries with relatively illiquid and/or segmented domestic capital markets. Moreover, it may matter to the understanding of the process to distinguish between situations where an ownership advantage is created or where an ownership disadvantage is eliminated. For instance, a firm resident in a small, emerging market country, making its way out of a thin and regulated domestic capital market by an innovative financial strategy, may have eliminated an ownership disadvantage vis-à-vis its competitors in developed countries. But at the same time it may also have created an ownership advantage vis-à-vis its competitors in other emerging economies, which can be exploited by FDI during a limited period.

Oxelheim et al. (2001) identify three major financial strategies, or groups of strategies, that may qualify as underpinning ownership advantages. The first of these is gaining and maintaining a global cost and availability of capital (for example by