

Home Advantage (Not Bias) in Perfect Markets with Global Firms: Necessary Conditions and Empirical Implications

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Abstract : Existing explanations for home bias depend on market imperfections such as government restrictions, information asymmetry, or behavioral reasons. We show that home bias can exist in perfect markets with information symmetry and with rational firms and investors. We develop a parsimonious asset pricing model where firms operate domestically and globally. Home advantage emerges if firms' operations can be diversified more efficiently with domestic rather than global risks. This is possible when domestic diversification across industries yields greater gains than international diversification across countries. We, therefore, obtain a rationale for 'home advantage' rather than home bias and discuss empirical implications.

Keywords : international asset pricing, firm globalization, home bias, home advantage

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