© Academy of Management Executive, 2003, Vol. 17, No. 3

Coping with corruption in foreign markets

Jonathan P. Doh, Peter Rodriguez, Klaus Uhlenbruck, Jamie Collins, and Lorraine Eden

Executive Summary

Government corruption is a pervasive element of the international business environment and has damaging effects on governments, firms, and the broader society in which it takes place. Recently publicized scandals in Russia, China, Pakistan, Lesotho, South Africa, Costa Rica, Egypt, and elsewhere underscore the extent of corruption globally, especially in the developing world. Yet, the impact of government corruption on foreign investment has received limited attention. In this article, we examine how multinational firms respond to corruption when investing in foreign markets, especially developing countries. The article begins with a discussion of the direct and indirect costs of corruption to business and provides illustrations of corruption's impact on firms that invest in foreign markets. We employ a framework that incorporates two basic dimensions of government corruption—pervasiveness and arbitrariness. We then propose five broad strategies that multinationals should consider in responding to corruption and give examples of organizations that use these approaches. Corruption involves costs that firms investing abroad are likely to misjudge or ignore. A clear understanding of corruption's nature creates value for decision makers and allows for a strategic analysis of responses to corruption pressures.

In 1998, incoming Pakistani Prime Minister Nawaz Sharif alleged that foreign companies investing in independent electric power projects had bribed officials from the previous Benazir Bhutto government in return for high electricity rates. He threatened to rescind the project contracts if the foreign companies did not cut their rates by more than 30 per cent.[1] In Russia, several Canadian oil and mineral extraction firms were expropriated by their local joint venture partners who were able to take advantage of Russia's unpredictable court system.[2] On the African continent, legal proceedings are underway against some of the biggest European building companies for passing bribes to a local government official overseeing World Bank-financed construction projects.[3] These are among the hundreds of publicized examples of how foreign investment has been affected and disrupted by corruption.

Foreign direct investment (FDI) has grown rapidly over the past decade. Private investment in developing countries, especially in large emerging markets such as China, Brazil, Mexico, Indonesia, and Poland, has seen a particularly large increase.[4] Fueled by the broad forces of globalization and technological advancement, private investment by multinational enterprises (MNEs) in property, plant, and equipment has contributed to economic development in many emerging economies. These initiatives have also helped investors diversify portfolios and generate higher returns from fast-growing markets. Yet, beneath the veneer of benefits to both host countries and MNE investors is a troubling and persistent pattern of uncertainty and added costs associated with the risks of FDI.

Political and economic risks have received widespread attention from management practitioners and scholars, and a body of helpful managerial literature has developed around advising firms on how best to navigate political pressure and instability.[5] One type of risk, however—the risk of government corruption—has received much less attention.[6] Although many studies detail the impact of corruption on national economies, and others have considered corruption in the context of ethics and social responsibility,[7] few efforts have been directed at assessing its impact on firms. Yet, the likelihood of investing firms confronting corruption is much higher than the chance of facing expropriation or other such events that fall into the category of political risks. This is because corruption exists (and persists) "below the radar screen" of many corporate officers, management researchers, and even government officials. The very nature of government corruption, which we define as *the abuse* (or *misuse*) *of public power for private* (*personal*) *benefit*, lends itself to a tendency to look the other way and fosters an attitude of "don't ask, don't tell." Firms are concerned that exposing corrupt behaviors will reduce profits or anger corrupt officials without changing the behavior of others. Some have suggested that corruption may even create an opportunity for international firms to overcome numerous difficulties associated with entering new foreign markets.[8] However, the costs of corruption to foreign investors, host countries, and broader societal interests are substantial. We emphasize that firms choosing to comply with or even exploit local corruption often neglect significant long-term costs.

Firms choosing to comply with or even exploit local corruption often neglect significant long-term costs.

Our focus is on FDI in developing countries. These countries have poorly developed and often ineffective institutional systems, and it is in these environments where corruption is most rampant and creates the greatest potential for distorting investment plans. While corruption is present in a variety of industries and country settings, it is more common in certain sectors. For instance, infrastructure projects are especially prone to corruption because they involve large investments and complex contracts in which corrupt payments can be easily disguised.[9]

We begin by detailing the direct and indirect costs of corruption to both host countries and foreign investors. Drawing from research on the impact of corruption on economic development, we present a framework that incorporates two important dimensions of corruption—its pervasiveness and arbitrariness. We conclude with a discussion of strategies which multinationals can pursue alone or in conjunction with governments and international organizations to stem the tide of corruption or at least reduce its worst effects.

Costs of Corruption

Corruption can be viewed as a tax that increases costs and shifts risk from some stakeholders to others. Specifying its direct and indirect costs helps isolate the ways in which corruption affects business decision-making.

Direct Costs

Bribes, kickbacks, "grease," and "speed" money are perhaps the most conspicuous types of corrupt activity. Direct costs of corruption are those costs that result from direct interaction between the firm and the government (as represented by any of its officials or policy makers). Hence, bribes, bureaucratic red tape, and various categories of transaction costs are considered direct costs since they can be identified with a direct interaction or transaction between a particular firm and corrupt officials. Similarly, resources expended in an effort to avoid extortion by corrupt officials of a given firm are also a direct cost. Table 1 provides a summary of six major types of direct costs of corruption that we have identified from our research.

Bribes

Bribes cost firms and other stakeholders through monetary and non-monetary payments to those with public power. Examples of bribery are numerous. However, only a small fraction of bribes are exposed, suggesting that bribery is far more pervasive than what is reported. Consider these examples. In September 2002, Michael Woerfel, a senior employee of European Aeronautic Defense and Space Company (EADS), was charged with corruption in connection with a 1999 $5 billion arms deal with South Africa. EADS conceded that it had "helped" 30 South Africans with hefty discounts on luxury cars. In related developments, chief whip of the ruling African National Congress (ANC) Tony Yengeni was charged with corruption, fraud, and perjury.[10] Also in September of 2002, a Lesotho court found Acres International, a Toronto-based firm, guilty of passing $260,000 as a bribe to the chief executive of the project. The executive was convicted of 13 counts of bribery and of accepting more than $2 million in total bribes.[11] In July 2002, Xerox admitted in a regulatory filing that it had made improper payments of more than $500,000 "over a period of years" to government officials in India to push sales.[12]

Red Tape and Bureaucratic Delay

Red tape and bureaucratic delay are examples of non-monetary costs that result from dealing with corrupt officials or complying with the requirements of corrupt regimes. To avoid red tape and

TABLE 1
Direct Costs of Government Corruption

Type	Explanation
Bribes	Monetary and non-monetary payments to those with some degree of public power as a response to extortion or in exchange for some misuse of public power.
Red Tape/Bureaucratic Delay	Non-monetary and opportunity costs of dealing with corrupt officials or of complying with the illegitimate bureaucratic requirements of corrupt regimes.
Avoidance	Efforts to avoid and limit the firm's exposure to extortionary behavior by corrupt officials, including hiding output and opting out of the official economy.
Directly Unproductive Behavior	Investments in channels of influence to gain advantage in dividing up the benefits of economic activity; includes lobbying and more direct vote and influence peddling.
Foregoing Market Supporting Institutions	Costs imposed on the firm as a result of foregoing the use of courts for the enforcement of contracts, local financial operations, etc.
Engagement with Organized Crime	Monetary and non-monetary costs imposed on firms as a result of willing or unwilling engagement with organized crime.

delays in facilitating project approvals, firms often use bribes to "grease the skids."[13] This was the case when Robert King, a leading investor in Owl Securities (OSI), was convicted on five counts of conspiracy and for violating the Foreign Corrupt Practices Act by planning to bribe Costa Rican officials. The bribery was related to OSI's plan to build a new Caribbean super-port and a 124-mile dry canal through Costa Rica, designed to rival the Panama Canal.[14] Lockheed Martin agreed to a consent decree (neither admitting nor denying allegations) in which it paid nearly $25 million in fines after it was accused in 1995 of paying $1 million to an Egyptian member of parliament in order to facilitate the sale of Lockheed aircraft to the Egyptian Air Force.[15] Tehelka, an Internet news portal, captured several government officials taking bribes from undercover reporters in India. The reporters were posing as arms dealers peddling "fourth-generation" thermal hand-held cameras on behalf of a British company.[16]

Avoidance

Firms may be forced to engage in expensive efforts to avoid and limit their exposure to extortion by corrupt officials, including hiding output and opting out of the official economy. Avoiding corruption can be costly. For example, Procter & Gamble, as part of its broader exit strategy from Nigeria, decided to close a Pampers plant rather than pay a bribe to a customs official.[17]

Directly Unproductive Behavior

Corruption may force firms to engage in a range of costly and unproductive behavior. This may include investment in channels of influence to gain advantage in dividing up the benefits of economic activity through lobbying, direct vote solicitations, and influence peddling.

In China, various forms of obligatory "profit sharing" with city officials in Hainan province have been reported. Employment of relatives, donations, and other "favors" are apparently an expected cost of doing business in that region. One private firm in Hainan province reported having a formal profit-sharing plan with the city officials. Firms report hiring key officials or their relatives as a way to develop political or social influence. Owners of local private firms in Wenzhous in eastern China have been known to give firm shares to senior cadres in exchange for protection from government interference.[18]

Foregoing Market-Supporting Institutions and Engaging with Organized Crime

Firms bear additional costs when, because of corruption, they are unable to use institutions such as courts for the enforcement of contracts. Costs increase when firms are willing (or unwilling) to engage with organized crime by paying for "protection" and other security services that would otherwise be unnecessary.

For example, many firms doing business in Russia in the post-Soviet era have been forced to take part in the underground market for "protection" by paying high fees for "security" services because the state cannot provide adequate public protection. The Canadian International Development Agency has spent $130 million to help generate Canadian business in Russia; however, many companies have claimed that projects have been stolen out from under them because of government corruption. As a result, Canadian investment in Russia has practically stopped all together, and the CIDA has virtually nothing to show for its investment.[19] This example shows how specific acts of corruption result in multiple costs; in this case, efforts to build institutions were thwarted through organized crime, which contributed to other unproductive and costly behavior.

Indirect Costs

Many of the destructive costs of corruption affect firms indirectly via public-sector failure that results from missing or weak institutions, government failure to effectively use public resources, and government policies that keep the economy from growing. The indirect costs of corruption are those costs imposed on firms that cannot be specifically identified with a particular interaction between a firm and the government or its officials. These costs may result in higher prices for resources, lowered prospects for profitability, and macroeconomic instability. Indirect costs of corruption have been relatively well documented in terms of system-wide effects;[20] however, individual firms may overlook these costs because they don't recognize how such costs affect them. These indirect costs limit investment returns because they increase operating costs and decrease growth potential. Moreover, such costs may fall more heavily on some firms than others. Table 2 provides a summary of six major types of indirect costs of corruption, with a brief description of each.

Reduced Investment and Distorted Public Expenditures

Corruption has been shown to reduce the ratio of investment to GDP.[21] Corruption may also reduce public expenditures because tax revenues fall when business activity takes place outside of the official economy. Moreover, the expenditures that remain are often skewed from the most pressing needs toward projects that benefit privileged insiders. Recently, Nicaragua resorted to a national tax audit lottery to combat the problem of low tax revenues due to rampant corruption. Each month the government chooses 100 professionals at random, audits them, and publicizes the results. The government has estimated that 40 per cent of all professionals are tax dodgers. The inefficient and proportionally small tax collections result in inadequate investment in infrastructure and education.[22]

Macroeconomic Weakness and Instability

More generally, corruption weakens institutions like courts and regulatory agencies, slowing economic growth.[23] Corruption also reduces aggregate investment through reduction in public and private investment, increasing poverty and the social ills that go along with it.[24]

Weak Infrastructure

Corruption weakens public infrastructure, resulting in inadequate, expensive, and intermittently

TABLE 2
Indirect Costs of Government Corruption

Type	Explanation
Reduced Investment	Reduced public and private investment flows. Lower rates of foreign direct investment for the formation of a robust commercial environment.
Reduced and Distorted Public Expenditures	Reduced taxes as a result of the deterrence of business activity and recourse to the unofficial economy. Selection of privately beneficial and publicly costly expenditure projects.
Macroeconomic Weakness and Instability	Reduced rates of macroeconomic growth, weak commercial environment, and greater susceptibility to financial crises.
Weak Infrastructure	Inadequate, expensive, and intermittently supplied infrastructure services such as telephony, electricity, and transportation. Weak infrastructure foments opportunities for small bribes and may indirectly reduce public trust.
Squandered/Misdirected Entrepreneurial Talent	Engagement of entrepreneurial and otherwise talented individuals into the socially unproductive avenues of advance afforded by corrupt environments.
Socio-Economic Failure	Increased poverty, income inequality, and reduced income growth for the poorest in society. Increases demands on already weak central governments.

supplied services such as telephony, electricity, and transportation.[25] Weak infrastructure foments opportunities for small bribes and thereby increases direct costs of corruption. Corruption has even been shown to increase an economy's susceptibility to financial crises, such as those that occurred in Russia in the mid-1990s, Southeast Asia and Korea during 1997–1998, and in Latin America in the early 1980s and again in the mid- and late-1990s.[26]

Squandered/Misdirected Entrepreneurial Talent

Corruption leads to squandered and misdirected entrepreneurial talent because individuals are drawn to socially unproductive avenues for advancement afforded by corrupt environments. Hence, corruption stymies the very entrepreneurial activities that could offset or mitigate some of its harshest effects.

Corruption leads to squandered and misdirected entrepreneurial talent because individuals are drawn to socially unproductive avenues for advancement afforded by corrupt environments. Hence, corruption stymies the very entrepreneurial activities that could offset or mitigate some of its harshest effects.

Socio-Economic Failure

Finally, weaker economies, poor infrastructure, and squandered investment contribute to general socio-economic misery. Results include increased poverty, income inequality and slow income growth for the poorest in society, increasing demands on already weak central governments, and the retarding of developmental goals such as education, literacy, and life expectancy.[27] This is perhaps the most tragic cost of corruption.

Two Dimensions of Corruption

Our research suggests that the magnitude of both direct and indirect costs of corruption is driven by two key dimensions: the pervasiveness (or level) of corruption and its arbitrariness (uncertainty).[28]

Pervasiveness

The *pervasiveness of corruption* reflects the number and frequency of transactions (and individuals) with which (whom) the firm deals over the course of a fixed time period that involve illicit activities. Although the level of corruption is clearly difficult to measure (making a single index number inherently problematic), it captures the relative preponderance of corrupt transactions in a given country and correlates with the number of corrupt transactions that a firm expects to encounter in its normal operations. The higher the pervasiveness of corruption, the higher the direct and indirect resource costs of corruption to the firm.

When corruption is predictable, its effects are similar to an especially onerous tax; while damaging, companies may be able to budget for this tax as a business expense.[29] These conditions occur under well-structured, stable corruption regimes in which payment expectations are predictable and effective. Hence, firms can reasonably expect to receive the particular government-administered services in exchange for a bribe. Under such conditions, the pervasiveness of corruption could be high, but firms would still be able to operate with some degree of predictability. For example, in some countries, a standard "payment" accompanies requests to clear goods through customs.

Arbitrariness

Corruption can be viewed through a second critical characteristic—*arbitrariness*. A disorganized corruption network emerges when government agents act independently and capriciously in an effort to maximize their own bribe revenue while disregarding the effects of their efforts on other officials. In such a setting, firms are uncertain of whom to pay, what to pay, and whether the payments will result in the delivery of the promised goods or services. The lack of coordination among corrupt agents works to diminish economic activity as some officials appropriate bribe revenues that would otherwise accrue to others.

These characterizations fit well with anecdotal reports by MNEs. In some countries, one bribe guarantees access to the desired property or service; in others, the size and number of bribes necessary to obtain a license or permit are uncertain and, even when paid, do not guarantee the desired right or service. For example, the *Wall Street Journal* reports that Indonesia and Russia have become nations with both pervasive and arbitrary corruption: "Before, you paid a lump sum in Jakarta and could be certain you had smoothed things out . . . Now you pay a lot of small amounts locally, and you can't be sure things will be smooth . . . It is a continuous, confusing, and discouraging process." As for Russia, "Without the structure the

Communist Party provided, people didn't know who to pay, and many anarchistic bribe collectors stepped up with their hands out."[30] In such environments, corruption expectations can escalate, with each subsequent transaction demanding a higher payment.

Whereas the relationship between pervasiveness and direct costs of corruption is straightforward and positive, the arbitrariness of corruption reduces a firm's ability to estimate these costs. While pervasiveness of corruption is highly problematic, when corruption is arbitrary firms cannot anticipate the direct costs of corruption nor can they easily evaluate the impact of corruption on their operations. This aspect of corruption, however, is less obvious. Where corruption is arbitrary, firms might accept corruption and ignore the total cost of their actions, or they may avoid corrupt markets and incur opportunity costs by not entering these markets at all.

Measuring Corruption's Dimensions

We assessed the pervasiveness and arbitrariness of corruption based on the World Business Environment Survey (WBES) that was published by the World Bank in 1998. This survey focuses on perceptions of environmental factors facing firms. The WBES is based on a sample of 8,000 firms representing approximately 100 companies of various sizes in each of 80 developing countries. We draw the measure of the two dimensions of corruption—pervasiveness and arbitrariness—from two sets of questions on corruption in the WBES. Figure 1 represents our framework of two key dimensions of corruption and identifies five representative countries in each of four cells that reflect basic combinations of pervasiveness and arbitrariness. We chose only countries where pervasiveness of corruption, although low, is still considered a major impediment to local business. This figure shows how some countries can rank high on one measure and low on another, suggesting that corruption is a more complicated phenomenon than some companies might expect.

Coping with Corruption: Key Strategies

Corruption, like many public policy problems, generates a negative "externality" in that individual firms may benefit, while the damage to society is substantial. Hence, a firm may not have sufficient incentives to avoid or report corruption because the "benefits" of corruption are concentrated, whereas many of the costs are diffuse. Participation in corruption may be due to competitive pressures, respect for local cultural norms, extortion, or

Pervasiveness \ Arbitrariness	Low	High
High	**C1** Argentina China Mexico Nigeria Venezuela	**C2** Egypt India Indonesia Pakistan Russia
Low	**C3** Brazil Chile Italy South Africa South Korea	**C4** Czech Republic Hungary Malaysia Namibia Poland

*Note: Countries have been placed in four cells in alphabetical order and do not reflect specific ordered rankings within the cells.

FIGURE 1
The Two Dimensions of Corruption

the difficulty in monitoring individual employees. Unfortunately, if firms refuse to engage in corruption, they may consider themselves at a disadvantage vis-à-vis competitors. Nonetheless, many firms have developed strategies to respond to corruption without acquiescing to it, as summarized in Table 3.

Strategy: Avoidance

Corporations face numerous challenges when considering whether to enter a market characterized by corruption. One option is to avoid the market entirely and, in so doing, eliminate the direct costs of corruption whether generated from its pervasive or arbitrary application. Often, there are other reasons to avoid markets that are corrupt, such as weak profit potential, unstable government, and slow market growth; however, these conditions may themselves result in part from corruption.

- *Pervasiveness and arbitrariness of corruption cause firms to avoid markets.* Higher pervasiveness and higher arbitrariness of corruption both reduce total investment and FDI.[31]
- *Corruption causes delays in investment.* Investment rates fall as the arbitrariness surrounding corrupt payments rises for a given level of corruption.[32] Higher degrees of ownership and specialized knowledge advantages favor delaying FDI, particularly in uncertain environments.[33] Therefore, a widespread firm-level response to corruption appears to be outright avoidance in terms of foregoing investment opportunities.

TABLE 3
Strategies for Coping with Corruption

Strategy	Cost Targeted	Effective Against	Advantages	Problems
Avoidance	Direct	Pervasive & Arbitrary Corruption	Bypasses problem	Forego opportunities
Adjusting Entry Mode	Direct	Pervasive & Arbitrary Corruption (different strategies for each)	Allows firm to maintain participation in market while avoiding exposure to corruption Allows firm to avoid opportunity and other costs of foregoing markets	Denies firm some advantages of entry-mode options, including acquisition of local resources Denies host country some benefits
Corporate Codes of Conduct	Direct & Indirect	Pervasive & Arbitrary Corruption	Could incorporate major MNEs around the world	Viewed as lacking "rigor" Local firms unlikely to sign on, generating differential costs/benefits
Training, Development, and Public Education	Direct & Indirect	Pervasive, but less for Arbitrary Corruption	Regional-focused programs could make progress easier For government-sponsored programs, participation could be tied to World Bank loans and aid Makes policies clear and gives employees practical examples	Training initiatives may lack "teeth" in terms of enforcement Company-sponsored initiatives affect only one company Company-sponsored initiatives may have uneven application throughout subsidiaries
Social Contributions/ Public Donations	Direct	Pervasive Corruption	Provides needed services without breaking law or ethics	May be difficult to determine when "line has been crossed" May raise expectations of continued and rising payment
Laws and Agreements	Indirect	Pervasive & Arbitrary Corruption	FCPA includes strict rules with penalties OECD agreement relatively comprehensive Some developing countries now adopting OECD principles	FCPA may disadvantage U.S. firms vis-à-vis competitors Initially covered only OECD and a few developing countries Lack of enforcement and uneven implementation in developing world creates free-rider problem

Strategy: Adjusting Entry Mode

Individual firms will not always be willing or able to avoid investment in countries plagued by corruption. Rather, many firms attempt to offset the direct costs of corruption through selection of different entry modes and structures. For instance, in Eastern European and the former Soviet economies, the probability of an MNE investing abroad through a joint venture rather than a wholly owned subsidiary increases with the level of corruption.[34] Further, firms may employ different approaches in response to pervasive versus arbitrary corruption pressures.

We further examined how firms adjust entry modes depending on the nature of corruption, generating information that should be helpful to managers facing similar conditions. We used World Bank data on more than 400 telecommunications projects in 96 emerging and developing economies to analyze the influence of the two dimensions of corruption discussed above on entry strategies.[35] When choosing to enter a corrupt country via joint or sole venture, firms face competing pressures. On the one hand, entry via a joint venture with local partners may provide access to local networks and reduce uncertainty.[36] On the other hand, corruption weakens property rights and could allow local partners to take advantage of the foreign firm. Here is what we found:

- *Generally, foreign entrants into national markets choose joint ventures more often than wholly owned entry* as the level of corruption—both arbitrary and pervasive—increases.
- *As pervasiveness of corruption increases, market entry modes are more likely to include local partners.* As Figure 2 shows, pervasiveness has opposite effects on two subcategories of the joint-venture entry mode. The probability of choosing mixed joint ventures (that include local and international partners) grows as pervasiveness increases, but joint ventures between just international (i.e., non-local) partners become less likely as pervasiveness rises. Pervasiveness of corruption increases the preference exhibited by foreign entrants to join with local firms, suggesting that there may be benefits to including local partners as a way to mitigate risks associated with arbitrariness.
- Figure 3 shows that *joint ventures between local and foreign entrants are about as likely at low levels of arbitrariness as they are at high levels.* Foreign entrants appear to become more concerned that they may be subject to local partner opportunism as corruption becomes more arbitrary, offsetting the perceived advantages gained from partnering. Where corruption is highly arbitrary, entrants attempt to reduce risk via entry with international partners only.
- *In addition, if both pervasiveness and arbitrariness of corruption are high, entry modes are more likely to take the form of build-own-transfer or management contracts versus build-own-operate (traditional FDI) modes.* Firms appear to reach a tipping point at which they are more inclined to transfer ownership and less willing to remain to operate their projects. In countries where both pervasiveness and arbitrariness are very high (C2 in Figure 1), virtually all projects are transferred after their completion.

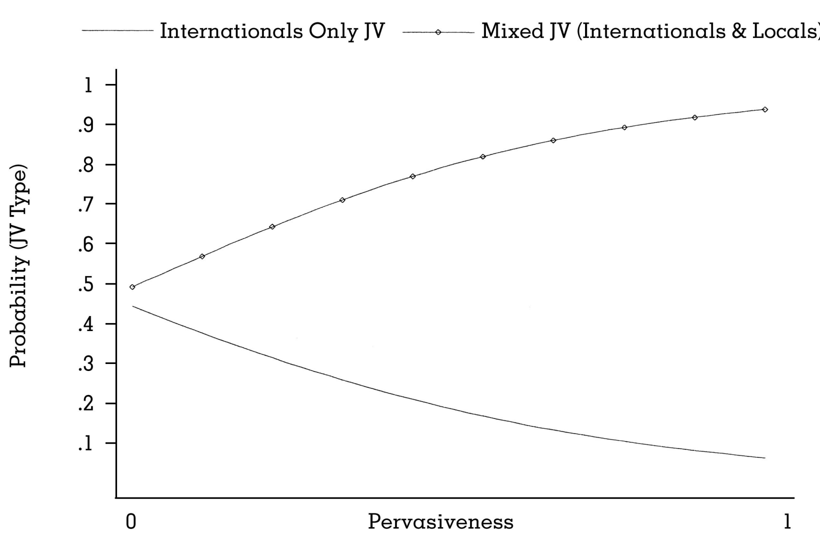


FIGURE 2
Relationship Between the Probability of Joint-Venture Types and Pervasiveness

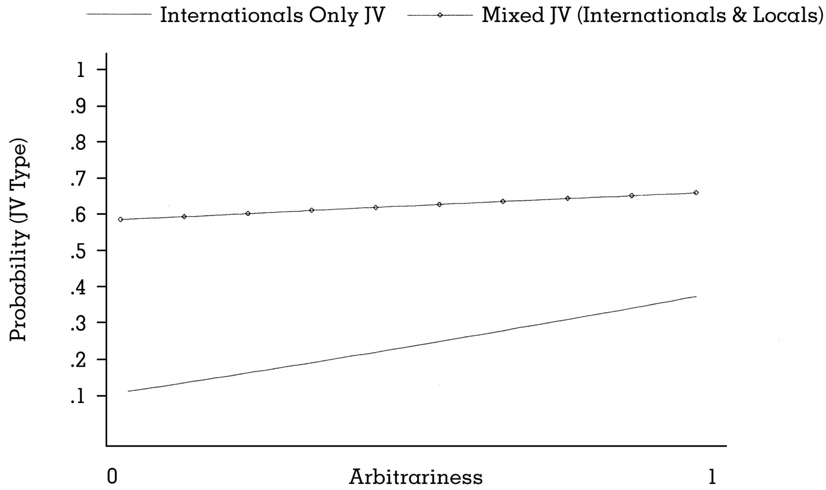


FIGURE 3
Relationship Between the Probability of Joint-Venture Types and Arbitrariness

Strategy: Corporate Codes of Conduct

A complementary strategy for reducing both direct and indirect costs of corruption is the adoption of anti-bribery principles. Below we list several examples. A number of companies have developed rigorous codes and principles that guide their policies on corruption around the world, while other MNEs rely on guidelines provided by public institutions. Such approaches may be effective in environments characterized by pervasive or arbitrary corruption.

- *Shell's General Business Principles* guide corporate behavior in the area of corruption. On the specific issue of bribes, for example, the Principles state, "The direct or indirect offer, payment, soliciting, and acceptance of bribes in any form are unacceptable practices." According to Shell, each year each country chairman reports to executive management on how these business principles are being implemented, and "issues concerning corruption and bribery are always at the top of the list." Shell's goal is to help managers understand the elements of corruption and bribery and to "exercise sound judgment when faced with difficult dilemmas."[37]
- *International Chamber of Commerce (ICC) Rules Against Extortion and Bribery.* The ICC has a Standing Committee on Extortion and Bribery that promotes its "Rules Against Extortion and Bribery" in international business transactions. These rules specifically target "large-scale extortion and bribery involving politicians and senior officials." The seven basic rules address extortion, bribery and kickbacks, agents, financial recording and auditing, responsibilities of enterprises, political contributions, and company codes.[38]
- *Transparent Agents Against Contracting Entities (TRACE).* The TRACE Standard, which is based on a review of the practices of 34 companies, applies to many types of business intermediaries, including sales agents, consultants, suppliers, distributors, resellers, subcontractors, franchisees, and joint venture partners. It is the first global business standard of its kind and is being disseminated directly by TRACE and by investment houses and pro-business organizations like the Centre for International Private Enterprise, the non-profit arm of the Chamber of Commerce. It has been well received because it sets out best practices and gives companies the confidence that they are doing as much due diligence as their corporate peers, which is an important part of a defense if an intermediary does pay a bribe.[39]
- Building from the ICC Rules, two legal experts have proposed a *Comprehensive International Corruption Code* that (1) emphasizes transparency, (2) provides guidance concerning specific practices associated with paying bribes, (3) reflects relevance to organizational environments, (4) identifies with and supports an independent entity such as an NGO or an academic center, and, perhaps most importantly, (5) can be monitored and assessed by external, independent entities.[40] This code and approach resolve the "free rider" problem by requiring many competing firms to adhere to the same standards. Further, it addresses challenges raised by both pervasiveness and arbitrariness of corruption.

Strategy: Training, Development, and Public Education

Training and development is a natural extension of corporate codes and principles, and may help respond to both direct and indirect costs of corruption. Firms can work with governmental bodies that are eager to promote local participation in foreign-sponsored projects to help convince them to crack down on corruption. This may be effective even in countries that have highly arbitrary corruption because enforcement actions can specifically target, and ideally isolate, these cases. Unilateral efforts, as well as those supported by multinational organizations such as the UN, World Bank, or IMF, should be encouraged. Often, assistance is available from multilateral bodies that provide financial and technical support for the development of efficient government and "good governance." Below are examples of individual firm activities as well as those involving public-private collaboration.

- *Honeywell* lists "integrity and the highest ethical standards" first among its set of eight company values and unequivocally admonishes against any bribes or kickbacks in its corporate code of conduct. As a constant reminder of the code, employees are issued business-size cards containing ethically driven questions that they should ask themselves in ambiguous situations. Moreover, Honeywell flags "high risk" employees for additional corruption and bribery training. The company has established a toll-free ethics advice line run by a third-party security firm. In one specific case, Honeywell declined to bid on a major airport contract in Asia because it was asked for a bribe as a price of entry. When an investigation revealed that 11 companies paid the bribe, they were disqualified and Honeywell was awarded the contract, showing that refraining from participation in corrupt transactions may sometimes have positive competitive effects.[41]
- *TDI Brooks International, Inc.,* a U.S.-based oil exploration firm, openly resists corruption. The company drew attention to suspicious activities during a recent public tender clarification meeting in Mexico. TDI demonstrated that the tender included specifications and restrictions added merely to favor one particular bidder and exclude others. The company further provided evidence that the project was heavily inflated compared to a reasonable bid for the proposed work. TDI thus served as a whistleblower, suggesting corrupt interactions between managers of one of the bidding organizations and of the state-owned firm that offered the tender. Ultimately, TDI lost the specific contract to this competing bidder but, by making corruption public, initiated an investigation into corrupt practices at this state-owned firm. Subsequently, the firm has indicated that it will hire TDI for another project. Whistleblowing may be a more promising strategy in countries where arbitrariness of corruption is low and perpetrators more easily identified.
- According to *Motorola,* a longstanding ethics program helps facilitate the understanding of bribery and corruption practices worldwide. The firm's ongoing ethics training program reportedly explores all facets of bribery and corruption, and guides employees on how to act in ethically difficult situations. Management uses actual case studies as part of its training in an attempt to give employees real-world situations, and the firm actively helps fight corruption in countries in which it operates. For example, Motorola supported training projects for internal auditors in Thailand designed to minimize corrupt behavior.
- *World Bank Anti-Corruption Knowledge Centre.* Since 1996, the World Bank has supported more than 600 anti-corruption programs and governance initiatives developed by its member countries. According to the Bank, "Corruption undermines policies and programs that aim to reduce poverty, so attacking corruption is critical to the achievement of the Bank's overarching mission of poverty reduction." The World Bank's anti-corruption strategy addresses both pervasiveness and arbitrariness of corruption and builds on five key elements: (1) increasing political accountability, (2) strengthening civil society participation, (3) creating a competitive private sector, (4) institutional restraints on power, and (5) improving public-sector management.[42]

Strategy: Social Contributions and Public Donations

Some companies employ the strategy of social contributions and public donations as an alternative to both avoidance and compliance. For example, sometimes bribes are presented as agent fees or fees for public services that might not otherwise be available. Several examples are presented below. This strategy targets primarily the direct costs of corruption. These approaches, however, are unlikely to protect firms from the arbitrary application of corruption because even if a legal contribution is offered to an organization (versus individuals), other officials may demand further payments.

- *Cargill, Inc.,* an international marketer, processor, and distributor of agricultural, food, financial, and industrial products, aggressively attempts to strengthen the communities in which it operates by avoiding and speaking out against bribery and corruption as well as supporting specific causes.[43] After two Cargill offices were set on fire in India following political opposition concerning the company's entry into the sunflower seed market, the company responded by teaching Indian farmers how to improve their crop yields.[44]
- *Motorola* has permitted the payment of agent fees where they are a relatively small part of the contract. In other situations, rather than pay a fee to ensure the provision of local public services, Motorola donated equipment to the relevant government agencies. This increased the likelihood that the equipment would be used for the stated purpose.[45]
- *Hope Group* donated textbooks to 17 million students in China as a means to facilitate business relationships and reputation. In China, such relationships are considered especially important in business dealings, and this contribution also provided a substantial social benefit.[46]

Strategy: Laws and Agreements

Individual corporate behavior or joint activities by groups of corporations are important elements in firms' response to corruption. Ultimately, much of the burden is on governments to restrain corrupt tendencies. Firms are expected to support these efforts. Corruption has a substantial deterrent effect on FDI in host countries, especially in emerging economies, and these agreements have helped to even the playing field, at least in specific countries and regions. On the other hand, problems are created when firms from one country (like the U.S.) are held to a different standard than others. This strategy, which obviously relies on cooperation with government agencies, targets the direct costs of corruption and is most effective at combating corruption in environments where it is pervasive but may also have some effectiveness in environments characterized by arbitrary corruption. Three examples of governmental initiatives in the area follow.

- *The Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.* On November 21, 1997, negotiators from 33 countries (28 of the 29 member states of the OECD, along with Argentina, Brazil, Bulgaria, Chile, and the Slovak Republic) adopted a Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. The Convention was signed by representatives of participating countries on December 17, 1997.[47]
- *U.S. Foreign Corrupt Practices Act (FCPA).* This U.S. law, enacted in 1977, was prompted by a series of scandals involving questionable or illegal payments by U.S. firms to foreign government officials overseas. There were revelations that some of this money had returned to the U.S. in the form of political contributions. The FCPA prohibits American firms from giving anything of value—such as a payment, gift or bribe—to induce a foreign government to enter into a contract or business advantage or relationship. The Act carries criminal penalties, including imprisonment for up to five years, fines of up to $100,000 for individuals, and fines of up to $2 million for companies. In 1998 the U.S. passed legislation expanding the scope of the FCPA to bring its provisions into accord with the OECD Convention. Prior to implementation of the OECD Corruption Code, the United States was unique in having this kind of law, and in countries where corruption was widespread, the Act had made it difficult for U.S. companies to compete. Moreover, many executives have complained that the prohibited acts are standard operating procedure in some countries, although with the OECD agreement and implementation, this is changing.[48]
- *The Organization of American States (OAS) Inter-American Convention Against Corruption:* The OAS Convention, which entered into force in March 1997, was the first multilateral anti-corruption treaty negotiated in the world. The Convention requires parties to criminalize bribery of foreign officials and to assist one another in the investigation and prosecution of such acts. The Convention also explicitly disallows the use of "bank secrecy" as a basis for denying assistance. More than 25 Western hemisphere countries are signatories to the Convention, including Argentina, Brazil, Chile, Mexico, and the United States.[49]

Coping with Corruption: Lessons for Managers and Policy-Makers

Corruption has direct and indirect effects on aggregate FDI into a given economy and influences firm-level decisions about entry mode and project structure. In sum, we find that:

1. The nature of corruption is not fully appreciated and incorporated in managerial decision-making. Failure to comprehend differing types of corruption may hinder effective operation of international businesses, where resource commitments are substantial and difficult to reverse and reputation effects are long lasting.
2. While firms fully recognize the costs related to pervasiveness of corruption, arbitrariness is often disregarded in the development of proactive strategies. Whereas firms appear to adjust their entry modes when confronted by high arbitrariness, they may forego other strategies due to a mistaken perception that arbitrariness affects all firms the same, when in fact it can have significantly disproportionate impacts on firms.
3. Firms adjust and adapt their market-entry approaches to minimize exposure to partners who may attempt to exploit the corrupt environment for their own gains, yet maximize relationships with partners that can facilitate project development.
4. Firms often don't fully recognize the range of strategic alternatives to acquiescing to corrupt pressures. These strategies can help reduce costs, and some may help in deterring corruption more broadly.
5. Some strategies may be pursued by individual firms, collectives of companies, or in conjunction with governments. For example, a number of the companies mentioned above support broad, government- or industry-driven efforts to reduce corruption through membership in organizations such as the International Chamber of Commerce, while at the same time focusing on shorter-term and transaction-specific challenges that affect their day-to-day business opportunities.

Governments, independently and through international consortia, continue to struggle in their efforts to identify effective solutions to the destructive practices of corruption. At the same time, companies seeking new markets and opportunities continue to explore options that minimize the most pronounced impacts of corruption. Both governments and companies have made important steps in their efforts to stem the spread of corruption, but much more needs to be done.

We considered five strategies that show how firms can deal with corruption in a manner that preserves their strategic choices in international market entry, while protecting themselves from the costs of corruption. None of the strategies we propose comprehensively addresses corruption. At best, each reflects a partial solution. Taken together, they may provide a more comprehensive approach, particularly given the interactive and mutually reinforcing nature of firm- and government-sponsored strategies. Just as firms pursue multiple business strategies to address their objectives in international markets, so too should they consider the range of options to combat corruption.

In the interim, firms should be aware—and be wary—of their dealings in countries where corrupt practices are common. Firms would be wise to work cooperatively with each other and with government organizations to realize the substantial benefits of reduced corruption: improved firm and aggregate business performance, more effective host-nation governance, and greater and more widespread social and economic development.

Acknowledgments

We would like to thank Bernie Bernard, Don Hellriegel, and Alexandra Wrage for helpful comments and acknowledge the input and guidance of Robert Ford, Celeste Wilderom, and two anonymous reviewers on earlier versions of the article. We take responsibility for any remaining errors.

Endnotes

[1] *Asian Wall Street Journal*. Ruling puts foreign infrastructure investors at risk, 29 March 2002: A3.

[2] Webster, P. 2002. Ripped off in Russia. *Maclean's*. *www.mcleans.ca*.

[3] *Economist*. Corruption in Lesotho: Small place, big wave. 21 September 2002: 73.

[4] The World Bank, 1998. *Global development finance*.

[5] See Henisz, W. J., & Williamson, O. E. 1999. Comparative economic organization—within and between countries, *Business and Politics,* 1: 261–277; Hill, C. W. L., Hwang, P., & Kim, W. C. 1990. An electric theory of the choice of international entry mode. *Strategic Management Journal,* 11: 117–128; Kobrin, S. 1979. Political risk: A review and reconsideration, *Journal of International Business Studies,* 10: 67–80; and Murtha, T. 1991. Surviving industrial targeting: State credibility and public policy competencies in multinational subcontracting. *Journal of Law, Economics and Organization,* 7: 117–143.

[6] A limited but growing body of research has explored the impact of corruption on FDI, generally finding that corruption significantly reduces FDI into an economy. For a recent review, see Habib, M., & Zurawicki, L. 2002. Corruption and foreign direct investment. *Journal of International Business Studies,* 33: 291–307. These authors find that corruption reduces aggregate FDI even when controlling for political risk, cultural distance, and level-of-corruption differences between the home and host countries.

[7] See D'Andrade, K. 1985. Bribery. *Journal of Business Ethics,* 4 (4): 239–248; Johnson, H. L. 1985. Bribery in international markets: Diagnosis, clarification and remedy. *Journal of Business Ethics,* 4 (6): 447–455; and Lane, H. W., & Simpson, D. G. 1984. Bribery in international business: Whose problem is it? *Journal of Business Ethics,* 3 (1): 35–42.

[8] See Ahlstrom, D., & Bruton, G. D. 2001. Learning from successful local private firms in China: Establishing legitimacy.

The Academy of Management Executive, 15(4): 72–83; and Boddewyn, J. J., & Brewer, T. L. 1994. International business political behavior: New theoretical directions. *Academy of Management Review,* 19(1): 119–144.

[9] For a review of the particular challenges associated with securing foreign investment in infrastructure, see Vernon, R. 1971. *Sovereignty at bay: The multinational spread of U.S. enterprises.* New York: Basic Books; Doz, Y., & Prahalad, S. 1980. How MNCs cope with host government intervention. *Harvard Business Review,* March–April: 149–157; Fagre, N., & Wells, L. T. 1982. Bargaining power of multinationals and host governments. *Journal of International Business Studies,* 13: 9–23; Kobrin, S. 1987. Testing the bargaining hypothesis in the manufacturing sector in developing countries. *International Organization,* 41: 609–638; and Wells, L. T., & Gleason, E. S. 1995. Is foreign infrastructure investment still risky? *Harvard Business Review,* September–October: 44–53.

[10] *The Economist.* Not quite so squeaky clean. 18 October 2001. *www.economist.com.*

[11] *The Economist.* Small place, big wave. 19 September 2002. *www.economist.com.*

[12] *The Economist.* When something is rotten. 25 July 2002. *www.economist.com.*

[13] It should be noted that "grease payments" or "facilitating payments" are permitted under the Foreign Corrupt Practices Act if they are paid to government officials in order to induce them to undertake a routine non-discretionary task which is otherwise within their job description.

[14] Cassidy, W. B. 2002. Fraud, bribery, etc. *Traffic World.* 266(29): 8–10.

[15] Scott, R. 2002. Eliminating bribery as a transnational marketing strategy. *International Journal of Commerce & Management,* 12(1): 1–17.

[16] *The Economist.* Dotcom coup. 15 March 2001. *www.economist.com.*

[17] *The Economist.* Special report: The short arm of the law—Bribery and business. 2 March 2002. *www.economist.com.*

[18] Ahlstrom & Bruton, op. cit.

[19] Webster, op. cit.

[20] See Mauro, P. 1995. Corruption and growth. *The Quarterly Journal of Economics,* 110 (3): 681–712; Mauro, P. 1998. Corruption and the composition of government expenditure. *Journal of Public Economics,* 69: 263–279; World Bank. 1997. *World development report 1997: The state in a changing world.* Oxford, UK, and New York: Oxford University Press; and Herrera, A., & Rodriguez, P. 2001. *Bribery and the nature of corruption.* Papers and Proceedings, LACEA Conference, Montevideo, Uruguay.

[21] Mauro, 1995, op. cit.

[22] *Economist.* The revenue problem. 15 February 2003: 36. Other Latin American countries feature similarly low tax yields: Guatemala (10%), Mexico (18%) versus 30% in the US.

[23] Brunetti, A., & Weder, B. 1998. Investment and institutional uncertainty: A comparative study of different uncertainty measures. *Weltwirtschaftliches Archiv,* 134: 513–533.

[24] Gray, C., & Kaufmann, D. 1998. Corruption and development. *Finance and Development,* 35 (1): 7–10.

[25] Mauro, P. 1997. The effects of corruption on growth, investment, and government expenditure: A cross-country analysis. In K. A. Elliot (Ed.), *Corruption and the global economy:* 83–107. Washington, DC: Institute for International Economics; Keefer, P. 1996. Protection against a capricious state: French investment and Spanish railroads, 1845–1875. *The Journal of Economic History,* 56(1): 170–192; and Brunetti & Weder, op. cit.

[26] Transparency International. 2003. *2003 global corruption report.* London: Profile Books.

[27] Johnston, M. 1999. Corruption et démocratie: Menaces pour le développement, possibilités de réforme. *Revue Tiers Monde,* 161: 117–142.

[28] See Rodriguez, P., Uhlenbruck, K., & Eden, L. (in press) Government corruption and the entry strategies of multinationals. *Academy of Management Review;* Shleifer, A., & Vishny, R. 1993. Corruption. *Quarterly Journal of Economics,* 108: 599–617.

[29] Ibid.

[30] Borsuk, R. In Indonesia, a twist on spreading the wealth: Decentralization of power multiplies opportunities for bribery, corruption. *Wall Street Journal,* 29 January 2003: A16.

[31] See World Development Report, op. cit.; Wei, S.-J. 1997. Why is corruption so much more taxing than tax? Arbitrariness kills. NBER working paper No. 6255; and Campos, J. E., Lien, D., & Pradhan, S. 1999. The impact of corruption on investment: Predictability matters. *World Development,* 27: 1059–1067.

[32] Campos, et al., op. cit.

[33] Rivoli, P., & Salorio, E. 1996. Foreign direct investment and investment under uncertainty. *Journal of International Business Studies,* 27: 335–357.

[34] Smarzynska, B., & Wei, S.-J. 2000. Corruption and the composition of foreign direct investment: Firm-level evidence. NBER Working paper No. 7969. A recent Department of Justice Advisory Opinion, however, has stated that U.S. firms would be held responsible for the business practices of the agents hired by JV partners, even if the agents were hired prior to the JV. Now, the legal burden is as great as operating alone, but the controls (through a JV partner) are virtually non-existent. In addition, while it has been suggested that some companies try to push the payment of bribes down their marketing chain to local partners, FCPA and new laws implementing the OECD Corruption Agreement state expressly that payments may not be made directly or indirectly through third parties.

[35] Telecommunications is a particularly appropriate industry for this study because a significant portion of FDI in the 1990s came from telecommunication MNEs, especially investment into emerging countries with high market potential but with significant and varying corruption levels. Further, infrastructure projects typically involve numerous government agencies, and thus corruption as defined herein is an important environmental variable. While it is true that the telecom industry has idiosyncratic characteristics that may not be applicable to some other industries, it is has been identified as the "flagship" industry for the range of international infrastructure investment—electric power development, transportation, water and sewerage—and so many other industries are reliant upon telecom services. These figures represent the findings of logistic regression analysis that includes a number of control variables at the country, industry, firm, and project levels.

[36] See Zaheer, S. 1995. Overcoming the liability of foreignness. *Academy of Management Journal,* 38(2): 341–363; Beamish, P. W. & Banks, J. C. 1987. Equity joint ventures and the theory of the multinational enterprise. *Journal of International Business Studies,* 18(2): 1–16; Hill, et al. op. cit; and Yiu, D., & Makino, S. 2002. The choice between joint venture and wholly owned subsidiary: An institutional perspective. *Organization Science,* 13(6): 667–683.

[37] Rigby, P. 2001. Dealing with business and legal institutional risk. *Energy Business and Technology,* 3 (5): 10. *http://www.cumna.com/shell/intro.htm.*

[38] Controversy incorporated. 2002. *The McKinsey Quarterly,* 4: *http://www.mckinseyquarterly.com/category_editor.asp?L2=18.*

[39] Major initiative launched to curb corruption in global business. TRACE. December 11. *http://www.traceinternational.org/TRACE_Press_Release_121102.doc.*

[40] See Hess, D., & Dunfee, T. 2000. Fighting corruption: A principled approach: The C2 principles (Combating Corruption). *Cornell International Law Journal,* 33(3): 595–628.

[41] Business for Social Responsibility. 2002. *Corruption and bribery White Paper. http://www.bsr.org/BSRResources/WhitePaperDetail.cfm?DocumentID=180.*

[42] *Anticorruption. www.worldbank.org/publicsector/anticorrupt/.*

[43] *Cargill citizenship report. http://www.cargill.com/citizenship.pdf.*

[44] Cogman, D., & Oppenheim, J. M. 2002. Controversy incorporated. *The McKinsey Quarterly,* 4: *http://www.mckinseyquarterly. com/category_editor.asp?L2=18.*

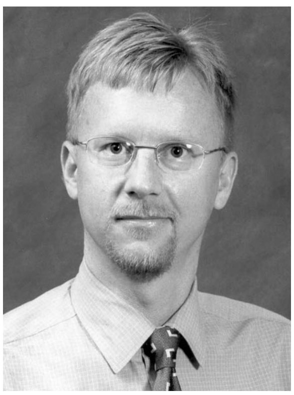
[45] Business for Social Responsibility, op. cit.

[46] Alhstrom, D., & Bruton, G. D. 2001. Learning from successful local private firms in China: Establishing legitimacy. *The Academy of Management Executive,* 15(4): 72–83.

[47] *OECD anti-bribery convention summary. http://Usinfo.State.Gov/Journals/Ites/1198/Ijee/Factoecd.htm.*

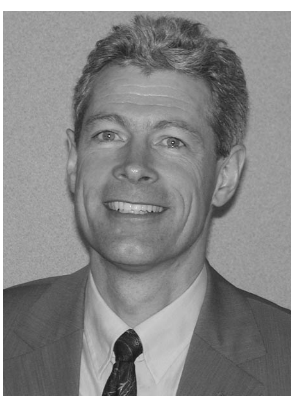
[48] Stackhouse, D. The foreign corrupt practices act: Bribery, corruption, recordkeeping and More. *Indiana Lawyer* 23 April 1993.

[49] Business for Social Responsibility, op. cit.



Jonathan Doh is assistant professor of management and director of the Center for Responsible Leadership and Governance at Villanova University, and member of the executive faculty at GSBA-Zurich. His research interests include management strategy in emerging economies and corporate social responsibility. He received his Ph.D. from George Washington University in international strategy. He is editor (with Hildy Teegen) of *Globalization and NGOs* (Praeger, 2003). Contact: *jonathan.doh@villanova.edu.*

Peter Rodriguez is an associate professor of business administration at the Darden Graduate School of Business at the University of Virginia. His research interests include economy and firm-level effects of corruption and the political-economy of international trade policy with a particular focus on regional and multilateral trade agreements. He received his Ph.D. in economics from Princeton University. Contact: *rodriguez@darden.uva.edu.*



Klaus Uhlenbruck is assistant professor of management at Mays Business School, Texas A&M University. He received his Ph.D. from the University of Colorado in strategic management. His research and publications address international diversification, MNE management, privatization, and enterprise strategies in emerging economies. His research on corruption is funded by the Shell Oil Company Foundation. Contact: *kuhlenbruck@tamu.edu.*

Jamie Collins is a doctoral student at Texas A&M University. His research interests include sociological influences on strategic management, the interaction between firms and their environments, international strategy, and corporate social responsibility. Contact: *jamiecollins@tamu.edu.*

Lorraine Eden is professor of management and University Faculty Fellow at Texas A&M University where she teaches courses on multinational enterprises and international business. Her research focuses on the political economy of multinationals, specializing in transfer pricing and international taxation. She holds a Ph.D. with distinction in Economics from Dalhousie University. Contact: *leden@tamu.edu.*

Copyright © 2003 EBSCO Publishing