GOVERNMENT CORRUPTION AND THE ENTRY STRATEGIES OF MULTINATIONALS

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Multinational enterprises (MNEs) often encounter government corruption when operating in host countries; however, in the international management literature, it is typically assumed that government officials pursue national interests rather than their own. We introduce a two-dimensional framework to further the understanding of public sector corruption and identify its implications for MNEs. Using an institutional perspective, we examine how the pervasiveness and arbitrariness of corruption can affect an MNE's organizational legitimacy and strategic decision making. We apply our analysis to the mode of entry decision.

Through laws, regulations, and institutions, governments influence and sometimes dominate transactions within an economy. Governments, to a large degree, "set the rules of the game" that make up the fundamental reward structure of an economy and thereby determine the nature of commercial activity within it. But government rules and institutions rarely are crafted—and never operate—solely for the benefit of the general public. Rather, all governments are beset in their pursuit of legitimate objectives by the presence of corruption. Corruption—the abuse of public power for private benefit—warps the rules of the game. Often, corruption rewards unproductive behavior by channeling unmerited contracts and rights to firms in exchange for bribes, thereby penalizing efficient and innovative firms. Indeed, corruption is at least as harmful to firm growth and economic development as bad monetary policy or fiscal insolvency (Tanzi, 1998). Nevertheless, coping with corruption is an intrinsic activity in international business that sometimes offers appreciable advantages to individual firms (Boddewyn, 1988; Boddewyn & Brewer, 1994; Ring, Lenway, & Govekar, 1990).

Corruption is everywhere, to be sure, but it is not the same everywhere. Indeed, corruption varies across countries as much as labor costs or corporate tax rates (Smarzynska & Wei, 2000). The challenges firms face on entering foreign countries largely reflect their efforts to understand and adapt to local corruption. Assessing corruption by level alone, however, is inadequate and of limited use to firms. As recent studies show (Shleifer & Vishny, 1993; Wei, 1997), the experience of operating in a corrupt environment is substantially characterized not only by the amount of corruption but also by the uncertainty associated with corrupt transactions.

To adapt and perform effectively within a new environment, firms must comprehend and appreciate corruption's essential characteristics. Especially for multinational enterprises (MNEs), understanding the nature of corruption in a given country and differentiating it from corruption in other countries are central to decisions on entry and expansion. Moreover, the study of corruption itself, apart but not isolated from other institutions, has the potential to substantially expand our understanding of how governments differ and how they matter in the decisions of firms. In the management literature and international business literature, researchers generally assume that government—and its agents—maximize the public interest (e.g., Dunning, 1993; Lenway &

Murtha, 1994; Zahra, Ireland, Gutierrez, & Hitt, 2000), and, thus, they fail to consider the effects of corruption on firms. Others view corruption as an opportunity for political behavior by MNEs (Boddewyn, 1988; Boddewyn & Brewer, 1994).

Despite its potential for illuminating the various challenges and opportunities posed by corruption, a meaningful framework characterizing the nature of corruption has yet to be developed in the management literature. Other disciplines have begun to contribute to this effort (Bardhan, 1997; Johnston, 1997; Shleifer & Vishny 1993), but no study has put forth a serviceable model. Our purpose in this article is therefore twofold: (1) to offer a parsimonious framework that allows for effective differentiation of corrupt environments and (2) to further the understanding of corruption and how it affects multinational entry.

Entry strategy is a critical element in international expansion. The mode of entry substantially determines a firm's resource commitment, investment risk, degree of control, and share of profits from international operations (Davis, Desai, & Francis, 2000; Schrader, 2001). Drawing on institutional theory, we discuss the implications of government corruption for the MNE's organizational legitimacy (Kostova & Zaheer, 1999), thereby developing a set of propositions explaining how corruption, through its impact on organizational legitimacy, can alter the entry mode decisions of multinationals.

We use institutional theory because it provides a theoretical explanation for MNE responses to government actions (Westney, 1993). Institutional theory is particularly appropriate for our purposes because it emphasizes contextual factors influencing entry mode decisions (Yiu & Makino, 2001) and draws attention to nonmarket pressures (Davis et al., 2000; Haveman, 1993; Oliver, 1991). The core insight of institutional theory is that organizations strive for external legitimacy by complying with their institutional context (Glynn & Abzug, 2002); organizational legitimacy is influenced by corruption through its widespread effects on formal and informal institutions. Moreover, institutional theory addresses the importance of relationships between entry mode choice and MNE internal legitimacy of subsidiaries (Rosenzweig & Singh, 1991), which may be threatened by compliance with corruption.

In the following section we develop a framework for differentiating corruption across countries. After this, we use this framework to generate propositions regarding mode of entry choice as an adaptive response to corrupt governments. In the final section we discuss our conclusions and suggest topics for future research.

A TWO-DIMENSIONAL FRAMEWORK OF CORRUPTION: PERVASIVENESS AND ARBITRARINESS

The effort to represent the complex characteristics of an environment within a simple theoretical framework is valid only as long as the simplification facilitates meaningful analysis while still capturing essential features of the environment. Our aim in this section is to achieve such a successful reduction by developing a simple framework that allows for effective differentiation of corrupt environments and their consequent influences on firm behavior.

The wide variety of corrupt behaviors confounds the attempt to characterize corruption in a way that distinguishes one environment from the next. For the most part, scholars have responded to this challenge either by categorizing corrupt transactions by the parties and stakes involved (Elliott, 1997; Maitland, 2002; Rose-Ackerman, 1999) or by aggregating all categories of corrupt transactions into a single index (ICRG, 1999; Kaufmann, 1998; Transparency International, 2000; Treisman, 2000). Others have distinguished types of corrupt activities based on the characteristics of the participants in corrupt transactions or the objectives of the parties involved (Hellman, Jones, Kaufmann, & Schankerman, 2000; Schacter & Shah, 2001). Each of these strategies for measuring corruption is valuable for some purposes, but none offers ready interpretations of key differences in the experience of corruption across states.

One of the main challenges of describing corruption is addressing both its transaction- and state-specific characteristics. This problem arises because corruption refers both to a type of transaction—that is, one that involves the abuse (or misuse) of public power for private gain—and to a prominent statewide relationship among public officials, established institutions, and private parties. It may be that corruption is defined by characteristics of a particular transaction, but its nature is differentiated by systemic qualities, which refer to the *set* of corrupt transactions in a given country. Thus, when scholars say that corruption in Ukraine is differ-

ent from corruption in Egypt, they typically are referring to an identical class of transactions but intend to accentuate the particular characteristics of the overall experience with corruption in the two countries.

We direct our analysis of corruption toward these aggregate characteristics that apply to the set of all corrupt transactions with governments in a given country. In doing so, we address a second challenge as well: separating the effort to describe corruption from the effort to explain its origins and possible remedies. Corruption in any nation state owes its nature and trajectory to a variety of economic, historical, and institutional antecedents. Efforts to explain the histories of states and their characteristics are vital, but beyond the scope of this paper, in which we are concerned with the experience of corruption and its relationship to firm behavior.

Our review of the substantial literature on corruption reveals two key dimensions that together differentiate corruption across countries: pervasiveness and arbitrariness.[1] *Pervasiveness* is the average firm's likelihood of encountering corruption in its normal interactions with state officials. Pervasiveness, which is independent of the nature of corrupt transactions themselves, reflects an expectation of the proportion of interactions with the state that will entail corrupt transactions. More than this, "pervasiveness" captures the degree to which a firm is obliged to address corrupt behavior. Our notion of pervasiveness, as it relates to the expected level of involvement of firms with corrupt officials, could result from brief or protracted corrupt transactions, but in either case signals the degree to which corruption is a regular and meaningful part of commercial activity in a given country. In this sense, pervasiveness correlates with the necessity of actively addressing the opportunities or threats posed by corruption, which may be substantial.

Owing to its firm-level construction, pervasiveness is meant to be a value-neutral characterization. Heavy involvement with corrupt officials has been associated directly and indirectly with numerous social and commercial maladies but may just as readily offer some firms opportunities to internalize environmental threats through absorption (Ring et al., 1990) or by the

outright purchase of facilitating services and beneficial regulatory decisions (Boddewyn & Brewer, 1994). Moreover, firms may select pervasively corrupt institutional environments in their search for a venue where activities that are deemed illegitimate in some countries are deemed appropriate or are simply overlooked in others (Suchman, 1995). Firms might also achieve legitimacy by complying with corruption where it is broadly diffused (cf. Oliver, 1991). Finally, we would expect pervasiveness to go hand in hand with important economy-wide effects of corruption. The quality of infrastructure services, public institutions, economic growth, and financial stability is likely to be lower where firms are heavily involved in corrupt transactions, regardless of an individual firm's ability to extract benefits in such an environment (Keefer, 1996; Rose-Ackerman, 1978, 1999).

The pervasiveness of corruption varies widely across countries and is somewhat related to the popularized concept of the level of corruption (Transparency International, 2001; World Bank, 2000).[2] But corruption varies by more than just the degree to which it engages firms. Numerous empirical studies have highlighted varying degrees of uncertainty associated with corruption. We label this characteristic *arbitrariness* and define it as the inherent degree of ambiguity associated with corrupt transactions in a given nation or state. Where corruption is arbitrary, laws and informal policies may be subject to capricious and varied interpretation (Ahlstrom & Bruton, 2001), or overlapping and tenuous jurisdictions may lead to ineffectual bribes (Oldenburg, 1987). Arbitrariness may also result from the ability and willingness of corrupt officials to vary the set of necessary approvals to extract maximal bribes (Banerjee, 1997; Levy, 1989) or from the entry of bureaucrats into the market for extortion (Shleifer & Vishny, 1993).[3] Indeed, many circumstances and characteristics of

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[1] For extensive reviews of research on corruption, see Bardhan (1997), Tanzi (1998), and Treisman (2000).

[2] However, as mentioned earlier, the "level" of corruption as reported by Transparency International and others is an aggregation of all categories of corrupt acts and is not directed at an individual's or a firm's experience in corrupt transactions.

[3] This analysis is inspired by Shleifer and Vishny (1993), who describe the "industrial structure" of corruption. A paradoxical message of their analysis is that "organized" corruption regimes may be more extractive yet less harmful to firm performance than disorganized and less extractive regimes.

states may promote arbitrariness. Rather than theorize on particular causes, we emphasize that arbitrariness renders important features of corrupt transactions less transparent and, more important, less predictable, since they do not emerge from a stable underlying structure or process.

"Arbitrariness," as we use it, proceeds from normal statistical uncertainty, which is characterized by quantifiable risk over knowable outcomes, toward "Knightian" or immeasurable uncertainty, where the underlying probability distribution over events is unknown (Fox & Tversky, 1995; Knight, 1921). Where corruption is highly arbitrary, transactions with government officials are characterized by an enduring uncertainty regarding the size, target, and number of corrupt payments necessary to obtain an approval. Consequently, a low degree of efficacy is attached to engagement with corrupt officials, despite the fact that such involvement may be quite regular. In the limit, arbitrariness renders the corrupt environment largely unknowable, since rules of behavior, expectations over outcomes, and the power and purview of enforcers are inherently unstable. Firms are unlikely to achieve legitimacy by engaging government officials in an arbitrarily corrupt environment (Oliver, 1991).

The best example of highly arbitrary corruption is that of Russia throughout the 1990s. Following the demise of the formidable and intrusive Soviet state, Russian reformers seeking real change followed the mantra of "freedom first, rules later." Into the institutional void rushed formerly powerful party officials with dubious and overlapping claims to authority, newly elected but corrupt politicians, and organized rackets offering protection from venal bureaucrats (Hoffman, 2002; Peng, 2001). The result was widespread corruption, of course, but one truly characterized by "arbitrary power, individual whims and private score settling" (Hoffman, 2002: 234).

Arbitrary corruption also occurs in more stable and democratic states. The process of land consolidation in the north Indian state of Uttar Pradesh was fraught with bribery but accompanied by a complex and near endless appeals process that took force once initial decisions were made (Oldenburg, 1987). As a result, bribes of multiple sizes dotted the long event and only rarely were effective at inducing the desired treatment.

At the opposite extreme is hierarchical and stable corruption characterized by predictable and effective bribery. For example, under Marcos's heavy hand, all graft in the Philippines was controlled from the top down. Bureaucrats at all levels who supplied complementary approvals were part of a somewhat unified and controlled system (Alfiler & Concepcion, 1986). Consequently, corrupt payments were regular, predictable, and typically effective (Easterly, 2000; Shleifer & Vishny, 1993) The authoritarian regimes of Suharto in Indonesia (Easterly, 2000) and Mexico under the PRI (Cothran, 1994; Morris, 1991) were also known for systemic and predictable corruption.

The two dimensions of corruption—pervasiveness and arbitrariness—are independent, capturing wholly different aspects of corruption, but neither is sufficient to fully characterize the local environment; they are simultaneously experienced and must be considered together. An illustrative exercise is to consider moving along various trajectories from any given point in a hypothetical two-dimensional space, shown in Figure 1. Consider first moving along arrow A from the midpoint of the pervasiveness axis to the right, increasing arbitrariness while holding pervasiveness constant. Firms expect to confront corrupt state officials equally often along this trajectory, all the while experiencing increased levels of ambiguity regarding the size, nature, and efficacy attached to these encounters. As the processes that generate corruption become less learnable, firms find it more difficult to make use of any benefits they may derive from engaging corrupt officials. The ability to plan for corruption fades along this path, as does the value of engaging in local corruption so as to acquire and maintain legitimacy.

Consider next moving upward along arrow B from the midpoint of the arbitrariness axis, increasing pervasiveness while holding arbitrariness constant. The terms and outcomes of corrupt transactions remain only somewhat predictable along this course, but they arise more and more regularly and are attached to an ever-higher proportion of interactions with governments. Firms find it increasingly necessary to address corruption. Opportunities to utilize corruption for any purpose grow, as do the costs associated with opting out and avoidance.

Finally, consider any northeastward movement. By construction, the principal effect of

FIGURE 1
Two Dimensions of Corruption: Pervasiveness and Arbitrariness[a]
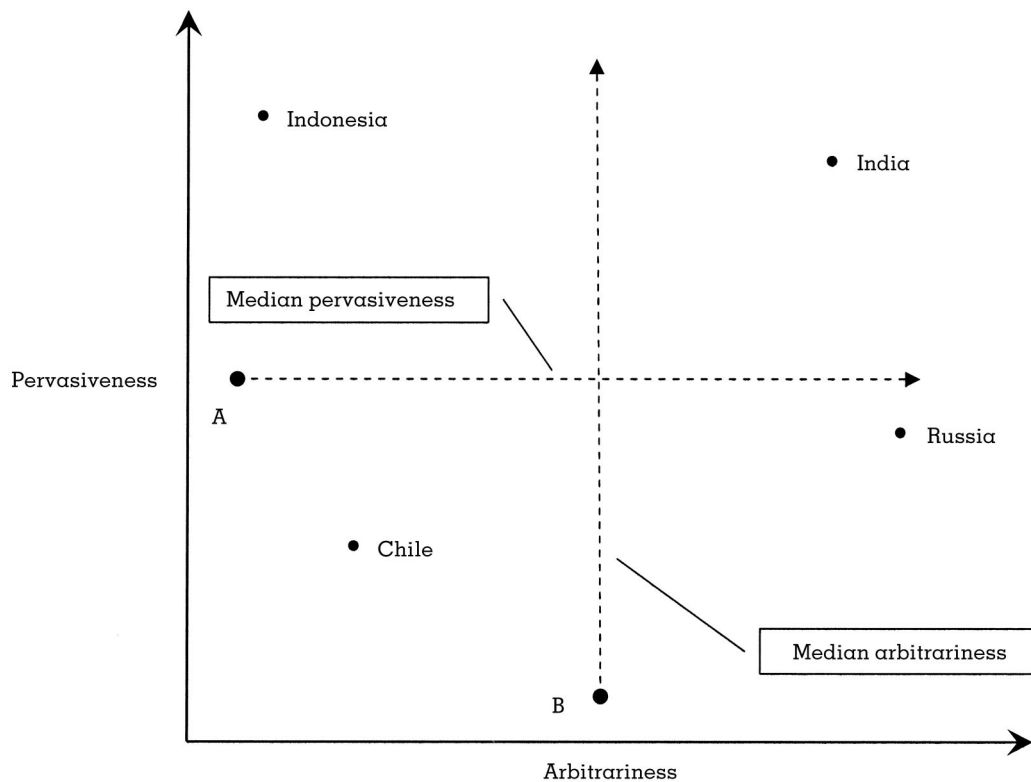
[a] Countries and their locations in Figure 1 are included for illustrative purposes only.

such a path is a straightforward combination of the two previous effects. Advancing along both dimensions, however, raises the challenge to firms more acutely than moving along a single dimension. Moving to an environment where corruption is both more pervasive and more arbitrary raises the demands of adapting to the local environment and simultaneously makes those demands more difficult to address. Taken together, pervasiveness and arbitrariness capture fundamental features of the experience of corruption in a given state. In the following section we discuss the relationship of this framework of corruption to the entry mode decisions of MNEs.

ENTRY INTO CORRUPT COUNTRIES

Corruption significantly reduces direct investment flows into an economy, as a growing body of research shows (Lambsdorff, 1999; Mauro, 1995, 1998; Wei, 1997). Also, corruption is negatively associated with economy-wide growth

(Mauro, 1995) and openness to international trade (Ades & DiTella, 1999). Together, these effects suggest that corruption also deters entry via exporting, although no study has yet directly examined the effect of corruption on entry via arm's-length strategies. Clearly, corruption reduces aggregate entry, but many firms choose to enter a locale despite the challenges corruption presents.[4]

While both firm- and investment-specific characteristics matter greatly in determining whether entry into a given country by any mode will be profitable, our focus is on the marginal influence of corruption on the entry decision. Put another way, we focus on how the nature of corruption influences the choice of entry mode as an adaptive behavior of firms. Using the framework discussed above, we propose how

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[4] Moreover, MNEs cannot reasonably avoid public sector corruption altogether, since it is present to some degree in all countries (Transparency International, 2001) and is substantial in many of the largest world markets.

MNEs might choose a mode of entry so as to mitigate the consequences of corruption for the firm, to insulate itself from government intervention (Jacobson, Lenway, & Ring, 1993), or to avail itself of opportunities created by corruption through political behavior (Boddewyn, 1988).

The mode of entry decision is critical to MNE performance and survival and has been carefully studied in the international business literature (for recent reviews, see Buckley & Casson, 1998; Chang & Rosenzweig, 2001; Davis et al., 2000; Root, 1994). The two main categories of entry are (1) nonequity modes, such as exporting or licensing, where a local agent distributes and/or produces the firm's goods and services in a host country, and (2) foreign direct investment (FDI)—that is, equity modes. When an equity mode is chosen, an entering firm may invest via a wholly owned subsidiary or via a joint venture with another firm, typically a local partner, whose knowledge and/or network ties can help overcome less formal barriers to entry.

Host country conditions, such as investment risk, industry structure, and culture, are among the most salient determinants of entry mode choice (Anderson & Gatignon, 1986; Kogut & Singh, 1988). Similarly, conditions of the entering MNE—its home country environment, resources, international experience, strategic disposition, and competitive advantage—affect the choice of entry mode (Buckley & Casson, 1976, 1998; Hill, Hwang, Kim, 1990). According to the entry literature, firms choose FDI over arm's-length entry modes when they are willing to accept the financial risk associated with the control necessary to minimize the costs of transferring firm-specific advantages via the intrafirm hierarchy. Evaluating control needs and financial risk also affects the decision to partner or not when entering via FDI. In exchange for partial control and a stake in the profits, a partner reduces the level of resources committed and, especially when the partner is local, can be helpful in reducing the burden of adjusting to a new environment.

Within the substantial literature on entry mode choice, researchers have focused little on the influence of host country corruption.[5] More-

over, there remains a lack of consensus concerning the antecedents of entry mode choice (Lu, 2002). Extant research, strongly influenced by transaction cost economics, has focused on minimizing the costs of entry and operations. However, this literature overlooks political behavior by MNEs, which can be both a defense against threats from the state and a means to create economic opportunities for the firm (Boddewyn, 1988; Ring et al., 1990). The entry literature is also silent on nonmarket transactions, which may be critical to survival and performance (Blumentritt & Nigh, 2002; Boddewyn & Brewer, 1994). Yet nowhere can the actions of government and political actors be considered truly exogenous to MNE strategies; political and nonmarket transactions are often essential, especially where corruption is significant. We apply institutional theory to the analysis of entry mode choices of MNEs in corrupt environments to examine these less appreciated aspects of entry.

Traditionally, institutional theorists have studied the effects of government agencies, interest groups, regulatory structures, laws, social norms, and values on the structures and processes of domestic firms (DiMaggio & Powell, 1983; Scott, 1995; Zucker, 1983). These theorists have predicted that firms will conform to their institutional context so as to achieve (external) legitimacy, which, in turn, renders their existence and actions desirable and appropriate in the view of customers, suppliers, and the government (Dacin, 1997; Suchman, 1995). Without legitimacy, firms may not have access to valuable resources that are vital to survival and profitability. Thus, firms' economic choices are constrained by socially constructed norms of acceptable or appropriate behavior (Oliver, 1997). Nevertheless, institutional theorists recognize a significant role for firm choice in the adaptation to the institutional context (Kostova & Roth, 2002; Oliver, 1991) and the dependence of competitive advantage on a firm's ability to manage the institutional context (Oliver, 1997).

The challenges of attaining legitimacy and adapting to multiple institutional contexts are especially high for MNEs. A host government's ignorance about foreign MNEs may lead to the

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[5] A noteworthy exception is the study by Smarzynska and Wei (2000), in which the authors found that corruption increases the likelihood of joint ventures over wholly owned

subsidiaries in Eastern European and formerly Soviet economies. This study does not distinguish characteristics of corruption (e.g., level versus uncertainty) and addresses only FDI forms of entry.

use of stereotypes, the application of prejudicial standards, and the promotion of aggression from local interest groups, thereby increasing the liability of foreignness (Hymer, 1976). MNEs may avert these costs through isomorphism with the host country environment, which should enhance external legitimacy, resource availability, and survival capabilities (Zaheer & Mosakowski, 1997).[6] External legitimacy is also more likely to be enhanced when the MNE develops partnerships with local organizations and personal relationships with host government agencies and their officials (Boddewyn & Brewer, 1994).

AN INSTITUTIONAL PERSPECTIVE ON CORRUPTION AND MNE ENTRY STRATEGY

To study the effects of arbitrariness and pervasiveness of corruption on equity entry, we assess the partnering choice in light of the nature of host government corruption, assuming that an MNE has decided to enter the host country. We also address how internal institutional pressures resulting from corruption may lead the firm to prefer arm's-length entry to FDI. Because firms will simultaneously encounter degrees of both dimensions of corruption, we end this section with a discussion of entry choice as it relates to combinations of arbitrariness and pervasiveness.

Arbitrariness of corruption increases the incentives for an MNE entering via direct investment to partner with local firms. The core insight of institutional theory is that organizations strive for external legitimacy by complying with the institutional context (Glynn & Abzug, 2002). Yet this process is obstructed by the complexity of the institutional environment (Kostova & Zaheer, 1999). Where corruption is highly arbitrary, firms cannot easily determine their critical constituents. Moreover, a firm may face a multiplicity of corrupt agents, creating numerous and possibly conflicting pressures (Pfeffer & Salancik, 1978; Scott, 1987). The resulting complexity of the institutional environment reduces the firm's ability to conform and thereby gain legitimacy and other economic advantages through compli-

ance with local corruption (Oliver, 1991). In such an environment, an entering MNE will need to find alternative sources of external legitimacy.

Furthermore, arbitrary corruption increases the benefits of external legitimacy. Government officials face less risk when abusing nonlegitimate firms and, thus, are more likely to support and/or engage in corrupt behavior toward them. A firm with a high degree of legitimacy can evoke the support of other institutions to protect itself from corruption in general (cf. Powell, 1988; Suchman, 1995) or to create a defense against corrupt officials (Ahlstrom & Bruton, 2001). This protection is most valuable when corruption is highly arbitrary, because firms will be uncertain as to whether and how their freedom to operate will be reduced by corrupt activities. The higher the external legitimacy of a firm, the lower the probability that corruption will limit its activities.

Arbitrary corruption likely encourages the development of social networks, which can be important sources of external legitimacy. When dealing with uncertain and nontransparent rules, firms develop "coping mechanisms" (Radaev, 2000). In states where the government cannot enforce property rights and contracts, firms must build their own relational trust in order to engage in transactions with other firms (Rose-Ackerman, 2001). When people do not believe that the state will protect their property rights, interpersonal trust will be "very important but very scarce" (Rose-Ackerman, 2001: 49). Relational trust can be developed through repeated trades, reputation, and social networks. Once trust is developed in existing partners, firms are reluctant to shift (Rose-Ackerman, 2001), creating barriers to entry by new firms. A small group of firms in a network, in effect, can act like a cartel. Firms cope by resorting to negotiations with partners and to private persuasion. The result is the development of business circles or networks that exclude newcomer firms.

In order to enter these social networks and promote its legitimacy, an MNE will likely choose a local partner when entering a country with highly arbitrary corruption. When faced with uncertainty, newcomers rely on established firms as sources of information and legitimacy (Tolbert & Zucker, 1983). Research indicates that a joint venture provides significant sources for legitimacy gains, as well as knowledge of dealing with the local government and

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[6] Parallel arguments for isomorphism are motivated from a financial development framework and discussed at length in Rajan and Zingales (2003).

other institutions (Makino & Delios, 1996; Shan & Hamilton, 1991). Foreign firms may be induced to trade ownership for legitimacy in the local environment (Yiu & Makino, 2002). A further advantage of a local joint venture partner is the reduction in interaction with government agencies and the associated chance for meeting corrupt officials, because foreign firms are more often subjected to regulatory constraints than local firms (Yiu & Makino, 2002).

> *Proposition 1: The higher the arbitrariness of corruption in a host country, the higher the likelihood that an MNE will choose to enter with a local partner rather than via a wholly owned subsidiary.*

Unlike arbitrariness, pervasiveness reduces the likelihood that a firm entering via FDI will choose a local partner rather than a wholly owned subsidiary, because the benefits to partnering are reduced and compliance with pressures to engage in corruption is expected. Oliver summarizes the motivation for compliance in the face of pervasive corruption: "When institutional rules or norms are broadly diffused and supported, organizations will be predicted to acquiesce to the pressures because their social validity is largely unquestioned" (1991:169). Partnering does not meaningfully reduce the likelihood or costs of confronting corruption where firms regularly comply with corrupt agents. Rather, because corruption is socially valid where it is pervasive, compliance with the practices of a corrupt environment is likely to yield external legitimacy. Firms may acquire legitimacy by acquiring government consent with their actions. The state can provide the firm with resources and procurement contracts that make it appear accepted and legitimate, which may improve the firm's visibility in the eyes of local customers and reduce the need for integration into local networks.

Pervasiveness also tends to reduce institutional complexity as perceived by firms. If firms can acquire the goodwill of government agents, they may overcome typical challenges of entry and postentry operational and strategic problems (Boddewyn & Brewer, 1994), such as obtaining local licenses or necessary infrastructure. Likewise, the MNE can reduce the risk of government intervention if it can co-opt officials through engagement in corrupt transactions

(Ring et al., 1990). The diversity of national environments offers firms the opportunity to select among corrupt environments for those that match particular motives or the requirements of a given investment (Suchman, 1995). Some MNEs may enter a pervasively corrupt country to avoid another environment where legitimacy must be acquired through acts of adherence to more costly practices. Corruption can allow firms to buy their way out of costly requirements in stringent environments. Oliver (1991) points to chemical plant migration to third world countries, where, presumably, the demands of legitimacy are less costly. When government decisions can be readily influenced through bribery, officials may create market imperfections that benefit entering MNEs by changing regulatory standards or raising the institutional complexity for competitors.

Compliance with corruption, especially where it is pervasive, assists in overcoming the liability of foreignness, increases external legitimacy, and thereby decreases the benefits of a local partner. Moreover, the costs of partnering, such as sharing profits, are not reduced by pervasiveness but are likely to rise if MNEs increase profits because of effective exploitation of government corruption.

> *Proposition 2: The higher the pervasiveness of corruption in a host country, the higher the likelihood that an MNE will enter via a wholly owned subsidiary rather than with a local partner.*

Conformity to the external institutional context is not the only institutional concern in selecting the appropriate mode of entry. Adaptation of the subsidiary to host country conditions may lead to the adoption of local norms and customs that are at odds with those of other MNE subunits, thereby threatening internal legitimacy. Researchers recently have emphasized the importance of intrafirm institutional pressures, which confer internal legitimacy on subunits when they conform to the norms and structures of the rest of the organization. Conformity by subunits to the parent organization's norms eases replication and integration and allows for better control (Kostova & Zaheer, 1999; Rosenzweig & Singh, 1991).

We propose that the impact of corruption on the decision to enter via arm's-length modes

versus FDI is determined largely by the institutional distance (i.e., differences among the regulatory, normative, and cognitive institutions) between the MNE's home and host countries. It is easier for an MNE to deal with institutional pressures and to introduce subunits in host countries similar to its home nation. The greater the institutional distance, the greater the threat to internal legitimacy of a new subsidiary as it faces two sets of isomorphic pressures—the MNE's and the host country's (Davis et al., 2000; Kostova & Roth, 2002).

Corruption affects institutional distance the most where it is highly pervasive. Under pervasive (i.e., broadly diffused) corruption, MNE subunits can largely be expected to comply with corrupt government agents. Becoming isomorphic with a pervasively corrupt environment means complying with pressures to pay bribes, engage in corrupt activities, and so on, which may support the subsidiary's external legitimacy, because it conforms to local business norms and creates acceptance by government agencies.

However, in complying with their institutional environment at home or in other countries, many MNEs may have adopted norms and practices that ban corrupt behaviors by their subunits. For instance, MNEs headquartered in the United States are subject to the Foreign Corrupt Practices Act, which forbids firms listed on U.S. exchanges from engaging in corruption anywhere. Strong regulatory or normative institutional forces may exist that condemn engaging in corruption within some MNEs. Yet the more the subunit of such an MNE becomes embedded in the norms, rules, and practices of corruption in a host country, the greater the institutional distance it creates between itself and the rest of the MNE network (Kostova & Zaheer, 1999). In this way, achieving external legitimacy in the host country strains internal legitimacy within the MNE network (Ghoshal & Bartlett, 1990). To avoid this internal tension and still access a pervasively corrupt foreign market, MNEs may decide to enter via nonequity modes.

> *Proposition 3: The higher the pervasiveness of corruption in a host country, the higher the likelihood that an MNE from a home country with anti-corruption laws, norms, or values will choose an arm's-length mode of entry.*

The relationship between arbitrariness and the decision to enter via arm's-length modes is more complex and its ultimate impact less clear. To begin with, arbitrariness of corruption has an indeterminate impact on the institutional distance between a subsidiary and the parent MNE. Uncertainty encourages compliance with pressures from the institutional environment (DiMaggio & Powell, 1983; Thompson, 1967). Because arbitrary corruption increases environmental uncertainty, it provides incentives for a subsidiary to conform to the local conditions. However, arbitrariness also reduces the perceived economic and legitimacy gains from engaging in corruption, encouraging the firm to resist local corruption (Oliver, 1991). We argue that arbitrariness results in offsetting pressures to conform to the corrupt environment. Thus, arbitrariness has no clear impact on the institutional distance between a subsidiary and its MNE. Following institutional theory, we do not expect that the arbitrariness of corruption independently affects the decision to select an arm's-length entry mode versus FDI.[7]

We do expect the relationship between corruption and entry to be moderated by the previous experiences of the MNE. Firms vary in their ability to negotiate a given institutional context and manage important external contingencies (Boddewyn, 1988; Oliver, 1997). Kostova and Zaheer (1999) suggest that MNEs with extensive organizational experience should be better able to cope with legitimacy issues than de novo MNEs. Large MNEs with mature international operations should have developed better organ-

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[7] Our argument is based solely on institutional theory. From an economic perspective, however, arbitrariness of corruption may lead to arm's-length entry modes. Uncertainty may make FDI more delayable or less reversible (Rivoli & Salorio, 1996). A delayable investment means that the foregone profits from delay are not large. An irreversible investment means that there are high barriers to exit. The resulting uncertainty implies that the "wait and see" option may be quite valuable. Where prospects for political and economic reform are unresolved, there are large downside risks and FDI will be less likely. At the same time, firms can seek insurance for reasonably predictable but still irregular events. In such cases, uncertainty is reduced to risk and the costs of corruption are akin to taxes on the MNE. It is the irresolvable, unpredictable aspect of corruption that is most devastating for MNEs; it cannot be solved by waiting and cannot be covered by insurance. In such cases, we argue that the arbitrariness of corruption makes arm's-length modes of entry more likely.

izational capabilities for dealing with a diverse set of host country environments. The more similar the institutional profiles of host countries, the easier it is for the MNE to understand and respond to their institutional pressures (Johanson & Vahlne, 1977). Essentially, learning how to achieve legitimacy in one environment can be internalized and utilized in another. In particular, firms may learn how to exploit corrupt governments to raise legitimacy and reduce institutional complexity.

However, as we argued above, a simple perception of the level of corruption is insufficient when comparisons are made across countries. Meaningful comparisons between countries require an MNE to accurately assess the nature of local corruption. The type of corruption—whether it is pervasive or sporadic, confined to bureaucrats or to politicians—will be important. An MNE's diversity of experiences in corrupt environments is therefore likely to moderate the relationship between the pervasiveness of corruption and mode of entry.

With regard to arbitrariness, however, we argue that learning in one host environment is less transferable to others, especially when corruption is highly arbitrary. The basis for this presumption is the observed behavioral difference between actions taken under estimable probabilities, which take on the character of definable risks, and those taken under vague probabilities, in which decision makers are ignorant of underlying statistical frequencies (Epstein & Wang, 1994).[8] Vague probabilities correspond to situations where the underlying causes are often unique and where a priori calculations over them are infeasible. In this way, experiences in highly arbitrary environments are almost always new and of such a variegated nature that learning in them is difficult to exploit elsewhere.[9] This suggests that the experiences of the MNE in other host countries will not moderate the relationship between arbitrariness and mode of entry, as it does between pervasiveness and mode of entry.

Proposition 4: The positive relationship between the pervasiveness of

corruption in a host country and entry via a wholly owned subsidiary is strengthened by an MNE's previous experience with pervasive corruption.

Arbitrariness and pervasiveness jointly describe the nature of corruption in a given state; MNEs encounter degrees of both dimensions wherever they locate. In countries where the experience of corruption is largely captured by its pervasiveness, we expect that firms will tend to select wholly owned subsidiaries as the preferred mode of equity entry. Where arbitrariness is the dominant characteristic, joint ventures will be the preferred choice. What then should we expect regarding entry into countries where public corruption is both highly pervasive and highly arbitrary? To address this question, we must consider the interaction of these two dimensions of corruption.[10]

We suggest that as both dimensions of corruption increase, arbitrariness will come to dominate regarding entry mode choice. Although we expect that MNEs can fully internalize the benefits of pervasive corruption, higher degrees of arbitrariness reduce the likelihood that the MNE can achieve effective access to those benefits. Highly pervasive corruption raises the likelihood that any government official the MNE encounters will be corrupt, but the outcome of engaging that official in corruption grows more and more uncertain as arbitrariness simultaneously increases. In other words, arbitrariness reduces the MNE's ability to exploit the benefits of pervasive corruption. As arbitrariness obstructs the comprehension of the local institutional context, entering firms will likely come more and more to rely on local firms to provide some measure of the legitimacy and knowledge needed to deal with host country institutions (Shan & Hamilton, 1991; Tolbert & Zucker, 1983).

Proposition 5: The positive relationship between the pervasiveness of corruption and equity entry via a wholly owned subsidiary is weakened as the arbitrariness of corruption increases.

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[8] See Camerer and Weber (1992) for a survey of empirical evidence on these behavioral differences.

[9] See Ellsberg (1961) for a classic discussion of risk versus uncertainty.

[10] When both little arbitrariness and pervasiveness of corruption exist, the effect on entry mode is, in all probability, negligible.

DISCUSSION AND CONCLUSIONS

In the preceding pages we have emphasized that government corruption warps "the rules of the game" and that the prevailing one-dimensional view is incapable of sufficiently guiding theory or characterizing the experiences of firms with corruption. We suggest that the nature of corruption should be conceived of as a combination of two defining characteristics: pervasiveness and arbitrariness. Using this two-dimensional framework to describe local corruption enables MNEs to meaningfully comprehend the challenges of corruption in a particular state and how they differ from those in other states so as to avert or exploit them. In particular, we suggest how firms might adapt their entry modes in response to the pervasiveness and arbitrariness of corruption.

We use institutional theory, which is particularly suited to this analysis, because corruption is an element of the norms and rules of states and, thus, affects both the external and internal legitimacy of MNE subsidiaries. The examination of government-firm interactions and of the broader institutional environment has much to add to the literature on entry modes, which typically centers on firm-specific issues. By developing a framework for understanding corruption, we contribute to the entry literature and highlight government corruption as an important and complex external issue affecting entry decisions. Moreover, our analysis distills often-conflicting pressures exerted by corruption. An MNE subsidiary is more likely to engage in corruption where pervasiveness is high, although doing so may threaten internal legitimacy if the firm has established strong ethical or anticorruption norms. These same internal norms, which confer legitimacy on subsidiaries, significantly influence the decision to enter via equity versus arm's-length modes. Of course, the nature of local corruption matters greatly in and of itself. Highly arbitrary corruption increases the likelihood that MNEs entering via FDI will choose a local partner, because local partners increase external legitimacy. Pervasiveness creates opposite incentives for partnering that increase the likelihood of entry via a wholly owned subsidiary.

Corruption occurs everywhere, but it is particularly widespread in transition and less developed economies (Hellman et al., 2000), which

MNEs have increasingly targeted for entry. These countries' developmental needs and commercial possibilities cannot be fully realized without the capabilities and resources of MNEs, whose entry is contingent on the expectation of profitable operations. Our two-dimensional framework deepens the understanding of corruption and suggests how entry mode choices can alleviate the challenges to legitimacy that result from entry where corruption is substantial.

Empirical investigations of corruption and firm behavior support our theory. For example, Smarzynska and Wei (2000) found that the likelihood of entry with a local partner increases with the level of corruption in the transition economies of Eastern Europe and Central Asia. However, because corruption tends to be highly arbitrary in these same countries, it is not clear that these results can be generalized to other countries where pervasiveness is similarly high but arbitrariness low. Our analysis suggests that such results are not generalizable and warns against any suggestion that corruption is the same everywhere.

We also hope we have expanded the conversation on MNE political behavior by emphasizing the uncertainty associated with government-firm relationships. In prior management research, scholars have considered the opportunity corruption creates for political behavior by MNEs (Boddewyn, 1988; Boddewyn & Brewer, 1994; Ring et al., 1990). Owing to their size and the diversity of their experiences, it has been suggested that MNEs can acquire a competitive advantage through involvement with local corruption. Our analysis adds to this work and suggests that when corruption is highly arbitrary, neither firm size nor previous experience with corruption is advantageous. Where corruption is highly pervasive but not arbitrary, however, some firms may successfully enter via FDI and engage in corrupt transactions. Through the development of these relationships, we characterize corruption as a meaningful institution and demonstrate the importance of legitimacy concerns to entry mode decisions.

The continuing diversification and growth of MNEs necessitate effective strategies for coping with corruption. We have furthered the understanding of the nature of public sector corruption and suggested means of advantageous adaptation. In future research scholars might

consider further strategies that firms can use to address corruption. For instance, the adoption of an MNE-wide code of conduct may help to insulate MNE subunits from the pressures of local corruption. Kostova and Zaheer (1999) argue that MNEs with a geocentric managerial philosophy will be better able to cope with the tensions between internal and external legitimacy by adopting globally acceptable structures, policies, and practices.

Finally, we agree with recent work in the economics literature that emphasizes the advantages to the general public, domestic firms, and multinationals of reducing corruption. Government corruption is a serious impediment to economic development and stability in developing countries (Kaufmann, 1997). The U.S. Foreign Corrupt Practices Act and similar efforts by the Organization for Economic Cooperation and Development (OECD) and other international institutions signal a collective push to reduce corruption and should realize some measure of success. We expect these efforts to be of great service to MNEs in the long run, since a reduction in corruption is strongly linked with increased rates of economic growth. While some consider corruption the "grease" that makes commerce possible and profitable, we conclude that such advantages mask deeper developmental challenges that are far more costly.

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