Corruption in the Context of International Business: Conceptual and Methodological Issues

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ABSTRACT. Corruption is widely accepted in the popular press as a problem for economic development and in conducting international business. Yet, it remains somewhat under-researched, particularly in an academic setting. This article describes corruption in the context of international business. It presents a critical evaluation of the conceptual and methodological issues associated with corruption. In doing so, it portrays the inherent complexities in studying this topic. The paper ends with recommendations for addressing the main concerns.

KEYWORDS. Corruption, international business and foreign direct investment

Until recently corruption per se has not been used as a separate explaining variable in the analyses of international business activities. Rather, it was implicit in various approximations of the economic and

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political risk–of which it is a component in a number of ratings available. With the interest in adverse aspects of corruption growing, the emphasis in international business research tends to account for it directly. Corruption has many facets and several definitions. It manifests itself as the "petty" malaise and also reaches high level formats. It can be associated with mere "grease" activities as well as with those that break the law (Oldenburg, 1987). Corruption may occur at the points of contact between public administration and business and thus relate to the nature of regulatory environment, clarity of authorization procedures and the degree of public scrutiny. In addition, within the business world itself corrupt practices do take place. Rose-Ackerman (1999) provides a very good overview of corrupt phenomena and their implications around the world. In short, while etymologically Corruption refers to a break-up of sound and orderly established rules, it represents an abuse of position of power to obtain private (or group–political parties) gains.

Unfortunately, it remains a global rather than local issue. Even though it appears that the level of corruption is much lower in prosperous countries than in the less affluent ones (see Table 1), the media in the former keep exposing scandals involving top political and business figures.[1]

EFFECTS OF CORRUPTION

From a business perspective, corruption has two meanings:

1. It translates into a necessity to offer payments as a condition sine qua non to get something done.
2. It secures a more favorable treatment conditional upon offering bribes.

While in the first case a bribe is equal to additional burden/tax, in the second it can help to improve the outcomes (profit) for the paying firm and resembles more an investment. Corruption is bad and often synonymous with crime. Yet as we know there is both demand and supply for corruption (Tanzi, 1998) that calls for application of transaction cost approach to study it (Husted, 1994). Because not everybody resorts to corrupt practices, those who rationally do so expect to obtain additional benefits to more than compensate for the cost of corruption.

Since Gunnar Myrdal's (1968) vigorous condemnation of corruption, many theoretical publications focused on its adverse aspects (Krueger,

TABLE 1. 1999 Transparency International's Corruption Perception Index (CPI) (10 = Highly Clean and 0 = Highly Corrupt)

Country Rank	*Country*	*CPI Score*
1	Denmark	10.0
2	Finland	9.8
3	New Zealand	9.4
4	Sweden	9.4
5	Canada	9.2
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95	Uzbekistan	1.8
96	Azerbaijan	1.7
97	Indonesia	1.7
98	Nigeria	1.6
99	Cameroon	1.5

Source: Transparency International (www.transparency.de)

1974, Shleifer and Vishny, 1993). Corruption breeds corruption (Leisinger, 1998) by setting a bad example and by encouraging reciprocity of corrupt practices wherever social and economic environment allows it. It can de-motivate economic actors and thus slow down economic growth. Further, as Bardhan (1997) hinted, rules and regulations that make "life difficult" are not exogenous but can be designed by corrupt politicians and bureaucrats to set the stage for extracting bribes. In his econometric study, Mauro (1995) specifically estimated the degree to which corruption negatively affects economic growth, public expenditures and investment.

In an ideal world marked by the transparency of economic activities and perfectly rational decision rules, corruption would undoubtedly represent an unnecessary nuisance. Similarly, if everybody were equally disposed to resort to and accept corruption it probably would not make much sense to anybody. In reality, we do not live in a perfect world. Hence, since Leff (1964), arguments have been presented that corruption does not directly diminish economic results on a national scale in a similar way as taxes do not (illegal aspect of corruption makes a lot of difference, though). For example, in a special case of rigid egalitarian regimes administering scarce resources (and lacking efficient market system), bribes help achieve Pareto optimality and "grease" the system (Rashid, 1981). Khan (1996) theorizes that effects of corruption vary depending on the power relationships between patrons (bureaucrats) and clients and on the structure of these relationships. Consequently, the loss of efficiency cannot always be determined. What is certain though, is that corruption produces re-distribution and re-allocation effect. As Rodrik (1997) points out, it is not clear who ultimately bears the cost of corruption. A recent attempt by Kaufmann and Wei (1999) to refute the above mentioned efficient "grease" approach suggests that companies who pay more bribes end up wasting more time in negotiating with the government officials. While this points to inefficiency with respect to time, the economic benefits for the company due to bribes may still justify its action and, hence, continue the "grease" effect.

A couple of quantitative studies have in recent years specifically looked at the relationship between corruption and one major form of international business, foreign direct investment (FDI). Wei (2000) suggests that corruption in a tax like fashion reduces the FDI. Drabek and Payne (1999) found that lack of transparency negatively affects incoming FDI and that the relationship is of nonlinear nature. Transparency, which is a composite measure including corruption, was found to affect the FDI most for the countries in the middle range of transparency classification. Even though the above findings could be intuitively predicted, in reality it is not that obvious. Table 2 presents for 1999 the FDI destinations enjoying the greatest investors' confidence index along with the perceived corruption index (CPI) and the actual investment figures. As can be seen, the confidence in the markets is strongly and positively correlated with the actual FDI flows but not with the perceived corruption. On the other hand, the FDI and the CPI data also indicates correlation in the expected direction–greater perceived corruption (low index in CPI) lead to lower FDI. However, the strength of the latter correlation needs still to be evaluated.

Further, in a study of bilateral trade data between 1992 and 1995 for the leading 18 exporting and 87 importing countries, Lambsdorff (1998) concluded that certain countries might have an advantage over others in the import markets perceived to be corrupt. This would imply that the taxing impact of corruption does not have to be uniform and ultimately is a function of, among other things, the exporters' differentiated propensity to offer bribes.

Finally, it appears that the impact of corruption on international business partners can vary depending on the form of operation and the prospective time horizon. FDI represents a special case of international business transactions because of the magnitude of capital involved,

TABLE 2. Comparison of FDI Confidence Index with Corruption Perception Index (CPI) and FDI Flows for 1999

Country	*FDI Confidence Index*	*CPI*	*FDI ($ mil.)*
US	1.87	7.5	193373.00
UK	1.46	8.6	67480.00
China	1.45	3.4	43751.00
Brazil	1.41	4.1	31913.00
Poland	1.32	4.2	6365.00
Germany	1.28	8.0	18712.20
Mexico	1.25	3.4	10238.00
Italy	1.22	4.7	2920.24
Spain	1.20	6.6	7218.09
Australia	1.20	8.7	6255.01
India	1.14	5.2	1936.45
France	1.13	6.6	27997.60
Canada	1.09	9.2	16514.50
Thailand	1.07	3.2	6941.18
Korea	1.04	3.8	5415.10
Japan	1.03	6.0	3268.11
Netherlands	1.03	9.0	33346.20
Czech Republic	1.02	4.6	2553.55
Argentina	1.01	3.0	6150.00
Hungary	0.94	5.2	1936.45
Singapore	0.93	9.1	7218.09
Malaysia	0.89	5.1	5105.00
Taiwan	0.88	5.6	---
Belgium	0.86	5.3	20823.70
Ireland	0.83	7.7	2634.61
Correlation	*Confid. Ind. & CPI*	*Confid. Ind. & FDI*	*CPI & FDI*
Coefficient	0.03	0.77	0.24
Significance	0.88	0.00	0.25
(2-tailed)			

Sources: A.T. Kearney (for FDI Confidence Index), Transparency International (for CPI), and the International Monetary Fund (for FDI Inflows).

long-term commitment and the degree of involvement in managing money at stake. Also, upon completion of the investment project, direct investors (local as well as foreign) become hostages of the situation that can hardly be reversed. Thus it appears that theoretically corruption should affect FDI to a greater extent than exports, subcontracting or licensing agreements.

CONCEPTUAL ISSUES

The problem of corruption gains in importance as witnessed by recent UN and OECD initiatives (Alvazzi del Frate and Pasqua, 2000; UN, 1999; OECD, 1998). Globalization contributes to intensification of international business contacts and translates into increased exposure to corruption. Vice versa, in the interrelated world, ethical business entities and the managers representing them can exert a positive impact on corrupt environment. Which of the two tendencies prevails, remains yet to be seen. Many obstacles make evaluating corruption a heroic task. Corruption, by its very nature, is illegal and secretive which makes it difficult to identify. On top of that, not all the incidents are uncovered–the degree of the freedom of media varies across countries as does the independence and effectiveness of their judicial systems. Second, individual cases of corruption vary by magnitude of economic and social consequences. Benign forms (offering a qualified relative of a bureaucrat or business person a well paid job in a petitioning company in exchange for approving its offer) on the surface do not cause much harm. Offering a loan on terms advantageous to the borrower just arbitrages between different capital markets constitutes another example. At the same time, many high profiled cases illustrate how bribes enrich individuals and not the nation as a whole–the fortunes amassed by some lifelong heads of state are just the tip of the iceberg. The problem is that, motivated by bribes, unscrupulous individuals can support sub-optimal solutions for their organizations. Third, delineating subtle boundaries of corruption is not easy. Donations to political parties, while perfectly legal in many countries, are clearly made in expectation of favorable treatment. Finally, perceptual and attitudinal differences towards corruption in different countries create comparison problems (Osborne, 1997).

The scope of corruption may differ, too. It can be widespread, requiring firms to make concessions frequently or it could be limited, making it possible for firms to avoid payments at times. Another aspect of scope would be how broadly one "defines" corruption. One definition suggests corruption as "the misuse of public power for private gain" (Rose-Ackerman, 1999). This definition does not preclude existence of corruption within the private sector. Generally speaking, the broader the definition, the more it is likely to be associated with other concepts such as level of bureaucracy, integrity of the legal system, and political stability. This can be problematic from an empirical standpoint because the effects of corruption may be difficult to separate. Finally, there is the element of uncertainty in corruption. For example, corruption can be fairly "organized" or "chaotic." Under a "chaotic" context it is difficult to predict the required amount or the appropriate recipient. It is also doubtful whether the payment would deliver the expected outcome. Thus, chaotic corruption regime can have a more risky consequence for firms (Wei, 1997).

In many instances, corruption is synonymous with crime albeit at times in a softer disguise. However, the national laws differ in provisions and penalties (making corruption a greater or lesser evil). Also, one can conceptualize corruption as an opposite of "honesty." In an international context, however, the issue of appropriate standards appears of paramount significance. If the practice of the least corrupt countries is to be used as a benchmark, then the experts from these countries need to be the judges.

So far the concept of a corrupt national economy has gained popularity. Is it possible to develop a parallel one of a "corrupt multinational company" or a "corrupt industry"? Such a construct can prove useful, as the corruption level does not have to be uniform across different sectors of national or global economy. For example, based on anecdotal evidence, the defense industry has been deemed particularly prone to corruption worldwide.

METHODOLOGICAL ISSUES

The measurement of corruption is a distinct challenge. To start with, the measure must match the conceptual definition of corruption. For example, it could be the dollar volume of corruption (a measure of magnitude) or the number of corrupt incidents reported (a measure of frequency and, perhaps, scope) or a relative financial burden it imposes on succumbing firms. Table 3 illustrates the latter approach as applied to the post-Communist countries. Depending on selection of category different implications can follow.

TABLE 3. The Burden of Corruption (Examples from Eastern Europe and Former USSR)

	% of firms bribing frequently	*cost as % of revenue*
Azerbaijan	59.3	6.6
Romania	50.9	4.0
Uzbekistan	46.6	5.7
Armenia	40.3	6.8
Georgia	36.8	8.1
Ukraine	35.3	6.5
Slovakia	34.6	3.7
Poland	31.3	3.5
Russia	29.2	5.5
Czech Rep.	26.3	4.5
Croatia	17.7	2.1
Belarus	14.2	3.1
Estonia	12.9	2.8
Slovenia	7.7	3.4

Source: Transition Report 1999, EBRD

There is also the issue of the type of instrument being used–objective or subjective. We believe that the objective data on corruption is preferable. However, it is not always available and, when it is, it might be difficult to standardize. For example, a United Nations project gathered data on crime trends that provide comparable international data on actual prosecutions/convictions for bribery (and in addition fraud and embezzlement) in many countries of the world (UN, 2001). While not always complete (a number of important countries like Brazil, France, Mexico, UK and US are not reported), and not the most recent (in early 2001 the most recent data available pertained to 1997), these statistics are certainly very valuable yet hardly used for research purposes. In pursuit of objective data, Leiken (1997) made a commendable effort. He implemented an approach relying on the number of press reports on corruption published in the national papers. Unfortunately, this method is cumbersome and has not resulted in consistent longitudinal data.

A typical approach by businesses and academics has been to rely on subjective (that is performed by experts and managers) evaluations of countries' corruption level. Various research and consulting organizations compile data on corruption either as a component or the main feature of the country evaluation effort. Subjective rankings that are based on individual experience rather than pure perception are better measures. In other words, people who had direct experiences with the country in question are expected to provide superior subjective evaluation than those who do not possess such experience. One organization heavily involved in exposing corruption–Transparency International–should be complimented for providing since 1995 the Corruption Perception Index (CPI) which is helpful in analyzing the issue in a comparative way (TI, 1999).

When comparing and averaging different subjective indices of corruption, one needs to recognize the fact that neither of these indices exactly refer to the same aspects of corruption nor do they look at the same aspects from the same perspective. Questions are formulated differently in different surveys, the respondents represent a varying spectrum of expatriates and local general public, and even for each individual index the methodology changes from one year to another, rendering the longitudinal comparisons difficult. As an example, Transparency International's index, CPI, is based on different surveys that vary over time.

It is somewhat intriguing that several of these subjective rankings are highly correlated which makes it difficult to decipher their real meanings (e.g., CPI and Business International Corruption Index are correlated at 0.89 even though they were calculated 10 years apart). Whereas CPI is based on an average of usually ten surveys, each probing into corruption by asking a slightly different question, the BI index focuses on "the degree to which business transactions involve corruption or questionable payments." It is also clear that the survey questions (scales) which are more narrowly focused on bribery deal with public officials rather than with corruption within the private sector. Is it then fair to assume that the scope of bribery with respect to public administrators is an accurate reflection of the corruption within the business community? Further, another problem revolves around the significance of the differences between the levels of corruption. If country A's rating equals 7.5, is it really perceived as less corrupt than country B with the perceived corruption index of 7.1? Similarly, if from one year to another the ratings for a country improved from 3.0 to 3.3 does it mean that the perception of corruption is really more favorable? How closely a change in the index reflects a real change in a given economy is an empirical question. There is always the risk that a widely publicized major corruption incident in the country will significantly sway the perception of experts regarding the level of corruption. Ultimately, while most indices have adopted a certain maximum level, does it mean that the countries at the top of the list cannot improve their (already good) ratings any further?

We attempted to compare the objective with subjective ratings of national corruption for the period 1995-1997, using above-mentioned world surveys data on crime trends published by the UN (1999) and the CPI data from Transparency International. When first correlating the national rates of bribery convictions per capita with the CPI ratings, no significant results were obtained. However, when the pooled national rates of bribery plus embezzlement and fraud per capita were analyzed along with the corresponding CPI indices, the resulting correlation coefficient was 0.54. Once again, what this outcome suggests is that there is more to corruption than bribery alone and that applying objective data to comparative international studies on corruption could render comparable results to analyses using subjective data. At the same time, when looking at ratios of bribery plus fraud and embezzlement per $1 billion of GDP of individual countries, we did not find any significant correlation with the CPI ratings. Assuming that the volume of GDP reflects the number of business transactions and hence the opportunities for corruption, this result combined with the previously quoted one suggests that it is the number of corruption-prone individuals rather than their exposure to business deals which more accurately reflects comparative international corruption levels. Also, to corroborate this assumption, one can reiterate the fact that more affluent countries (with higher GDP/capita) are generally characterized by a lower perceived corruption than the poorer countries (see Table 1).[2]

Related to the issue of objective versus subjective (perceptual) measures of corruption is the difficulty of measuring the phenomenon in absolute terms. Since the intrinsic nature of corruption measures applied so far has been relative, the question is whether one should look at the actual or, rather, a differential value of the indices.

All of the not so many large-scale corruption studies in the international business context have utilized regression analysis. One problem with these cross-country regressions is the notion of causality. To be fair, this is a common problem in all such studies but the issue is significant. It is important because we do not know if corruption will lead to lower economic growth rate and investment. It could very well be that the opposite is true, i.e., level of corruption will decrease with increase in economic growth and investment. Indeed, some authors argue that greater internationalization will contribute to the lower corruption rate in the vulnerable countries (Ades & Di Tella, 1994). Moreover, as Wei (2000a) pointed out, even some broader attributes of the economy such as freedom of press, civil rights, and rule of law are correlated with corruption. Once again, this makes it difficult to isolate the effects of corruption in any study on international business.

A final issue in evaluating the effects of corruption on international business is related to the intent and size of the company. Companies may make payments to block competitors, to make themselves more competitive, or to ensure survival and gain legitimacy in global markets. Depending on the strategic intent, payments can be viewed as more or less costly with different overall implications. Also, large and small companies are not expected to behave in a similar fashion in a corruption scenario because the stakes are different. It is likely that large companies not only have greater resources but also a broader experience base to rely on, thus making them more expert in handling corruption.

CONCLUSION AND SUGGESTIONS

Given the presence of corruption in both developed and developing economies, researchers must think of new ways to study its impact on international business operations. First, attempts must be made to clearly define and measure corruption based on its scope and form. Corruption, at the broadest level, can be defined in terms of abuse of power by public enterprises, private enterprises or both. Also, it may be interesting to view corruption as a behavioral characteristic and measure how widespread it is. In other words, do most people in a host country take advantage of corruption to increase individual gains? Or could it be that corruption is localized in major metropolitan areas? Corruption can also take different forms such as bureaucratic or political, cost-reducing or benefit-enhancing, coercive or collusive, and predictable or arbitrary, each of which may have different implications for the parties involved (Tanzi, 1998).

Second, in order to appreciate the impact of corruption, the operating foreign company's intent and size must be included in the analysis. One must focus on the beneficiaries as well as the desired outcomes. If the intent for the firm is not just market penetration but also increasing efficiency of its global network, then the form of operation (for example FDI) and related corruption will hold a far greater significance. It is imperative that all major benefits of foreign operations and investments are taken into account so as to gauge the comparative cost-benefit effects for the firm. It may very well be that the economic and other benefits far outweigh the costs associated with corruption. Thus, even though corruption may make it difficult and costly for firms to operate they nevertheless will. Corruption, viewed in this manner, is not an absolute deterrent but a barrier to overcome for multinational companies. This barrier becomes more important for companies if the cost of corruption cannot be included in the final price charged to the consumers. In empirical studies, corruption must be analyzed once the usual factors for exports, licensing and FDI have been controlled for.

It is important to note that some foreign operations (e.g., FDI) have a long time horizon and corruption is a dynamic phenomenon when such an investment decision is considered. Therefore, assumptions as to the evolution of corruption need to be made to correct for current perception of corruption. For example, in some situations, the bribes (and other payments) might have to be recurrent as opposed to "one-shot" incentives. In repeat payments, the balance of bargaining power might evolve as well as the appetites of dealing parties. These could be very hard to predict unless the "tax-like" approach has been and would continue as an established practice.

Most studies have analyzed and compared corruption at the country level. While there are good theoretical and practical reasons to do so, it nevertheless fails to detect corruption where it matters most–the firm level. In order to properly grasp "corruption in practice," it may help to view acts of corruption from a business transaction perspective for firms (Husted, 1994). Firm-level analysis should consider the direct and indirect costs and benefits of corruption as it relates to multinational operations. Nobody is innocent in corrupt practices, neither the payer nor payee. The initiative to bribe can originate with the corrupt authority as well as with the result-oriented company. The ultimate choice will depend on the elusive balance of power and the relative cost–accounting for the risk of punishment–of alternatives.

Finally, as it is hard to believe that different business entities are equally immune or prone to corruption, one issue to investigate is the deterrence it poses to business activities by the "locals" on the one hand and foreign companies on the other. One can think of developing a simultaneous measure of "tolerance for corruption." This can, in dynamic terms, prove helpful in determining the potential for future improvement in corrupt environments.

Further, it is important to ask whether destination countries with the same levels of corruption will attract similar volumes of FDI. Also, one should attempt to measure any change in FDI level due to a change in the level of corruption. Tests using CPI, for example, can provide the opportunity for researchers to see whether small changes in the index actually record any change in the level of FDI. Answering these questions will help explain the relative effects of corruption for FDI and other forms of international business. They may even assist in recognizing the credibility of both the objective (UN international bribery statistics) and subjective measures (Transparency International's CPI).

The above discussion leads to interesting areas for researchers such as:

a. Under what circumstances is it rational for individual MNCs to resist corruption?
b. Apart from willingness to avoid penalties of law whenever applicable, does an incorruptible company develop a desirable image? What benefits per se would such image represent?
c. Do large corporations have the same problems weeding out corruption as the nation-states do?

NOTES

1. For example, the conviction of the former French Prime Minister involved in milking benefits from Elf Corporation–press reports February 2000.

2. Following Lambsdorff (2000), however, some methodological approaches tend to compound this perception in an exaggerated way.

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