Impact of Perceived National Corruption on the Returns to US Multinationals in Transactions with Foreign Governments

by *Kimberly C. Gleason,* Assistant Professor of Finance, Florida Atlantic University, FL 33431; *Charles A. Malgwi,* Assistant Professor of Accountancy, Bentley College, Waltham, MA 02452; *Ike Mathur*, Professor of Finance, Southern Illinois University, IL 62901 and *Vincent Owhoso,* Associate Professor of Accountancy, Bentley College, Waltham, MA 02452

Abstract

In this exploratory study, we investigate the influence and effects of foreign government corruption on the market value and accounting outcomes of US multinational corporations. We use hierarchical cluster analysis on Transparency International Corruption scores to identify high and low corruption in both developed and developing countries. We argue that corruption obscures the true value of assets, makes valuation difficult, and reduces the potential gains of an acquisition. We find that firms acquiring assets from governments in high corruption environments tend to be larger in size and more intangible asset-oriented than those expanding into low corruption environments. We find that the market responds much more favorably to expansions into low corruption environments than high corruption environments for both acquisitions and joint ventures. We find little evidence that long run accounting performance is adversely affected by government-multinational relationships in high corruption environments. However, long run market value outcomes are negative for all firms entering into relationships with foreign governments, and are especially negative for joint venture relationships in developing high corruption environments. Finally, we find that systematic risk increases substantially for firms entering high corruption environments through trust-based modes of expansions.

1. Introduction

Managers of multinational firms face a bevy of potential internal and external complexities with the potential to create considerable costs, such as cultural differences, unfamiliar regulations, insufficient physical infrastructure, underdeveloped legal systems, poor telecommunications systems, and the overextension of intangible resources (Caves, 1996; Odenthal, 2001). In addition to these complexities, there is the cost of corruption, which has the potential of distorting the level-playing field for US multinational corporations (MNCs) in foreign markets. The perpetration of corrupt business practices has been a major concern to most US multinational managers (Buckley, 1996). Corruption cripples economic development and undermines rule of law, which in turn weakens the institutional foundation upon which economic growth depends (Wolfensohn, 1997). Corruption also obliterates transparency, particularly in an unfamiliar environment; it has the potential to lead managers into a quagmire of asymmetric information where the true value of assets becomes difficult to ascertain and contracts are difficult to enforce. The consequences of failing to understand the business environment could be dire. In fact, according to Merchant International Group, multinationals lose on average 10% of their direct investment in

the emerging markets, because they ignore or underestimate business risks, including corruption and cronyism (Industry Week, 1998).

If US managers found corruption to be a disruptive force, they appear to find anti-corruption measures aggravating as well. The Foreign Corrupt Practices Act (FCPA) of 1977 forbids managers of US multinationals from taking any practice deemed unethical, including bribery, but not prohibiting "tipping." The FCPA marked a large departure from the global legal attitude towards corruption at the time, where several European countries allowed bribery expenses to be deducted from corporate taxes (Windsor and Getz, 1999; Cooper, 1996). Although discussions have been held among members of the OECD nations regarding the appropriate behavior of multinational managers abroad, the European Union has made little progress in terms of actually adopting any regional convention in addressing corruption. Managers of US firms often claim that the FCPA puts them at a competitive disadvantage in that their rivals can engage in unethical behavior in foreign markets that they cannot.

Survey evidence suggests that managers' perceptions of corruption in a given country affects their willingness to engage in foreign direct investment (FDI) and may be one reason why FDI in countries with high corruption may be limited relative to previously anticipated levels (Transparency International, 1997). This exploratory study examines five related issues. First, to examine the characteristics of firms operating in high corruption environments. Second, to identify accounting profitability changes following expansions into high corruption areas to see if the burdens of internalizing corruption leads to performance declines for US firms, which are prohibited by the FCPA from engaging in corrupt practices. Third, to examine the market's perception of the wealth gains or losses of expansions into high corruption areas, both in the short and long run. Fourth, to assess any changes in systematic risk arising from entry into these markets. Fifth, to examine whether cooperative agreements or acquisitions are more conducive to profitability enhancement in high corruption environments.

The remainder of the study is organized by a review of relevant literature on multinationality and mode decisions in high corruption environments. This is then followed by a development of the hypotheses, methodology employed, the corresponding outcomes, and the analysis of the results.

2. Literature Review and Hypothesis Development

2.1 *Multinationality*

The transactions cost theory of the multinational enterprise argues that market imperfections may exist that allow the MNC to take advantage of superior knowledge and expertise (Dunning, 1992). These market imperfections are overcome through investment in intangible assets, which enables managers to internalize markets across national borders. As a result of these imperfections, it is possible to experience differential access to technology across firms and countries, product differentiation, or oligopolistic markets. Oligopolistic markets are characterized by barriers to entry that are overcome by MNCs through exploitation of several avenues of proprietary knowledge. Advertising expenditures, research and development (R&D) outlays, organizational complexity, capital cost barriers, and scale economies in

production are all intangibles useful in overcoming barriers to entry that have been identified in the literature (Caves, 1996). Empirical evidence suggests that MNCs are effective in overcoming such barriers to entry, particularly through the use of advertising and R&D outlays, much better than domestic firms (Geroski, 1991). However, scale economies in production and capital cost barriers may act as deterrents to MNCs in some markets (Shapiro, 1983).

The issue of whether multinational expansion is beneficial in terms of firm performance, and hence, shareholders response to announcements of FDI is mixed and at times contradictory. Although several decades of research have uncovered what managers have known for a long time - that some level of global diversification is value enhancing - the nature of the relationship between diversification and performance is neither clear nor robust across time periods and performance proxies.

Early literature suggested that spatial diversification led to higher risk adjusted performance than strictly domestic strategies (Hughes, Logue, and Sweeny, 1975; Mikhail and Shawky, 1979). Agmon and Lessard (1977) argue that MNCs are rewarded by investors for their unique abilities to overcome barriers to global diversification. Examples of such abilities could include knowledge and experience of the competitive nature of the industry, firm specific factors, economic development, political uncertainty, and other strategic issues. Tallman and Li (1996) find weak or insignificant accounting performance differentials across levels of diversification. Evidence of market value gains resulting from diversification are mixed in research where performance is measured by market value. Fatemi (1984) finds that excess returns to diversified firms are negative, while Doukas and Travlos (1988) and Errunza and Senbet (1981) find evidence that diversification is market value enhancing. Similarly, Morck and Yeung (1991) find positive wealth effects associated with internationalization. Mitchell, Shaver, and Yeung (1992), in their investigation of the medical diagnostics imaging equipment, observe that changes in the level of international diversification negatively affect firm performance, as measured by market value and firm survival. Since information asymmetry leads to hierarchy failure when the valuation of assets is difficult, therefore, in environments where value is difficult to assess, it may be value-destructive to utilize acquisition strategies.

Aside from the FDI modes, firms are increasingly utilizing alternative expansion strategies (Dunning, 1997). FDI involves an investment overseas where the investor maintains control over the resources transferred. Foreign indirect investment, in contrast, involves the transfer of specific assets and intermediate products, such as capital, debt, equity, skills, or technology, between two independent economic agents. Control similarly is transferred by the seller to the buyer. In other words, foreign indirect investment transfer is organized by the market, while FDI transfers are "administered by, and within, investing hierarchies" (Dunning, 1992). Firms have numerous options in terms of engaging in non-FDI modes of behavior: licensing agreements, franchising, exporting, management contracts, alliances and consortia, and non-equity joint ventures. The strategic decision to engage in a particular non-FDI mode may depend on the type of asset being transferred, the time horizon of the transferor, the competitive nature of the industry, firm specific factors, economic development, and political uncertainty. Internalization theory suggests that the decision to use FDI depends on whether market failures

compel it to protect its competitive advantage over host country firms by internalizing its foreign market.

Joint ventures (JVs) represent a sharing of resources, ownership, and control by two or more firms of a common organization. The motives for forming joint ventures involve sharing complementary, but distinct, knowledge or to "coordinate a limited set of activities to influence the competitive positioning of the firm" (Kogut, 1988). An extensive body of literature exists describing the factors that contribute to the use of joint venture strategies. Strategy literature further indicates that international JVs are used as substitutes for traditional FDI modes. Benefits of the JV mode include a lower level of risk relative to FDI modes, production rationalization, and local acceptance (Harrigan, 1988). While acquisitions may, in some circumstances, enable the firm to overcome location specific disadvantages as well, the cost of an acquisition mode may be high due to asymmetric information in valuing the target asset (Barney,1991). Therefore, unless the expansion is taking place in a geographic market with few viable partners, JVs may be preferred to acquisitions. Firms prefer to engage in such expansions to reduce their resource commitment when obtaining complementary assets. However, if they must share proprietary information about their "critical competencies" they hesitate to engage in cooperative arrangements.

Strategic alliances, as previously discussed, have become an increasingly important part of the internationalization process of firms. Motivations for strategic alliances are similar to those of strategic asset acquiring FDI: to acquire new produce or process technologies in the area of the core competency; to realize economies of synergy and scale; to spread the cost of new product development and R&D; to reduce the time involved in the innovation process; and to enter new markets or distribution channels. Strategic alliances are also useful as an entry mode in reducing political risks, "getting in good" with local firms who are favored by the government, or to cope with unfamiliar markets (Dunning, 1997). In a case study of Upjohn Corporation, Fina and Fugman (1996), found that strategic alliances were frequently used to enter markets and diffuse products. Strategic alliances were especially effective in countries with relatively high degrees of internationalization. Alliances and other cooperative arrangements, unlike mergers and acquisitions, typically involve only one part of the participating firms' activities.

While an independent approach can be good because dependence on others can lead to quality and cost problems (Teece, 1992), the problem arises because the commercialization with complex goods is due to many different knowledge bases (Badaracco, 1991 and Rosenberg, 1982). For this reason, it could be difficult for a firm to get a leading edge position in all relevant areas of knowledge. Trying to do all things, or become a "jack of all trades" required things internally as well, and can lead to lower equality and higher cost. To avoid this problem, firms can enter a collaborative relationship, which works well when key development and marketing knowhow is spread across different organizations (Teece, 1992). An advantage of these relationships allows firms to identify and coordinate each other's capabilities (Hamel, 1991) and exchange technical information (Mitchell and Singh,1992). These arrangements could generate more trust and less opportunism in general than other types of relationships. Collaborations can help firms "develop interorgani-

zational routines suited to their skills and the conditions that occur in practice" (Levinthal and Fichman, 1988) so firms that participate in these alliances may be better suited to a changing environment.

At the same time, alliances can be difficult to exit. If market conditions or industry standards change, participants and/or their partners' skills may become obsolete. It might be difficult for the group as a whole to respond appropriately to competitive or demand uncertainty. Thus, Mitchell and Singh (1992) note "once established, a collaborative relationship is a sticky asset that commits a firm to a relatively immobile strategy." However, the degree of stickiness depends on the nature of the partners' commitment and the degree of the shock to the industry.

Other problems frequently arise within collaborative relationships. Such relationships can expose a firms' proprietary information to competitors (Hamel, 1991). Organizational disruption and adaptation difficulties have also been noted in such relationships (Lorange and Roos, 1992). Cooperative modes also involve trust issues. If the enforceability of contracts is low, and/or the partner is not reliable, then proprietary information is likely to be lost. In regimes where the trustworthiness of the partner is difficult to assess, collaborative modes of expansion can be dangerous to profitability.

2.2. Corruption

Due to the nebulous nature of corruption, it is better understood when described than defined. However, a commonly adopted definition of corruption is "any misuse of public or quasi-public office or any other position of trust" (Banfield, 1975; Bardhan, 1997; Goudie and Stasavage, 1997; Shleifer and Vishny, 1993, Windsor and Getz, 1999). In general, corruption refers to bribery or unfair assertion of power, such as extortion, with the caveat that what might be seen by one culture as a framework of corrupt activity may be seen by another as a normal business practice. One well-known source of reference is Transparency International. Transparency International defines corruption in terms of managers' perceptions of how much of an impact it has on operations. We utilize Transparency International's index of management surveys related to corruption for a given country to proxy for national corruption and this is presented in Appendix A.

Little research has been done to provide evidence on how US multinationals fare in high vs. low corruption environments. However, a substantial body of literature has emerged highlighting the difficulties of operating in a culturally distant market. The challenges faced by MNCs in terms of trust and asymmetric information when forming a joint venture with a partner from a dissimilar trust context, or of attempting to value an acquisition target in an environment where cultural barriers prevent effective communication and negotiation are many. The same elements of trust and communication in situations that are not fair games – where a European or Asian rival may have information advantages due to bribery or engage in illegal competitive activities forbidden to US managers – exist when American managers attempt to operate in high-corruption environments. However, if the business environment is transparent, managers can assess in advance the costs they will have to expend in order to evaluate whether the project adds value or not. Corruption, however, obscures the costs associated with the expansion, and misrepre-

sents the value of revenues that the firm can anticipate, and the firm may realize only too late that the project was value destructive. This scenario is illustrated from the following quote from the representative of Bata Corporation, which withdrew from Nigeria due to high perceived environmental uncertainty associated with corruption: "The corruption killed us. Telephone lines were cut, power was cut, products couldn't get through customs. We decided not to play along and finally moved out. It's heartbreaking." (Goldman, 1997 and Oyo, 1997). Understanding a foreign business environment, particularly complex situations, requires a substantial amount of human capital, time, and monetary resources.

International business paradigms also assert that foreign market entry requires a high level of intangibility in order to internalize barriers to entry such as corruption (Dunning, 1996). Therefore, it is likely to be the case that a large asset base, high level of intangible assets, and organizational learning are relevant to the success of business endeavors in high-context and corrupt operating environments. Firms that are larger may have the level of organization to compensate for a scarcity of reliable external institutions in the corrupt environment. Furthermore, MNCs that are more profitable prior to expansion may be in a position to cross-subsidize a poorly performing unit in any situation. From the preceding review of the literature, the following hypotheses are formulated:

Hypothesis 1: US multinationals announcing new expansions into high corruption state of affairs are larger, more diversified, and more profitable prior to the expansion than firms that do not expand into high corruption environments.

Hypothesis 2: The market value and accounting profitability implications of expansions into high-corruption environments will be negative.

2.3 Mode Decisions in High Corruption Environments

There are many problems involved with the management of international joint venture partners. Differences in management practices may be magnified as a result of communication breakdowns (Clegg, 1990; Lane and Beamish, 1990). Additional aggravation may result from incompatibility between the foreign management and the domestic labor force. Distrust of the partner may emerge due to cultural factors, especially in the presence of incomplete information (Williamson, 1985). Trust may deteriorate particularly if the partners anticipate competition. These problems may lead to a distaste for joint ventures with international partners.

Strategic alliances are in some cases replacing simple market based transactions (Lorange and Roos, 1992). Cooperative ventures are being used to create global and organizational relationships. A firm may not have "full range of expertise needed to offer timely and cost effective new product innovations" (Teece, 1987). This is especially true mainly because of today's technologically sophisticated competitive environment, which involves "new product innovation requiring the integration of R&D, marketing, engineering, and design" (Kotabe, 1992). To deal with the increased complexities, firms use alliances to obtain knowledge and technology externally so they can focus on their relative competitive advantage. They can "leverage the skills and knowledge outside the firm to maximize competitive advantage" (Dickson, 1992). Furthermore, firms get into alliances to reduce development costs,

reduce risk of new product introduction, and access technology and know-how that is hard to obtain internally (Kogut, 1988; Ohmae, 1989).

Many cross-national alliances are horizontal in nature, involving cooperation across the same level of the value added chain - R&D consortia, patent swaps, and technology transfers. Such relationships add to the partners' internal technology base and are motivated by a desire to enhance the long term marketability of the product market combinations of the company. They may help to reduce cultural and technical barriers to innovation within a firm.

Similar arguments as those presented for joint ventures regarding the effects of culture on strategic relationships apply to global alliances. Alliances with co-nationals are usually preferred to those with foreigners (Montgomery, 1993). Compatibility between partners with a common set of values, styles, and culture may determine the success of alliances (Perlmutter and Heenan, 1986). As a result, Kotabe and Swan (1995) note that cooperation between firms from the same country may result in more innovative products than cross-national alliances.

Dollinger, Golden, and Saxton (1997) find that firms with a high tolerance of ambiguity may ignore negative information about a potential partner and will be more willing to enter into an alliance. At the same time, managers with high locuses of control will be more inclined to make decisions to get into alliances and not feel limited by negative factors or other individuals. This may provide some evidence as to the factors considered by managers from countries with low uncertainty avoidance, and high power distance scores might make decisions about whether to create an alliance or joint venture.

Mergers and acquisitions are also important modes of internationalization that are extensively utilized by firms. They may be plagued by some of the same issues as joint ventures. They face the additional disturbing problem of the integration of the acquired unit (Cartwright and Cooper, 1993). However, due to the nature of the industry and the level of risk involved in the project, acquisitions may be preferred to joint ventures when the investor has previous experience in the domestic market (Hennart and Reddy, 1997). Furthermore, mergers and acquisitions are useful in situations where managers need to control a substantial amount of the activities of the venture. We, therefore, hypothesize as follows:

Hypothesis 3: High control modes such as acquisitions will result in better market value and accounting performance in high corruption environments than trust-based modes such as joint ventures.

Our final hypothesis relates to the risk side of the return-risk paradigm. We know from anecdotal evidence that managers routinely use higher discount rates to assess foreign investments, commensurate with their view that foreign direct investment increases systematic risk overseas. Specifically, systematic risk is a measure of the covariance of returns between an asset and the market, standardized by the market's own variance. Beta can be rewritten as follows:

$$B_i = \rho_{i,m}\sigma_j / \sigma_m \qquad (1)$$

Where $\rho_{i,m}$ is the correlation coefficient between the return on asset I and the market, σ_{i} is the standard deviation of firm i's returns, and σ_{m} is the standard deviation of the market returns.

The international diversification literature suggests that cash flow diversification should lead to a decline in systematic risk, because the correlation of returns to the domestic market would decline. On the other hand, other research has suggested that in certain circumstances, systematic risk may actually rise as a result of multinationality, because the volatility of the firm's cash flows go up to the point that the effect cancels out the impact of lower correlation of cash flows. Reeb, Kwok and Baek (1998), point out that some factors that increase the volatility of cash flows are various agency problems arising from a lower ability to monitor, from political risk, and from management's perceived risk, which becomes a self-fulfilling prophecy. Our conjecture is that in cases of high corruption, the correlation of cash flows may not go up, but the volatility of the firm's cash flows would, leading to an increase in systematic risk.

Firms forming agreements in high corruption environments may find that the complexity of the situation causes an increase in the volatility of cash flows, particularly, as Reeb, Kwok and Baek (1998) point out, when the arrangement is more difficult to monitor and agency conflict begins to do damage. In other words, corruption can result in the systematic risk, as measured by the beta of the firm, to increase.

Hypothesis 4: US MNCs realize increases in systematic risk when they expand into highly corrupt markets, particularly through trust-based modes.

3. Data

3.1 Sample

Our sample consists of announcements of transactions with foreign governments of US firms through joint ventures, strategic alliances, and mergers and acquisitions. The data were obtained from Securities Data Corporation's International Mergers and Acquisitions and International Joint Ventures databases. The sample period ranges from 1985 to 1999. To be included in the sample, firms had to meet two screening criteria: First, their stocks had to trade on the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), or the National Association of Security Dealers Automated Quotation (Nasdaq) system. Second, their daily stock market returns had to be available from the NYSE/AMEX/Nasdaq Daily Returns database from the Center for Research on Security Prices (CRSP) at the University of Chicago. Data on the CRSP equally weighted (EW) stock market index were obtained from the CRSP Indices database.

Financial data for the sample firms were obtained from the 1999 edition of the COMPUSTAT Research Insights database. The final sample included 1,492 deals with governments by US firms.

Of the total, 868 (58%) were joint ventures and 624 (42%) were acquisitions. Table 1 shows the distribution of the firms by mode of FDI expansion in each level of country development, and by level of corruption. Of the 868 joint ventures, 139 (16%) were in the developing high-corruption category, 217 (25%) were in the devel-

oping low-corruption category, 259 (30%) were in the developed high-corruption group, and the remaining 253 (29%) were from the developed low-corruption category. Of the 624 acquisitions, 101 (16%) were in the developed high-corruption group, 80 (13%) were in the developed low-corruption group, 239 (38%) were in the developing high-corruption group, and 204 (33%) were in the developing low-corruption group. Our data set is unique in that it is the first to empirically investigate MNC-government relationships using actual expansion announcements. Thus, we are able to look directly at the units involved in managers' perceptions of corruption, as noted by Transparency International.

Table 1
Deals with Governments by US Firms

	ACQUISITIONS		JOINT VENTURES	
	Developed	Developing	Developed	Developing
High Corruption	101 (16%)	239 (38%)	259 (30%)	139 (16%)
Low Corruption	80 (13%)	204 (33%)	253 (29%)	217 (25%)
Total Sample Size	624 (42%)		868 (58%)	
Total Deals	1,492			

This Table presents the distribution of the firms by mode of FDI expansion in each level of country development, and by level of corruption.

3.2 Research Variables

3.2.1 Firm Operating Characteristics

In our effort to assess the characteristics of multinational firms engaging in MNC-government relationships as well as the performance implications of these expansions, we use two broad categories of performance metrics, Accounting Measurements of Performance and Market Value.

(i) Measurements of Performance

This category of accounting performance metrics utilizes some selected accounting variables that have been used and supported in banking and similar studies (see Deephouse, 1999; Woodward, 1991; Le Saint, 1991; Kaplan, 1984; and Chakravarthy, 1985). We utilize measures of size and diversification, both business and spatial, as control variables. Similarly, we examine the changes in performance variables two years following the announcement to identify firms with the biggest increases in profitability. For both acquisitions and joint ventures, we categorize the variables by consolidating them into five strands for purposes of these analyses. These include: *Size* (in terms of Total Assets, Market Value, and Sales); *Profitability* ((Return on Asset (ROA), Return on Equity (ROE), Net Profit Margin (NPM)); *Intangibility* ((Research and Development to Asset Turnover (RD/AT), XAD/AT, Intangible Assets to Asset Turnover (INT/AT)); *Efficiency* ((Asset Turnover (AT), Inventory Turnover (INV), Current Ratio)); and *Diversification* (in terms of Business Segments, Geographic Segments, and percentage of Foreign Sales to Total Sales). Profitability measures such as ROA, ROE and NPM are particularly and often regarded as the

traditional measures of performance. These are the fundamental index of profitability that demonstrates the highest factor magnitude of performance measure of the firm as a whole. Detailed descriptions of these variables are presented below.

Return on Equity: The return on equity (ROE) indicates the profitability of equity funds. ROE is calculated by dividing after tax earnings by average stockholder's equity. A higher ROE than industry indicates that firms are efficient in product pricing and/or low operating costs than most firms. MNC's could take advantage of the product pricing efficiencies and low operating costs by expanding overseas.

Return on Assets: Return on Assets (ROA, also known as ROI) - This provides information on profits relative to investment in assets. ROA is calculated by dividing after tax earnings by average assets. If a firm's ROA is higher than industry average, it shows that the firm's receivables, inventory and/or fixed assets are adequate to generate a higher level of sales while maintaining the same level of net profit margin. A company that is able to use smaller investment in fixed assets to generate profits better than other firms in the industry is likely to benefit by expanding overseas.

Net Profit Margin PM: Net profit margin (NPM) is a measure of the firm's efficiency after operating expenses and taxes are deducted from gross profit. It indicates the overall effectiveness of managerial decisions by providing insights into the operations of the firm. A higher net profit margin than the industry may indicate that selling costs, administrative expenses or taxes are at a manageable level or decreasing. MNC's are probably more able to manage these costs by expending overseas where certain operating costs are reduced.

Inventory turnover ratio: This ratio indicates how often inventory is turned into cash or accounts receivable. It address the issue of whether the company is building up excessive inventory and not converting them into cash on a timely basis. Inventory turnover ratio is calculated by dividing the cost of goods sold by average inventory.

Asset turnover ratio: This ratio measures the overall indicator of firm efficiency in utilizing its assets, that is, it profiles how efficient a firm is in using its assets to generate sales. Asset turnover ratio is measured by dividing net sales by average total assets. Companies that are efficient in generating higher sales are likely to expand overseas.

Leverage ratio: Leverage refers to a company's use of borrowed capital (debt) as compared to owner invested capital (equity) to finance the company's operations. A company's leverage will also provide information about its current financing flexibility. A company's financing flexibility refers to the company's ease in obtaining additional financing, if needed. For example, a company might need to obtain financing to open a new manufacturing plant.

Debt to equity ratio: The debt to equity ratio measures the proportion of capital provided by creditors rather than common stockholders. This is measured by dividing total liabilities by total equity and it indicates whether companies are using debt excessively.

(ii) Market Value

The use of "window dressing," or artificially modifying assets prior to reporting financial statements may be a common practice of publicly held firms for a variety of reasons (Allen and Saunders, 1992), potentially making profitability measures unreliable. In fact, Allen and Saunders report that over 75 percent of banks practice upward window dressing of assets on the last day of each quarter over the 1978 to 1986 time period. For this reason, and because they provide unique insights into the perceived gains and losses on behalf of shareholders, we also examine announcement-date and long horizon market value impacts of mergers and joint ventures in high corruption environments. The precedence has been set for using event-study oriented performance metrics (Morck and Yeung, 1991; Lubatkin, 1986, Chaterjee, 1991). In this study, we use both an announcement date event study to examine the market's perceptions of the value added to shareholders by the transaction as well as a long-horizon event study technique to examine the improvement or decline in market value over a one year period following the announcement of the expansion.

(iii) Systematic Risk

Our final analysis involves looking at the systematic risk changes (defined previously) of US firms forming cooperative relationships with and acquiring units of foreign governments in high and low corruption environments.

3.2.2 Nation-Specific Variables

(i) National Corruption

We utilize a measure of corruption developed by Transparency International, a nonprofit organization engaged in research on national corruption. Transparency International's Corruption Perceptions Index scores countries on the basis of surveys of managers who work in the country. As stated by Dr. Joan Graf Lambsdorff, research associate for Transparency International, "...unbiased, hard data continue to be difficult to obtain and usually raise problematic questions with respect to validity. International surveys on perceptions therefore serve as the most credible means of compiling a ranking of nations." Furthermore, she states that while alternative sources of information, such as Political Risk Services, measures not corruption, but political risk caused by corruption. Transparency International, on the other hand, uses survey techniques that address aspects of corruption directly. The reliability of the corruptions perceptions index is very high, as indicated by several nonparametric tests, such as the bias corrected accelerated method. In short, we believe that the Transparency International Corruption Perceptions Index meets scholarly criteria for reliability and validity, and is the best measure available for capturing perceptions of corruption[1].

(ii) Economic Development

To control for the effects of economic development, we also utilize the following country classification: Advanced Industrialized, Newly Industrialized, and Developing. These classifications are also used by The Economist, among others[2].

4. Methods

4.1 Event Study

To test the markets' reaction to the announcement of these mergers, joint ventures and strategic alliances, we follow a standard event study methodology. Returns for each firm (R_{it}) are modeled using ordinary least squares. A 150-day estimation period was chosen immediately preceding the 21-day (+10 to -10) event window. To calculate a beta value and intercept for the market model, the holding period return for each firm (R_{it}) is regressed on the CRSP equally weighted returns index (R_{EWt}), which includes all dividends and distributions. The OLS takes the form:

$$R_{it} = a_i + b_i R_{EWt} + e_{it} \quad (2)$$

The expected return for the announcement window is then computed from the capital asset pricing model.

$$E(Rit) = Rf + bi\ (Rmt\text{-}Rft) \quad (3)$$

The abnormal return (AR) is then computed as the difference between the observed return (OR) to stock i and the expected return (ER) on a day t in the event window:

$$AR_{it} = OR_{it} - ER_{it} \quad (4)$$

An average abnormal return (AAR_t) is calculated across the sample for each day (t) in the event window. Finally, the cumulative abnormal return (CAR_t) is computed by summing the AAR over the appropriate intervals. The results from several event windows are presented.

Long Horizon Holding Period Returns

We further examine wealth effect issues related to these cooperative transactions using long-horizon holding period returns. Previous studies have shown that estimating long-horizon returns by accumulating short-term abnormal returns leads to biased test statistics (see, e.g., Conrad and Kaul, 1993; Barber and Lyons, 1997). Barber and Lyons provide evidence that using benchmarks comprised of control firms yield well-specified test statistics because this benchmarking approach mitigates the biases discussed (new listing, rebalancing, and skewness biases).

We use a matching firm sample procedure for estimating the long-horizon average holding period abnormal returns (AHAR) for our sample firms. We first identify matching firms for our sample of firms on the basis of four digit SIC codes. From this set we then match firms on the basis of size as measured by total assets. We then calculate raw returns for both sample and matching firms from the month subsequent to the announcement date for six, twelve, and eighteen month holding periods. The reported AHARs are the average difference between the holding period returns for the sample and matching firms.

4.3 Changes in Systematic Risk

For each firm, we estimate the pre-announcement beta, $Beta_{pre}$ [post-announcement beta, $Beta_{post}$], over the period from t-110 to t-11 [t+11 to t+110], where t=0 is the announcement date. We look at the sample firms participating in

these cooperative activities, where the change in beta is calculated as Beta $_{POST}$ minus Beta $_{PRE}$.

5. Results

Descriptive Statistics

Table 2
Sample Descriptive Statistics

Panel A. Firms Acquiring Government Units

Variable	Firms Expanding into High Corrupt Environments	Firms Expanding into Low Corrupt Environments	Difference in Mean (t-statistic)
Size			
Assets, $ Mil	35,488	30,656	4,832 (0.887)
Market Value, $ Mil	20,052	12,087	7,967 (3.371)***
Sales, $ Mil	21,104	15,486	5,617 (2.300)**
Profitability			
ROA	4.483	2.945	1.539 (2.444)**
ROE	15.976	9.278	6.699 (2.955)***
NPM	5.423	-1.805	7.228 (0.220)
Intangibility			
RD/AT	3.200%	3.000%	0.200 (0.605)
AD/AT	3.500%	1.700%	1.77% (3.667)***
INT/AT	8.500%	5.600%	2.90% (3.150)***
Efficiency			
AT	0.915	0.806	0.109 (2.627)**
INV	12.798	18.105	-5.306 (2.304)**
Current Ratio	1.532	1.509	0.023 (0.197)
Diversification			
Bus Segments	2.987	2.869	0.118 (0.504)

Geo Segments	3.981	3.745	0.236 (2.305)**
Foreign Sales/Total Sales (%)	32.882	23.305	9.577 (3.181)***
Panel B. Firms Forming Joint Ventures with Governments			
Size			
Assets, $ Mil	30,491	30,015	476 (0.126)
Sales, $ Mil	29,643	33,939	3,296 (0.610)
Market Value, $ Mil	25,419	21,974	4,445 (0.904)
Profitability			
ROA	3.217	0.154	3.063 (1.981)**
ROE	12.535	9.870	2.665 (0.751)
NPM	5.300	1.400	3.900 (1.246)
Intangibility			
RD/AT	4.300%	7.800%	-3.500 (-2.114)**
AD/AT	2.300%	1.900%	0.430 (1.238)
INT/AT	6.200%	5.000%	1.200 (1.552)
Efficiency			
AT	0.947	0.973	-0.026 (-0.794)
INV	15.727	16.799	-1.072 (-0.315)
Current Ratio	1.535	2.147	-0.612 (-2.726)***
Diversification			
Bus Segments	3.047	2.801	0.246 (1.017)
Geo Segments	3.852	3.843	0.009 (0.097)
Foreign Sales/Total Sales (%)	26.460	26.025	0.435 (0.161)
This Table provides the descriptive characteristics of firms expanding into high corruption vs. low corruption environments using either acquisition or joint venture methods.			

Table 2 presents descriptive statistics of the firms that acquired government units or entered into joint venture relationships in high vs. low corrupt environments. In panel A, firms expanding into high corrupt environments through acquisitions appear to be larger in size as measured by assets, market value, and sales and are more profitable as measured by ROA, ROE, but not NPM. They are also more efficient in employing resources with respect to asset turnover, but are less efficient than firms expanding into low corrupt environment with respect to inventory turnover. Firms acquiring government units in high corrupt vs. low corrupt environments are equally well diversified in their business segments. However, firms acquiring government units in high corrupt environments have more geographical segments and higher percentage of foreign sales to total sales than firms acquiring government units in low corrupt environments. This supports the previous theoretical literature, such as Dunning (1996), that the internalization of barriers to entry requires size, scope, and an investment in intangibility, particularly for high control modes.

In panel B, firms expanding into high vs. low corruption environments through joint ventures are not different in assets size sales, or market value. They are also not different in profitability as measured by ROE and NPM. However, firms with joint ventures in high corrupt environments have a higher ROA, but lower current ratio. These results suggest that low control modes involving resource sharing do not require as substantial size, scope and intangibility as high control, FDI modes. These results are among the first to document that firms who are involved in doing deals with governments are those that are large and intangibility intensive. In general, the results for both acquisitions and joint ventures support Hypotheses 1.

5.2 Event Study

Table 3
Market Reactions to Expansions

Panel A. Overall Sample			
Sample	CARS (-10,+10)	CARS (-1, +1)	CARS (-1,0)
N = 1302	0.85 (2.96)***	0.33 (3.07)***	0.26 (2.97)***
Panel B. Acquisitions			
Overall N=544	1.18 (2.78)***	0.38 (2.36)**	0.31 (2.37)**
Developed N=383	1.17 (2.14)**	0.39 (1.91)*	0.33 (2.01)**
High Corrupt N = 210	1.14 (1.61)	0.18 (0.69)	0.12 (0.32)
Low Corrupt N = 173	1.22 (2.61)	0.64 (2.62)***	0.52 (2.61)***
Developing N = 161	1.21 (1.67)*	0.34 (1.25)	0.24 (1.09)
High Corrupt N = 89	-0.07 (-0.08)	0.49 (1.40)	0.55 (1.91)*

Low Corrupt N=72	2.81 (2.37)**	0.15 (0.34)	-0.13 (-0.37)
Panel C. Joint Ventures			
Overall N = 758	0.61 (1.58)	0.30 (2.06)**	0.23 (1.92)
Developed N = 437	-0.81 (-0.02)	0.24 (1.18)	0.19 (1.15)
High Corrupt N = 213	-0.22 (-0.33)	-0.06 (-0.24)	0.00 (0.01)
Low Corrupt N = 214	0.19 (0.25)	0.52 (1.83)*	0.37 (1.58)
Developing N = 321	1.46 (2.71)***	0.38 (1.88)*	0.28 (1.69)*
High Corrupt N = 127	0.78 (0.92)	-0.05 (-0.16)	0.12 (0.47)
Low Corrupt N = 194	1.91 (3.25)***	0.67 (3.02)***	0.38 (2.13)**
Developed N = 820	0.54 (1.32)	0.31 (2.03)**	0.26 (2.06)**
Developing N = 482	1.35 (3.23)***	0.37 (2.29)**	0.27 (2.04)**
Low Corrupt N = 663	1.16 (2.71)***	0.55 (3.45)***	0.36 (2.72)***
High Corrupt N = 639	0.53 (1.21)	0.10 (0.61)	0.16 (1.21)

Table 3 presents the announcement period cumulative abnormal returns (CARs) for (-10, +10), (-1, +1), and (-1, 0) event window announcements of US firms expanding to developed and developing high and low corrupt environments. CARs are calculated using the market model from 110 t0 11 days prior to the event announcement. CARs represent the cumulative market model adjusted change over the event window.

Table 3 provides the results from the event study. Panel A shows results for the overall sample. In Panel B, we find that the market does not respond significantly to announcements of acquisition-type government relationships in either developing or developed high corruption environments; however, it responds favorably to announcements of these deals for developed-low corruption environments. For joint ventures, the results in Panel C show that collaborative relationships with governments are viewed positively in low corrupt environments and indifferent in both developing and developed high corruption environments.

Overall, the results indicate that acquisitions and joint ventures are viewed as wealth enhancing in both developed and developing countries and in low corruption environments, whereas the market is indifferent or negatively oriented when announcements of these expansions in high corruption environments are made. These results support Hypothesis 2, and are consistent with previous literature regarding the value destruction that sometimes occurs in diversification, such as

Fatemi (1984) and Mitchell, Shaver, and Yeung (1992). The results are also particularly pronounced in circumstances where asymmetric information is high, obscuring the value of assets in the joint venture or acquisition (Barney, 1991). These results are the first to document that the abnormal returns to firms acquiring from governments or partnering with governments in high corruption environments are perceived unfavorably by the equity markets.

Accounting Performance Outcomes

Table 4
Accounting Performance Changes Two Years After Firms' Expansion to High and Low Corrupt Environments.

Panel A. Acquisitions						
Variables[a]	Developed -High Corrupt	Developed -Low Corrupt	T (High Corrupt- Low Corrupt)	Developing -High Corrupt	Developing- Low Corrupt	T(High Corrupt-Low Corrupt)
Size						
Assets	7.246 (4.711)***	5.349 (6.380)***	1.083	3.0170 (4.956)***	8.688 (4.545)***	-3.115***
Market Value	7.357 (43.90)	6.715 (5.230)***	0.209	5.2290 (6.280)***	8.016 (4.387)***	-1.500
Sales	5.946 (2.797)***	5.242 (5.394)***	0.275	2.7170 (4.579)***	4.464 (3.939)***	-1.456
Profitability						
ROA	-0.7413 (-0.796)	-6.95 (-0.159)	-0.592	-2.100 (-0.941)	-1.479 (-1.749)*	-1.699*
ROE	-0.361 (-0.419)	-2.33 (-0.547)	-0.081	-1.870 (-0.977)	-1.026 (-1.962)**	-0.379
NPM	-0.5808 (-0.778)	-10.90 (-0.278)	-0.595	-1.750 (-1.018)	-1.0122 (-1.686)*	-1.874*
Intangibility						
RD/AT	0.423 (0.106)	4.320 (0.356)	-0.255	2.77 (1.573)	-24.22 (-2.852)***	3.344***
AD/AT	-2.97 (-0.923)	-21.27 (-3.053)***	2.906***	-12.22 (0.558)	-9.65 (-1.045)	-1.163
INT/AT	0.7802 (2.832)***	0.828 (2.424)	-0.100	-7.17 (-1.810)*	0.7051 (1.716)*	-0.895
Efficiency						
AT	0.7316 (0.191)	2.306 (0.925)	-1.756*	-6.350 (-0.370)	-0.1132 (-3.045)***	-2.309**
INV	6.433 (2.242)**	11.49 (2.689)***	-1.985**	-4.469 (3.125)***	-0.5577 (1.10)	-0.966

Diversification						
Bus Segments	28.12 (2.702)***	19.37 (1.930)*	2.014**	4.235 (2.313)**	15.76 (2.211)**	1.126**
Geo Segments	4.11 (1.987)**	5.423 (2.488)**	0.726	0.511 (2.236)**	6.765 (2.141)**	-1.845*
Frn Sales/ Total Sales (%)	0.7457 (1.277)	5.423 (1.596)	0.413	-0.5708 (1.413)	2.268 (1.480)	-2.588**
Panel B. Joint Ventures						
	Developed -High Corrupt	Developed-Low Corrupt		Developing -High Corrupt	Developing-Low Corrupt	
Size						
Assets	7.465 (2.08)**	4.942 (2.42)**	-1.732*	3.205 (1.98)**	4.694 (2.36)**	-1.253
Market Value	7.866 (2.16)**	7.975 (2.39)**	0.561	5.107 (2.25)**	8.762 (2.65)***	-2.678**
Sales	2.239 (3.20)***	3.809 (3.08)***	-0.048	2.608 (3.46)***	3.672 (3.55)***	-1.048
Profitability						
ROA	6.501 (2.65)**	4.421 (1.11)	0.630	4.553 (1.35)	-4.106 (-2.66)**	1.257
ROE	4.181 (1.48)	-3.652 (-0.65)	0.636	2.913 (1.70)	-3.273 (-1.87)*	1.427
NPM	4.823 (1.88)*	1.035 (1.17)	-0.417	-6.07 (-1.84)*	-4.348 (-2.85)**	1.094
Intangibility						
RD/AT	-0.676 (-0.58)	11.300 (3.21)***	-1.272	-8.60 (-2.50)**	-9.18 (1.05)	0.114
AD/AT	7.315 (1.58)	9.139 (1.86)*	-0.212	-1.45 (-0.66)	7.12 (0.58)	-0.917
INT/AT	9.388 (2.05)**	3.417 (2.43)**	-1.760*	1.239 (1.43)	4.959 (1.68)	-1.055
Efficiency						
AT	-1.70 (-1.04)	8.27 (1.55)	-1.524	-0.235 (-0.53)	-0.750 (0.78)	0.150
INV	20.75 (3.57)***	27.98 (2.05)**	-0.618	22.10 (3.00)***	13.74 (1.75)*	0.866
Current Ratio	3.93 (1.00)	28.92 (1.82)*	-1.516	6.33 (2.03)**	1.699 (1.55)	0.864

Diversification						
Bus Segments	1.131 (0.67)	12.40 (2.65)**	-1.388	8.784 (2.04)**	6.206 (1.34)	0.306
Geo Segments	6.430 (1.68)	2.133 (1.04)	1.395	7.589 (1.93)**	3.603 (0.88)	1.434
Frn Sales/ Total Sales (%)	31.46 (2.96)***	12.64 (2.58)**	0.677	11.48 (2.19)**	39.16 (3.36)***	-0.647

This Table shows the Accounting Performance Changes for variables two years following the transaction from one-year prior.

[a] ROA = Return on Asset, ROE = Return on Equity, NPM = Net Profit Margin, RD = Research and Development, AT = Asset Turnover, INV = Inventory Turnover, INT = Intangibles, Frn Sales = Foreign Sales, CR = Current Ratio

We next examine the accounting performance implications of acquisitions and co-operative agreements with governments over a two year period and the results are presented in Table 4. Panel A provides the results for acquisitions of government units in high corrupt and low corrupt, developed and developing countries. We find that firms engaging in government-MNC acquisitions appear to follow strong growth objectives in the two years following the announcement of the transaction. On average, MNCs in both low-corruption and high-corruption environments seem to realize significant positive growth rates in assets. For example, assets of MNCs in developed, high corrupt and developed low corrupt environments increased by 7.25% and 5.34% respectively while the assets of MNCs in developing high-corruption and developing low-corruption environments also increased by 3.02% and 8.68% respectively. Although the results shows that the total asset size of MNCs in low versus high corrupt areas is generally increasing, there is no significant difference in the size of the increases between developed high corrupt versus low corruption environments. There is, however, a significant increase in the size of MNCs assets in developing low corruption environments than in developing high corruption environments.

Acquiring MNCs seem to experience significant positive growth in market share after the acquisition in both low-corruption and high-corruption environments. The market share of MNCs in developed high-corruption environment grew by 7.40% and while the market share in developed low-corruption environment grew by 6.72%. Likewise, the market share of firms expanding into developing high-corruption countries grew by 5.23% while the market share of those entering developing low-corruption countries grew by 8.02%. The difference in the market share growth rate was not significant between high versus low corrupt developed environments or between high versus low corruption developing environments.

Sales growth was also positive for MNCs in both developing and developing environments. Sales grew by 5.95% in developed-high corrupt environment and by 5.24% in developed-low corrupt environment. In developing high-corruption environments, sales grew by 2.70% and by 4.47% in developing low-corruption environments. Similar to the growth rate experienced in the market share value, the

difference in the sales growth rate was not significant different between developed high versus low corruption environments or between developing high versus low corruption environments.

Together, these results might be expected, given that the firm may grow in size following an acquisition. However, there is a substantial body of literature indicating that many firms who engage in one type of diversification (geographic vs. product market) simultaneously focus in terms of the other (Bodnar et al, 1999). Hence, if a firm simultaneously divests in addition to expanding its global scope, it may see a decline in assets. In addition, if a firm engaged in a value destroying acquisition, its market value may go down following the acquisition.[3] However, firms expanding into high-corruption environments grow more slowly post-acquisition, in terms of assets, market value, and sales than those expanding into low-corruption environments, and this applies to both developed and developing countries.

Next, we examine changes in profitability and efficiency. We find that all firms engaging in MNC-government acquisitions realize declines in profitability. However, the declines are not statistically significant for developed high and low-corruption environment. Specifically, the net profit margin for developed high corruption environments declined by 0.58 percent compared to a decline of 10.90% in developed low corruption environments. Similarly, net profit margin declined by 1.75 percent in developing high corruption environments and by 1.01 percent in developing low corruption environments. These results are however are not significant at conventional levels for developing countries. Thus, the two-year performance outcomes do not appear to be large.

We find mixed results when we examine efficiency. Firms in both developed-high corrupt and developed low-corruption environments realize increases in efficiency as proxied by asset and inventory turnover. Firms expanding to developed low-corruption environment are more efficient with higher asset turnover (2.30), inventory turnover (11.49) and current ratios (5.29) than firms expanding into developed high-corruption environments with asset turnover being 0.73, inventory turnover 6.43 and current ratios -1.75. Firms expanding to both developing high and low corrupt countries generally experience decline in asset turnover (6.390 and 0.11) respectively, inventory turnover (4.47 and 0.56) respectively, and current ratios (11.03 and 6.74) respectively. However, these declines are greater for developing high-corruption environments than for developing low-corruption environment, particularly for asset turnover. Overall, for all proxies of efficiency, asset turnover declines significantly more for acquisitions in high corrupt than low-corruption environment. However, neither inventory turnover nor current ratio is different.

Evidence on changes in refocusing strategies for acquiring firms two years post-acquisition are provided by changes in business segments, geographic segments and the ratio of foreign sales to total sales. Firms acquiring units in developing countries appear to be undergoing scope enhancement as shown by the positive increases in diversification. Firms expanding into high corruption environments appear to be pursuing the strongest business diversification objectives, increasing the number of business units at a significantly higher pace than those expanding into low-corruption environments. The number of business segments increased by

28.12% in developed high corruption environment compared to 19.37% in developed corruption environment. However, the number of business segments in developing high corruption environment increased at a slower rate than in developing low corruption environment (4.24 versus 15.78). The results also suggest that scope is increasing more rapidly for firms expanding into developing countries through acquisitions of government units than for those expanding into high-corruption environments as shown by product market segments and geographic market segments. As shown, increases in geographic units are 4.11% for developing high corruption environments, 5.42% for developed low corruption environment, 0.511% for developing high corruption environment and 7.76% in developing low corruption environment. Foreign sales are not particularly different between developed high corruption and developed low corruption environments or between developing high corruption or developing low corruption environments.

Panel B provides evidence on size, profitability, efficiency, and diversification for US firms engaging in cooperative relationships with foreign governments. The results are qualitatively similar to those of acquisitions. Firms expanding into developed-high corrupt areas tend to have higher growth rates in terms of assets, market value, but not in sales than those expanding into developed low-corruption regions. However, firms expanding into developing high-corruption regions have lower growth rates than those expanding into developing low-corruption environments. No significant differences are observed for profitability measures for high corrupt vs. low corrupt environments, although in general, firms realize profitability declines in the two years following the cooperative venture. Like acquisitions, the evidence for cooperative forming firms is mixed. All firms realize declines in asset turnover, but improvements in inventory turnover two years following the transaction, although no significant difference is observed for firms in high-corruption vs. low-corruption environments. Finally, although all firms significantly increase geographic and product market scope, no significant difference is observed across levels of corruption.

5.4 Market Value Performance Outcomes

Table 5
Long Horizon Holding Period Returns

	LHR (0,6)	LHR(0,12)	LHR (0,18)
Overall Sample	-4.44***	-6.58***	-7.69***
Acquisitions	-3.23***	-3.62**	-5.37**
Developed Low Corrupt	0.51	2.53**	8.65***
Developed High Corrupt	-1.88*	-2.54*	-2.60**
Developing Low Corrupt	-1.54*	-1.67*	-1.48*
Developing High Corrupt	-6.25**	-7.89**	-8.96***
JVs	-2.25***	-4.96***	-4.21**
Developed Low Corrupt	0.66*	1.58**	2.54**
Developed High Corrupt	-2.67**	-3.25**	-3.52**

Developing Low Corrupt	-2.61**	-3.45**	-5.41
Developing High Corrupt	-7.99**	-8.59***	-9.53***
High Corrupt	-2.50***	-6.39***	-5.99***
Low Corrupt	-1.67**	-2.82**	-3.64***

This table reports the long-horizon average holding-period abnormal returns (AHAR) for our sample firms. We compute long-horizon holding period raw returns for the sample firms (HPRFi) and for the matched firms (HPRCi). AHARi = HPRFi - HPRCi. The two-tailed significance tests are based on the standardized cross-sectional method. HPRFi, HPRCi and AHARi are calculated starting with the month after the announcement date for 6, 12, and 18 month holding periods. Firms in the sample with multiple transactions that confound the long-horizon analysis are omitted from the analysis.

We next turn to market value performance outcomes shown in Table 5. Overall, the results suggest that almost all deals with governments, regardless of the level of corruption present, precede significant declines in share price over the following six, twelve, and eighteen months. The only transactions that yield significant share price improvements are expansions into developed-low corrupt countries, for both acquisitions and joint ventures. Developing country transactions tend to be value destructive for both acquisitions and joint ventures, particularly so for transactions in high corrupt countries.

For the acquisitions subsample, six, twelve, and eighteen month, the long horizon holding returns (LHRs) are declines of 4.44, 6.58, and 7.69% respectively. The largest contributing group to this substantial decline comes from the developing-high corruption sample. Share prices declined by 8.9% relative to the market by eighteen months after the developing high-corruption transaction. This is a significantly larger decline than that of the developing-low corruption subgroup. Results are similar for the developed sample. Although acquisitions of government units in developed-low corruption countries yield share price increases of 8.65% over the market by eighteen months post, firms expanding into developed high-corruption countries realize significantly negative share price declines of 2.60% over the market.

For the joint venture subsample, similar results are obtained. The overall decline of 4.21% in share price over eighteen months is largely driven by the significant negative share price activity of the developing high-corruption sub sample (9.53%). Cooperative agreements with governments of developing-low corruption countries realize significant share price declines over eighteen months as well, although significantly lower declines than the developing-high corrupt group. The developed low corrupt JV group realizes wealth enhancement above the market over the eighteen months following the formation of the cooperative agreement, while the developed high corrupt group experiences wealth declines in excess of the market.

Comparing acquisitions and joint ventures in highly corrupt environments shows that acquiring firms in all cases outperform partnering firms. The difference is especially pronounced for high corrupt countries. Where the eighteen-month share price decline for firms forming JVs with developing-high corrupt governments was 9.53%, the decline for acquiring firms was only 8.96%. Furthermore, the decline for

firms forming joint ventures in developed-high corrupt environments is 0.92% larger than that of firms forming partnerships of developed-high corrupt firms. These results indicate that transactions with corrupt governments, rather than helping firms construct artificial monopolies, actually are followed by share price declines. Furthermore, firms engaging trust based strategies like joint ventures experience larger declines than those who do acquisitions in corrupt environments. These results indicate that control modes provide more favorable outcomes than non-control modes. To our knowledge this has not been investigated in previous research.

5.5 Systematic Risk Outcomes

Table 6
Changes in Systematic Risk from Expansions

Panel A. Acquisitions			
	Change in beta High corrupt	Change in beta Low corrupt	t
All	-0.0121	-0.0866	1.353
Developed	0.0498	-0.0882	1.729*
Developing	-0.0496	-0.0827	0.077
Panel B. Joint Ventures			
All	0.049	-0.051	2.083**
Developed	0.035	-0.1106	2.323**
Developing	0.069	0.0159	0.466

The Table reports the changes in systematic risk around the announcement of the relationship with the government unit. For each firm, whether in the joint venture or strategic alliance or the acquisition sample, we estimate the pre-announcement beta, $Beta_{PRE}$ [post-announcement beta, $Beta_{POST}$] over the period from t-110 to t-11 [t+11 to t+110], where t=0 is the announcement date.

Our final hypothesis relates to changes in systematic risk following acquisitions and joint ventures with foreign governments. These results are shown in Table 6. Panel A shows that acquisitions of units of high corrupt governments yield decreases in systematic risk for the developing country sample and increases in systematic risk for the developed country subsample, although this result is not significant. However, in the low corrupt environments, firms experience large significant declines in systematic risk. In the case of developed countries, the decline in systematic risk is significantly larger for the low corrupt subsample than for the high corrupt subsample. In other words, acquiring firms in low corrupt environments were able to realize reductions in systematic risk commensurate with their lower returns, whereas firms expanding through acquisitions into high corrupt environments simply realized reductions in return.

Panel B provides systematic risk results for firms forming joint ventures with governments. In all cases, firms forming JVs in high corrupt environments realize significant increases in systematic risk, whereas firms forming JVs in low corrupt en-

vironments realize significant declines in systematic risk. For developed country JVs, the difference between changes in systematic risk for low corrupt environments is significantly higher than for high corrupt environments. However, there is no significant difference in the systematic risk for low vs. high corrupt environments for developing countries. These results suggest that the wealth losses from expanding through cooperative modes in high corrupt environments are not offset by corresponding decreases in systematic risk. It appears that the results at least partially support the contention of Reeb, Kwok and Baek (1998) that internationalization can contribute to an increase in cash flow volatility, and hence, a net increase systematic risk, though the link to corruption and mode strategy has not been previously investigated.

5.6 Limitations of the Present Study and Directions for Future Research

As in any study utilizing expectational or subjective information, the results of our study are exploratory. We hope that given the importance of the subject of corruption, additional research will uncover in more depth the manner in which corruption impacts foreign direct investment decisions of corporate managers. Future research could also investigate specific transactions in high corruption countries to shed light on which managerial actions and which deal structures can help managers negotiate the environment and prevent loss of value.

6. Conclusions

In this paper, we investigate the market value and accounting outcomes of multinational-government relationships to identify the influences of corruption. We use hierarchical cluster analysis on Transparency International Corruption scores to identify high-corruption and low-corruption countries in both developed and developing countries. We argue that corruption obscures the true value of assets and makes valuation difficult, reducing the potential gains from an acquisition. We find that firms acquiring assets from governments in high corruption environments tend to be larger and more intangibility intensive than those expanding into low corruption environments. Also, we find that the market responds much more favorably to expansions into low corrupt environments than high corruption environments for both acquisitions and joint ventures. We find little evidence that long run accounting performance is adversely affected by government-multinational relationships in high corruption environments. However, long run market value outcomes are negative for all firms entering into relationships with foreign governments, and are especially negative for joint venture relationships in high corruption environments. Finally, we find that systematic risk increases substantially for firms entering high corruption environments through trust-based modes of expansions.

Overall, the results of this exploratory analysis suggest that corruption has some impact on the market's perception of government-multinational relationships, however difficult it may be to quantify corruption. It appears that the Foreign Corrupt Practices Act may, in fact, put US multinationals at a competitive disadvantage, as US firms' relationships with high corrupt governments yield poor performance and increased risk. The analysis further reveals that subsequent investigation of the specific impact of corruption on valuation and the coordination of activities through trust-based modes is warranted. Further survey-based analysis could provide in-

sights into how managers conduct valuation and cooperative activities in high corruption environments.

Acknowledgements

We thank Mohammad Abdolmohammadi, Mahendra Gujarathi, Lawrence Klein, Clifford Brown, and members of the Scholarly Activities Committee at Bentley College for their helpful and insightful comments.

Endnotes

1. The Transparency International Corruptions Perception Index has also been used in other extremely reputable journals, such as Nature (Smith et al. (2003). Governance and the loss of biodiversity. *Nature,* 426, 67-70), *The American Journal of Economics and Sociology* ("Slapping the Grasping Hand: Correlates of Political Corruption in Emerging Markets" Oct, 1999, by Arthur A. Goldsmith), and Treisman, Daniel, "The causes of corruption. A cross-national study," *Journal of Public Economics* (June 2000): 76, no. 3 (399-457)

2. We have obtained GDP per capita data from International Financial Statistics for the year prior to the acquisition, though this variable is typically used in the literature to represent the size of the market rather than development per se. Very few changes in categorization of the sample firms were made based on the GDP per capita statistic. We thank an anonymous reviewer for this suggestion.

3. An example would be Quaker Oats' $1.7 billion purchase of Snapple in 1994 which caused a large decline in market value. The unit was divested, causing a decline in assets over the two years following the acquisition as well.

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Appendix A Country Corruption Scores								
Country	**Ti 99**	**Ti 98**	**Ti 97**	**Ti 96**	**Ti 88 to 92**	**Ti 80 to 85**	***Dvlpd***	**Cluster**
Denmark	10	10	9.94	9.33	8.88	8.01	1	10
Finland	9.8	9.6	9.48	9.05	8.88	8.14	1	10
New Zealand	9.4	9.4	9.23	9.43	9.3	8.41	1	10
Sweden	9.4	9.5	9.35	9.08	8.71	8.01	1	10
Canada	9.2	9.2	9.1	8.96	8.97	8.41	1	10
Iceland	9.2	9.3	na	na	na	na	1	10
Singapore	9.1	9.1	8.66	8.8	9.16	8.41	1	10
Netherland	9	9	9.03	na	na	na	1	10
Norway	8.9	9	8.92	8.87	8.69	8.41	1	10
Swiss	8.9	8.9	8.61	8.76	9	8.41	1	10
Luxmbourg	8.8	8.7	8.61	na	na	na	1	10
Australia	8.7	8.7	8.86	8.6	8.2	8.41	1	10
U.K.	8.6	8.7	8.22	8.44	8.26	8.01	1	10
Germany	8	7.9	8.23	8.27	8.13	8.14	1	10
Hong Kong	7.7	7.8	7.28	7.01	6.87	7.35	1	10
Ireland	7.7	8.2	8.28	8.45	7.68	8.28	1	10
Austria	7.6	7.5	7.61	7.59	7.14	7.35	1	10
USA	7.5	7.5	7.61	7.66	7.76	8.41	1	10
Chile	6.9	6.8	6.05	6.8	5.51	6.53	2	20
Israel	6.8	7.1	7.97	7.71	7.44	7.27	1	11
Portugal	6.7	6.5	6.97	6.53	5.5	4.46	1	11
France	6.6	6.7	6.66	6.96	7.45	8.41	1	11
Spain	6.6	6.1	5.9	4.31	5.06	6.82	1	11
Botswana	6.1	6.1	na	na	na	na	2	20
Japan	6	5.8	6.57	7.05	7.25	7.75	1	11
Slovenia	6	na	na	na	na	na	2	11
Estonia	5.7	5.7	na	na	na	na	2	11
Taiwan	5.6	5.3	5.02	4.98	5.14	5.95	2	20
Belgium	5.3	5.4	5.25	6.84	7.4	8.28	1	11
Hungary	5.2	5	5.18	4.86	5.22	1.63	1	11
Malaysia	5.1	5.3	5.01	5.32	5.1	6.29	2	20
S. Africa	5	5.2	4.95	5.68	7	7.35	1	11

Greece	4.9	4.9	5.35	5.01	5.05	4.2	1	11
Mauritius	4.9	5	na	na	na	na	2	20
Italy	4.7	4.6	5.03	3.42	4.3	4.86	1	11
Czech	4.6	4.8	5.2	5.37	5.2	5.13	1	11
Peru	4.5	4.5	na	na	na	na	2	20
Jordan	4.4	4.7	na	4.89	5.51	5.3	2	20
Uruguay	4.4	4.3	4.14	na	na	na	2	20
Poland	4.2	4.6	5.08	5.57	5.2	3.64	1	11
Brazil	4.1	4	3.56	2.96	3.51	4.67	2	20
Malawi	4.1	4.1	na	na	na	na	2	20
Morocco	4.1	3.7	na	na	na	na	2	20
Zimbabwe	4.1	4.2	na	na	na	na	2	20
Lithuania	3.8	na	na	na	na	na	2	11
Skorea	3.8	4.2	4.29	5.02	3.5	3.93	2	20
Slovak	3.7	3.9	na	na	na	na	2	11
Philipines	3.6	3.3	3.05	2.69	1.96	1.04	2	20
Turkey	3.6	3.4	3.21	3.54	4.05	4.06	1	11
Zambia	3.5	3.5	na	na	na	na	2	20
Belarus	3.4	3.9	na	na	na	na	2	20
China	3.4	3.5	2.88	2.43	4.73	5.13	2	21
Latvia	3.4	2.7	na	na	na	na	2	11
Mexico	3.4	3.3	2.66	3.3	2.23	1.87	2	21
Bulgaria	3.3	2.9	na	na	na	na	2	21
Egypt	3.3	2.9	na	2.84	1.75	1.12	2	
Romania	3.3	3	3.44	na	na	na	2	21
Thailand	3.2	3	3.06	3.33	1.85	2.42	2	21
Nicaragua	3.1	3	na	na	na	na	2	21
Argentina	3	3	2.81	3.41	5.91	4.94	2	21
Colombia	2.9	2.2	2.23	2.73	2.71	3.27	2	21
India	2.9	2.9	2.75	2.63	2.89	3.67	2	21
Croatia	2.7	na	na	na	na	na	2	21
Ivory Coast	2.6	3.1	na	na	na	na	2	21
Ukraine	2.6	2.8	na	na	na	na	2	21
Venezuela	2.6	2.3	2.77	2.5	2.5	3.19	2	21
Vietnam	2.6	2.5	2.79	na	na	na	2	21

Bolivia	2.5	2.8	2.05	3.4	1.34	0.67	2	21
Ecuador	2.4	2.3	na	3.19	3.27	4.54	2	21
Paraguay	2.4	1.5	na	na	na	na	1	11
Russia	2.4	2.4	2.27	2.58	3.27	5.13	1	11
Albania	2.3	na	na	na	na	na	2	22
Georgia	2.3	na	na	na	na	na	2	22
Kazakhstan	2.3	na	na	na	na	na	2	22
Kyrgyz	2.2	na	na	na	na	na	2	22
Pakistan	2.2	2.7	2.53	1	1.9	1.52	2	22
Uganda	2.2	2.6	na	2.71	3.27	0.67	2	22
Kenya	2	2.5	na	2.21	1.6	3.27	2	22
Yugoslavia	2	3	na	na	na	na	2	22
Uzbekistan	1.8	na	na	na	na	na	2	22
Azerbaijan	1.7	na	na	na	na	na	2	22
Indonesia	1.7	2	2.72	2.65	0.57	0.2	2	22
Nigeria	1.6	1.9	1.76	0.69	0.63	0.99	2	22

This Table presents the Transparency International's index of management surveys related to corruption for a given country for 1999.

Biographical Information

Balata, Pascal Bayl, is an Associate Professor of Finance, Accounting, Management Control and Research Methodology at ASEC (Advance School of Economics and Commerce) of the University of Douala, PO Box 1931, Bassa. He is also an associate professor at CESAG (West African Regional Top Management Training Center) in Dakar, Senegal and external lecturer at the Université du Québec a Montréal. He received his Ph.D from the Université du Québec a Montréal joint doctoral program in 2001. He has co-authored a book edited by l'Harmattan, Paris. His current interest is in the accuracy of corporate disclosure for stock market, pension funds development and business reengineering in Africa. He has published in: *Gestion: An International Review of Management.*

Behnezhad, Ali R., is a Professor of Systems and Operations Management in the College of Business and Economics at California State University, Northridge. He received his Master's and Ph.D degrees in Industrial Engineering from the University of Southern California. His research interests include applications of management science techniques in design and control of manufacturing operations, supply chain management, accounting and information systems. He has published in peer-reviewed journals such as: *International Journal of Production Research, Production Planning and Control, Journal of Information Systems Education* among others.

Breton, Gaétan, is a Professor of Financial Accounting at the Universite du Quebec a Montreal, CP 8888, Succ. Centre Ville, Montreal (Qc), H3C 3P8. He received his Ph.D from the City University of London, U.K., in 1993. He has published in: *Accounting and Business Research, Accounting Education, Comptabilite Controle Audit, Financial Accountability and Management, Revue d'Economie Financiere, The International Journal of Public Sector Management,* and *Review of Finance and Accounting*

Gleason, Kimberly, Department of Finance, Florida Atlantic University, FL 33431. She is an Assistant Professor of Finance at Florida Atlantic University. Her research interests include corporate governance and multinational financial management.

Kane, Gregory, Department of Accounting, University of Delaware, Newark, Deleware 19716. He is an Associate Professor at the University of Delaware. He received his Ph.D from the Virginia Polytechnical Institute and State University in 1992. He has published in a number of academic journals, including: *Contemporary Accounting Research, Journal of Business, Finance and Accounting, Review of Accounting and Finance, Journal of Business Research and Research in Accounting Regulation.*

Lin, Horn-Chern, Strategic Research Unit, Office of Budget and Taxation, Ontario Ministry of Finance, Toronto, Ontario, Canada M7A 1Y7. He is an economist at Ontario Ministry of Finance. He obtained his Ph.D degree in economics at Queen's University in 2001. He has published in: *Academic Economic Papers and Taiwan Economic Review.*

Malgwi, Charles A., Department of Accountancy, Bentley College, 175 Forest Street, Waltham, MA 02452. He is an Assistant Professor of Accountancy at Bentley College. He obtained his Ph.D degree at the University of Reading, England in 1993 and taught in Nigeria, The United Kingdom and Suffolk University in Boston before joining Bentley College in 1998. He is a Certified Fraud Examiner (CFE). He has published in several jourrnals such as *International Business Review, Research in Accounting in Emerging Economies, and Journal of College Teaching and Learning, Journal of Financial and Quantitative Analysis, Journal of Banking and Finance, Journal of International Money and Finance, Journal of Futures Markets, Economic Letters, Journal of International Business Studies, Journal of Business Research, Journal of Advertising, Journal of Advertising Research, and Journal of Macromarketing.* He serves on the editorial boards of a number of journals and is the editor of *Journal of International Financial Markets, Institutions and Money, and Journal of Multinatinational Financial Management,* both published by Elsevier Science. During 1983/84, he was Fulbright Professor of International Business at Turku School of Economics in Finland and during 1993/94 he was Fulbright Professor of International Finance at Portuguese Catholic University in Portugal. He is listed in a variety of directories including: *Who is Who in Finance and Industry, Who is Who in the Midwest, Who is Who in America, Who is Who in the World, Community Leaders of America, and Who is Who Among Asian Americans*

Mohamed, Abdel-Aziz M., College of Business and Economics, California State University-Northridge, 18111 Nordhoff Street, Northridge, CA 91330-8378. He is an Assistant Professor of Systems and Operations Management. He holds an M.Sc. and a Ph.D degree in industrial engineering from the University of Oklahoma. Dr. Mohamed's research and teaching interests are in management science, statistics, reliability, decision support systems, simulation and operations management. He has over 20 publications in refereed journals and proceedings. His publications have appeared in: *The International Journal of Operations and Quantitative Management, and Reliability Engineering and System Safety* among others. He has won several teaching awards.

Owhoso, Vincent, Department of Accountancy, Bentley College, 175 Forest Street, Waltham, MA 02452. He is an Associate Professor of Accountancy, Department of Accountancy, at Bentley College. He obtained his Ph.D degree in accountancy at the University of Florida in 1998 and joined the Bentley College faculty in 1996. He has published in: *The Journal of Accounting Research, Managerial Finance, Internaitonal Business review* among others.

Qureshi, Mahmood A., is Professor of Accounting and Information Systems in the College of Business and Economics, California State University, Northridge, California. He holds a master's degree in commerce from Pakistan, and an MBA and a PH.D degree from the University of California Los Angeles. He has the international experience of having taught in Pakistan, England, and Canada. His research interests are varied and cover financial, managerial, and international accounting. He has presented papers at various national and international conferences. His research work has appeared in the *International Journal of Accounting, Management International Review, Management Accounting (England)* among others.