# Three Essays on Corruption, Government Transparency and Foreign Direct Investment

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**BIG Question:**

***"How does firm-specific technology disruptiveness affect the relationship between country-level corruption distance, host government transparency, and MNE's decision to expand in an emerging market?"***

## Introduction

Government transparency – the increased flow of reliable and timely economic, political, and social information accessible by all interested stakeholders (Kaufmann & Kraay, 2002) – is touted as a key factor in the fight against corruption. I argue, that transparency by itself cannot decrease corruption. Instead, under certain conditions of institutional misalignment, it can actually increase corruption. Corruption, the abuse of entrusted power for private gain, is clandestine by nature because those who engage in it do not voluntarily disclose it. Shedding light on government's decisions, policies, and actions is a key mechanism in detecting government's corruption. But is corruption just a public sector phenomenon? No. Business corruption is on the supply side of government corruption. Moreover, in some countries, business-to-business corruption is the main problem, according to Transparency International. Yet business corruption has received less attention in the literature. I argue that some multinational enterprises (MNEs) use corruption as a non-market strategy that negates supra-national institutional efforts to decrease corruption around the world.

Why is it important to study corruption? According to conservative estimates by the World Bank, corruption diverts at least $1 trillion annually to the pockets of corrupt individuals. What do they spend the money on? A realistic example of the application of these money is the 2014 Oscar-nominated motion picture "The Wolf of Wall Street," a movie based on the true story of a corrupt stock broker living in distasteful excess. Ironically, this movie about corruption was made with money from corruption. In 2016, the US Department of Justice (DOJ) seized the rights to "The Wolf of Wall Street" funded by a young Malaysian businessman with links to individuals in Malaysian government circles. Investigations revealed that the movie was made with Malaysian Sovereign Investment Fund (aka 1MDF) money that was diverted from Malaysia's development via an elaborate and complex corruption scheme spanning the territories of nearly a dozen countries including the US, UK, Switzerland and Singapore. Prominent bankers from reputable financial organizations, such as UBS and Goldman Sachs, were involved. The Malaysian SWF corruption scheme amounted to $4.5 billion, a significant amount for a country with an average GDP per capita of approximately $9,000 during the last five-year period. This is an example of why, in relative terms, corruption is more harmful for emerging markets than it is for wealthy economies. For this reason, my dissertation is staged in the context of the emerging market countries. The informality of emerging markets is an important factor in my analysis.

Corruption schemes such as the one leading to the funding of The Wolf of Wall Street reached the public mainly through online media channels, such as WikiLeaks and social media. Their success is made possible by radical advances in information, communication, and cell phone technology over the last decade. These technological advances are a disruptor of government's and business' opacity.

Disruptive technology changes the basic rules of the game for creating and capturing economic value, and places the established models under attack. This fast pace of change is what keeps CEOs awake at night. In a survey by Fortune 500 magazine published in June 2017, 75% of CEOs listed disruptive technology change as their number one worry. Thus, disruptive technology is likely to be a key factor in executives' decisions making. It's time to catch up with reality and factor technology disruptiveness in executives' decisions to internationalize.

Some of the most prominent disruptive technology firms, such as Apple, Google, and Amazon, are among the largest in terms of market capitalization worldwide. $16 trillion! That is the combined market capitalization of the 100 largest publicly traded MNEs. Their combined financial power is comparable to the US GDP. These large MNEs can have enormous influence over emerging countries' governments and the way of doing business in these countries.

Thus, it's time to drill deeper on the topic of government transparency and corruption. Is the effect of corruption distance and government transparency on FDI contingent upon firm-specific technology disruptiveness? How does government transparency affect MNE's non-market strategies, and to what degree do these strategies influence the country governance?

## Summary of the Dissertation's Research and Scholarly Contributions

Three essays on the common theme "Corruption, Transparency and Foreign Direct Investment (FDI)" comprise this dissertation. My objective is to offer insight on how MNEs and government can collaboratively achieve greater progress on curbing corruption and on stimulating economic progress and sustainability in emerging markets. Evidence is drawn from both proprietary survey data and secondary data sources. Two different methods—multi-level Bayesian and ordinal probit regression analyses—complement each other in the analysis of the data and contribute to the robustness of the results.

The results present a richer view of the relationship between firms' investment abroad and institutions in the global economy. The findings extend the theory on internationalization, capabilities and governance by bringing fresh new perspective and more nuanced understanding of the dynamics between institutions and MNEs' cross-border investment strategies. In the following pages of this abstract, I provide a summary of the findings and contributions of each of the three essays.

The first essay, titled "The Pursuit of Government Transparency in Emerging Economies: Panacea or Pandora's Box to MNE's Corruption," is theoretical. Its focus is on understanding the effect of emerging markets' governmental transparency on MNEs' behavior as it relates to corruption. Given the paucity of prior international business research on the topic, the study makes several significant contributions. First, this essay studies a less examined question in institutional theory, namely, whether MNEs affect their institutional environment. Second, I present a case for government transparency as an emerging institution that on its own cannot decrease the level of country corruption. Institutional misalignment and interaction effects with organized crime, national culture and collective action hinder the intended positive effect of transparency. Third, I treat corruption as a collective action problem, rather than an agency problem, which is the prevailing paradigm in the corruption literature. Fourth, this essay challenges the tenet that government transparency decreases corruption and presents a case that, under some circumstances, transparency increases business and grand corruption. Fifth, it opens the 'black box' of corruption by studying specific types of corruption, such as business corruption and grand corruption. Lastly, my research unbundles the generic theme of government transparency into specific components more amenable to policy intervention.

In the second essay, "FDI and MNE's Strategic Response to Corruption Distance: Evidence from the Energy Sector," I analyze the effects of corruption distance on the amount of FDI in disruptive technologies vs. conventional technologies in emerging markets. Firms' investment to emerging markets is critical to the countries' economic development and to the firms' business growth. Decisions involving location selection and the amount of investment are highly complex and dependent on macro-economic, industry, and firm factors. How these factors interplay with countries' institutions is important to international business research. Among my findings' key contributions is that the effect of institutional distance is contingent upon the nature of firm's technology disruptiveness. In a world of disruptive technology, such as massive open online courses that threaten traditional business schools, and virtual cryptographic currency that threatens clearinghouses, studying the differences between conventional businesses and disruptors in terms of their FDI choices is timely. My empirical approach is based on panel data of firm-level amount of investment per deal, as the primary dependent variable, and on Bayesian statistical analysis. My findings indicate that disruptive technology firms that have chosen to invest in an emerging market (re)invest less than conventional technology firms when corruption distance increases.

The third essay, "Who is Not Afraid of Corruption?: Effects of Emerging Markets' Government Transparency on MNEs' Entry Decisions," ties together the first two essays of the dissertation and focuses on C-Suite executives' location choice decisions as they relate to host government transparency and corruption. To overcome the challenges of paucity of data, I perform an experimental design analysis with a scenario-based survey of 300 C-suite executives across various industries. The results have theoretical contributions to the internationalization literature. This essay posits that transparency avoidance and corruption are firm-specific capabilities used to gain advantages over competitors. The results indicate that firms may choose to internationalize in corrupt countries. Even more striking is the finding that disruptive technology firms are less likely to invest in an emerging market economy as host government transparency increases. In other words, I find that disruptive technology firms prefer opacity to transparency when selecting an emerging market for an international expansion.

The dissertation also has methodological contributions including multi-level Bayesian analysis novel to the internationalization and the governance literature. This empirical test yields more nuanced results that allow us to predict future events and compare outcomes in terms of actual probabilities. Finally, the dissertation offers empirical contributions. Using both data per investment deal and proprietary factorial survey data of C-suite executives is a significant advantage of this research. Such methodology is highly appropriate but has rarely been utilized in the strategic management and the international business literature. Deal-level secondary data in combination with C-Suite executives survey data complement each other and allow for testing of firms' decisions about both FDI location choice and amount per FDI transaction.

## Discussion of Practical, Policy, and Pedagogical Implications

The dissertation has several practical implications that can be of interest to business executives, policymakers and the society at large. For business executives, the implications are that without them taking responsibility for corruption in the emerging markets in which they operate, corruption will continue to thrive. The myth that government officials alone should be held accountable for high corruption in their countries should be replaced with a shift of the attention towards corporate accountability. Only by instilling strong intra-firm ethics and compliance cultures, MNEs will be able to avoid going down the corruption path.

The dissertation can guide policymakers in their pursuit of government transparency by alerting them of the dangers they can face if their anti-corruption institutions are weak. The implications of the research are that governments should strive for progress in transparency that's in alignment with anti-corruption institutions. Transparency, by itself, can shed light on corruption, but is not likely to decrease it. Moreover, in corrupt countries, improving anti-corruption institutions should be a prerequisite to attracting FDI from clean firms, and from firms investing in disruptive technologies. Corruption distance decreases the amount that MNEs invest in disruptive projects relative to conventional. In the age of disruption, paradigm shift to attracting disruptive technology is needed in order to propel an emerging market's economic development.

Focus on the renewable technology investment, in particular, contributes to the environmental sustainability literature by pointing in direction that environmental sustainability policies alone are not likely to attract renewable FDI to emerging markets unless these policies are in alignment with strong anti-corruption institutions. Investment size to renewables is critical for curbing global warming. Global warming is the quintessential manifestation of globalization, and for this reason selecting the energy sector as the industry context of my second essay is deemed justified for a dissertation in the field of international business.

The dissertation has implications for educators as well, for when it comes to corruption, an investment in anti-corruption education is likely to yield positive results. If we teach future business leaders to recognize that corruption has many shades of gray, and that these shades have various degrees of harmful consequences, we can change the trajectory of business corruption. Transparency is not a panacea to corruption. Even when coupled with strong anti-corruption rules of law, transparency can fail to yield positive results. Laws have loopholes, differ across jurisdictions, and are often subject to judicial interpretation. As a result, an individual can be convicted, and then pardoned, depending on the court and the judge presiding over the case. For example, the former governor of the State of Virginia, Bob MacDonnell, was convicted of 11 acts of corruption in 2014 because of receiving over $170,000 in the form of undisclosed gifts from a businessman in exchange for favors. In 2016, the Supreme Court overturned the ruling. If laws are ineffective in defining corruption, then we should look toward human consciousness as a key mechanism for recognizing it.

## References

Kaufmann, D. & Kraay, A. 2002. *Growth without governance*. World Bank Policy Research Working Paper No. 2928.

**Neli Kouneva Loewenthal (nelik@email.gwu.edu) received her PhD in International Business from George Washington University. Neli's intrinsic need to conduct meaningful research that is on the intersection of business, society and technology drives her scholarly pursuits. She is particularly interested in non-market strategies, technology disruption, and C-suite executives' investment decisions.**