

# Host Market Corruption and Multinational Enterprise Strategy

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## Introduction

In July 2000, the United Nations launched the Global Compact, an initiative designed to promote the adoption of socially responsible and sustainable business practices by corporations. The Compact's framework was originally constituted by nine principles that were organized under three broad categories—human rights, labor and the environment. However, in an effort to garner greater transparency in both the public and private sectors, academics, non-governmental organizations and industry executives began to petition for the recognition of “the missing tenth principle”, in reference to the institution of corruption (Waddock, 2004: 318). Their concerns were well-founded. Research by the World Bank has estimated that global expenditures on bribery totaled approximately one trillion dollars per year, an amount equal to roughly three percent of global gross domestic product (Svensson, 2005). Consequently, by 2004, advocacy efforts culminated in the creation of the tenth canon of the Global Compact—*Businesses should work against corruption in all its forms, including extortion and bribery*.

Subsequent to the expansion of the Global Compact's purview, institutional scholars have directed their attention towards the development of theory that could be used to facilitate corruption-based inquiry (Lambsdorff, Taube, & Schramm, 2005). Moreover, international business strategy researchers have also emphasized the need to develop theory, frameworks, measures and methods within the domain of corruption-oriented international business scholarship (Rodriguez, Siegel, Hillman, & Eden, 2006). Notwithstanding the overlap between these research agendas, we continue to lack a comprehensive, theoretically-grounded and empirically-validated understanding of how host market corruption affects the subsidiary-level strategic behavior of multinational enterprises (MNEs) in foreign markets. I contend that two factors have precipitated this theoretical impasse. First, the literature pertaining to the relationship between MNE strategy and host market corruption has focused primarily on the interrelationship between global foreign direct investment flows and the degree of perceived corruption in host markets. Second, researchers who have focused on the impact of host market corruption on subsidiary-level strategy have adopted an overly broad conceptualization of the corruption phenomenon. As such, the dissertation is guided by three broad research questions. First, how do different types of host market corruption impact the market entry strategies implemented by MNEs with respect to their foreign subsidiary investments? Second, does host market corruption increase the likelihood of market exit? Third, can MNEs implement strategies which reduce the likelihood of market exit under conditions of more pervasive host market corruption?

Historically, the corruption-oriented international business strategy research agenda has been primarily constituted by a rich body of macro-level studies that have focused on the role of host market corruption as a factor influencing the international flow of foreign direct investment (FDI). While the

insights garnered by these studies have advanced comprehension of the corruption phenomenon, more recently, international strategy scholars have begun to focus attention on the impact of host market corruption on subsidiary-level strategies. This smaller body of work serves as the starting point for this dissertation and it informs the associated theory-building efforts at the phenomenological level. Seminal conceptual work by Rodriguez et al. (2005: 385) has characterized corruption in terms of its pervasiveness or, “the likelihood of encountering corruption in normal interactions with state officials.” In testing this theory, Uhlenbruck et al. (2006) found that as the pervasiveness of corruption increases, foreign investing firms are more likely to prefer nonequity modes of entry over equity modes. This observation has been supported by Luo (2011) who found that an increase in the pervasiveness of host market corruption decreased the likelihood that MNEs would engage in subsidiary investments in emerging markets and increased the likelihood that they would adopt an export market orientation. However, Uhlenbruck et al. (2006) also found that corruption pervasiveness was not a significant predictor of an MNE's equity-based investment decisions (i.e., JV versus WOS). As such, Rodriguez et al.'s (2005) conceptual work has provided a strong theoretical foundation for scholars to advance corruption-oriented international business strategy research. However, the qualified empirical support for its propositions suggests the need for further conceptual effort in order to refine the theory's precepts. Consistent with this position, Uhlenbruck et al. (2006: 411) have suggested that “there may be underlying constructs behind pervasiveness that have conflicting effects”, as well as advocating in favor of “further exploration of the institutional underpinnings of the pervasiveness of corruption.”

## Overview of the Research

In this dissertation, I contend that the traditionally-employed conceptualization of corruption is overly broad and, as a consequence, has inhibited progress in advancing comprehension of the relationship between host market corruption and the subsidiary-level strategies of foreign-investing MNEs. In this regard, my work draws from Rodriguez et al. (2006: 739), who argue that the domain of corruption-based research would benefit from more attention being given to defining and conceptualizing the phenomenon. Settling upon a comprehensive definition of corruption has proven to be a challenging exercise for academics, policy-makers and business executives alike. While Argandoña (2003: 255) has acknowledged that corruption is “a varied and shifting phenomenon that is difficult to define in terms that are clear”, the chair of Transparency International's Board of Directors has lamented that “[The boundaries] of corruption are becoming harder to define, despite the best efforts of high profile international treaties and initiatives” (Labelle, 2010: 109).

As such, this dissertation builds on Rodriguez et al.'s (2005: 385) extant

conceptualization of host market corruption in terms of its pervasiveness. I propose that the concept of pervasiveness provides an appropriate foundation upon which we should continue to unpack more robust and theoretically-rich conceptualizations of the phenomenon. To elaborate my theory, I further dimensionalize the phenomenon according to the host market sector within which it occurs, and according to the origins of the norms that permit or prohibit the existence of corrupt transactions in the public sector of foreign markets. In doing so, my theoretically-grounded efforts extend the scope of the pervasiveness construct, as well as establish boundary conditions within and around the construct. The dissertation employs these more nuanced conceptualizations of the phenomenon in order to investigate the impact of host market corruption upon several strategies, including foreign entry strategy and partnering strategy, as well as exploring the longer-term implications of corruption upon the subsidiary's continued existence.

Organized as a collection of integrated essays, the dissertation theoretically disaggregates host market corruption into a wide range of manifestations, including grand, public, petty and private corruption. Notably, in addition to the theoretical relevance of the dimensions that are proposed in this dissertation, a review of both executive surveys pertaining to corruption and international legal compacts that have been designed to combat corruption reveals that these dimensions are also relevant in practice. Synthesizing institutional theory with tenets from bargaining power, resource dependence and integrative social contracts theories, I detail the theoretical mechanisms through which I expect that the multiple varieties of corruption will impact upon the foreign entry strategy of MNEs, in addition to investigating the relationship between host market corruption, firm strategy and the likelihood of subsidiary exit. Notably, my results replicate the findings presented in Uhlenbruck et al.'s (2006) test of Rodriguez et al.'s (2005) foundational theory pertaining to an MNE's preference for non-equity entry under conditions of more pervasive host market corruption. However, my findings also reveal that each type of corruption exerts a distinct range of impacts upon the entry mode and partnering strategies of MNEs, in addition to illustrating that these impacts can vary according to the host market's status as either a developed or emerging market. Taken together, these empirical findings and the associated theory facilitate the linkage between the concept of informal institutions and the notion of pluralism. In this regard, my work is consistent with prior conceptual work that has advocated efforts to pursue theoretical contributions that could emerge from the investigation of pluralistic phenomena, notwithstanding scholars' general preference for parsimony and generalizability in theory-construction (Glynn, Barr, & Dacin, 2000).

This dissertation also leverages the different types of corruption elaborated in my research to investigate whether host market corruption increases the likelihood of market exit and whether MNEs can implement strategies which reduce the likelihood of market exit. The research theoretically categorizes the choice of strategies that MNEs implement in terms of geographic orientation. In doing so, I focus on the MNE's pursuit of external legitimacy

and the survival implications associated with various strategic initiatives that are implemented at the subsidiary level to secure legitimacy in increasingly corrupt host market environments. The nuanced results reveal a complex relationship which is contingent upon the type of corruption, the geographic-orientation of the localization strategies employed by the MNE and the degree of economic development in the host market environment.

## Implications for Research and Practice

As a whole, the essays constituting the dissertation collectively make several conceptual and empirical contributions. In addition to providing empirical and theoretical support for the foundational theory of host market corruption in international business strategy research (Rodríguez, Uhlenbruck, & Eden, 2005), my work also extends the conceptualization of host market corruption in terms of its normative origins and in terms of its sectoral origins. My efforts to advance theory with respect to the relationship between host market corruption and the subsidiary-level strategies of MNEs contributes new tenets to institutional theory by introducing the concepts of informal institutional pluralism, proximal and distal localization. Notwithstanding these contributions, I concede that corruption is challenging to research because

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“...the parties involved have every reason to keep the data hidden” (Klitgaard, 1991: 30). This predicament has grown even more imposing over time. In fact, Webster (2008: 807) notes that “Ten years ago, corruption was considered incidental to doing business internationally and, for better or worse, an inescapable reality. Today, corruption is considered to be...an enemy that must be defeated. Accordingly, the international community is focused, like never before, on efforts to reduce corruption.”

Despite the obstacles associated with pursuing scholarship pertaining to the phenomenon of corruption, institutional scholars have made considerable advances. Notably, both institutional economists and institutional sociologists have contributed to this research imperative. Accordingly, this dissertation has leveraged tenets from both of these theoretical perspectives, an approach advocated by Lambsdorf (2005: 1-3), who suggests that “the task is too complex to rely on a single theoretical tradition...only an interdisciplinary approach is likely to be successful...approaching corruption from an institutional economic perspective, as well as from a sociological one, can enrich our understanding.” Ultimately, institutional theory is employed as the base theoretical foundation in this dissertation, and it is the theoretical tradition to which I seek to contribute for a combination of practical and philosophical reasons. First, the conceptual work upon which I build my theoretical and empirical contributions has been broadly grounded in institutional theory (cf. Doh, Rodriguez, Uhlenbruck, Collins, & Eden, 2003, Lambsdorff, Taube, & Schramm, 2005, Lambsdorff, 2007, Rodriguez, Uhlenbruck, & Eden, 2005, Uhlenbruck, Rodriguez, Doh, & Eden, 2006). Second, embedded in my

research is a belief in the utility of institutional theory to predict and provide explanations for the behavior of foreign-investing MNEs. This commitment traces its roots to my background as a lawyer and my ten years of executive-level experience in industry. My involvement in both domestic and cross-border business activity has made me acutely aware of the routine impact of institutions upon strategic and operational decision-making.

This dissertation research was initially motivated by a theoretical gap which I believe has important practical consequences from the perspectives of both international strategy scholars and international business ethicists. Absent sufficiently precise theory, scholars are not able to formulate theoretically-grounded predictions with respect to the strategic behavior of MNEs under conditions of heightened host market corruption, nor are they able to recommend strategic configurations that will enhance the likelihood of achieving positive investment outcomes. Moreover, without a theoretically-based understanding of the interrelationship between host market corruption and subsidiary-level strategy in foreign markets, it becomes more difficult to prescribe how MNEs can effectively integrate the Global Compact's tenth principle into the business strategies, operations and structures of their foreign subsidiaries. Notably, in developing a framework designed to secure corporate commitment to the Global Compact's principles, the United Nations has suggested that the engagement of worldwide subsidiary operations is one of the most important avenues through which MNEs can scale-up corporate responsibility efforts (Kell, 2012). Although this dissertation research has been principally motivated by my commitment to bolstering MNEs' comprehension of the strategic impact of corruption in foreign markets, my efforts to advance understanding with respect to the phenomenon of host market corruption do not preclude the possibility that normative insights might also emerge from this work. More specifically, it is my hope that the theory and empirical findings associated with this dissertation will also be of interest to executives, policy makers and business ethicists, particularly given that "understanding corruption...is vital to any effort to limit corruption" (Rodriguez, Siegel, Hillman, & Eden, 2006: 739).

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