

Corruption in a Multinational Context: Two Essays

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Dedication

*Soli Deo gloria.*

Also to my dearest parents, Junling and Hui ren Yan, for their life devotion of  
unconditional love and inspiration.

## Acknowledgements

Prior to and during my doctoral program, I often wondered what the purpose would be for me to finish this program other than fulfilling my educational pursuit. Now at the end of this program, the purpose became crystal clear to me: to learn grace. It was with so many people's sacrificial love and support that I was so fortunate to be able to fulfill my academic pursuit.

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Only grace can make this all happen. To God alone be the glory.

## Abstract of Dissertation

### Corruption in a Multinational Context: Two Essays

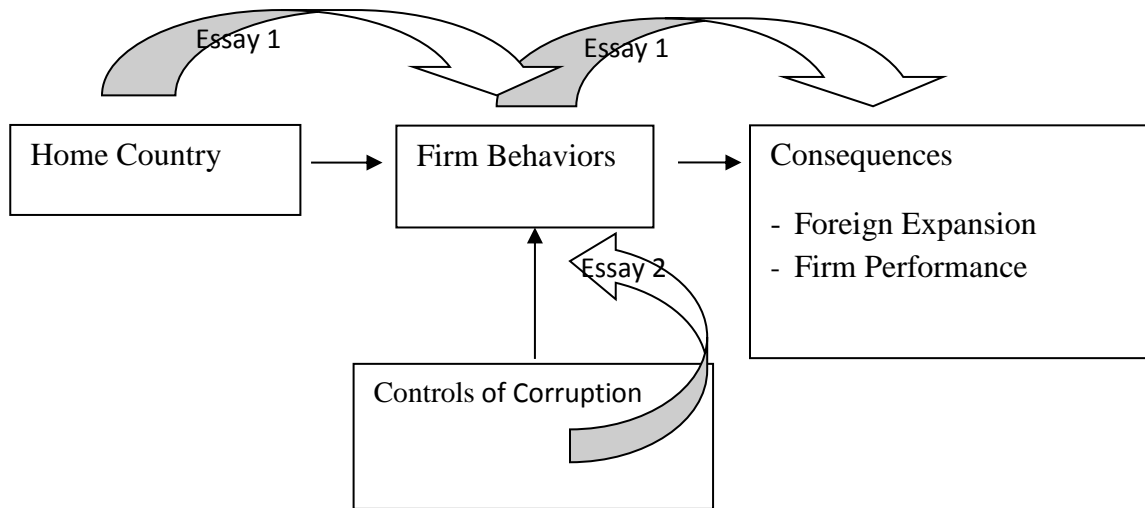
This dissertation is comprised of two essays examining the common theme of corruption in a multinational context. It focuses on the strategic and ethics implications that arise at the intersection of business and corruption. This research sheds light on how multinational firms respond to home and host country corruption norms and the complexity firms create by both shaping and being affected by such norms. This dissertation responds to the call for interdisciplinary research by Cheng, Henisz, & Roth (2009) in the study of international business by integrating resource-based view in nonmarket strategy, neo-institutional theory in international business, and business ethics and law in contributing to a comprehensive understanding of corruption.

The first essay examines whether firms' home country corruption norms affect their location choice in foreign expansions, how firms' bribery experiences work as a nonmarket capability in influencing their foreign expansion strategy, and how bribery ultimately affects firms' market performance. This research is unique empirically by using a dataset with accurate bribery data at the firm level.

The second essay examines strategies to control corruption in a multinational context through examining the normative standard to apply among communities with various corruption norms, and proposes a context-based anti-corruption strategy. It draws from literature on extraterritorial anti-corruption restrictions, Integrative Social Contract Theory (ISCT), mediating institutions theory and industry leaders' roles in systemic risks,



and discusses how a firm from one community can practically fit in another community of different corruption norm or size to maintain both universal principles of justice and diversity among people who need mediating institutions to give meaning and understanding to universal principles. The following is a diagram of the dissertation overview, followed by a summary of each essay.



## Essay 1

This paper examines the relationship between corruption and nonmarket strategy in a multinational context, using a unique dataset with accurate, firm-specific measures of corruption. The study first examines the effects of home country corruption on firms' foreign investment location choice. I find that a firm's home country corruption norm is related to where it invests abroad, but this effect exists only among multinational firms from clean countries. The study then moves beyond the institutional context to explore the rationale behind the heterogeneity among firms from the same home country in compliance with a host government's bribery request. I propose that a firm's bribery

experience interacts with their home country corruption to affect its foreign investment location choice. Only bribery experience of firms from dirty countries is found to be related to the firms' foreign location choice. In addition, firm-specific bribery experience is not found to be related to firm performance. My study built a unique dataset using resources from the United Nation's (UN) Oil-for-Food Program (OFFP)'s investigation information to conduct both country and firm-level analysis. This paper contributes to the strategy and international business literature by expanding the study of corruption from country level to micro level by connecting nonmarket capability through foreign bribery experience to home country corruption, and to the limited literature using OFFP as a unique data source to study firm behaviors.

## Essay 2

The second essay takes up the question of what should be the standard to be used to eradicate corruption across borders. The debate over the viability of extraterritorial application of anti-bribery laws remains thought-provoking when we look at the effectiveness of the OECD Anti-bribery Convention in curbing bribery in the OFFP. My empirical analysis from Chapter 1 shows that firms from countries with extraterritorial legal restrictions do not necessarily refrain themselves from paying bribes in the OFFP. This essay builds on the Salbu-Nichols' debate, the Integrated Social Contract Theory (ISCT), mediating institutions theory, and the Pelican Gambits theory. It proposes that governments should not be the sole players in combating corruption; local community and corporations which play an important role in shaping corruption norms should be emphasized in an effective anti-corruption strategy. It emphasizes the importance of recognizing the interactive relationship between a community and firms when designing

anti-corruption strategy in a global environment. A two-by-two matrix is suggested for designing an effective anti-corruption mechanism.

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## **Chapter 1**

### **DO DIRTY MNES PREFER DIRTY COUNTRIES? FIRM-LEVEL EVIDENCE ON CORRUPTION AND FDI LOCATION**

#### **I. Introduction**

Firms engage in corruption in almost all countries regardless of their level of economic development (Langseth, 1999). This fact indicates that factors attributable to corruption exist not only at the country level, but also from within firms. The current literature on corruption is mostly at the country level, focusing primarily on the negative impact of host countries' corruption on firms' foreign direct investment. Few studies focus on the development of individual firms in dealing with corruption and its influence on firms' strategic decision making in foreign investment locations. One reason for this dearth of literature is that researchers take the study of country of origin as a given (Cuervo-Cazurra, 2011). Another reason, which may explain the assumption, is the lack of empirical evidence of corruption at the firm level, due to the difficulty of capturing data on firm corruption that can be used to relate firm behaviors to country corruptions. The lack of such information, however, is an important obstacle to understanding corruption's influence on firm strategy in foreign expansion location choice and on firm performance. Recognizing that corruption takes on varying forms across all countries, this research examines whether firms that have experienced bribery respond to corruption

differently from firms that have not, and how this difference influences their foreign location choices and market performance.

Two major research streams have explored the relationship between country corruption and firms' internationalization strategy. The first stream focuses on the country-level perspective: how a country's economic, political and cultural factors can impact a multinational corporation (MNC)'s foreign investment strategy. Institutional theory underlines this stream of work. Firms tend to choose countries with institutional characteristics similar to those of their countries of origin. Host country studies have dominated such research focuses (Spencer & Gomez, 2011). A firm's foreign location decision has been related largely to its host countries' characteristics. The studies under this stream leave open the question of how a firm's country of origin affects its international expansion strategy.

The second stream of literature, emerging but limited, offers new perspectives from home countries on corruption's effect on firms' internationalization strategies. It integrates the resource-based view (RBV) (Barney, 1991; Wernerfelt, 1984) with institutional theory in examining how a firm's institutional background can work to its advantage in competing in a foreign market of similar institutional characteristics and thereby influence its investment strategy abroad (Cuervo-Cazurra & Genc, 2008). Institutional characteristics of a country can influence a firm's internationalization strategies (Cuervo-Cazurra, 2011; citing recent literature review in Rugman, 2009). Studies in this literature interpret a firm's internationalization from the perspectives of "incremental internationalization" model (Johanson and Vahlne, 1977) and the

advantage-driven model (the “eclectic paradigm”) (Dunning, 1977). Cuervo-Cazurra (2007 and 2011) propose an “integration” model, synthesizing the prior two models by explaining how firms from corrupt home countries can transform the disadvantages represented by weak institutional background into an advantage in their internationalization strategies, especially those with “difficult” governance conditions (Cuervo-Cazurra, 2005; Cuervo-Cazurra & Genc, 2008). The studies under this stream leave open a question similar to that of the first stream: will firms from the same home country all get the “advantage” and behave the same abroad?

More studies have begun to give insights in recent years into firm-level factors that influence a firm’s decisions to bribe. Goal achievement can lead firms to bribe to remove financial constrains in achieving firm performances in a domestic context (Martin et al., 2007). Economic incentives have been identified to relate to firms’ bribery payments abroad in the highly corrupt oil industry (Jeong & Weiner, 2012). Although these studies are able to detect corruption at the firm level and relate them to firm characteristics in understanding and analyzing firm corruptions, they are limited to either a domestic context or a single industry and are not helpful in understanding a firm’s foreign expansion strategy.

This study bridges the gap by including both country and firm-level analysis in examining the cause and consequence of corruption in a cross section of country and industry context. I propose that a firm’s institutional knowledge of corruption gained from its home-country’s corruption norms is positively related to the firm’s location choice abroad, and that such relationship is intensified by the firm’s prior experience of

bribery, because firm-specific bribing experience, together with its institutional knowledge of corruption, becomes a unique firm capability in advancing the firm in dealing with foreign government for successful foreign expansions.

I examine the relationship between firms' home country corruption, firm-specific bribery experience, and firms' foreign location choice by host countries' corruption. I found that a firm's foreign investment location choice is positively related to its home country corruption level, but only among firms from clean countries. A firm's home country's corruption norm, however, is different from the firm's actual experience of bribery. A firm's actual experience in dealing with corruption, such as paying bribes, can transfer to an active, non-market firm resource in their dealing with government and political risks in host countries (Perkins, 2014; Henisz & Delios, 2004), and thereby enable the firm to go to host countries where such resources can play a positive role in making their foreign location strategy. The relationship between home country corruption and foreign location choice, therefore, can be moderated by a firm's non-market capability in dealing with corrupt government through its bribery experience.

To examine the impact of bribery on a firm's market performance, I use firm-specific bribery experience as a proxy for the firm's nonmarket capability and test its effect on the firm's longitudinal financial performance. Studies of the consequences of corruption on firm performance have been dichotomous: negative effect when bribery is viewed as sand in the wheels of commerce and positive effect when viewed as grease (Cuervo-Cazurra, 2015; Wei, 2000; Kaufmann, 1997; Fisman & Svensson 2007; Huntington, 1968; Cheng, Ding, & Kim, 2010). Size and industry of the firm have not

been studied fully as to how they affect the influence of bribery on firm performance. I propose that bribery is negatively related to small firms' long-term performance, but positively related to long-term performance of large firms. My study finds no significant relationship between firm bribery and performance.

This essay expands on the nonmarket strategy literature and international business literature and proposes that a firm's home country corruption norm and its firm-specific nonmarket capacity interact with each other in influencing the firm's location decisions abroad. It provides a theoretically integrated mechanism from both the institutional theory and resource-based view in explaining the drive behind firms supplying bribes overseas as a strategic tool in dealing with host governments. This study contributes to international business literature that relies on institutional theory and nonmarket strategy literature that has been focused mainly on domestic market environment in the study of corruption by introducing firms' nonmarket resources developed through their country backgrounds that exacerbate bribery activities across borders.

To test my theory, I use the UN Oil-for-Food Program (OFFP) as a unique source for firm data. The United Nation's Independent Investigation Committee (IIC) has issued an independent investigation report (the IIC Report 2005) on the rampant corruption in the humanitarian transactions in OFFP. The IIC Report 2005 captures accurate, firm-specific bribery evidence, granting me the unique opportunity to expand corruption research to examining firms' location choice by using their actual bribery evidence.

I use the following terms in this study to illustrate my theory. "*Dirty firms*" refers to firms identified by the United Nation's Independent Investigation Committee (IIC) as

being asked to pay kickbacks and with actual evidence of illicit payments to the Iraqi government in the OFFP to gain contracts. “*Clean firms*” refers to firms identified by IIC as being asked to pay kickbacks but without evidence of such illicit payment. Although a lack of evidence of paying kickbacks in the OFFP does not remove the possibility that a firm could still have paid bribes, I consider highly valuable the immense efforts and money IIC invested in identifying bribing firms through examining the banking transaction records and the Iraqi government documents. (See Section III for the empirical setting of this paper). Thus, a lack of evidence indicates a high possibility that a firm is *clean*. “*Clean countries*” and “*dirty countries*” refer to a binary measure to categorize countries based on their level of corruption. In rating a country’s corruption level, I use the Corruption Perception Index (CPI) published by Transparency International (TI), an organization that monitors and rates corruption worldwide. I define a country as a *clean* if its CPI score is above the median score (6.7) in my sample, and *dirty* if its CPI is equal or below the median score.

This work should be of particular interest to international business scholars and corruption researchers in general, who to date have been forced to rely on country-level data or anecdotal evidence in studying firm strategies abroad. This study also contributes unique value to nonmarket strategy scholars who have been interested in exploring the blurred border between corruption and nonmarket strategy.<sup>1</sup> It can be also beneficial to practitioners who need more accurate firm information for strategy designing in competing with corrupt rivals abroad. This study serves as a window into corrupt firms,

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<sup>1</sup> Such interest has been shared during the discussion in the Non-market Strategy Practice and Competitive Advantage panel session in Strategic Management Society’s Annual Conference 2014.

providing insights that will allow international firms to remain competitive without breaking laws or compromising ethics.



## **II. Theory and Hypotheses**

### **1. Country Level: Home Country Corruption Effect on Host Country Location Choice**

International business literature explains the relationship between a firm's home and host countries' social norms of corruption and its international strategy at the country level. Such literature lays its theoretical foundation in institutional theory. North (1991) defines institution as "the humanly devised constraints that structure political, economic and social interaction" (North, 1991: 97). In the business context, the institutional constraints by which a firm operates affect its behavior. DiMaggio and Powell (1983) examine the impact of institutional isomorphism, which suggests that institutions can shape the behaviors of individual members within it, and that businesses within the same institution tend to have the same organizational structure and behave similarly with each other to maintain their organizational power and survival values. Managerial efforts at dealing with uncertainty and constraints lead to homogeneity of organizational structure (DiMaggio and Powell, 1983). In recent years, more attention from international management scholars has been applying institutional theory to the study of MNCs (Kostova, T., Roth, K., & Dacin, M., 2008; Dacin, Goodstein, & Scott, 2002). What has been relevant to the research of corruption under this umbrella is applying institutional theory to explain the relationship between MNCs and their host environments based on the notions of legitimacy and liability of foreignness (Kostova, T., Roth, K., & Dacin, M., 2008). Under institutional theory, international firms are more likely to invest in host countries with similar institutional environments to their home countries' due to their

governance strategy influenced by the normative, mimetic, or coercive pressure of the society and other organizations and legislative bodies (DiMaggio and Powell, 1983; Fiss 2008).

Studies of the interaction between social norms and corruption are not new. An earlier study of the relationship between social norms in trust and performance of local governments suggests that the social capital of trust determines the performance of local governments (Putnam, 1993). Putnam finds that across north and south regional borders in Italy, trust is shown through high tendency for the public to cooperate with each other in regions where local governments have higher objective measures of performance and less corruption.

Recent research also sees relationship between corruption and culture (Fisman & Miguel, 2007; Jeong & Weiner, 2012; Banuri & Eckel 2012). Culture and corruption correlate with each other and reveal specific patterns (Banuri & Eckel 2012). According to Banuri & Eckel, culture is an array of concrete factors such as trust, religiosity, or institutional arrangements, which influences institutions and social norms, dictates the interactions of agents within society, and affects the types of corruption that becomes prevalent. Thereby, culture affects corruption through its influences on formal institutions and social norms, both of which can differ across countries. Corruption norms, as a specific form of social norms, dictate the extent to which individuals engage in, and expect others to engage in corruption. Institutional history affects the level of corruption in a society.

Fisman and Miguel (2007) use a unique natural experiment method to test how corruption can relate to culture. They observed the number of unpaid parking tickets for diplomats in New York City and tested to see if there is a relationship between the number of unpaid tickets and the diplomats' home country corruption levels. Their research finds a strong correlation between the unpaid tickets by diplomats and their home countries' Corruption Perception Index scores. Experiment on individuals has been used to suggest that cultural norms of corruption are persistent and that individuals carry such norms to new environments (Banuri & Eckel, 2012).

In the field of international business (IB), a firm's foreign location choice is of primary relevance. Some interpret a firm's foreign location as part of an internationalization sequential process that the location should be similar to its home country (Johanson & Vahlne, 1977). Others examine how a firm's home country's corruption culture can affect its investment strategy on corruption abroad. Cuervo-Cazurra (2006) looks at how the country characteristics are related to firms' incentive to engage in bribery in its foreign direct investment (FDI) to a host country. Spence & Gomez (2011) look at the impact of host country institutional environments on MNC subsidiaries' strategy and find that MNCs look at both their home and host countries' corruption norms when they face the issue of corruption in their foreign investments. Both studies indicate that there is a relationship between a firm's home country corruption norms and its foreign corruption practice.

As examined above, social norms of corruption from a home country can persist over long time and across borders (Fisman & Miguel, 2006). A firm's decision about its

host country location choice can be affected by its home country's corruption norm. I draw my first hypothesis at the country level:

*Hypothesis 1: There is a positive relationship between home country corruption levels and firms' location choice: firms from more corrupt home countries tend to invest in more corrupt host countries; firms from less corrupt home countries tend to invest in less corrupt host countries.*

## **2. Firm-Level: transferring corruption experience into a nonmarket capability**

The key to surviving under neo-institutional theory is to conform to institutional pressure so as to deal with uncertainty and constraints. That assumes homogeneity across firms. The resource-based view assumes the opposite. Firms' heterogeneous assets are tied uniquely to their performance (Wernerfelt, 1984; Barney, 1991). In the context of corruption, not all firms are created equal in dealing with foreign government. Some firms from low-corruption ("clean") signatory countries of OECD still pay bribes when asked to in a host country.<sup>2</sup> On the other hand, a firm may face the pressure to behave alike with their fellow firms from a highly corrupt home country yet choose to stay clean (not corrupt) in a host country. This is why integrating firm-level theory with institutional theory is important in studying corruption. This section builds on the resource-based view and corporate learning theory to examine the influence of nonmarket capability on firms' foreign expansion strategy and performance. I propose that firms' foreign location strategies vary according to their nonmarket capability accumulated through their prior

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<sup>2</sup> See Table 1 for statistic result of this claim.

experience of paying bribes, which interact with their home country corruption norms in determining their international location strategy.

The resource-based view sees firms as bundles of resources and capabilities and studies how firms can gain sustained competitive advantage with firm-specific resources and capabilities (Penrose, 1959; Barney, 1991). In a multinational business context, how managers can create and transfer firm resources from a home country to a host country is the essence of study. Peng (2002) proposes from an institutional-based view that knowledge and experience in dealing with the home country's corrupt institution can become a firm advantage in competing with other firms abroad (Peng 2002; Cuervo-Cazurra 2015; Cuervo-Cazurra & Genc, 2008; Martin 2014). Expanding from Barney's four attributes of resources and capabilities – valuable, rare, imperfectly imitable, and non-substitutable (Barney 1991: 105), Bonardi (2011) calls for a “drastic adaptation” of the traditional RBV when studying a firm's political resources by focusing on a firm's capability in dealing with the political environment.

A nonmarket strategy is “a *concerted pattern* of actions taken in the nonmarket environment to create value by improving its overall performance” (Baron, 1995: 47). Nonmarket assets can give a firm a nonmarket advantage (Baron, 2003). An overall competitive strategy must be tailored to a firm's both market and nonmarket competencies in the context of its market and nonmarket environments (Baron, 1995: 48), with an increasing attention on the political context (Jimenez, 2013: 1).

Bonardi, Holburn, and Bergh (2006) use the term *nonmarket capability* to refer to a firm's experience in dealing with government and learning from other firms' experiences in dealing with government their (p. 1214). In political strategy literature,

Bonardi et al. (2005) explain that politicians exchange policy favors for resources from organized interest groups to improve their electoral prospects. Such resources can take the forms of interest groups' supporting votes, financial contributions, and useful information (Bonardi, 2011: 3; citing Hillman & Hitt, 1999). In IB literature, Cuervo-Cazurra (2006) examines how home-country characteristics influence FDI sensitivity to host-country corruption. He finds that high corruption in host countries can not only result in relatively less FDI from countries that have anticorruption legal mechanism, but also relatively higher FDI from countries with high levels of corruption, because firms which have been exposed to bribery at home may not be deterred by corruption abroad, but instead seek countries where corruption is prevalent (Cuervo-Cazurra, 2006: 807). In a separate study, Cuervo-Cazurra & Genc (2008) argue that firms from developing countries can actually benefit from the disadvantage they suffered from an underdeveloped institutions as an advantage when they compete with developed-country MNEs in countries with "difficult governance conditions," because "developing-country MNEs are used to operating in such conditions." (p. 957). In countries where corruption is significant, political and non-market transactions are often essential (Blumentritt & Nigh, 2002; Boddewyn & Brewer, 1994). Bribery has been recognized as a manipulation tool used by MNEs to deal with underdeveloped governments (Rodriguez, Siegel, Hillman & Eden, 2006). In summary, prior exposure to government corruption can be a firm asset as nonmarket capability: it improves a firm's competencies to profit in a new institutional setting, by taking advantage of the firm's asymmetric information gained earlier to address the allocation of resources, over the interests of its competitors and nonmarket players.

Bonardi (2004) suggests that firms expanding international operations first explore their opportunities in obtaining favorable entry conditions given at host government's discretions (Jimenez, 2013: 3; citing Bonardi, 2004). The importance in understanding the host government and dealing with it strategically is the key to a firm's success in a politically challenging host country (Jimenez 2013; Bonardi 2004; Henisz & Zelner, 2001; Holburn, 2001, Holburn & Zelner, 2010). Political strategy literature studies how a firm's perception of a foreign government's political risk and stability can affect its investment decision making. A firm's past experience in dealing with difficult situations, such as political unrest or a risky situation where the government played a big role, increases its knowledge and skills to deal with host government in future politically risky situations.

MNEs entering a host country are more likely to succeed if they possess political capabilities developed through organizational learning and cognitive imprinting in experiences, which facilitates them to identify key political actors and form coalitions (Holburn & Zelner, 2010) and if the target countries are with institutional environment similar with the MNEs' prior regulatory experience (Perkins, 2014). MNEs are more likely to fail in target countries unrelated to their own institutional experience (Perkins, 2014). Development of a firm's capability of a political nature allows firms to obtain competitive advantages (Jimenez, A., et al., 2013), and this can be a unique resource on which a firm can base their strategy across borders (Perkins, 2014; Henisz & Delios, 2004). If dealing with corruption is of a political nature, then a firm can take advantage of its past experience of paying bribes in one corrupt system to enter in a new environment

and improve its chance to succeed over its competitors who lack such experiences and knowledge.

*Hypothesis 2: The relationship between firms' home country corruption norms and location choices is moderated by whether a firm has prior experience of compliance with a government's bribery request.*

### **3. Firm-Level: Nonmarket capability of bribery experience on firm performance**

Is firm performance actually enhanced by paying bribes? The rationale for bribery is that bribes help firms achieve the legitimacy (or even illegal legitimacy) needed to cooperate with local government, mitigate the uncertain cost of complying with host government's regulations, increase the efficiency of entering into a new market, and thereby increase the competitiveness over other firms who do not make such a payment. The earlier section of this paper shows that a corrupt government environment is not necessarily an exogenous constraint on MNEs (Rodriguez, et al., 2006), but is also susceptible to manipulation through MNC non-market activities such bribery (Rodriguez, et al., 2006, 734; Baron, 1995). Firms develop their non-market capability through experiences of dealing with corrupt government and leverage such experience in expanding their foreign investment in locations with similar nonmarket environment.

Little is known whether costly bribes actually pay-off and help firms grow (Zhou & Peng, 2011; 907). IB scholars interested in corruption have focused on the effect of corruption across countries. Micro-level studies of firm bribery and firm performances are scarce. Most of such limited studies rely on survey data with limited cross-section



data, making it impossible to examine the dynamic effect of firm's bribery experience on its performance development (Jiang & Nie, 2014; Sahakyan & Stiegert, 2013; Zhou & Peng, 2012). Such study is also susceptible to reverse causality: firms might have chosen to bribe because their performance was already so low that they needed some government favor to increase their competitiveness.

The purpose of this section of the study is to examine whether a firm's nonmarket capability in dealing with corrupt government by paying bribes has any positive effect on its performance in a multinational context. The literature on bribery's effect on firm performance is divided in two camps: the positive view seeing corruption as grease in the wheels of commerce through reallocation of limited resources, and the negative view seeing corruption as sand in the wheels of commerce due to the inefficiency caused by increased cost and uncertainty (Cuervo-Cazurra, 2015). The positive view proposes that firms gain efficiency by circumventing dysfunctional regulations in a low quality institutional environment (Huntington, 1968). The negative view argues that corruption negatively affects firm performance, because of the high cost associated with uncertainty and secrecy (Shleifer & Vishny, 1993), the diversion of productivity and misallocation of public resources (Mauro, 1995), inefficiency due to long-term excessive bureaucratic procedures (Kauffman & Wei, 1999), and the taxing effect of corruption on firm growth (Fisman & Svensson, 2001; Wei, 2000). Corruption is reported to substantially reduce sales growth and firm competitiveness (Gaviria, 2002).

Although firms may use bribery experience as a nonmarket capability and transfer their home country institutional disadvantage into competitive advantage in foreign

expansion (Cuervo-Cazurra and Genc, 2008), such advantage is not permanent. After the initial entrance stage into the foreign market, firms which have not relied on bribery may begin growing faster with skills and knowledge in dealing with the host government and the products and services they can offer with competitive qualities. Thereby, the political resource of a firm could benefit it at the initial entrance stage, but may not in a long run. When firms' profits are driven down by competitive pressure, there are less excess profits from which to pay bribes (Svenssen 2005; citing Ades and Di Tella, 1999). Therefore, bribery does not positively relate to a bribing firm's long-term performance.

*Hypothesis 3: A firms' bribery experience is negatively related to its long-term performance.*

Depending on a firm's size, it could be forced or strategically choose to engage in bribery (Zhou & Peng, 2011). If the bureaucracy continuously demands bribes to a point that the cost becomes too high and if a firm has sufficient capital assets, the firm may prefer lobbying for deregulation over paying bribes (Harstad & Svensson, 2011; 47). However, if a firm does not have sufficient capital assets to lobby, this may lead to the holdup problem (Harstad & Svensson, 2011: 51). Harstad & Svensson (2011) points out that when the cost of the bribe increases faster to the firm's capital than does the cost of lobbying (page 51), small firms are held up to pay bribes without the option of lobbying, while large firms can afford to lobby instead of bribing. Therefore, bribery can hurt small firms' performance while may enhance large firms' performance in the long run.

*Hypothesis 4:* Firms' bribery is negatively associated with their market performance for small firms, but positively associated with their market performance for large firms.

### **III. Empirical Setting: the United Nations Oil-for-Food Program (OFFP)**

The secret nature of corruption makes it hard to capture. Secrecy and ethical considerations leave accurate, firm-level corruption data almost unavailable (Jeong & Weiner, 2012). Several reputable international databases measure corruption based on practitioners' and scholars' perceptions. Such measurement approach has intrinsic limitation because of the potential errors of assessment or political preferences by experts (Razafindrakoto & Roubaud, 2010).

An ideal dataset for this research of firm strategies based on its bribery experience needs to consist of accurate data of firm-specific bribery evidence, the bribery transactions, and a wide arrange of industry with minimum bias. The United Nations Oil-for-Food Program provides a unique source of information on firm-specific bribery to build such a dataset.

### **The United Nations Oil-for-Food Program (“OFFP”) and Humanitarian Kickbacks**

The United Nations Security Council (“Security Council”) imposed comprehensive sanctions on Iraq after the country's invasion to Kuwait in 1990 to isolate the Saddam Hussein regime.<sup>3</sup> In an effort to mitigate the negative consequences of the sanctions on the civilian population, the Security Council established the Oil-for-Food

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<sup>3</sup> The United Nations Security Council Resolution 661, 1990.

Program<sup>4</sup> in 1995, which allowed Iraq to sell its oil on the world market and use the revenues to purchase food and other humanitarian relief supplies through the UN-managed escrow account system. Humanitarian goods transactions refer to any transactions using the Iraqi oil sale proceeds from the escrow account for purchasing medicine, health supplies, food, and any essential civilian needs in the OFFP. The Iraqi government was not allowed to have any access to or authority over any of the funds in the OFFP. Seventy two percent of Iraqi oil export proceeds funded the humanitarian program through the escrow account.<sup>5</sup>

The OFFP started in December 1996 and suffered from corruption and abuse since 1999 when the Iraqi government began manipulating the OFFP by generating income outside the UN oversight by requesting illicit surcharges on oil export contracts and kickbacks on humanitarian goods transactions. Importing companies of humanitarian goods were pressured to obtain contracts through paying kickbacks to gain political preference. The Iraqi government manipulated the OFFP to dispense contracts on the basis of political preference and to derive illicit payments from the contract vendors. The UN authorized an Independent Inquiry Committee (“IIC”) to execute independent investigation of the administration and management of the OFFP in Iraq. In its final report issued in October 2005 (“The IIC 2005 Report”),<sup>6</sup> results of illicit payments made in connection with oil contracts, and results of illicit payments made in connection with humanitarian contracts under the OFFP were both disclosed. According to the IIC 2005 Report, 3,614 companies sold \$34.5 billion of humanitarian goods to Iraq, among which

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<sup>4</sup> The United Nations Security Council Resolution 986, 1995.

<sup>5</sup> Source: <http://www.un.org/Depts/oip/background/index.html>.

<sup>6</sup> The Independent Inquiry Committee into The United Nations Oil-for-Food Program. Report on Program Manipulation. October 27, 2005 (“the IIC 2005 Report”).

kickbacks totaling more than \$1.5 billion were paid in connection with the contracts of 2,253 companies.<sup>7</sup>

### ***Kickbacks from the humanitarian contracts***

According to the IIC 2005 Report, Iraq's largest source of illicit income in relation to the OFFP came from "kickbacks" paid by companies that it selected to receive contracts for humanitarian goods in mid-1999 (IIC 2005 Report, Chapter 3). These illicit payments to the Iraqi government were disguised as "inland transportation fee" and were not reported to the United Nations by Iraq or the participating contractors. Rather than seeking approval from the United Nations for compensation of sea-to-land transportation costs from OFFP's escrow account, Iraq required humanitarian contractors to make such payments directly to Iraqi-controlled bank accounts or to front companies outside Iraq that in turn forwarded the payments to the Government of Iraq (IIC 2005 Report, Chapter 3). Another source of illicit income came from an "after-sale-service" fee, which is a ten percent kickback the Iraqi government generally applied on all humanitarian contractors, in addition to the requirement of inland transportation fees (IIC 2005 Report, Chapter 3). The after-sales-service provisions were incorporated into contracts as a way to inflate prices and permit contractors to recover from the United Nations escrow account amounts they have paid secretly to Iraq in the form of kickbacks. Contractors paid these "after-sale-service" fees before their goods were permitted to enter Iraq (IIC 2005 Report,

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<sup>7</sup> The Independent Inquiry Committee into The United Nations Oil-for-Food Program. Report on Program Manipulation. October 27, 2005 ("the IIC 2005 Report"), Chapter 1, page 1.

The reported number of firms (3,614) participating in the OFFP Humanitarian transactions and the reported number of firms (2,253) having paid kickbacks in the IIC 2005 Report are inconsistent to the actual numbers that are published in the Report, according to the authors' counting. I find a total of 3,599 participating firms in the IIC 2005 Report, among which a total of 2,044 firms are recorded to have paid kickbacks. The discrepancy is suspected to be caused by missing data in the publishing process.

Chapter 3, page 249 of 623). All the transactional details of kickbacks, including contracts values and numbers, have been recorded in an electronic database maintained by the Iraqi government, cross checked by the IIC against bank records, and verified through IIC's interviewing the Iraqi officials involved in the OFFP.

Few other studies have used the OFFP for their empirical data setting, with the exceptions for Jeong & Weiner (2012), Hsieh & Moretti (2006) and Heaton (2005). I use the OFFP data differently from Jeong & Weiner (2012) in the following two ways: first, Jeong & Weiner's research is in a single-industry setting – the petroleum industry. A single industry may not reflect other industries' firm behaviors in response to the demand for corruption. Firms in my sample come from twelve industries. Data collected through forensic investigation from a natural experiment with a broader selection of industries increase the external validity of my research. These qualities and quantities of the data enhance the reliability, comprehensiveness, and validity of the empirical test that I would need for a higher prediction power. Second, Jeong & Weiner (2012) uses bribes in the OFFP as their focal interest. My research goes beyond the study of OFFP and uses the report of illicit payments in the OFFP as a channel to extend the corruption research to firm-specific effect on location choice and performance. Hsieh & Moretti (2006) use the OFFP oil contracts to analyze oil price. Heaton (2005) focuses on the oil contracts at the country analysis level. My study is the first paper to my knowledge utilizing the humanitarian transactions data in the OFFP data to examine firm behavior and performance in a multinational context.

## **IV. Empirical Analysis**

### **1. Data and Sample**

To examine my hypotheses, I built a dataset compiling firm-specific bribery information from the OFFP's IIC 2005 Report, each firm's home and host country data from Transparency International's Corruption Perceptions Index, as well as other firm data from the Bureau van Dijk Electronic Publishing (Bureau van Dijk or BvD)'s Oribs database.

The OFFP data provide detailed information of company names, home countries, goods categories (to imply industry sectors), contract face values, and evidence of illicit payment (or lack of evidence for same). It is a unique source of measurement of firm-specific bribery from a quasi-natural experiment, free from any design manipulation.

I use Transparency International's Corruption Perceptions Index (CPI) for measuring corruption at home and host country level of each OFFP company. Although I discussed the limitation of survey-based data in the earlier section, the choice of using TI's perceptions index is motivated by the very nature of my research question. Since my study is to test whether a firm's home country corruption affects its location strategy in foreign investment, I used CPI to reflect managers' perception of a country's corruption level in making their location choice, even though CPI does not necessarily reflect their direct experiences with the home and host countries' corruption environments.

I complement this database with company information from Bureau van Dijk's Oribs database, which provides data of over 200 million private and public companies

worldwide. Data information from Orbis in my study includes each OFFP company's home country, foreign subsidiary countries (host countries), parent companies, financial data, and industry sectors.

The original OFFP dataset is composed of 3,599 firms from 72 countries across 12 industry sectors, among which 2,044 firms (57%) made illicit payments. Firms that are not in Orbis are dropped from my sample. Due to the multinational nature of my study, I also dropped local firms without any foreign subsidiaries or foreign parent companies. Each multinational firm from the OFFP IIC 2005 Report is treated as an independent company. This reduced my sample to 304 firms from 36 countries across 12 industries, among which 207 firms (68%) made illicit payments.

A summary of countries represented and the frequency of their firm bribery in the OFFP is included in Table 1a (full OFFP data) and 1b (sample of this study). Table 2 compares statistics for the full OFFP data recorded in the IIC 2005 Report and sample of this study. The mean of home country CPIs in my sample is higher than that of the full OFFP sample. This is due to the fact that my research is confined to the study of multinational firms only. Multinational firms are more likely from developed countries, whose corruption index is generally rated higher due to their institutional advantage (Cuervo-Cazurra & Genc, 2008).

## **2. Measures**

(1) Dependent variable

### ***Host country location choice***



My first research question asks how a firm's home country corruption affects its location strategy in international business and how its own bribery experience moderates that relationship. To test my hypotheses 1 and 2, I used a dependent variable that reflects a firm's location choice that is related to corruption. Holburn and Zelner (2010) use a binary measure that distinguishes new and old facility location in testing firms' tendency to seek out riskier host countries based on their political capabilities in the electronic power generation industry. Other papers have also used the following three measures as their dependent variables: the number of countries where MNEs have subsidiaries as a dependent variable to measure the scope of internationalization (Jimenez, Luis-Rico & Benito-Osorio, 2014), the probability that a given firm chooses one particular host country from the available set of countries for their subsidiaries (Estrin & Meyer, 2013, *Working Paper*), and FDI stock from Chinese firms in each of the eight host Asian economies (Kang & Jiang, 2012). To test my hypothesis, I needed a dependent variable more directly related to location choices based on host countries' corruption levels.

I use the mean host country corruption (host CPI) as my dependent variable. It is measured by the averaged CPI scores of all the subsidiary countries of a firm. I construct two different methods in measuring a firm's host country corruption: the weighted and unweighted average. The weighted average is calculated by counting each host country only once, even if a firm could have the same host country more than once. The unweighted average is calculated by counting each host country separately. For example, if a given firm has three subsidiaries in Country X and four subsidiaries in Country Y, I count X and Y only once for each and divide the sum of the corruption scores of X and Y by two. In the unweighted average method, I count X three times and Y four times and

divide the sum by seven. In an unreported test, I find the correlation between the weighted and unweighted methods high (0.99), indicating that there is little difference between the two measuring methods. I use the unweighted method in this study because it reflects more accurately a firm's location choice.

I measure host country corruption by using Transparency International's Corruption Perception Index. Measuring corruption based on perception has been criticized for its subjective limitation (Razafindrakoto & Roubaud, 2010). But the subjective nature of CPI at the country level makes it particularly useful in my study because they can be used as a proxy for business' decisions based on their perception of how corrupt a host country they want to go.

### ***Firm performance***

I use return on assets (ROA) to measure firms' performance. In my study, ROA is defined as net income divided by total assets. Return on assets is a widely used measure to assess financial performance (Bowen & Wiersema, 2005; Berry, 2015), because it indicates how profitable a firm's operation is relative to its total assets.

### (2) Independent variables

#### ***Home country Corruption***

I measure home country corruption by using Transparency International's CPI. To accurately reflect the home country corruption norms around the time of the OFFP, I use the CPI scores of 2000. Year 2000 was when Iraq instituted the kickback policy on all humanitarian contractors. All the firms participating in the OFFP took actions to either

reject or consent to pay illicit payments to the Iraqi government around that year. A CPI score of that year reflects the corruption norm of a home country when its firms paid bribes in the OFFP. This increases the validity of my empirical test. For any firm whose home country was not reported by TI in its CPI report 2000, I use the year closest to 2000 when its CPI score first became available. For example, while TI's CPI score is not available for United Arab Emirates in Year 2000, I used its CPI score of Year 2003 when its CPI score first became available

### ***Binary measure of home country corruption***

To further examine the effect of home country corruption on a firm's host country location choice, I also use a binary measure: a country is defined as *clean* if its CPI score is above the median score (6.7) of all represented countries in my sample, and *dirty* if its CPI score is below the median. This is a relative definition because all countries are corrupt in some ways. *Clean* countries in my study are those with low corruption in comparison with those with high corruption (*dirty* countries) in my sample.

### ***Firm bribery: evidence of illicit payment***

Evidence of illicit payment captures both a firm's bribery experience and its nonmarket capability in dealing with corrupt host government. The IIC 2005 Report provides an accurate record of such evidence thanks to its forensic investigation. The IIC 2005 Report designates firms with evidence of illicit payments in any of the following three categories: "A" for firms with evidence of illicit payments based in whole or in part on actual payment data; "P" for firms with evidence based entirely on projected amounts,

and nothing for firms without evidence of either of the above. In this study, a firm takes a value of 1 if it is marked with “A” or “P;” such firms are termed as *dirty* firms in my study. Otherwise, a firm takes a value of 0 and is termed as *clean* firms. *Dirty* firms are those who paid bribes in the OFFP, and clean firms are those who did not comply with the Iraqi government’s bribery request.

### (3) Control variables

It is important to control industry-, country-, and firm-level variables in my model because firms can have different location choice and performance outcomes influenced by those factors in a multinational context.

#### ***Industry-level***

Industry context has been recognized as affecting firm performance and stakeholder relationship (Griffin and Mahon, 1997; Griffin & Bryant, 2012). Some industries can be positively associated with firm performance (Hadani & Schuler, 2013). Experience and knowledge in dealing with governments may also differ among different industries. Firms’ experiences in dealing with political risk are shown to play an important role in regulated industries (Jimenez, 2013). The more regulated the industry in which a firm is, the more crucial it is for a firm to obtain the experience and knowledge to deal with government interventions. Holburn & Vanden Bergh (2008) attribute this cycle to the fact that firms develop the ability to manage their relationship with regulatory agencies so to navigate through the regulated environment and gain regulatory favors.

I included industry as my control variable. According to the OECD Foreign Bribery Report, the top four industry sectors where the foreign bribery cases occurred are: extractive, construction, transportation and storage, and information and communication (OECD 2014, page 8). An industry takes a value of 1 if it falls into any of the four sectors above.

Table 3 provides a list of all the industry sectors represented in my data.

### ***Country-level***

For controls, I include country location attributes that can impact the attractiveness of a host location for foreign direct investment (Berry, 2015). Geographic distance has been identified to affect investment motivations (Nachum1 & Zaheer, 2005). I first used Geographic Information System software to incorporate geographic distance of any host country from a home country. I then included gross domestic product (GDP) per capita growth to capture a country's growth, which can contribute to firm growth in that country. I use the World Bank's World Development Indicators for these time-varying variables.

### ***Firm-level***

In addition to separating firms into large and small firms, I also include the log of total assets to control for the size of a firm. This enables to me to control for the general effect of firm size on firm performance, but still be able to test the different influence of firm bribery on performance in big and small firms.

Table 4 provides descriptions and sources of my variables.

### 3. Models

#### (1) Foreign Location Choice

To examine my hypotheses of the relationship between a firm's home country corruption and its location choice in host countries, moderated by firms' bribery experience, I use an ordinary least squares (OLS) regression model. Due to the fact that many of the firms in my sample are private firms, tracking their foreign location choices over time is difficult. This limitation determines that my regression is cross sectional. The host country corruption CPI scores were collected in year 2013. I estimate a firm's host country location choice by using the following regression:

$$Y = \beta_0 + \beta_1 * (\text{Home country CPI}) + \beta_2 * (\text{Firm bribery}) + \beta_3 * (\text{Home country CPI} * \text{Firm bribery experience}) + \lambda * X(\text{control variables}) + E$$

where Y is the unweighted host country CPI as a proxy for a firm's foreign investment location choice,  $\beta_1$ ,  $\beta_2$  and  $\beta_3$  are parameters of interest,  $\lambda$  is a vector of control variables, and E is error.

#### (2) Firm performance

To examine the relationship between a firm's bribery experience and its financial performance, I could use an OLS on panel data as the following,

$$Y(\text{firm performance}) = \lambda_1 * (\text{bribery}) + \lambda_2 * X(\text{control variables}) + \lambda_t + \lambda_k + E_i \quad (1)$$

where firm performance is measured by return on assets (ROA),  $\lambda_1$  is the estimator of focal interest, and  $\lambda_2$  is the estimator of a vector of control variables;  $\lambda_k$  is industry fixed effect,  $\lambda_t$  is year fixed effect, and  $E_i$  is for errors.

A potential concern of this model is that firm bribery may be endogenous with respect to firm performance. To be specific, firm performance itself might have affected a firm's decision to pay bribes in the OFFP. To try to correct and control for endogeneity issues, I tested my hypotheses using a two-stage least squares (2SLS) regression model. 2SLS model is commonly used to estimate the parameters in panel data models with endogenous repressors. This simultaneous equation model treats my endogenous variable, firm bribery, by instrumenting it with an exogenous variable in a two-stage procedure. A fitted value is predicted in the first stage and substitutes my endogenous variable in the second stage regression. An instrument variable is uncorrelated with the dependent variable but for the endogenous variable. A 2SLS model allows me to consistently estimate the parameters in a system of simultaneous equations.

Specifically, I instrumented *firm bribery* with a firm's *contract value* in the OFFP program. This measure captures firms' incentive to bribe driven by economic rent coming from a contract (Jeong & Weiner, 2012). Contract value is a good instrument because short-term financial incentive is a strong predictor of a firm's bribery in the OFFP, but is extremely unlikely to be systematically related to a firm's long-term financial performance because contract value in the OFFP was set by the Iraqi government regardless of the size or performance of a firm. In the first stage, firm bribery is regressed on contract value in the OFFP. The predicted values from this regression

produce an instrumented firm bribery. In the second stage, equation (1) is run with instrumented firm bribery. The regression equation is as the following:

$$Y(\text{firm performance}) = \lambda_1 * (\text{instrumented firm bribery}) + \lambda_2 * X(\text{control variables}) + \lambda_t + \lambda_k + E_i$$

$$\text{Stage 1: } S_i (\text{firm bribery}) = \pi_{10} * (\text{contract value}) + \pi_{11} * X(\text{control variables}) + \lambda_{1t} + \lambda_{1k} + E_{1i} \quad (2)$$

$$\text{Stage 2: } Y(\text{performance}) = \lambda_1 * (\text{level of firm bribery as predicted by contract value}) + \lambda_2 * X(\text{control variables}) + \lambda_t + \lambda_k + E_i \quad (3)$$

The coefficient of interest is  $\lambda_1$ , which measures the effect of instrumented firm bribery on a firm's financial performance.

One challenge in using this model comes from the fact that my endogenous variable, firm bribery, is a dichotomous (dummy) variable. 2SLS is a linear model. The appropriate estimation procedure of using current statistical software packages is "extremely limited." (Keshk, O.M., 2003: 158). MIT econometricists Joshua Angrist, together with Steve Pischke, suggest using a garden variety 2SLS (Angrist & Pischke 2009:191) in dealing with such a problem. A garden variety 2SLS does not require the first-stage regression to be linear. They also suggest an alternative method by using the estimate of the first stage as an instrument in a conventional 2SLS procedure. But they acknowledge this method can be confusing in what the underlying experiment really is.<sup>8</sup> I choose to use a garden variety 2SLS (using "xtivreg" command in *Stata*) because

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<sup>8</sup> For detailed explanation, see Angrist & Pischke 2009, at 191.



consistency of its estimates does not depend on correct specification of the first-stage regression.<sup>9</sup>

#### **4. Statistical Analysis**

##### (1) Descriptive analysis

Table 1 shows there is no perfect relationship between a country's corruption norm and its firms' bribery experience. Firms from almost all countries traditionally perceived with low corruption paid kickbacks in the OFFP's humanitarian transactions, except for the United States. For example, 33% of the Finnish firms were recorded in the IIC 2005 Report to have paid kickbacks, while Finland was rated the highest corruption free country in Transparency International's Corruption Perception Index in Year 2000. 67% of the Danish firms participated in paying kickbacks in the OFFP, while Denmark was rated the second in TI's CPI Year 2000. In contrast, some traditionally perceived corrupt countries actually had surprisingly low percentages of firm bribery in the OFFP. For example, although the former Yugoslavia ranked the lowest in TI's CPI Year 2000, only 25% of its firms made illicit payments according to the IIC 2005 Report. This finding emphasizes the need for this research in examining firm factors that separate from country factors in influencing a firm's decision to pay bribes.

Table 5 and 6 provide descriptive statistics and correlation matrices for both location and performance samples. I further provide descriptive statistics of subsamples by clean and dirty home countries in the location sample, and by large and small firms in the performance sample. Although some of the variables show high correlation, a

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<sup>9</sup> For detailed explanation, see Angrist & Pischke 2009, at 191.

variance inflation factor (VIF) test (using “vif” command in *Stata*) shows no multicollinearity.

## (2) Results

Testing results from Hypotheses 1 and 2 using the cross sectional data are reported in Table 7. Testing results from hypotheses 3 and 4 using panel data are reported in Table 8.

### ***Hypotheses 1 and 2: Foreign Location Choice***

As my study investigates how a firm’s home country corruption and its own bribery experience as a nonmarket capability affect the firm’s foreign location choice, I examine the relationship in three samples: the full sample, the subsample of firms from clean countries, and the subsample of firms from dirty countries. The first column under each sample shows the relationship between a firm’s home country corruption and its host country corruption. The second column shows the partial analysis when a firm-specific bribery experience is added in. The third column shows the full analysis with the interaction between a firm’s home corruption and firm bribery added in.

First, the coefficient of home country corruption is negative and statistically insignificant in the full sample, not supporting Hypothesis 1. The result, however, becomes different when I dichotomize the full sample into two subsamples based on whether a firm is from a clean or dirty country (a country with low or high corruption). In the subsample of firms from clean countries, the coefficient of home country corruption is positive and statistically significant ( $<0.1$ ). This means that one standard deviation increase in a firm’s home country CPI score is associated with an increase of a firm’s

host country CPI score by 2.806. The statistical power increases ( $<0.05$ ) when a firm bribery experience and the interaction between home country bribery and firm experience are added, increasing the coefficient to 2.890 and 6.029 respectively. The result remains negative and statistically insignificant for the subsample of firms from dirty countries. This outcome shows that Hypothesis 1 is supported only within the subsample of firms from clean countries, where the cleaner a firm's home country is, the cleaner the host countries the firm is likely to invest to. The result does not find that firms from dirty countries are more likely to invest in dirty countries. In other words, although firms from low corruption countries are more likely to be discouraged from investing in host countries with high corruption, firms from high corruption countries are not discouraged from investing in host countries with social norms against corruption.

Second, for Hypothesis 2, the coefficient of the interaction between home country corruption and firm bribery is statistically insignificant in any of the three samples. The negative signs shown in both the clean and dirty home country subsamples still can be useful for my study. It indicates, though does not prove, the possibility that a firm chooses to invest in a host country with less corruption could be suppressed as a result of the firm's bribery experience. Without taking into consideration the interaction effect, my result finds a statistically significant and negative effect of a firm's bribery experience on its host country choice by corruption levels among firms from dirty home countries. A bribery experience is associated with a decrease of a firm's host country CPI score by 8.192. Such effect is not found among firms from clean countries. This result suggests that in countries of high corruption, a firm's bribery experience itself can develop into a nonmarket capability that affects its foreign location choice.

### ***Hypotheses 3 and 4: Firm performance***

After examining the effect of country- and firm-level corruption on a firm's strategy in foreign location choice, I investigate how a firm's bribery experience affects its financial performance.

In Hypothesis 3, I propose a negative relationship between a firm's bribery experience and its long-term financial performance. The main variable of interest is a firm's bribery experience. The 2SLS results in Table 8 show that this variable fails to achieve a significance level at 0.10 across the full sample and the two subsamples. Hypothesis 3 is therefore not supported. The negative sign of the result in the full sample matched my hypothesis' direction prediction. It indicates the negative effect a firm is likely to suffer from its bribery experience. Hypothesis 4 examines whether bribery affects large firms and small firms differently. I divide the full sample into subsamples of large firms and small firms. Although the results remain insignificant, the signs are opposite for large and small firms: negative for small firms, and positive for large firms.

## **V. Discussion and Conclusion**

In this paper, I examine the effect of corruption on a firm's foreign investment behavior and performance. Although corruption disturbs resource allocation and imposes extra cost at firm and country levels, I propose that corruption can impact firms differently, depending on their home country corruption norms, their firm-specific bribery experience, and their size. From my test results I conclude that the relationship between a firm's home country corruption norm and its foreign investment location choice decided by host countries corruption is only significant among firms from clean

home countries, but firms from dirty home countries are likely to invest in both directions: clean and dirty host countries. (Figure 1 shows the distribution of host country choice by firms from clean and dirty countries.)

This result complements Cuervo-Cazurra & Genc (2008, 2011) and Bonardi (2006) from an empirical perspective that firms learn how to operate in weaker institutional environments by understanding what is missing and taking time to develop the capability to fit in a deficient environment in those missing dimensions. Once a firm acquires that capability, they are not limited to host environment similar to their home countries. Firms from countries of low corruption may not have as much experience in acquiring such capabilities through “knowledge to manage complexity” and “differences in competitive conditions” (Cuervo-Cazurra, 2011: 426) as their counterparts in highly corrupt countries. That explains why my research produces a significant relationship between a firm’s home and host country corruption norms only among firms from clean countries and not among firms from dirty countries.

My study adds depth to Cuervo-Cazurra & Genc (2011) theoretically in that it includes firm-level factors in examining how corruption affects a firms’ host country location choice. Although I find firms from clean home countries more likely to invest in other clean countries, their firm-specific bribery experience is not shown to be related to its future location choice by host country corruption. If the lack of knowledge to manage complexity and difference in competitive environment is the reason attributed to a firm’s tendency to invest in clean host countries, a bribery experience should have increased such knowledge of the firms from clean countries, and thereby increased the likelihood of

such firms to invest in countries not similar to their own. The insignificant result found in my study suggests that more explanation is needed beyond the advantage gained through knowledge of a disadvantaged home country environment or a bribery experience on its own. One explanation is that clean countries have stronger institutional governance mechanism, such as extraterritorial laws and regulations that prohibit foreign bribery. This in turn discourages firms from investing in highly corrupt countries. The interesting question remains about why those firms from clean countries in my study were not intimidated to engage in bribery in the OFFP but yet chose to invest in clean host countries. An alternative explanation can be that the social norms of clean countries encourage firms to improve their company culture to guide their behaviors and strategies overseas. Thus, if a firm from clean country paid bribes in the OFFP, the social norm of that country and the organizational culture of that firm will absorb the negative effect.

For firms from dirty countries, although we do not see a significant relationship between a firm's home and host country CPI scores, my study shows that a firm-specific bribery experience is significantly related to their host country corruption levels: dirty-country firms that paid bribes in the OFFP tend to invest in high corrupt countries. This complements Cuervo-Cazurra (2011) in that firm-specific bribery experience, in addition to the knowledge learned from their home countries' institutional environment, contributes to a firm's decision to invest in corrupt host countries. Combining results from both clean and dirty country subsamples suggests that neither one-time firm-specific bribery nor corrupt home country influence is sufficient to predict a firm's location

choice. When both country knowledge and firm experience are present, we are able to better predict a firm's foreign location strategy by their host country corruption.

The results show some unanticipated findings in firm performance. Although I proposed that firm bribery would negatively affect a firm's long-term performance, the results show that one-time firm bribery does not have a significant effect on the performance of a firm. One explanation for this finding may be that the cost of bribery has been absorbed by a firm's later development in other areas of competitiveness, such as R&D and firm diversifications. Despite the lack of statistically significant support in Hypotheses 3 and 4, the signs of the results are compatible with my hypothesis that bribery in general has a negative relationship with firm performance, and that small firms suffer from a negative relationship, but large firms may benefit from a positive relationship. This may be due to the hold-up situation or managerial cost discussed in the paper, or to the fact that some small firms are not prepared for long-term growth from the beginning.

The direction of a negative sign has significant policy implications. It suggests that bribery hinders small firms' value creation over the long-term. Contrary to their public image of being ambitious and promising entrepreneurship, most small firms do not have the intention of staying in the market for long. That could lead their decision-making being short-term oriented. Because of their limited capital assets and lack of resort to protest, small business can be impacted by corruption the worst. From a home country policy perspective, policy makers should focus on encouraging small firms to target for long-term goals and reward them for fulfilling those goals. When a small firm

sees the alternatives and rewards, bribery becomes less attractive to them. For a host country policy that indulges corruption, it may actually run counter to an objective to attract foreign investment when fewer small firms survive in the market over the long run.

There are several limitations to this research that should be acknowledged. First, I have examined only multinational firms. How bribery affects local firms' performance is not examined. Second, among the multinational firms in my study, while most of them own foreign subsidiaries, many of them have parent companies that are also multinational companies. It is an unknown field for scholars to explore at which level the decisions are made on foreign investment locations, the parent companies or the subsidiaries? A future study on this nature may be beneficial to the study of whether a parent company's home country corruption can affect a firm's foreign location choice. Third, in my sample collection, almost 92% of the firms from the original data were dropped due to the fact that they are either not a multinational company or not in the Orbis database. This reduces the predictive power of my hypotheses. Fourth, while I have used the garden variety 2SLS model to try to control for endogeneity in my performance regression, other approaches that deal with issues of endogeneity can be also effective.

Despite these limitations, this paper provides one of the few studies using firm-specific bribery evidence in examining the relationship between home country corruption and host country location choice, as well as the impact of bribery on firm performance. It suggests that a firm's foreign location choice may be predicted by considering both its own bribery experience and its home country corruption norms. It also implies that firm performance is influenced by factors more than one-time bribery experience. Overall,



studying corruption in a multinational context requires an understanding of both firm behaviors and the complex institutional environments across countries.

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**Table 1a. Summary of countries and firms in the OFFP's humanitarian transactions**

Home Country Represented	Firms	Frequency of Firms that Paid Bribes ("Dirty Firms")	Percent of Dirty Firms
Afghanistan	1	0	0
Algeria	37	19	0.513514
Argentina	2	1	0.5
Australia	3	3	1
Austria	69	37	0.536232
Bahrain	11	8	0.727273
Bangladesh	1	0	0
Belarus	4	2	0.5
Belgium	71	34	0.478873
Bosnia and Herzegovina	1	0	0
Brazil	10	4	0.4
Bulgaria*	13	6	0.461538
Canada	14	4	0.285714
Croatia	4	1	0.25
Cuba	2	0	0
China	114	76	0.666667
Cyprus*	26	18	0.692308
Czech Republic	1	0	0
Denmark	31	21	0.677419
Egypt	145	101	0.696552
Finland	12	4	0.333333
France	414	174	0.42029
Germany	141	59	0.41844
Ghana	1	0	0
Greece	17	9	0.529412
Hungary	7	2	0.285714
India	182	131	0.71978
Indonesia	40	32	0.8
Iran	5	3	0.6
Ireland	8	2	0.25
Italy	302	156	0.516556
Japan	12	1	0.083333
Jordan	424	268	0.632075
Kenya	1	0	0
Korea	14	11	0.785714

Lebanon	112	83	0.741071
Libya	1	1	1
Luxembourg	1	1	1
Macedonia	1	0	0
Malaysia	57	39	0.684211
Mexico	1	0	0
Morocco	15	12	0.8
Myanmar	2	2	1
Netherland	34	6	0.176471
New Zealand	3	1	0.333333
Oman	25	22	0.88
Pakistan	23	18	0.782609
Poland	3	0	0
Portugal	2	1	0.5
Qatar	5	3	0.6
Romania	9	5	0.555556
Russia	147	90	0.612245
Saudi Arabia*	44	25	0.568182
Singapore	4	2	0.5
Slovakia	3	3	1
Slovenia	5	0	0
South Africa	7	4	0.571429
Spain	85	42	0.494118
Sri Lanka	29	27	0.931034
Sudan	10	4	0.4
Sweden	36	12	0.333333
Switzerland	71	33	0.464789
Syria	148	94	0.635135
Thailand	4	3	0.75
Tunisia	61	37	0.606557
Turkey	251	136	0.541833
Ukraine	3	2	0.666667
United Arab Emirates*	138	101	0.731884
United Kingdom	52	10	0.192308
United States	19	0	0
Vietnam	27	25	0.925926
Yemen	13	11	0.846154
Yugoslavia	8	2	0.25
Total	3,599	2,044	0.567936



**Table 1b. Summary of home countries in the sample (304 MNCs)**

Country	Firms	Dirty firms	Percent	CPI <sup>10</sup>
AUSTRALIA	1	1	1	8.3
AUSTRIA	11	9	0.8182	7.7
BELGIUM	13	6	0.4615	6.1
BRAZIL	1	0	0	3.9
BULGARIA*	1	1	1	3.9
CANADA	2	0	0	9.2
CHINA	9	6	0.6667	3.1
CYPRUS*	2	2	1	6.1
DENMARK	9	8	0.8889	9.8
EGYPT	5	5	1	3.1
FINLAND	3	2	0.6667	10
FRANCE	66	37	0.5606	6.7 <sup>11</sup>
GERMANY	20	16	0.8	7.6
GREECE	2	1	0.5	4.9
INDIA	16	15	0.9375	2.8
IRELAND	1	0	0	7.2
ITALY	48	32	0.6667	4.6
JAPAN	3	1	0.3333	6.4
JORDAN	7	6	0.8571	4.6
KOREA, REPUBLIC OF	4	4	1	4
LEBANON	1	1	1	3
MALAYSIA	4	3	0.75	4.8
MOROCCO	1	1	1	4.7
NETHERLANDS	5	1	0.2	8.9
POLAND	1	0	0	4.1
RUSSIAN FEDERATION	4	2	0.5	2.1
SAUDI ARABIA*	3	3	1	4.5
SLOVENIA	1	0	0	5.5
SPAIN	15	12	0.8	7
SRI LANKA	3	2	0.6667	3.7
SWEDEN	5	3	0.6	9.4
SWITZERLAND	13	9	0.6923	8.6
TURKEY	12	11	0.9167	3.8
UNITED ARAB EMIRATES*	4	4	1	5.2
UNITED KINGDOM	7	3	0.4286	8.7
UNITED STATES	1	0	0	7.8
<hr/>				
Number of observations (firms)	304			6.7 (median by observations)
Number of countries	36			5.35 (median by countries)

<sup>10</sup> I use Transparency International's Corruption Perception Index ("CPI") scores of 2000 to measure these home countries' corruption levels. CPI scores of 2000 are not available for countries marked with asterisks. For Bulgaria, I use the CPI score of 2001. For the rest marked with asterisks, I use the CPI score of 2003.

<sup>11</sup> 6.7 is the median home corruption level in my sample.

**Table 2. OFFP samples**

OFFP Datasets <sup>12</sup>		Original OFFP population	My study sample
Home Country CPIs <sup>13</sup>	Total number	3,599	304
	Median	4.6	6.7
Host Country CPIs <sup>14</sup>	Total number	N/A <sup>15</sup>	304
	Median	N/A	58.59
Clean Firms <sup>16</sup>	Total number	1555	97
	Median Home CPI	4.6	6.7
	Median Host CPI	N/A	59.73472
	Fraction of the sample	0.432064	0.319079
Dirty Firms <sup>17</sup>	Total number	2044	207
	Median Home CPI	4.6	6.1
	Median Host CPI	N/A	58
	Fraction of the Sample	0.567936	0.680921

<sup>12</sup> The UN Oil-for-Food Program IIC 2005 Report

<sup>13</sup> I use Transparency International's Corruption Perception Index 2000 for our data because Year 2000 was when the kickback policy was instituted on all humanitarian contractors and illicit payment was either paid or rejected by the participating firms. Where Year 2000 data are absent, I use the most recent prior Index data. Transparency International's Corruption Perceptions Index scored countries on a scale from 0 (highly corrupt) to 10 (very clean) until 2011, and from 0 (highly corrupt) to 100 (very clean) since 2012. For the purpose of consistency, I multiply all home country CPIs by 10.

<sup>14</sup> Transparency International's Corruption Perception Index, Year 2014.

<sup>15</sup> The majority of the OFFP firms are not in Orbis. Therefore foreign subsidiary information is not available for these firms.

<sup>16</sup> UN OFFP Records from the IIC 2005 Report

<sup>17</sup> UN OFFP Records from the IIC 2005 Report.

**Table 3. Industry Sectors**

<b>Industry Sectors</b> <sup>1</sup>	<b>Sample = 304 MNCs</b>
Chemicals, rubber, plastics, non-metallic products	77
Clean Firms	15
Dirty Firms	62
Construction*	8
Clean Firms	2
Dirty Firms	6
Food, beverages, tobacco	11
Clean Firms	4
Dirty Firms	7
Machinery, equipment, furniture, recycling	109
Clean Firms	40
Dirty Firms	69
Metals & metal products	14
Clean Firms	3
Dirty Firms	11
Other services	40
Clean Firms	10
Dirty Firms	30
Extractives*	9
Clean Firms	5
Dirty Firms	4
Publishing & Printing	1
Clean Firms	1
Dirty Firms	0
Textiles, wearing apparel, leather	2
Clean Firms	0
Dirty Firms	2
Wholesale & retail trade	30
Clean Firms	15
Dirty Firms	15
Post & telecommunications*	2
Clean Firms	2
Dirty Firms	0
Gas, Water, Electricity	1
Clean Firms	1
Dirty Firms	0

<sup>1</sup> Industry sectors marked with \* are identified by OECD Report 2014 as the top four most prone to bribery.

<sup>2</sup> Industry sectors that are in the original OFFP dataset, but not in my sample of 304 MNCs are: banks, education & health, hotel & restaurant, transport, and wood cork paper.

**Table 4. Variable Description**

<b>Variables</b>	<b>Description</b>	<b>Data Source</b>
Dependent Variables		
Host country corruption (Host CPI)	Mean of a firm's host countries' CPI scores. I used Corruption Perception Index as a proxy to measure a firm's host countries social norms of corruption. CPI is on a scale of 1-10, where a low score indicates more corruption and a high score less corruption.	Transparency International's Corruption Perception Index (2013) <sup>18</sup>  Bureau van Dijk (BvD)'s Orbis database provides information of companies' subsidiary countries.
Performance (ROA)	Net income / Total Assets of a firm	Bureau van Dijk (BvD)'s Orbis database
Independent Variables		
Bribery	Dummy indicator equal to 1 if a firm is reported under Evidence of Illicit Payments in the IIC 2005 Report as either "A" (evidence of illicit payments based in whole or in part on actual payment data) or "P"(evidence based entirely on projected amounts)	IIC 2005 Report of OFFP
Home country corruption (Home CPI)	Transparency International's Corruption Perception Index as a proxy for social norms of corruption in a firm's home country. CPI is on a scale of 1-10, where a low score indicates more corruption and a high score less corruption.	Transparency International's Corruption Perception Index (2000) <sup>19</sup>
Control Variables		
Firm size	Natural log of total assets of a firm	Bureau van Dijk (BvD)'s Orbis database
Industry	Dummy indicator equal to 1 if a firm's main industry sector is in one of the four most corrupt industries identified in the OECD Annual Report 2014: extractive, construction, transportation and storage, and information and communication.	Bureau van Dijk (BvD)'s Orbis database
Contract value	Natural log of contract face value in the UN's Oil-for-Food Program.	IIC 2005 Report of OFFP

<sup>18</sup> I use TI's CPI score of 2013 for two reasons: first, it represents a firm's foreign invest location choices in about ten years after the ending of the OFFP program; second, it was a year most firms have reported data in Orbis. Countries' CPI scores vary little over years.

<sup>19</sup> Transparency International's Corruption Perceptions Index scored countries on a scale from 0 (highly corrupt) to 10 (very clean) until 2011, and from 0 (highly corrupt) to 100 (very clean) since 2012.

GDP per capita growth (home)	GDP per capita growth in home and host countries (annual %)	World Development Indicators database, World Bank (1960-2015)
GDP per capita growth (host)	GDP per capita growth in host countries (annual %). If a firm has more than one host countries, I use mean of their GDP per capita growth.	World Development Indicators database, World Bank (1960-2015) <sup>20</sup>
Geographic distance	Natural log of physical geographical distance between the capitals of a home and host countries. For firms with more than on host countries, I use the mean of their aggregate home-host distances.	Geographical information system (GIS) data
Clean home country (Home country with low corruption)	Dummy indicator equal to 1 if a firm's home country CPI is above the median of Home CPIs in my sample (6.7).	Transparency International's Corruption Perception Index (2000).
Dirty home country (Home country with high corruption)	Dummy indicator equal to 1 if a firm's home country CPI is below the median of Home CPIs in my sample (6.7).	Transparency International's Corruption Perception Index (2000).
Large firms	Dummy indicator equal to 1 if a firm's total assets are above 75% percentile of all firms' total assets in my sample.	Bureau van Dijk (BvD)'s Orbis database
Small firms	Dummy indicator equal to 1 if a firm's total assets are below 25% percentile of all firms' total assets in my sample.	Bureau van Dijk (BvD)'s Orbis database

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<sup>20</sup> The World Bank's World Development Indicators reports collection of development indicators for 214 economies over the period of 1960-2015, and includes national, regional and global estimates, compiled from officially-recognized international sources.

**Table 5a. Summary Statistics and Correlations of Total Firms in Location Regression**

VARIABLES	N	Mean	SD	Min	Max	1	2	3	4	5	6	7
1 HostCPI	219	57.99	13.62	25.33	85.00	1.000						
2 HomeCPI	219	6.02	1.98	2.10	10.00	-0.004	1.000					
3 Firm Bribery	219	0.70	0.46	0.00	1.00	-0.076	-0.155	1.000				
4 HomeCPI*Firm Bribery	219	4.06	3.16	0.00	10.00	-0.053	0.325	0.845	1.000			
5 Host GDP per capita growth	219	1.27	1.52	-5.71	5.57	-0.278	-0.116	-0.007	-0.051	1.000		
6 Geographic Distance	219	14.99	0.84	12.46	16.32	-0.046	-0.223	0.047	-0.057	0.434	1.000	
7 Industry dummy	219	0.03	0.16	0.00	1.00	0.075	-0.119	0.049	0.002	0.078	-0.043	1.000

**Table 5b. Summary Statistics and Correlations of Total Firms in Location Regression (Clean countries)**

VARIABLES	N	Mean	SD	Min	Max	1	2	3	4	5	6	7
1 HostCPI	67.00	58.51	12.97	28.00	78.00	1.00						
2 HomeCPI	67.00	8.27	0.97	7.00	10.00	0.21	1.00					
3 Firm Bribery	67.00	0.67	0.47	0.00	1.00	0.04	-0.10	1.00				
4 HomeCPI*Firm Bribery	67.00	5.51	3.96	0.00	10.00	0.06	0.08	0.98	1.00			
5 Host GDP per capita growth	67.00	1.05	1.19	-1.79	3.54	-0.53	0.02	0.01	0.01	1.00		
6 Geographic Distance	67.00	14.87	0.92	13.03	16.12	-0.23	0.11	0.06	0.08	0.54	1.00	
7 Industry dummy	67.00	0.01	0.12	0.00	1.00	-0.21	-0.16	0.09	0.05	0.23	-0.18	1.00

**Table 5c. Summary Statistics and Correlations of Total Firms in Location Regression (Dirty countries)**

VARIABLES	N	Mean	SD	Min	Max	1	2	3	4	5	6	7
1 HostCPI	105	57.88	13.86	25.33	83.00	1.00						
2 HomeCPI	105	4.28	1.05	2.10	6.40	-0.18	1.00					
3 Firm Bribery	105	0.76	0.43	0.00	1.00	-0.21	-0.19	1.00				
4 HomeCPI*Firm Bribery	105	3.17	2.00	0.00	6.40	-0.29	0.22	0.89	1.00			
5 Host GDP per capita growth	105	1.49	1.68	-5.71	5.57	-0.15	0.00	-0.04	-0.02	1.00		
6 Geographic Distance	105	15.17	0.77	13.10	16.32	0.16	-0.36	0.01	-0.14	0.29	1.00	
7 Industry dummy	105	0.05	0.21	0.00	1.00	0.19	-0.03	0.02	0.04	0.03	-0.04	1.00

**Table 6a. Summary Statistics and Correlations of Total Sample in Performance Regression**

VARIABLES	N	Mean	SD	Min	Max	1	2	3	4	5	6	7	8
1 ROA	1740	5.63	8.53	-82.61	94.25	1.00							
2 Bribery	2210	0.70	0.46	0.00	1.00	0.01	1.00						
3 Contract value	2210	15.06	1.69	10.54	19.20	-0.02	0.22	1.00					
4 Size (logassets)	1787	12.59	2.34	3.92	19.47	0.15	0.05	0.28	1.00				
5 Host GDP per capita growth	2173	1.90	3.19	-15.15	33.03	0.01	0.00	0.03	0.04	1.00			
6 Home GDP per capita growth	2173	1.14	3.47	-15.15	13.60	0.07	0.13	0.09	0.22	0.29	1.00		
7 Industry	2210	0.02	0.15	0.00	1.00	-0.06	0.06	-0.01	-0.01	-0.02	0.01	1.00	
8 Home governance	2172	0.94	0.90	-1.09	2.55	0.13	-0.18	-0.04	-0.01	0.03	-0.30	-0.05	1.00

**Table 6b. Summary Statistics and Correlations of Small Firms in Performance Regression (Small <= 25th Percentile)**

VARIABLES	N	Mean	SD	Min	Max	1	2	3	4	5	6	7	8
1 ROA	433	3.37	9.58	-82.61	51.43	1.00							
2 Bribery	465	0.59	0.49	0.00	1.00	-0.04	1.00						
3 Contract value	465	14.42	1.45	11.27	17.69	-0.06	0.23	1.00					
4 Size (logassets)	465	9.87	0.77	3.92	10.81	0.34	0.03	0.11	1.00				
5 Host GDP per capita growth	462	1.82	3.50	-15.15	23.64	0.10	0.02	0.04	-0.04	1.00			
6 Home GDP per capita growth	462	0.22	2.41	-8.71	5.79	0.08	0.02	0.07	0.08	0.29	1.00		
7 Industry	465	0.00	0.07	0.00	1.00	-0.02	0.06	-0.08	0.06	-0.01	0.04	1.00	
8 Home governance	462	0.88	0.77	-0.29	2.55	0.16	-0.19	0.03	0.02	0.01	0.22	0.05	1.00

**Table 6c. Summary Statistics and Correlations of Large Firms in Performance Regression (Large >= 75th Percentile)**

VARIABLES	N	Mean	SD	Min	Max	1	2	3	4	5	6	7	8
1 ROA	441	6.69	8.15	-26.70	94.25	1.00							
2 Bribery	445	0.72	0.45	0.00	1.00	0.02	1.00						
3 Contract value	445	15.57	1.66	11.17	18.99	-0.06	0.20	1.00					
4 Size (logassets)	445	15.77	1.16	14.32	19.47	0.07	-0.07	0.12	1.00				
5 Host GDP per capita growth	434	2.06	2.38	-6.94	8.75	-0.03	0.05	0.11	0.05	1.00			
6 Home GDP per capita growth	434	2.05	3.68	-8.71	13.60	-0.04	0.16	0.04	-0.04	0.46	1.00		
7 Industry	445	0.02	0.15	0.00	1.00	-0.06	-0.04	0.07	-0.14	-0.06	0.10	1.00	
8 home governance	434	0.83	1.01	-1.09	2.55	0.14	-0.05	0.06	0.07	-0.01	-0.52	-0.15	1.00

**Table 7. Location choice (OSL regression on cross sectional data)**

VARIABLES	Host CPI	Host CPI	Host CPI	Host CPI	Host CPI	Host CPI	Host CPI	Host CPI	Host CPI
	Full sample			Clean home countries (CPI>6.7)			Dirty home countries (CPI<6.7)		
Home corruption	-0.0490 (0.462)	-0.141 (0.466)	-0.991 (0.905)	<b>2.806*</b> (1.419)	<b>2.890**</b> (1.431)	<b>6.029**</b> (2.578)	-1.371 (1.334)	-2.072 (1.319)	-0.381 (2.522)
Firm bribery		-2.698 (1.947)	-9.858 (6.822)		1.866 (2.908)	39.37 (25.88)		<b>-8.192***</b> (3.005)	1.968 (13.26)
Home corruption*Firm bribery			1.135 (1.036)			-4.491 (3.080)			-2.252 (2.861)
Host GDP per capita growth	-2.952*** (0.648)	-2.986*** (0.648)	-3.004*** (0.647)	-5.820*** (1.465)	-5.748*** (1.476)	-5.679*** (1.463)	-1.757** (0.816)	-1.793** (0.791)	-1.757** (0.794)
Geographic Distance	1.627 (1.199)	1.676 (1.197)	1.669 (1.197)	0.397 (1.888)	0.258 (1.909)	0.185 (1.893)	3.554* (1.910)	3.265* (1.855)	3.233* (1.859)
Industry dummy	8.685 (5.496)	8.961 (5.487)	8.698 (5.490)	-4.711 (12.34)	-5.573 (12.47)	-7.488 (12.43)	12.95** (6.095)	13.15** (5.908)	13.79** (5.975)
Constant	37.41** (18.47)	39.14** (18.47)	44.78** (19.17)	35.58 (29.02)	35.64 (29.16)	10.29 (33.72)	11.83 (31.27)	25.49 (30.72)	18.08 (32.19)
Observations	219	219	219	67	67	67	105	105	105
R-squared	0.095	0.103	0.108	0.328	0.332	0.355	0.121	0.182	0.187

Standard errors in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1



**Table 8. Performance (2-Stage Least Squared Regression Model)<sup>21</sup>**

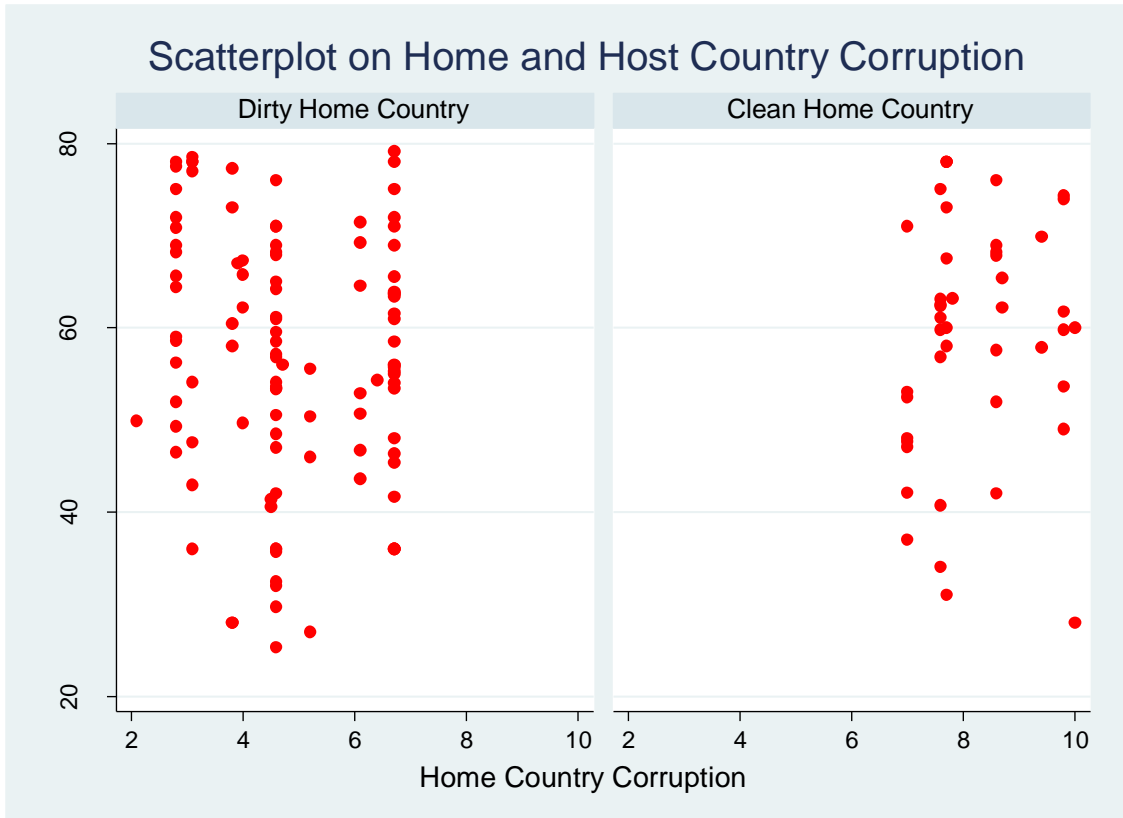
VARIABLES	(1)	(2)	(3)
	ROA Entire sample	ROA Small firms (<=25th percentile)	ROA Large firms (>75th percentile )
Firm Bribery	-8.013 (5.810)	-13.70 (9.167)	0.397 (6.722)
Size	1.128** (0.474)	6.914*** (2.033)	-0.462 (0.600)
Host GDP per capita growth	-0.00284 (0.106)	0.391** (0.186)	-0.146 (0.267)
Home GDP per capita growth	0.0303 (0.103)	-0.105 (0.304)	0.104 (0.174)
Industry	0.840 (2.464)		
Industry fixed effects	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes
Observations	1,720	430	430
Number of id	194	67	56

Robust standard errors in parentheses

\*\*\* p&lt;0.01, \*\* p&lt;0.05, \* p&lt;0.1

<sup>21</sup> Stata's xtivreg command suppresses the printing of an  $R^2$  on 2SLS if the  $R^2$  is negative. For explanations why the  $R^2$  has no statistical meaning in the context of 2SLS/IV, see <http://www.stata.com/support/faqs/statistics/two-stage-least-squares/>.

**Figure 1. Scatterplot on Home and Host Country Corruption**



## Chapter 2

### A CONTEXT-BASED STRATEGY TO COMBAT CORRUPTION

“They will beat their swords into plowshares and their spears into pruning hooks. Nation will not take up sword against nation, nor will they train for war anymore.”

(Isaiah 2: 4. Bible Old Testament)

#### I. Introduction

The opening vignette is an inscribed quotation from the Book of Isaiah on a granite staircase outside the United Nations headquarters in New York. It depicts a future of complete peace with no nations at war any more. The very location where this inscription is used implies the functions of the United Nations in bringing about such a future. But the inscription is incomplete. What is missing is the first half of the verse, “He will judge between the nations and will settle disputes for many peoples.”<sup>22</sup> The author of the Book of Isaiah was referring to the coming King of Israel, who is believed to reign over the world with His ultimate justice, a universal sovereignty to settle nations’ disputes and fulfill permanent peace. The omission in the quotation ironically suggests that the United Nations might not hold the universal authority of justice to bring forth peace in a world filled with different standards of justice.

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<sup>22</sup> Isaiah 2: 4. Old Testament.

The inadequacy of this quote is relevant to this paper. Just as global disarmament may not be fulfilled by an international organization without a universal standard of justice, can corruption be eradicated by any law or organizations without holding a universal normative standard? Professor Steven Salbu and Professor Philip Nichols' debate of more than a decade ago over extraterritorial application of anti-bribery laws has not become irrelevant but remains a thought-provoking starting point for ethics and legal scholars when examining the effectiveness of current anti-corruption efforts.

Multinational corporate counsels are still uncertain in applying the affirmative defense clause in the Foreign Corrupt Practices Act (FCPA) to justify their foreign dealings and avoid government agency's scrutiny. International and governmental collaborations are inspirational but not ground breaking. Corporations from OECD signatory countries publish their mission statements and governance policies to combat corruption, but news media constantly report new foreign bribery cases in the same group of companies.<sup>23</sup>

If extraterritorial legal restrictions, such as the U.S.'s Foreign Corrupt Practices Act (FCPA), or multilateral governmental conventions, such as Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials (the OECD Anti-Bribery Convention), are effective in fighting against corruption, we should see from an unbiased empirical research that firms from such signatory countries are significantly restrained from paying bribes, due to the putatively binding laws and rules. My empirical study shows a different story. Table 1 list all the home countries of participating firms in the United Nations' Oil-for-Food Program (OFFP) as well as the frequency and percentage of firms from each country that paid

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<sup>23</sup> Recent examples include widely published Siemens bribery scandals, Johnson & Johnson bribery scandals, and Wal-Mart bribery reports in Mexico.

bribes to the Iraqi government. The result reveals that some of the firms from the U.S. and other OECD countries were actively involved in making illicit payment to the Iraqi government while other firms from non-OECD signatory countries did not pay bribes when asked by the same government in the same program. This suggests that being a signatory country with extraterritorial restrictions on foreign bribery does not necessarily prevent its multinational corporations from foreign bribery in host countries with different corruption norms. Admittedly, this provides empirical evidence to the contrary of the claim that empirical experience supports the control of transnational bribery,<sup>24</sup> and affirms Salbu's warning that externally imposed anticorruption strategies may not be advisable. The root issue, however, goes deeper than empirical evidence and lies in whether governments shall play the role in effectively combating corruption. Nichols acknowledges that bribery and the control of bribery are not issues exclusively controlled by the U.S agenda.<sup>25</sup> Local community and corporations themselves play important roles in shaping corruption norms and should be emphasized in an effective anti-corruption strategy. Unfortunately, because of the lack of motivation or guidance in how to play such roles, most corporations implement their anti-corruption policies for the purpose of compliance to meet their governments' requirements and please their stakeholders.

The root of Professor Salbu's and Professor Nichols' debate lies in the question whether there is a universal standard to apply to combat corruption in different communities, given the universal normative grounding that corruption is a social vice and should be eradicated. Nichols believes that extraterritorial and multilateral prohibition of

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<sup>24</sup> Nichols, P.M. 1999. Are Extraterritorial Restrictions on Bribery a Viable and Desirable International Policy goal Under the Global Conditions of the Late Twentieth Century? Increasing Global Security by Controlling International Bribery, 20 *MICH. J. INTL L.* 451 (1999), 471.

<sup>25</sup> *Id.* at 453.

bribery is a logical approach to combat corruption globally since corruption is universally condemned. Salbu warns of the risk of cultural imperialism when activities within a community have to be evaluated by outsiders who may not fully appreciate the cultural context of the activities. Donaldson and Dunfee's Integrative Social Contracts Theory ("ISCT") gives moral argument against corruption that bribery violates the hypernorms of necessary social efficiency in undermining the fundamental right to political participation<sup>26</sup> and harming rational allocation of resources.<sup>27</sup> Fort and Noone (2000) extrapolate such argument beyond efficiency by focusing on a self-regulating mechanism -- the mediating institutions, where a community needs to be small enough for the community's interest to relate to individual business' interest and vice versa. The original question whether there is a universal standard to combat corruption globally remains.

This paper ties the Salbu-Nichols' debate, ISCT, mediating institutions theory, and Pelican Gambits strategy together to structure a context based anti-corruption framework. It builds on ISCT's authenticity and legitimacy principles to give context of the norms in order to apply various strategies to combat corruption. This paper is by no means to promote elimination of regulation of corruption or acquiescence of illegitimacy of corruption in international business. On the contrary, supported by results from my empirical research, the framework emphasizes the importance of the interactive dynamics between a community and firms when designing anti-corruption strategy in a global environment.

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<sup>26</sup> Donaldson T. and Dunfee, T.W. 1994. Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory. *The Academy of Management Review* Vol. 19, No. 2, pp. 252-284, 268.

<sup>27</sup> Donaldson T. and Dunfee, T.W. 1999. *Ties That Bind: A Social Contracts Approach to Business Ethics*. Boston: Harvard Business School Press, 228.

## II. The Foreign Corrupt Practices Act (FCPA), the Debate and Normative Justification for Corruption as a Legitimate Social Institution.

The Foreign Corrupt Practices Act<sup>28</sup>, first enacted in 1977 and then amended in 1988 and 1998, prohibits any bribes made *corruptly* by U.S. issuers, U.S. nationals or residents, or any persons acting on behalf of the U.S. issuers, domestic concerns or persons, inside or outside the United States to foreign officials to influence or induce any official act or decisions, for the purpose of securing any improper advantage, or obtaining, retaining or directing business.<sup>29</sup> The intent that is required for liability under FCPA is *willful* use of any means *corruptly* in furtherance of any offer, payment, promise to pay, any money or anything of value, with the *knowledge* that such money or thing of value will be offered to influence or induce a foreign official to do anything in violation of his or her lawful duty, to secure any improper advantage, or to assist obtaining or retaining business.<sup>30</sup>

Through its 1998 Amendment with the Congress' ratification of the OECD Anti-Bribery Convention, the FCPA's jurisdiction extends beyond the territory of the U.S. to "allow greater enforcement efforts by U.S. prosecutors."<sup>31</sup> Now the FCPA applies not only to the U.S. nationals or residence or companies within the US borders, but also anyone acting on behalf of a U.S. issuers or companies, even if they are outside the U.S. or are foreign nationals.<sup>32</sup> By expanding the scope of persons covered by the FCPA, the

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<sup>28</sup> The Foreign Corrupt Practices Act of 1977, as amended, and the International Anti-Bribery and fair Competition Act of 1998, 15 U.S.C. §§ 78dd-1 to 78dd-3, 78ff ("FCPA").

<sup>29</sup> 15 U.S.C. §§ 78dd-1 to 78dd-3, 78ff

<sup>30</sup> *Id.* See also Department of Justice's Overview of FCPA at <https://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act>.

<sup>31</sup> Bixby, M. The Lion Awakens: The Foreign Corrupt Practices Act – 1977 to 2010, 12 *San Diego Int'l L.J.* 89, 93 (2010), at 100. ; Crites, D.M., The Foreign Corrupt Practices Act at Thirty-Five: A Practitioner's Guide, 73 *Ohio St. L.J.* 5, 1049 (2012).

<sup>32</sup> 15 U.S.C. §78ff(c)

U.S. is allowed to battle against corruption in foreign business practices.<sup>33</sup> The ethical question is whether it is appropriate for the U.S. to legislate over and regulate foreign business practices that involve foreign norms and cultures.

The great debate between Steven Salbu's<sup>34</sup> and Philip Nichols<sup>35</sup> centered on two ethical issues: whether corruption can be culturally justified and, if so, whether extraterritorial legal restriction of bribery imposes moral intrusion upon members of a society that holds different values from that of the U.S. and western cultures. The later issue suggests the danger of cultural imperialism.<sup>36</sup>

Before addressing the “desirability and viability of extraterritorial prohibition of transnational bribery as an international policy goal,”<sup>37</sup> it is important to define what counts as corruption. Corruption has been studied by scholars from a variety of disciplines. Economic studies focus on the effect of corruption on competition<sup>38</sup> and resource allocation.<sup>39</sup> Management and finance literature look at corruption from a principal-agent model: focus on relationship between the principal, i.e., the government, and the agent, i.e., an official, examining the way of motivating the agent to be honest,

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<sup>33</sup> *Supra* note 31, at 100.

<sup>34</sup> Salbu, S. R. 1999. Extraterritorial Restriction of Bribery: A Premature Evocation of the Normative Global Village, 24 *YALE J. INT'L L.* 223 (1999). *See also*, Salbu, S. R. 2001. Transnational Bribery: The Big Questions. 21 *NW. J. INT'L L. & BUS.* 435 (2001). *See also* Salbu, S. R. The Foreign Corrupt Practices Act as a Threat to Global Harmony, 20 *MICH. J. INT'L L.* 419, 433 (1999);

<sup>35</sup> *Supra* note 24. *See also* Nichols, P.M. 1999, Regulating Transnational Bribery in Times of Globalization and Fragmentation, 24 *Yale J. Int'l L.* 257, 258 (1999). *See also* Nichols, P.M. 2000. The Myth of Anti-Bribery Laws as Transnational Intrusion, 33 *Cornell Int'l L.J.* 627 (2000).

<sup>36</sup> Wolf, S. and Schmidt-Pfister, D. 2010. *Between Corruption, Integration, and Culture: The Politics of International Anti-Corruption*, page 17. A chapter published in Sebastian Wolf, Diana Schmidt-Pfister (2010) *International Anti-corruption in Europe : between Corruption, Integration, and Culture*, Baden-Baden : Nomos, pages 13-21. Retrieved March 31, 2015 from [http://www.nomos-shop.de/assets/downloads/9783832958466\\_lese01.pdf](http://www.nomos-shop.de/assets/downloads/9783832958466_lese01.pdf)

<sup>37</sup> *Supra* note 24, at 453.

<sup>38</sup> Sun, L. and Peng, L. 2011. Game Theory Analysis of the Bribery Behavior. *International Journal of Business and Social Science*, Vol. 2 No. 8, pp104-107.

<sup>39</sup> Frye, T. and Shleifer, A. 1997. The Invisible Hand and the Grabbing Hand. *The American Economic Review*, Vol. 87, No. 2, Papers and Proceedings of the Hundred and Fourth Annual Meeting of the American Economic Association (May, 1997), pp. 354-358.



ranging from efficiency wages<sup>40</sup> to enhancing corporate governance values<sup>41</sup>. Strategy and international business scholars look at corruption from the perspective of institutional theory and resource-based view.<sup>42</sup> Ethicists propose normative moral arguments or “metaphors” against bribery, such as the deontological, consequentialist, teleological, non-teleological, pluralistic, and relativism approaches.<sup>43</sup>

Table 2 here gives a list of definitions of corruption in the literature. The fact that there is not a universal definition of bribery across different disciplines or even within one discipline suggests the culturally contextualized nature of corruption. As Wolf & Schmidt-Pfister (2010) put it, evaluating international anti-corruption regimes requires scholars to understand how corruption is manifested and interpreted in different cultural contexts, because corruption may be “a culturally determined, thus more or less justified practice in one country or another.”<sup>44</sup> The ubiquitous nature of corruption requires me to set boundaries of its concept before I can examine potential strategy to combat it.

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<sup>40</sup> Shleifer, A. & Vishny, R.W. (1993). Corruption. 108 *The Quarterly Journal of Economics* 3, 599-617. See also Jensen, M & Meckling, W. (1976) Theory of the firm: Managerial behavior, agency costs and ownership structure. 3 *Journal of Financial Economics* 4, 305-360.

<sup>41</sup> Daniel J. McCarthy and Sheila M. Puffer (2008), Interpreting the Ethicality of Corporate Governance Decisions in Russia: Utilizing Integrative Social Contracts Theory to Evaluate the Relevance of Agency Theory Norms, 33 *The Academy of Management Review* 1, 11-31.

<sup>42</sup> Cuervo-Cazurra, A. & Genc, M. 2008. Transforming disadvantages into advantages: developing-country MNEs in the least developed countries? *Journal of International Business Studies* 39, 957-979. See also, Cuervo-Cazurra, A. 2006. Who cares about corruption? *Journal of International Business Studies* 37, 807-822. See also Cuervo-Cazurra, A. 2011. Global strategy and global business Environment: the direct and indirect influences of the home country on a firm’s global strategy. *Global Strategy Journal* 1: 382-386.

<sup>43</sup> T.W., Smith, N.C. and Ross, W.T. 1999. Social Contracts and Marketing Ethics, *Journal of Marketing*, 63(July): 14-32, page 15; See also Donaldson T. and Dunfee, T.W. 1994. Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory. *The Academy of Management Review* Vol. 19, No. 2, pp. 252-284; Donaldson T. and Dunfee, T.W. 1999. *Ties That Bind: A Social Contracts Approach to Business Ethics*. Boston: Harvard Business School Press; Dunfee, Hess, D & Dunfee, D (2000) Fighting Corruption: A Principled Approach: The C Principles (Combating Corruption), 33 *Cornell International Law Journal* 3, 593-626.

<sup>44</sup> Wolf, S. and Schmidt-Pfister, D. 2010. Between Corruption, Integration, and Culture: The Politics of International Anti-Corruption. A chapter published in Sebastian Wolf, Diana.

**Table 2. A Comprehensive List of Definitions of Corruption and Bribery**

Corruption/ Bribery	Definition	Source	Focus
Corruption	Behavior which deviates from the formal duties of a public role because of private-regarding (personal, close family, private clique pecuniary or status gains); or violates rules against the exercise of certain types of private –regarding influence.	Nye (1967), at 419.	Both public and private sectors
Corruption	The abuse of public office for private gain.	The World Bank <sup>45</sup>	Public sectors
Corruption	An illegal payment to a public agent to obtain a benefit.	Rose-Ackerman (2009), at 353.	Public sectors
Corruption	The sale by government officials of government property for personal gain	Shleifer and Vishny (1993), at 599.	Public sectors
Corruption	The abuse of entrusted power for private gain.	Transparency International <sup>46</sup>	Both public and private sectors
Corruption	The use or abuse of public office for private gain.	Nichols (2004), at 1308, citing Bagley (1966, page 720), which defines corruption as the “misuse of authority as a result of considerations of personal gain, which need not be monetary.”	Public sectors

<sup>45</sup> Source: <http://www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm>

<sup>46</sup> Source: [https://www.transparency.org/whoIare/organisation/faqs\\_on\\_corruption/2/](https://www.transparency.org/whoIare/organisation/faqs_on_corruption/2/)

Bribery	Offering, promising, giving, accepting or solicitation of an advantage as an inducement for an action which is illegal, unethical or a breach of trust. Inducement can take the form of gifts, loans, fees, rewards or other advantages (taxes, services, donations, etc.).	Transparency International <sup>47</sup>	Both public and private sectors
Bribery	Transaction in which an official misuses his/her office “as a result of considerations of personal gain, which need not be monetary.”	Nichols (1999), at 258, citing Bagley (1966).	Public sectors
Bribery	Bribery occurs when one person (the briber) provides an inducement to another person (the bribe) that is intended to be in exchange for the bribe doing, or not doing, something that would favor the briber and be contrary to the bribee’s positional duty.	Dunfee, Smith and Ross (1999), at 22.	Including private sector commercial transactions (a wider notion of bribery)
Bribery	To corruptly offer, promise or give...anything of value...directly or indirectly, to any non-US government official or official of an international organization...to influence official acts, obtain or retain business, or secure any other improper advantage.	The Foreign Corrupt Practices Act of the United States of America, 15 U.S.C. §§ 78dd-1, 15 U.S.C. §§ 78dd-2 (1998).	Public sectors
Coarse Bribery	The promise or payment of a benefit that induces a public official to breach a duty pertaining to a significant community interest.	Hess & Dunfee (2000)	Public sectors

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<sup>47</sup> The Anti-Corruption Plain Language Guide.  
[http://issuu.com/transparencyinternational/docs/ti\\_plain\\_language\\_guide?e=2496456/2028282](http://issuu.com/transparencyinternational/docs/ti_plain_language_guide?e=2496456/2028282)

## 1. Definition of corruption/Bribery

The term “corruption” and “bribery” have been used interchangeably in the literature. Definitions in Table 2 give some guidance: corruption is a generic term that describes the abusive nature of using one’s entrusted position for private gain, whereas bribery describes the specific occurrence that involves at least two parties in a *quid pro quo* transaction. Because the nature of an abuse of an entrusted position for one’s private gain does not necessarily involve more than one party, bribery is a specific form, rather than a substitute, of the term “corruption.” As the World Bank explains it, “bribes are one of the main tools of corruption.”<sup>48</sup> For example, embezzlement is a form of abuse of one’s entrusted assets for private gains and extortion is a form of abuse of one’s entrusted position for private gains through coercion. The former does not require two or more parties, and the latter does not require *quid pro quo* conditions. Both are forms of corruption, but neither is bribery.

For the purpose of my research in a multinational context, I focus on the abuse of position of foreign public officials. To be specific, I borrow the World Bank’s definition and adjust it with the intent requirement by the FCPA for my research in defining corruption as a *willful* abuse of *foreign* entrusted power for private gain.<sup>49</sup> I choose to use the World Bank’s working definition because it is “concise and broad enough to include most forms” and “places the public sector at the center of the phenomenon.”<sup>50</sup> Adding in

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<sup>48</sup> *Helping Countries Combat Corruption: The Role of the World Bank* at the World Bank webpage: <http://www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm>

<sup>49</sup> Bribery can occur with respect to both a public and private official. The focus of this paper is on public bribery, so is my proposed definition. For discussion of defining bribery in both public and private sectors, see *supra* note 43, at 22.

<sup>50</sup> *Super* note 45.

the mental status requirement by FCPA is to recognize the importance of motives<sup>51</sup> in assessing corrupt behaviors.

## 2. Normative Justification of Corruption as a Social Institution

Can it be ethical to pay a bribe? Salbu (2001) raises the “big questions”<sup>52</sup> whether local and international laws should recognize culturally justified bribes and thereby, exempt “good-faith behaviors that can be morally justified.”<sup>53</sup> According to Salbu, a good-faith exemption would not undermine the spirit of anti-bribery laws, which target only bad-faith behaviors.<sup>54</sup> What underlies Salbu’s argument is that the current extraterritorial anti-corruption laws have not been effective in acknowledging and assessing the difference between coarse corruption and legitimate social practice with circumstantial evidence and in the local context where bribes are paid. To be specific, Salbu suggests ethical justifications from deontological, consequentialist, and social contract viewpoints.

A deontological approach looks at whether one’s moral duty has been violated by paying bribes, under all three of Immanuel Kant’s categorical imperatives. If paying bribes cannot become a universalized business practice without causing a self-defeating economic system by everyone acting on that, then it is immoral to pay bribes.<sup>55</sup> Salbu, however, by providing a hypothetical dilemma, suggests under certain circumstances, paying a bribe can serve a higher moral duty that justifies the bribes. The hypothetical

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<sup>51</sup> Salbu, S. R. 1999. Extraterritorial Restriction of Bribery: A Premature Evocation of the Normative Global Village, 24 *YALE J. INT’L L.* 223 (1999), 240-251.

<sup>52</sup> Salbu, S. 2001. Transnational Bribery: The Big Questions. 21 *NW. J.INT’L L. & BUS.* 435, page 437. Salbu raised four big questions in this paper.

<sup>53</sup> *Id.* at 448.

<sup>54</sup> *Id.* at 449.

<sup>55</sup> Bowie, N. (2008) “A Kantian Approach to Business Ethics” in Donaldson & Werhane, *Ethical Issues in Business: A Philosophical Approach* (8th ed.), Pearson Publication, 56-66.

case Salbu used, at the time thought of as unrealistic from business perspective by scholars,<sup>56</sup> suggests that bribes can be made by good-faith businesses to entrenched authorities in a politically motivated famine in order to donate food to the people and provide necessities to meet their basic needs.<sup>57</sup> Four years after Salbu's article, the United Nations (UN) published an independent investigation report on the illicit bribe payments made in connection with humanitarian contracts in OFFP by firms from all over the world to the Saddam Hussein regime in Iraq. The report, which is called "the Independent Inquiry Committee into The United Nations Oil-for-Food Program. Report on Program Manipulation. October 27, 2005" (the IIC 2005 Report),<sup>58</sup> discloses that 3,614 companies sold \$34.5 billion of humanitarian goods to Iraq, among which were humanitarian kickbacks totaling more than \$1.5 billion by 2,253 companies.<sup>59</sup> Although the intention of each firm which paid the kickbacks was hard to assess, from the fact that many firms that paid bribes were from the least corrupt countries in the world suggests that Salbu's hypothetical dilemma can be realistic in the business world as long as authoritarian governments still exist. If an American company had a bona-fide intention to fulfill their moral duty to provide necessities to the trapped Iraqi people, then under the deontological ethical decision-making model, their compliance to the Iraqi government's bribery request is justified.

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<sup>56</sup> Dunfee, T.W. and Hess, D. 2001. Getting from Salbu to the "Tipping Point" The Role of Corporate Action Within a Portfolio of Anti-Corruption Strategies, 21 *NW. J.INT'L L. & BUS.* 471 (2001), 487.

<sup>57</sup> *Supra* note 52, at 439.

<sup>58</sup> The Independent Inquiry Committee into The United Nations Oil-for-Food Program. Report on Program Manipulation. October 27, 2005 ("the IIC 2005 Report").

<sup>59</sup> *Id.*, Chapter 1, page 1.

A similar justification under the deontological approach that Salbu suggests is when one has no control in a corrupt system where bribery has been institutionalized.<sup>60</sup> The payment is made more to comply with one's duty to follow the rule in a crooked system for survival than to manipulate or abuse a legitimate process for one's own interest at the sacrifice of others.

In applying the consequentialist analysis to bribes, Salbu suggests that if a one-instance of bribery can pass the balanced test to "maximize net social utility," it may be ethically justified. Although he admits that it is difficult to do actual net effect analysis out of a hypothetical situation,<sup>61</sup> if we see "a plausible scenario under which the benefits of making a particular payment outweigh the costs," the bribe-payment can be justified. In the case of kickback payment in the OFFP, if the cost saved to the lives of the Iraqi civilian by the bribing firm with their humanitarian goods imported yields greater net social utility than not paying bribes, then such bribes are justified under a utilitarian point of view. Although my empirical result suggests that firms with the bribery experience in the OFFP are found to be more likely to invest in relatively corrupt countries ten years later, which may provide evidence of negative ripple effects in a real business case, in general, my empirical result do not show any significant relationship between the one-time bribery payment and firms' long-term performance or foreign investment location strategies among firms from clean countries.

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<sup>60</sup> *Supra* note 52, at 445 (using the classical case of a U.S. manager facing the dilemma of either hiring a *commercialista* to pay tax kickbacks in Italy or causing big financial loss to his company and losing his job.)

<sup>61</sup> *Id.*, at 443.

Salbu's third moral justification is through the social contract approach. Culturally different expectations may justify bribe-payment.<sup>62</sup> Although the FCPA provides one exception<sup>63</sup> and two affirmative defenses<sup>64</sup> to bribe payments, such exception and defenses are mostly deficient to provide clear guidance when managers face ethical dilemmas.<sup>65</sup> The most discussed example of this kind of dilemma is gift. A gift can be given as an expression of gratitude, loyalty, or for trust-building, or to send a message of caretaking in different cultural contexts.<sup>66</sup> A banquet of over \$1,000 U.S. dollars with government officials is a common (or even below-par) business practice in China when a new business introduces itself to the market, though it would be highly likely a bribery case in the U.S. The Confucius culture of paternalism that has lasted over thousands of years has a great influence on such business practice in China, because local authorities are regarded as the parents of business within its political jurisdiction. The banquet is not given necessarily to abuse the government official's power, but for the business to show respect to the authorities.

Philip Nichols, on the other hand, rejects the claim that extraterritorial anti-bribery laws constitutes cultural intrusion and posits that extraterritorial anti-bribery laws are viable "multinational and unilateral efforts to combat corruption."<sup>67</sup> Nichols' two main reasons are: first, bribery is universally condemned<sup>68</sup>; and second, there is nothing wrong for a home country to criminalize transnational bribery by its own citizens.<sup>69</sup> In

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<sup>62</sup> *Id.*, at 446.

<sup>63</sup> The "routine governmental action" exception to FCPA, 15 U.S.C. §§ 78dd-1(b), 78dd-2(b), and 78dd-3(b).

<sup>64</sup> 15 U.S.C. §§ 78dd-1(c), 78dd-2(c), and 78dd-3(c). Under the affirmative defense of FCPA, if a payment is legal under the written law and regulations in the country where the bribes are paid, or is considered "reasonable and bona fide expenditures," the payment maker is not liable for the bribe paid.

<sup>65</sup> *Supra* note 52, at 451.

<sup>66</sup> *Supra* note 51, at 232-240.

<sup>67</sup> Nichols, P.M. 2000. The Myth of Anti-Bribery Laws as Transnational Intrusion, 33 *Cornell Int'l L.J.* 627, at 655.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*



addition, Nichols sees the FCPA as “Bright Line Rules,”<sup>70</sup> and describes the effect of the law as “has significantly shaped the behavior of U.S. companies.”<sup>71</sup> Per Nichols, whether a business practice would be considered bribery in the host country depends on the local law.<sup>72</sup> If that is the case, dining at a luxury restaurant with Chinese government officials would not be bribery if it is legal according to the Chinese law. This interpretation is not adequate for two reasons. First, the FCPA criminalizes any actions that “corruptly offer, promise or give . . . anything of value . . . directly or indirectly, to any non-US government official or official of an international organization . . . to influence official acts, obtain or retain business, or secure any other improper advantage . . .”<sup>73</sup> Admittedly, the FCPA gives affirmative defense that allows for what is legal in the law of the host country. This defense, however, is almost practically impossible for business managers to prove, because most laws stipulate what is prohibited rather than what is legal. This is as futile as trying to prove the null hypothesis in statistical science. Second, the FCPA does apply not only to U.S. nationals, but any U.S. issuing companies and anyone working as an agent to the U.S. companies.<sup>74</sup> If a business cannot use the affirmative defense, this leaves the U.S. court to be in the position to assess whether a foreign national, outside the territory of the U.S., has corruptly paid bribes based on the U.S. courts’ understanding of what a foreign national’s local culture is. This is what makes the viability of an extraterritorial law questionable.

Both Salbu and Nichols agree that bribery is universally disapproved. Both of them agree that bribery should be prohibited. But what they do not agree on is the

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<sup>70</sup> *Id.*, at 641.

<sup>71</sup> *Id.*, at 642.

<sup>72</sup> *Supra* note 24, at 472.

<sup>73</sup> *Supra* note 28.

<sup>74</sup> *Id.*

viability of extraterritorial application of anti-bribery laws in culturally differentiated contexts. Salbu's concern of cultural sensitivity in different communities and Nichol's confidence of the viability of application of the U.S. law illustrate the *norm-taking*<sup>75</sup> problem in fighting against corruption that Donaldson and Dunfee try to resolve through their Integrated Social Contract Theory (ISCT).

### III. ISCT Framework

To fight against corruption in an international context, one ought to address the conflicts between home- and host-country's conflicts in ethical norms.<sup>76</sup> Donaldson & Dunfee (1994, 1999) attribute such conflicts to bounded moral rationality.<sup>77</sup> They provide a "communitarian-based theoretical framework setting forth a process for making certain normative judgments in business ethics," named Integrated Social Contract Theory ("ISCT").<sup>78</sup> Donaldson & Dunfee put the "ought" and "is"<sup>79</sup> in their ISCT framework: a "normative and hypothetical contract"<sup>80</sup> among all economic participants (macrosocial contracts), and an "existing implicit"<sup>81</sup> contract among members of specific communities (microsocial contracts).<sup>82</sup> ISCT emphasizes the role of communities in generating moral norms. For a community's norm to be authentic and legitimate, it has to meet the following three key principles under ISCT:

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<sup>75</sup> The term "norm-taking" was first introduced by de los Reyes, G., Scholz, M., & Smith, N.S. in *Beyond the "Win-Win": Creating Shared Value Requires Ethical Frameworks* (working paper, draft of April 21, 2016). They define *norm-taking* as a framework that helps a manager identify legitimate non-legal norms to follow, and *norm-making* as a framework of firms' taking the initiatives in making norms when there is a regulatory void to fill.

<sup>76</sup> *Supra* note 27, at 215.

<sup>77</sup> *Id.*, at 29.

<sup>78</sup> *Supra* note 26, at 272.

<sup>79</sup> *Id.* at 254.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

1. Moral Free Space. ISCT recognize that local economic communities may specify ethical norms for their members.<sup>83</sup> An example of such a norm created in the moral free space would be the “grease” affirmative defense given in the FCPA, which is a microsocial contract accepted among the U.S. legislative and business community, but not their British counterpart.
2. Microsocial contracts must be entered by participants with informed consent and a right of exit,<sup>84</sup> and
3. A microsocial norm must be compatible with hypernorms.<sup>85</sup>

ISCT also suggests six priority rules as a procedural, though not precise, principle when managers need to deal with conflicts among community norms.<sup>86</sup>

The relevance of ISCT for global anti-bribery ethics is meaningful. Research like Salbu and Nichol’s debate on the legitimacy of certain bribing activities in a multinational context and the viability of extraterritorial laws and regulations “provide a basis for application of ISCT by identifying authentic norms for different international communities.”<sup>87</sup> The application of hypernorms can help identify legitimate from illegitimate norms in paying bribes. Application of priority rules helps prioritize different authentic norms in a global context.

Though ISCT framework can be beneficial to business managers in making ethical business decisions, applying ISCT also poses challenges in global anti-bribery ethics. First, the boundaries of community are not consistently defined in ISCT.

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<sup>83</sup> *Id.*, at 262.

<sup>84</sup> *Id.*

<sup>85</sup> *Supra* note 26, at 267 (Donaldson and Dunfee left it open as to what constitutes a hypernorm; they used core human rights and obligation to respect the dignity of others as examples of hypernorms).

<sup>86</sup> *Id.*, at 269.

<sup>87</sup> *Id.*, at 277.

Donaldson & Dunfee acknowledge that making ethical decisions based on authentic norm needs “identification and specification of ethical norms at the community level,”<sup>88</sup> and “selection of the communities most relevant to a particular normative judgment is critically important and will influence the types of authentic norms that are recognized.”<sup>89</sup> But the definition of community in the ISCT framework is so open-ended that it makes identification and specification of communities difficult. A community in ISCT is defined as “a self-defined, self-circumscribed group of people who interact in the context of shared tasks, values, or goals and who are capable of establishing norms of ethical behavior for themselves.”<sup>90</sup> The defining characteristic of a community is “the ability of a given set of persons having some form of association with one another to generate authentic norms.”<sup>91</sup> The communities can be horizontally and vertically related to each other.<sup>92</sup> On the one hand, the definition calls for loose boundaries of community: a society with both formal and informal structures of norms should be included; it can be as broad as a nation or the European Union or as narrow and informal as people who gather together at the water cooler.<sup>93</sup> On the other hand, the examples the authors use (firms, corporations, bar associations, etc.) in elaborating the selection of communities are very narrow. They seem to suggest that a community should be small enough and formal for members of the community to be able to make authentic norms. These loose and narrow uses of the concept of community may cause inconsistency for managers to identify and specify communities for them to apply ISCT.

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<sup>88</sup> *Id.*, at 272.

<sup>89</sup> *Id.*, at 274.

<sup>90</sup> *Supra* note 27, at 39, 98; *Supra* note 26, at 273.

<sup>91</sup> *Id.*, at 101.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*, at 100.

What is more confusing is the assumption the authors made that priority of norms should be given to bigger community when there is a conflict of norms. The “loose and flexible definition” of community used in ISCT implies that “individuals may simultaneously be members of lots of different communities.”<sup>94</sup> One of the priority principles Donaldson & Dunfee suggest as rules of thumb in case of conflicts among norms is that, “the more extensive or more global the community which is the source of the norm, the greater the priority which should be given to the norm.”<sup>95</sup> In the case of gift-giving, this principle means, even if a small business community has a legitimate and authentic norm to give annual thanks-giving dinner to government officials to express gratitude, as long as the norm conflicts with the norms of some other bigger community, for example, the United Kingdom or other signatory countries to the OECD Anti-bribery Convention which do not require “corrupt intent” in relation to foreign bribery, the small business community should refrain from their gratitude expressing practice. In the context of the efficiency hypernorm, where there is a conflict between a smaller community and a bigger community in the pursuit of economic welfare, Donaldson & Dunfee suggest that the smaller community should succumb to the interest of the bigger community for the pursuit of aggregate economic welfare, because “a business person is well advised to choose what is best for the country, not what is best for the private interest of a small group of citizens.”<sup>96</sup> It is not clear why such an assumption is valid. If “aggregate” economic welfare is the only reason, then that means smaller community will always lose on this account. Why should the norms of a community of a bigger size

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<sup>94</sup> *Id.*, at 101.

<sup>95</sup> *Supra* note 26, at 269.

<sup>96</sup> *Supra* note 27, at 137.

override the norms of a smaller community, assuming they both follow authenticity and legitimacy? The answer is not clear in ISCT.

The biggest challenge in applying ISCT to combat corruption in a multinational context is that the framework fails to recognize the dynamic relationships between business and communities in shaping norms more than merely identifying and following extant norms. This is especially true when a multinational firm faces conflicting norms that are either illegitimate or unauthentic or both. Under ISCT framework, if a U.S. firm is approached to pay commonly-practiced coarse bribes in a host country, it is expected to say no to the norm, but ISCT seems to stop there and says nothing about what the business could do and should do before and after saying “no.” ISCT seems to assume that managers will be able to get a right answer and actually act on the right answer as long as they perform a procedural check of the authenticity and legitimacy of a norm, where the “is” and “ought” will be in harmony as Donaldson & Dunfee suggests.<sup>97</sup> The reality is that a right answer is not always available and businesses often fail to do what they ought to do. The *ought* and *is* are still in tension with each other in combating corruption globally, as long as the following three challenges are not dealt with: the nature of corruption, the nature of human behavior, and the hazy of community. I will discuss the three challenges in details in Section IV before suggesting anti-corruption strategies to deal with each challenge.

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<sup>97</sup> *Id.*, at 24.

#### IV. The Challenge of Combating Corruption Globally

The OECD Anti-Bribery Convention establishes legally binding standards to criminalize bribery of foreign public officials.<sup>98</sup> OECD signatory countries signed the Convention in 1997. All countries party to the Convention commit themselves to ensuring that their national parliaments pass legislation necessary for its ratification and implementation into national law,<sup>99</sup> and thereby criminalize bribery of foreign public officials.

Given the current curiosity about the effectiveness of such multinational organizations' efforts to combat corruption, I employed a statistical test to examine if there is any association between a country's commitment to and ratification of the Convention and their firms' foreign bribery. The empirical test result in Table 3a supports a significant association. The propensity to bribe in the UN Oil-for-Food Program drops from 67% for firms from non-OECD countries to 45% for firm from OECD countries. However, 45% of the firms from OECD countries still paid foreign bribes when asked for illicit kickbacks, irrespective of the deterrence and commitment given by their home countries' efforts. Table 3b also shows that almost half of the firms (48.49%) from countries with relatively less domestic corruption paid foreign bribes in the OFFP.

Hess & Dunfee (2000) called this kind of perplexing inconsistency in country- and firm- behavior *the paradox of corruption*: “corruption is widely condemned yet widely practiced.”<sup>100</sup> The authors attributed the problem to the reasons of “competitive

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<sup>98</sup> OECD Anti-Bribery Convention webpage: <http://www.oecd.org/corruption/oecdantibriberyconvention.htm>

<sup>99</sup> “OECD Anti-Bribery Convention: Entry into Force of the Convention” <http://www.oecd.org/daf/anti-bribery/oecdanti-briberyconventionentryintoforceoftheconvention.htm>

<sup>100</sup> Hess, D. and Dunfee, T. W. 2000. Fighting Corruption: A Principled Approach The C<sup>2</sup> Principles (Combating Corruption), 33 *Cornell J. Int'l L.* 593, at 594, 595-596.

necessity, respect for local cultural norms, extortion, and inability or unwillingness to control rogue employees.”<sup>101</sup> Effective combating corruption requires an understanding of the challenges this *paradox* presents.

## 1. The nature of corruption

Game theory studies strategic interaction. It can be used to study economic behavior and political negotiation,<sup>102</sup> and has also been used by business ethicists in their examination of the cause and solutions to corruption.<sup>103</sup> Corruption is compared to the prisoner’s dilemma in that it presents business actors with an assurance problem:<sup>104</sup> business actors are better off if they cooperate with each other, but due to the uncertainty that they cannot monitor each other, in the event of someone defecting, other actors are better off if they defect as well than they would be if they continued to comply with the rules.<sup>105</sup> The assurance problem explains why firms defect in paying bribery in a foreign country: when firms cannot monitor other firms’ behavior, they can be better off by engaging in bribery for short-term gain than losing competitive advantage by complying with the laws.

Game theorists suggest that coordination by other players can be reached through one’s leading by committing themselves to a particular choice. Other players will observe the leading choice and respond accordingly.<sup>106</sup> When players have uncertainty of how other players will behave, they may take the advantage of the leading player’s

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<sup>101</sup> *Id.*, at 594.

<sup>102</sup> Varian, H.R. 2010. *Intermediate Microeconomics: a Modern Approach* (8th ed.), W.W. Norton & Company, at 512.

<sup>103</sup> See Nichols, Philip M. 2004. Corruption as an Assurance Problem. *American University International Law Review* 19, no. 6: 1307-1349; Nichols, Philip M. 2009. Multiple communities and controlling corruption. *Journal of Business Ethics* 88.4: 805-813; Nichols, Philip M. 2012. The business case for complying with bribery laws. *American Business Law Journal* 49.2: 325-368.

<sup>104</sup> See Nichols 2004.

<sup>105</sup> Nichols 2009, at 805.

<sup>106</sup> *Supra* note 102, at 545-46.



commitment to not defect and defect instead to be better off. The solution is to try to set the game with infinite repetition and contracting.<sup>107</sup> In a repeated game, each party has the opportunity to establish a reputation for cooperation, and encourage other players to do the same.<sup>108</sup> The defecting party will be punished for not cooperating in the next round of the game or by contract.<sup>109</sup> Players cooperate for the advantage that cooperation will induce further cooperation in the future. Ways to achieve cooperation are for one of the players to move first to give assurance, or by opening itself to inspection for transparency purpose.<sup>110</sup> This sends strong signals that they are willing to cooperate with others and taking accountability for their actions.

This has great implications for strategies to combat corruption in a multinational context. Corruption signifies interactive irrationality<sup>111</sup> in uncertain circumstances. Firms face uncertainty when they cannot monitor how their local competitors behave in a foreign country and choose to defect for better payoff. Mere compliance with authentic norm in an ISCT framework is not sufficient to solve the problem. Mechanisms need to be developed that enable cooperation among firms and the communities. Payoffs are highest when they cooperate with each other: when firms have good reasons to predict other firms' behavior and their support for not paying bribes, coordination is effective. When such guarantee of coordination is lacking, the best strategy is for firms and countries to enter into contracts that will penalize bribery. OECE's anti-bribery Convention is a form of such contract, binding firms through their home countries' legal commitment to sanction against foreign bribery. The contract strategy against bribery is

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<sup>107</sup> *Id.*, at 546.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*, at 542-546

<sup>111</sup> Discussion of personal irrationality in Section IV.2 *infra*.

not effective, however, in countries where the legal enforcement is weak or where firm behavior is difficult to monitor.

It is also important to notice the policy implication here for a strategy to be effective. Because of the nature of corruption lies in secrecy and uncertainty, it is critical in how firms see themselves in the long term. If their purpose to have business is only for short-term gain, it is more likely for firms to bribe abroad when uncertainty and payoffs are both high. But if firms are encouraged and supported for long-term growth, they can look beyond short-term payoffs and take into considerations the punishment they may receive for bribery and refrain from defecting. Long-term goal for growth keeps firms in the “game” and can play a role in affecting the norm of a community by punishing firms which bribe through other firms refusing to do business with them and rewarding firms who refuse to pay bribes through giving favorable cooperation with those firms.<sup>112</sup>

## **2. Why do employees pay bribe?**

ISCT assumes that once managers know the rules or norms, they act on what is the right thing to do. So an ISCT platform only advises managers how to identify the right norm to comply with. In answering the question, “*why do employees pay bribes?*”<sup>113</sup> David Hess suggests a different answer from the social psychological perspective. Hess uses a recent study by Bazerman & Tenbrunsel<sup>114</sup> to explain that employees’ actions are not driven by trying to do the right thing, but by the emotions they are feeling at the time.<sup>115</sup> When a firm has a culture of acquiescing on or even rewarding

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<sup>112</sup> For a detailed explanation of a “tit-for-tat” strategy used in repeated games, *see Supra* note 102, at 530.

<sup>113</sup> Hess, D. 2015. Combating Corruption in International Business: The Big Questions. 41 *Ohio N.U.L. Rev.* 679, at 686.

<sup>114</sup> *Id.*, discussing Bazerman, M.H. & Tenbrunsel, A.E. *Blind Spots: Why We Fail to Do What's Right and What to Do about It*, Princeton University Press (2011).

<sup>115</sup> *Id.*

wrongful practices, employees rationalize that management approves that behavior.<sup>116</sup> Just as what journalist John Cassidy calls for the kind of behavior by the Wall Street CEOs who acted with greed, “rational irrationality,”<sup>117</sup> such behaviors seem “perfectly reasonable” on the individual level, yet produces calamity when aggregated in the marketplace.<sup>118</sup>

So an anti-bribery program that focuses on training managers to focus on understating the rules will not be as effective as training employees to understand how morally challenging situation will arise.<sup>119</sup> In fact, compliance programs that decouple from genuine implementation send signals to employees that rationalize wrongful behaviors.<sup>120</sup> Corporate culture is at the front and center in transforming from mere compliance to actively supporting ethical behavior in combating corruption.<sup>121</sup> Effective anti-bribery program should focus on sending a clear signal to employees that bribery is not to be tolerated, making it easier for employees to speak up, and breaking the pattern of rationalizing bad behaviors.<sup>122</sup>

### **3. The importance of a relational community**

Communities have been defined as “organizations built on underlying ethic of care,”<sup>123</sup> industry with idiosyncratic social and environmental concerns,<sup>124</sup> industry with

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<sup>116</sup> *Id.*, at 687.

<sup>117</sup> Nagano, F. “*Corruption, Game Theory, and Rational Irrationality*” in World Bank’s blog page. Retrieved on April 25, 2016 at <http://blogs.worldbank.org/publicsphere/corruption-game-theory-and-rational-irrationality>. (citing “Rational Irrationality” by John Cassidy at <http://www.newyorker.com/magazine/2009/10/05/rational-irrationality>).

<sup>118</sup> *Id.*, citing “Rational Irrationality” by John Cassidy at <http://www.newyorker.com/magazine/2009/10/05/rational-irrationality>).

<sup>119</sup> *Supra* note 113, at 686.

<sup>120</sup> *Id.*, at 690.

<sup>121</sup> *Id.*, at 691.

<sup>122</sup> *Id.*, at 688.

<sup>123</sup> Liedtka, J. 1999. Linking Competitive Advantage with Communities of Practice, *Journal of Management Inquiry* March 1999 vol. 8 no. 1 5-16, at 5.

<sup>124</sup> Griffin and Mahon, 1997. Griffin, J. J., & Mahon, J. F. 1997. The corporate social performance and corporate financial performance debate: Twenty-five years of incomparable research. *Business and Society*, 36(1): 5-31.

“shared or systemic risk,”<sup>125</sup> geographic adjacent neighbors vs. information-sharing-based set of relationships,<sup>126</sup> and “an open-ended complex set of relationships between its members.”<sup>127</sup> The broad and narrow definition of community in ISCT suggests the difficulty for managers to identify authentic norms in a boundary-expanding global context. Although community is not the focal study of this paper, it is important to recognize key characteristics of a community. What constitutes a community matters to how we determine appropriate actions to take when there is a conflict between communities.

Solomon (1994) provides a comprehensive description of a community’s characteristics: it is “a complex set of relationships between its members,” of “reciprocity and cooperation,” “fundamentally concerned with complementarity and difference,” consisting in “a shared sense of belonging,” “mission,” “mutual interest,” and “dependency on each other.” It is the “psychodynamics,” “membership,” and “a set of emotions” that “holds the organization together.”<sup>128</sup> The binding characteristic of a community is *a set of relationship*. It means dynamics within and between people. It means that to combat corruption, it takes more than a stop sign for people to comply, but a working relationship to respond to and transform the extant relationship that endorses corruption.

Donaldson and Dunfee’s ISCT framework provides guidance to business managers in treating bribery as an illegitimate norm because it violates the hypernorm of “necessary social efficiency” in political participation and social resources allocation. Its

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<sup>125</sup> Donaldson, T. & Schoemaker, P.H. 2013. Self-Inflicted Industry Wounds: Early Warning Signals and Pelican Gambits. *California Management Review* Vol. 55, No. 2, winter 2013: 24-45, at 24.

<sup>126</sup> Griffin, J.J. 2016. *Managing Corporate Impacts: Co-creating Value*. Cambridge University Press.

<sup>127</sup> Solomon, R.C. 1994. The Corporation as Community: A Reply to Ed Hartman. *Business Ethics Quarterly* Vol. 4, No. 3 (Jul., 1994), pp. 271-285, at 277-278.

<sup>128</sup> *Id.*

approach to combat corruption then is to ask managers to identify the legitimate and authentic norm and comply with it. Business managers are left as autonomous decision makers<sup>129</sup> in a framework that is based on a hypothetical, thought experiment.<sup>130</sup> This type of ethical decision making process will result in passive efforts to combat bribery. It ignores the dynamic relationship between firms and community: how people actually formulate their moral views<sup>131</sup> and act on those views. Business is a part of a set of dynamic relationships in the community; the relationships may not be concerned of others' political participation or unequal social resources allocation, but they are affected by and affecting how others behave in the same community. The heart of success in combating corruption is to connect business to their decisions in a relational context: why it is good for them not to bribe. Mere requirement of compliance with red stop signs is not enough for business to proactively choose to stop bribing. The following section introduces two models in how to achieve the interactive relationship in combating corruption, followed by proposing a context-based anti-bribery strategy framework.

## **V. A Context-based Strategy to Combat Corruption in a Global Context**

As discussed in the earlier sections, extraterritorial legal institutions are not always viable in recognizing legitimate justifications for paying bribes in a multinational context. ISCT focuses on the bottom-line compliance<sup>132</sup> by managers but ignores the dynamic relationship between firms and the community. The ratification of an

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<sup>129</sup> Fort, T. L. and Noone, J.J. 2000. Gifts, Bribes, and Exchange: Relationships in Non-Market Economies and Lessons for Pax E-Commercia. 33 Cornell International Law Journal 515-546, page 186.

<sup>130</sup> *Supra* note 26, at 259-260; *See generally* Fort, T.L. and Noone, J.J. 1999. Banded Contracts, Mediating Institutions, and Corporate Governance: A Naturalist Analysis of Contractual Theories of the Firm, 62 *Law and Contemporary Problems* 163-214.

*Supra* note 129, at 192; de los Reyes, G., Scholz, M., & Smith, N.S. in Beyond the "Win-Win": Creating Shared Value Requires Ethical Frameworks (working paper, draft of April 21, 2016), citing Scherer & Palazzo, 2007: 1102).

<sup>131</sup> *Supra* note 129, at 520.

<sup>132</sup> *See* de los Reyes, G., Scholz, M., & Smith, N.S. in Beyond the "Win-Win": Creating Shared Value Requires Ethical Frameworks (working paper, draft of April 21, 2016).

international anti-bribery law or the installment of a corporate compliance program may seem ensuring that some mechanism is functioning in combating bribery, but it can instill “a false sense of confidence that further compounded the wrenching outcomes.”<sup>133</sup> There is a need for a better strategy. I propose an interactive, context-based cooperation framework. I will first introduce two cooperation models that actively engage firms to address the collective cause. I then build an interactive framework using the two key elements of an ISCT norm as the context for corresponding strategies to combat bribery in a multinational context.

### **1. Model 1: Mediating Institutions**

The question at the heart of effective anti-bribery strategies is about how one connects her self-interest with the welfare of the community to which she belongs.<sup>134</sup> Tim Fort and James Noone suggest that it is through self-regulating structures that relate to basic, communal human nature.<sup>135</sup> They borrow from sociological and anthropological studies and introduce the concept of “mediating institutions.”<sup>136</sup> Mediating institutions refer to small organizations that “stand between the individual and the large superstructures of contemporary society.”<sup>137</sup> These organizations are small enough that they provide the means of an ongoing mediating process of dialogue and adjustment between individuals and the common.<sup>138</sup> It is through these dialogues and adjustments that “individuals’ moral behavior inculcates and relates to the good of a community

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<sup>133</sup> *Supra* note 125, at 27.

<sup>134</sup> *Supra* note 129, at 524.

<sup>135</sup> *Id.*, at 524.

<sup>136</sup> Fort, T.L. and Noone, J.J. 1999. Banded Contracts, Mediating Institutions, and Corporate Governance: A Naturalist Analysis of Contractual Theories of the Firm, 62 *Law and Contemporary Problems* 163-214. Also, Fort & Noone, 2000.

<sup>137</sup> *Id.*, at 193.

<sup>138</sup> *Id.*, at 186 (citing Rogene A. Buchholz & Sandra R. Rosenthal. 1996).

whose members are harmed by corruption.”<sup>139</sup> The interaction between individuals and the common in such small organizations “gains it meaning, significance, and enrichment through this process of *participatory* accommodation or adjustment.”<sup>140</sup>

The mediating institution model emphasizes that size of such organizations needs to be small enough that individuals can feel the consequence of their behaviors to the interest of the community; otherwise individuals will be disconnected from the consequence. According to Fort & Noone (2000), connecting one’s self-interest to the welfare of community is the key to prevent bribery. When one’s notion of individual autonomy takes priority over her notion of communal interest, the chance of bribery increases.<sup>141</sup> Small-size mediating institutions can accomplish the goal of connecting one’s self interest to the welfare of the community for two reasons.

First, people formulate their moral views by observing what other people in the same community are doing.<sup>142</sup> What others are doing may have “some moral force in business context.”<sup>143</sup> The “group mind”<sup>144</sup> shape human beings’ “interconnected moral identity with each other”<sup>145</sup> and “develop individual responsibility.”<sup>146</sup> Being in a community may require significant personal sacrifice to adapt to their communal identity.<sup>147</sup> How people actually formulate their moral views is not likely from applying

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<sup>139</sup> *Supra* note 133.

<sup>140</sup> *Supra* note 135, at 186 (citing Rogene A. Buchholz & Sandra R. Rosenthal. 1996. Toward a New Understanding of Moral Pluralism, 6 *Bus. Ethics Q.* 263, 268).

<sup>141</sup> *Supra* note 129, at 523.

<sup>142</sup> *Id.*, at 520.

<sup>143</sup> Mayer, D. 2001, Community, Business Ethics, and Global Capitalism, *Am. Biz. L. J.*, Vol. 38, 215-260, 220-221 (citing Donaldson & Dunfee, Unified Conception, at 258).

<sup>144</sup> *Supra* note 129, at 520.

<sup>145</sup> *Supra* note 135, at 193.

<sup>146</sup> *Id.*, at 194.

<sup>147</sup> *Supra* note 129, at 520.

to normative philosophy<sup>148</sup> but by observing what other people do in the same community. This is one way how one connects his or her own interest to that of the community. Second, morality can be communal in small organizations because they provide “an internal feedback mechanism to regulate behavior.”<sup>149</sup> Individuals in small communities are responsible to solve their problems within the communities. This requires “a level of participation by individuals within the community.”<sup>150</sup> Because the interest is communal and direct, an individual can also exert powerful influence on the community in small groups. Large-size community would have difficulties replicating this internal feedback mechanism<sup>151</sup>: it conceals the consequences of an individual’s actions,<sup>152</sup> hosts “scalar stress,”<sup>153</sup> and “can leave an individual disconnected from the consequences of his actions.”<sup>154</sup>

Applying this model in the context of corruption, a community dialogue about bribery would enable robust dialogue among small-size community to hear the voice of those affected by multinational and local rules that prohibits bribery. This relates to my earlier discussion of Salbu’s point that there could be moral justifications to bribe; extraterritorial laws and regulations without interactive dialogue and adjustment to those justifications will only cause scalar stress and concealing of the consequences of individual actions.

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<sup>148</sup> *Id.* (citing Malinowski, B. 1922. *Argonauts of the Western Pacific: an Account of Native Enterprise and Adventure in the Archipelagoes of the Melanesian New Guinea*, at 326).

<sup>149</sup> *Id.*, at 524.

<sup>150</sup> *Id.*, at 542.

<sup>151</sup> *Id.*, at 524.

<sup>152</sup> *Id.*, at 542.

<sup>153</sup> *Id.*

<sup>154</sup> *Supra note* 135, at 167.



This is also where Fort and Noone differ from Donaldson and Dunfee. According to Fort and Noone, people need to group themselves into communities small enough to prioritize the communal nature over self autonomy to effectively eradicate corruption. According to Donaldson and Dunfee, necessary social efficiency is what makes norms legitimate. Size or communal interaction is not as important. As discussed in the earlier section, by focusing only on necessary social efficiency and ignoring the discussion why norms of smaller group with stronger bonding should not be valued, ISCT has not been successful in addressing why small communities' norms for relationship building, such as gift-giving, should fail under the purview of bribery other than social efficiency argument.

The mediating institution model suggests a cooperative model found in the basic human nature of communal interaction. Fort & Noone, however, have not addressed how to practically fit the mediating institution model in a global context. To be specific, how and when should small-sized communities' dialogues and adjustments fit into the large international community to maintain both universal principles of justice and diversity among small communities in combating corruption? In the context of illegitimate corruption norms that are so formidably interdependent, can small organizations alone best manage systemic risks of bribery?

## **2. Model 2: Pelican Gambits**

Like Fort & Noone, Tom Donaldson and Paul Schoemaker suggest a model of cooperative strategy originally found in nature - Pelican Gambits. Pelicans and many other species of animals engage in "reciprocal altruism"-type of behaviors that "sacrifice

in the short run only to succeed in the long run both collectively and individually.”<sup>155</sup> Donaldson & Schoemaker define Pelican Gambits as “strategic moves towards cooperation in highly competitive economic environments for the purpose of limiting risks to one’s firm, the industry and society.”<sup>156</sup> Unlike traditional passive industry self-regulation, “a Pelican Gambit is a proactive strategy within an individual firm about systemic risk, opening the door to cooperative risk avoidance strategies at the industry level.”<sup>157</sup> This strategy is recommended to avoid risk that can cause catastrophic damage to the firm, industry and society.<sup>158</sup>

Warning signs of systemic risks across industries often include in the dominant paradigm weak regulations, practice of norms that would violate public trust, and lack of transparency or open discussion.<sup>159</sup> These risks cannot be managed by a single firm alone. In fact, illegitimate norms in an industry can be so prevalent that firms benchmark themselves by imitating one another.<sup>160</sup> In such a regime, legislators or regulators are not reliable in bringing effective change due to their lack of knowledge or information of the underlying risks.<sup>161</sup> Nor are insiders from within the firms or the industry, either because they lack the incentive or they have become numbed to the reality of the existing problem.<sup>162</sup> Donaldson & Schoemaker propose firms in this type of situations should do

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<sup>155</sup> *Supra note 125*, at 30.

<sup>156</sup> *Id.*, at 29.

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *See generally Id.*, at 33-37.

<sup>160</sup> *Id.*, at 27.

<sup>161</sup> *Id.*, at 28.

<sup>162</sup> *Id.*

what pelican do in nature by undertaking a temporary sacrifice through cooperation among industry members in order to better manage long-term systemic risk.<sup>163</sup>

Unlike Donaldson & Dunfee's ISCT framework to keep status quo, both Pelican Gambits and mediating institutions are proactive strategies for cooperation in situations of uncertainty. But Pelican Gambits differ from mediating institutions in that they call for leading firms to move forward to bring industry cooperation in order to change the illegitimate norms that breed systemic risks. This is counterintuitive; firms in industries with interdependent norm practice would want to manage themselves in isolation or take advantage of the norm deficiency, but Pelican Gambits call for a coordinated action to change the current norms.<sup>164</sup>

The authors use the Canadian chemical industry as an example of Pelican Gambit. Leaders of large companies of the Canadian chemical industry cooperated to address the safety and regulatory risks that have been prevalent in the industry. They met face-to-face with CEOs from other firms, made long-term business case for a cooperative, industry-level approach, provided cooperating system assistance, periodically met in small groups for monitoring purposes, and assembled "a cross-sectional group of activists, academics, consumers, seniors, and youth . . ." <sup>165</sup>

Effective steps for firm leaders to take in implementing Pelican Gambits include to assess various systemic risks for any industry (whether risky practices are prevalent in the industry and whether industry leadership are strong),<sup>166</sup> to work cooperatively among

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<sup>163</sup> *Id.*, at 30.

<sup>164</sup> *Id.*, at 32-33.

<sup>165</sup> *Id.*, at 31.

<sup>166</sup> *Id.*, at 39

business leaders to inform and assist the government to understand “the industry-based initiatives” to lower systemic risk,<sup>167</sup> to gather information across and within organizations to evaluate the systemic risk,<sup>168</sup> and to project future actions<sup>169</sup> based on the information collected.

Pelican Gambits complement mediating institutions in that Pelican Gambit call for positive dialogue within industries,<sup>170</sup> especially by leaders from large firms. This is important in combating corruption, because some industries are more prone to bribery than others.<sup>171</sup> Positive dialogue within both small communities and larger industry players complement each other in allowing firms to actively adjusting and transforming the norms of bribery and protecting themselves from the systemic risk of corruption. As we saw earlier from Salbu and Nichol’s debate, the problem of combating corruption is magnified in a multinational context when there is not a universal legal standard. To effectively combat corruption we need more than small-sized organizations’ dialogue and adjustment in countries and industries that are fraught with corruption.

### **3. A Context-based Strategy to Combat Corruption in a Global Context**

Donaldson & Dunfee’s ISCT provides a useful norm-taking mechanism,<sup>172</sup> but is not good in providing sufficient guidance of controlling corruption.<sup>173</sup> They write that “research based on detailed, context-rich scenarios...requiring subjects to respond to

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<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*, at 37 (emphasizing on positive intra-industry dialogue).

<sup>171</sup> OECD (2014), *Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials*.  
<http://dx.doi.org/10.1787/9789264226616-en>

<sup>172</sup> de los Reyes, G., Scholz, M., & Smith, N.S., 2016. Beyond the “Win-Win”: Creating Shared Value Requires Ethical Frameworks (working paper, draft of April 21, 2016).

<sup>173</sup> *Supra note* 105, at 811.

precisely delineated dilemmas is more consistent with the requirements of ISCT.”<sup>174</sup> An effective strategy to combat corruption calls for recognition of the context where dynamic interactions between individuals and community norms are taking place, and for dialogues and adjustment through small and large communities to address the tension in that context.

The cornerstones of norm justification in ISCT are authenticity and legitimacy. Although the purpose of this section is not to justify norms, the concept of authenticity and legitimacy provides a good framework for describing different types of context of community norms. Authenticity asks attitudinal and behavioral aspects of the putative norms:<sup>175</sup> whether a norm is approved and deviance disapproved by a substantial majority of the members of the community, and whether a substantial majority of the communities actually act in compliance with the norm.<sup>176</sup> Legitimacy asks if the putative norms are compatible with hypernorms.<sup>177</sup>

Building on the framework of authentic norm provided in ISCT, I categorize the context to combat corruption as a function of authenticity and legitimacy. The 2x2 matrix below is created for distinguishing among four different types of contexts for formulating strategies to combat corruption. The columns of the matrix correspond to the legitimacy of a norm. The rows of the matrix correspond to the authenticity. The four types of combination of authenticity and legitimacy to imply corruption contexts are: legitimate and authentic norms, legitimate and inauthentic norms, illegitimate and

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<sup>174</sup> *Supra* note 26, at 275.

<sup>175</sup> *Id.*, at 274-275.

<sup>176</sup> *Id.*, at 264; *Supra* note 24, at 209.

<sup>177</sup> *Supra* note 24, at 44, 222

authentic norms, and illegitimate and inauthentic norms. Each context calls for different, appropriate responses.

Authenticity	Legitimacy	
	Legitimate	Illegitimate (Systemic Risk - Context Transformation)
Authentic (Top-down Strategy)	A  Law; Transnational organizations	C  Pelican Gambits
Inauthentic (Bottom-up Strategy)	B  Mediating Institution	D  Pelican Gambits  Mediating Institution

The left column implies a context where bribe-paying is compatible with hypernorms and thus, legitimate. The right column implies a context where paying bribes violate hypernorms and thus, illegitimate. The top row implies a context where individuals in the community have a genuine attitude towards and actual complying behaviors with the putative norm of paying bribes. The bottom row implies a context where individuals either do not hold a genuine attitude toward paying bribes, or do not actually behave based on that.

### Quadrant A

Community members in this context have a genuine attitude towards legitimate cause for paying bribes and they take actual actions to do that. They also expect other members in the same community to do the same. The uncertainty that community members cannot monitor each other's behaviors in this context is low. Community members are most open to collaboration in this context. This is where Salbu's first example of legitimate bribe in meeting humanitarian needs would take place. In such a context, a top-down model of government laws and regulations with culturally justified exceptions to legitimate bribes would be sufficient.

### Quadrant B

Community members in this context comply with paying bribes, without a genuine attitude or actual behavior. This could happen when individuals hold an "attitude that recognizes an excuse or justification for certain forms of behavior in current circumstances" due to "social pressure or to a desire to conform to what they perceive to be the norms of the community."<sup>178</sup> Salbu's second justification of bribery for survival would apply to this context. But because of the divergence in individual attitudes and the legitimacy of the norm, uncertainty in monitoring other members' behavior in terms of paying bribes are present. This requires an anti-bribery strategy effectively reconnect individual self-interest to community interest. According to Fort & Noone, "it is critical to recapture the communal self and to provide structures that nourish it because otherwise

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<sup>178</sup> *Supra* note 24, at 91-92.

any attempts to outlaw bribery through transnational organizations would be empty rules because they make no meaningful connection between people and the prohibition.”<sup>179</sup>

Top-down methods, such as company rules or anti-bribery laws, may still apply to this context, but need to rely on small mediating institutions to reconnect individual self-interest to the meaning of the norm. To be specific, a law-making process that intends to give exceptions to legitimate bribery should include communication with individuals in local communities, hearing their reasons and concerns in legitimizing certain bribery actions, and incorporating feedbacks to them in the law-making process. HR training, employee associations, or independent board committee within a company can give voice to or hear the voice of employees in terms of bribe paying, deliver personal meanings of reasons for and against gift-giving,<sup>180</sup> “understand the ethical attitude of other communities,”<sup>181</sup> and confirm that illegitimate bribery are not tolerated while legitimate bribery is recognized. People respond to law compliance and good behaviors when they know they are not alone.<sup>182</sup>

### Quadrant C

This is a context where the norm of paying bribes is not compatible with the hypernorms, but the attitude and behavior of community members are authentic. Professor Andres Spicer suggests that this can happen in situations of systemic corruption where the institutional context shapes its community members’ attitude and behavioral

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<sup>179</sup> *Supra note 120*, at 530-31.

<sup>180</sup> *Id.*, at 531.

<sup>181</sup> Spicer 2009. The Normalization of Corrupt Business Practices: Implications for Integrative Social Contracts Theory (ISCT), *Journal of Business Ethics* 88:833-840, at 838.

<sup>182</sup> *Supra note 129*.



expectations.<sup>183</sup> Individuals in such context may not even be aware of or understand the ethical issues around corruption.<sup>184</sup> When a norm is illegitimate and the public attitude and actual behavior are authentic, the strategy is to transform the context.<sup>185</sup> Spicer calls for restructuring institutional arrangement in such a situation.<sup>186</sup>

The uncertainty to monitor other community members' bribery behavior is extremely high in systemic corruption. In effectual institutional norm transformation, I propose that large firms need to move first to give assurance to other firms that they will not bribe. Game theorists suggest that good coordination by other players can be reached through one's leading by committing themselves to a particular choice. When other players observe the leading choice, they will respond accordingly.<sup>187</sup> Firms have the opportunity to establish a reputation for cooperation, and encourage other players to do the same.<sup>188</sup> The defecting party will be punished for not cooperating in the next round of the game.<sup>189</sup>

It is necessary for the firms to vision themselves in the market for a long run to be willing to take such a step. It is also necessary for those firms to be influential enough in the industry for other firms to follow. Small mediating institutions are not the most effective actors in systemic corruption due to their limited influence in a highly corrupt environment. A top-down global anti-corruption program, such as extraterritorial regulations, is also less likely to be effective. In communities with high corruption, the institutional power to enforce laws and regulations are usually weak. The major resistant

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<sup>183</sup> *Supra note* 180, at 838.

<sup>184</sup> *Id.*, at 834.

<sup>185</sup> *Id.*, at 838.

<sup>186</sup> *Id.*

<sup>187</sup> *Supra note* 102, at 545-46.

<sup>188</sup> *Id.*

<sup>189</sup> *Id.*

power lies in the powerful members within the community. As Wolf and Schmidt-Pfister (2010) explain the potential situation OECD is facing when community members prioritize financial concerns over anti-corruption regulations,

“[t]he legal implementation and practical enforcement of international anticorruption provisions at the national level can be significantly hampered by lacking political will or contradicting interests of national key actors. If more states... disobey international anti-corruption norms because of national economic considerations, the OECD’s policy against overseas bribery – maybe the most successful international anti-corruption regime so far -- is jeopardized.”<sup>190</sup>

This context is where leading firms from a highly corrupt industry can take Pelican Gambits. Leading firms can take actions such as joining industry alliance in committing themselves not to pay bribes or initiating transparency program which allows other firms to monitor their accounting books or governance reports. These actions send strong signals that they are willing to cooperate with others and taking accountability for their actions. In addition to giving clear signals, industry leading firms can individually or cooperatively punish firms which continue paying bribes by refusing to cooperate with them, as well as rewarding firms who refuse to pay bribes by giving favorable cooperation with the latter firms.<sup>191</sup>

#### Quadrant D

This is a context where a norm of paying bribes is illegitimate, and community members’ attitudes and behavior are inauthentic.

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<sup>190</sup> *Supra note 36*, at 16.

<sup>191</sup> Game theorists would see such behavior as a “tit-for-tat” strategy in repeated games. *See Supra note 102*, at 530.

As discussed in Context C, even if the powerful members accept the laws themselves, legal implementation can be problematic in a context of systemic corruption. A top-down global anti-corruption program, therefore, is not the most effective strategy in this context.

Strategies for this context should be a combination of mediating institutions and Pelican Gambits. Although the community members in this context do not agree with the corruption norm, it is challenging for anti-corruption campaigns to “convince the least powerful in a community to mobilize resistance under conditions of vulnerability and risk” (Spicer, 2009). This is because the least powerful “often suffer high costs if they act on their moral values.”<sup>192</sup> For the same reasons discussed in Quadrant C, an effective anti-corruption strategy in Context D calls for industry or community leaders to act first.

Given the context of powerful community leaders’ initial actions, corporations and local societies can be in a better position to fight against corruption through reconnecting community members’ interest to the community. This is where mediating institutions play a big role in bringing about transformation from corrupt norms into ethical business practice. Specific strategies can be employed through communicative interactions with individual community members. One example is engaging in dialogues with employees for their opinions of what should be included into an anti-corruption guideline. This self-regulating structure provides a channel for employees’ voice to be heard, the harm that can be done to them be acknowledge, and the solution that works

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<sup>192</sup> *Supra* note 180, at 835.

best for them be considered. Fort & Noone (1999) describe such a strategy as “sequential hierarchy”<sup>193</sup>:

*A small group of individuals reach a consensus first, and then one of them attempts to reach a consensus with representatives of similarly sized groups. This allows cooperative action by large groups of individuals who do not grant differential status or power to any one member of their society. This sequential hierarchy requires a popular desire or perceived need for communal decision-making. Even in large corporations, relatively small communities could be created to provide the sense of moral identity necessary for business ethics.*<sup>194</sup>

A sequential hierarchy provides a solution where small-size communities do not have to follow large communities’ norms but align their interest with that of the large communities. In such a context, firms intervenes the dominant illegitimate corruption norm by both engaging with small mediating institutions and playing Pelican Gambits. This proactive approach allows for transforming illegitimate norms from submissive compliance to proactive transformation, at individual, firm, and industry level.

## **VI. Conclusion**

Sixteen years after the great debate between Salbu and Nichols, the issue of ethical justification of using extraterritorial restrictions against corruption still lingers. A corporate counsel in charge of anti-corruption compliance program in a U.S. international software company expressed her frustration about the practicality of FCPA compliance when she was approached by the author to discuss the topic. As the opening vignette

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<sup>193</sup> *Supra* note 135, at196.

<sup>194</sup> *Id.* (citing Johnson, G. A. 1978 & 1982).

implies, corruption cannot be completely eradicated with one single international organization. An imposed exterritorial application of anti-corruption laws may not be the best solution, because such an approach fails to recognize the norm-transforming roles of firms themselves.

Philip Nichols points out that business already knows not to pay and instead needs direction as to how not to pay and how to trust that others will not pay.<sup>195</sup> This paper tends to examine the current trend and identify new patterns on what directions can be given to managers to promote business not to pay bribes. I examine ISCT framework, mediating institutions, and the Pelican Gambit, and propose a context based framework for interactive anti-bribery strategies. Individuals, firms, and industries are involved based on the context of authenticity and legitimacy of a bribery norm. The strategies in the framework are by no means exclusive, but the framework complements the literature with a structured discussion of strategies to combat corruption.

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<sup>195</sup> *Supra* note 105, at 811.

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**Table 1. Frequency of Firms from 73 Home Countries in the OFFP's Humanitarian Transactions**

Home Countries Represented	Frequency of Firms	Frequency of Firms that Paid Bribes ("Dirty Firms")	Percent of Dirty Firms
Afghanistan	1	0	0
Algeria	37	19	0.513514
Argentina	2	1	0.5
Australia	3	3	1
Austria	69	37	0.536232
Bahrain	11	8	0.727273
Bangladesh	1	0	0
Belarus	4	2	0.5
Belgium	71	34	0.478873
Bosnia and Herzegovina	1	0	0
Brazil	10	4	0.4
Bulgaria*	13	6	0.461538
Canada	14	4	0.285714
Croatia	4	1	0.25
Cuba	2	0	0
China	114	76	0.666667
Cyprus*	26	18	0.692308
Czech Republic	1	0	0
Denmark	31	21	0.677419
Egypt	145	101	0.696552
Finland	12	4	0.333333
France	414	174	0.42029
Germany	141	59	0.41844
Ghana	1	0	0
Greece	17	9	0.529412

Hungary	7	2	0.285714
India	182	131	0.71978
Indonesia	40	32	0.8
Iran	5	3	0.6
Ireland	8	2	0.25
Italy	302	156	0.516556
Japan	12	1	0.083333
Jordan	424	268	0.632075
Kenya	1	0	0
Korea	14	11	0.785714
Lebanon	112	83	0.741071
Libya	1	1	1
Luxembourg	1	1	1
Macedonia	1	0	0
Malaysia	57	39	0.684211
Mexico	1	0	0
Morocco	15	12	0.8
Myanmar	2	2	1
Netherland	34	6	0.176471
New Zealand	3	1	0.333333
Oman	25	22	0.88
Pakistan	23	18	0.782609
Poland	3	0	0
Portugal	2	1	0.5
Qatar	5	3	0.6
Romania	9	5	0.555556
Russia	147	90	0.612245
Saudi Arabia*	44	25	0.568182

Singapore	4	2	0.5
Slovakia	3	3	1
Slovenia	5	0	0
South Africa	7	4	0.571429
Spain	85	42	0.494118
Sri Lanka	29	27	0.931034
Sudan	10	4	0.4
Sweden	36	12	0.333333
Switzerland	71	33	0.464789
Syria	148	94	0.635135
Thailand	4	3	0.75
Tunisia	61	37	0.606557
Turkey	251	136	0.541833
Ukraine	3	2	0.666667
United Arab Emirates*	138	101	0.731884
United Kingdom	52	10	0.192308
United States	19	0	0
Vietnam	27	25	0.925926
Yemen	13	11	0.846154
Yugoslavia	8	2	0.25
Total	3,599	2,044	0.567936

Table 3a.  $\chi^2$  test of association between a firm's home country's implementation of the OECD Anti-Bribery Convention and its foreign bribery in the OFFP.

Home country with implementation of the OECD Anti-Bribery Convention	Bribery		Total
	No	Yes	
No	635	1281	1916
(row percent)	(33.14)	(66.86)	100
(column percent)	(40.84)	(62.67)	53.24
Yes	920	763	1683
(row percent)	(54.66)	<b>(45.34)</b>	(100)
(column percent)	(59.16)	(37.33)	(46.76)
Total	1555	2044	3599
(row percent)	(43.21)	(56.79)	(100)
(column percent)	(100)	(100)	(100)
Statistic	Value	Prob.	
Chi-square	169.1331	0.000	

**H<sub>0</sub>**: There is no association between home country's implementation of the OECD Anti-Bribery Convention and foreign bribery by its firms.

**H<sub>a</sub>**: There is an association between home country's implementation of the OECD Anti-Bribery Convention and foreign bribery by its firms.

\* The row level is the OFFP bribery distribution among firms at the same country level, and the column level is the bribery distribution among OECD and non-OECD countries.

Given the interest in the effectiveness of international organizations' anti-bribery solution, I used a bivariate nonparametric  $\chi^2$  test to examine the association between countries whose national laws criminalize bribery of foreign public officials in international business transactions and their firms' bribery occurrences, and report the result in Table 2.

The Chi-square result shows that that the propensity to bribe drops from 66.86% for firms from non-OECD countries to 45.34% for firm from OECD countries (p-value <0.000), suggesting a deterrence effect of the Convention. While statistically significant, there is still 45% of the firms from OECD countries paid foreign bribes. This illustrates the "paradox of corruption" that Hess & Dunfee (2001) described in assessing international efforts to combat corruption.

**Table 3b.  $\chi^2$  test of association between a home country's domestic corruption norms and its firms' foreign bribery in the OFFP.**

Home country's domestic corruption norms	Bribery		Total
	No	Yes	
Clean	752	708	1460
(row percent)	(51.51)	<b>(48.49)</b>	(100)
(column percent)	(48.36)	(34.64)	40.57
Dirty	803	1336	2139
(row percent)	(37.54)	(62.46)	(100)
(column percent)	(51.64)	(65.36)	59.43
Total	1555	2044	3599
(row percent)	(43.21)	(56.79)	(1000)
(column percent)	(100)	(100)	100
Statistic	Value	Prob.	
Chi-square	68.9723	0.000	

**H0:** There is no association between a firm's home country's domestic corruption norms and its foreign bribery in the OFFP.

**Ha:** There is association between a firm's home country's domestic corruption norms and its foreign bribery in the OFFP.

\* The row level is the OFFP bribery distribution among firms at the same country level, and the column level is the bribery distribution among clean and dirty countries.

\* Clean = countries with a Corruption Perception Index (CPI) score higher than the median of all countries participating in the OFFP

\* Dirty = countries with a Corruption Perception Index (CPI) score equal to or smaller than the median of all countries participating in the OFFP

I used a bivariate nonparametric  $\chi^2$  test to examine the association between home country corruption norms and their firms' bribery occurrences. The Chi-square result shows that the propensity to bribe drops from 65.36% for firms of dirty countries to 34.64% for firm of clean countries (p-value <0.000). This suggests a corruption norm effect on firm behavior. Still, almost half of the firms (48.49%) from clean countries paid foreign bribes in the OFF. This illustrates the "paradox of corruption" that Hess & Dunfee (2001) described in assessing international efforts to combat corruption.