# Corruption and its effects on FDI

## Analysing the interaction between the corruption levels of the home and host countries and its effects at the decision-making level

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**CORRUPTION AND ITS EFFECTS ON FDI: ANALYSING THE INTERACTION BETWEEN THE CORRUPTION LEVELS OF THE HOME AND HOST COUNTRIES AND ITS EFFECTS AT THE DECISION-MAKING LEVEL**


## Abstract

This study furthers our understanding of how corruption affects the decision-making process of allocating foreign direct investment (FDI). Drawing on the responses of 28 managers in charge of establishing operations in a highly corrupt host country, we argue that those firms based in home countries with low levels of corruption are more proactive in preparing to face corruption abroad than those based in countries with high corruption levels. This means that firms from less corrupt home countries have strategies in place to deal with high corruption abroad. This finding is based on the fact that these firms have stronger pressures to not engage in corruption from their home stakeholders. Also, these firms might not have the experience of dealing with corruption at home, which hinders their potential to deal with corruption abroad. On the other hand, those firms based in highly corrupt home countries do not have clear strategies to deal with corruption abroad. This assertion is based on the fact that these firms might have familiarity in dealing with corruption and thus, might not see it as an obstacle to operating abroad.



KEY WORDS: Corruption; foreign direct investment allocation; firm-level analysis

## Introduction

Corruption, defined as the abuse of public power for personal gain (Collins, et al., 2008), is an important problem that affects all countries (Petrou & Thanos, 2014). The issue of corruption has been intensified by the fall of barriers to commerce, since firms that were not used to dealing with high corruption levels at home might be encountering them abroad. Corruption exists at some degree in all countries; however, it is more prevalent in developing ones (Hellman, et al., 2000). Accordingly, all firms deciding to start operations abroad should take the level of corruption of the host country into account when developing their strategies for internationalisation, especially if such location is considered developing. However, despite the fact that current literature acknowledges that the effects of corruption on businesses is very important (Collins, et al., 2008), most studies analysing how corruption affects the allocation of foreign direct investment (FDI) to a highly corrupt host country have focused on whether or not corruption deters FDI inflows (i.e. (Cuervo-Cazurra, 2006; Doh, et al., 2003; Habib & Zurawicki, 2002)), without paying enough attention to *how* the decision-making process of FDI allocation at the firm level is affected by high levels of corruption. Therefore, this study takes into account the heterogeneity of the home country of multinationals and sheds light in this regard by proposing a framework that illustrates the decision-making process of allocating FDI to a highly corrupt foreign location depending on the level of corruption of the home country compared to the corruption level of the host location.

Until recently, very few studies had actually analysed how firms took corruption into consideration when deciding to invest in a highly corrupt foreign location (Rodriguez, et al., 2005). To close this gap in the literature Goodspeed et al., (2011) analysed FDI flows to developing and developed countries, concluding that the uncertainty generated by the level of corruption of the host country has a direct negative effect on firms investing in the former but not the latter.

Furthering this line of research, Goodspeed et al., (2013) proposed that the main deterrent of FDI in a developing country is the level of uncertainty created by corruption as opposed to high taxation. Nevertheless, these studies have mainly focused on *if* the level of corruption of the host country affects the attraction of FDI rather than *how.*

Addressing this dearth of research is important, because even though many businesses declare that corruption affects them negatively, they still engage in it. Building on the premise that not all foreign investors perceive and react to corruption in the same manner, (Cuervo-Cazurra, 2006; Goodspeed, et al., 2013), we propose that foreign investors craft strategies differently depending on the level of corruption of their home country as compared to that of the host country. To do so, we follow Godinez and Liu (2015) and divide foreign investors in two categories: those based in home countries with lower corruption levels than the host country and those based in countries with higher corruption levels. The rationale for this categorisation is to understand whether those foreign investors familiar with dealing with corruption at home react differently to corruption abroad than those investors without such experience. In this sense, we argue that those firms headquartered in home countries with low corruption levels will have in place a plan to deal with corruption abroad. This is justified because of their need to be perceived ethically in their home country, as well as the lack of experience in operating in highly corrupt locations. On the other hand, those firms headquartered in home countries with high levels of corruption do not devise plans to deal with corruption abroad because they might not see this phenomenon as an impediment for conducting operations. The next section of the study presents a literature review on corruption and FDI, followed by the methodology, results and discussion, and conclusions.

**Literature Review**

*Corruption*

To study corruption one has to define it first. For this study we define corruption as the abuse of public power for personal gain (Collins, et al., 2008). Even though many other definitions have been used in different studies (see Judge, et al., (2011)). This definition is appropriate for our study since it encompasses transactional and institutional activities between governments and private individuals. From this definition, scholars have identified two kinds of corruption: public and organisational. Public corruption is the abuse of public power for personal gain (Luiz & Stewart, 2014). Organisational corruption is the conscious violation of legal rules of the organisation for personal gain, possibly at the organisation's detriment (Hodgson & Jiang, 2007). While corruption can occur exclusively in the private sector, analysing this phenomenon is beyond the scope of our study. Also, we focus on public corruption since the private sector should be regulated by the public sector of any given location. Therefore, if the public sector is highly corrupt, we can assume that the private sector can also be experiencing a very similar condition.

Corruption has its roots in the economic and institutional conditions of a nation (Ufere, et al., 2010) and reflects the legal, political, economic, and cultural institutions of a country (Svensson, 2005). Corruption thrives on a weak institutional system (Rose-Ackerman & Coolidge, 1997). This means that even though corruption is an important problem in any society, regardless of their development level (Collins, et al., 2008), this problem is more prevalent in developing countries (Powpaka, 2002) since they are characterised by challenging institutional environments that include low standards of living, weak administration capacity, underdeveloped industrial base, and low Human Development Indices (HDI) (Collins, et al., 2008; Cuervo-Cazurra, 2006; Pajunen, 2008; United Nations, 2014). Therefore, when analysing how firms react and implement strategies to operate in foreign locations characterised by high levels of corruption, emerging markets can be considered the obvious setting.

*Effects of Corruption*

Shleifer and Vishny (1993) state that if bureaucrats are self-interested and have monopolistic powers to manage public properties they might exploit such powers for personal benefit to the detriment of public interests. Therefore, corruption is believed to have negative effects on economic growth since it allows the misallocation of productive resources, leading to sub-optimal growth rates (Halkos & Tzeremes, 2010). Jain (2001) argues that corruption violates a country's legislation, which undermines a nation's sovereignty. Corruption also has direct effects on firms since it may act as a tax, even though participating in more distortionary and costly corrupt activities may cause higher transaction costs than taxes (Besley & McLaren, 1993; Shleifer & Vishny, 1993). The idea of corruption increasing costs more than taxes is developed by Shleifer and Vishny (1993) who argue that firms engaging in corrupt deals should devote human and financial resources to manage corruption, and that these resources could have been used more productively in other activities.

In addition to rising costs, high corruption in a given location also increases uncertainty, especially for businesses expanding their operations internationally (Curevo-Cazurra, 2008). The result of the uncertainty generated by corruption may include a reduction on FDI, or a reduction in the quality of such investment. For example, Wei (1997) argued that corruption in a host country would negatively affect FDI despite government policies to prevent this from happening. Lambsdorff (1998) concluded that corruption had a negative impact on FDI flows to developing nations due to the difficulty of navigating their institutional environment. Cuervo-Cazurra (2006) argued that foreign investors from countries who signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Transactions were also deterred by corruption abroad. Goodspeed et al., (2013) investigated the relationship between corruption, taxes, and FDI concluding that taxes and corruption are substitutes and that the impact of taxes on FDI will be lessened when corruption is higher. Since corruption tends to be more prevalent and tax administration weaker in developing countries, so the level of development of the host country has a direct effect on FDI flows to such location. On the other hand, Goodspeed et al., (2013) point out that if the host country is considered developed, corporate taxes are an important predictor for the attraction of FDI, but not the level of corruption because of the stability provided by the institutional environment in those countries.

Recent scholarship has attempted to shed light on this topic by arguing that the level of corruption of the home and host country should be taken into consideration when studying how corruption affects the attraction of FDI. In this regard, Habib and Zurawicki (2002) demonstrated that it was not only corruption what might negatively affect the attraction of FDI but the distance in corruption levels between home and host countries. Building on this premise, Godinez and Liu (2015) proposed that what deters FDI is not the level of corruption of the host country but the uncertainty created by the distance and direction of corruption levels between the home and host countries. The authors argued that the more distance between a home country with lower corruption levels than the host country, the more FDI will be negatively affected. On the other hand, if such distance is between a home country with higher corruption levels than an already highly corrupt host country, the corruption distance between these two countries does not affect the attraction of FDI.

Despite the wealth of studies analysing how corruption might affect the allocation of FDI, this subject is still not yet well understood. Even though the topic has remained popular in the management research agenda, this problem is elusive to study due to its secretive nature. Another reason why corruption and its effects on FDI are not yet fully understood may be because of the macroeconomic method usually employed to analyse this phenomenon. According to Yackee (2010), generally, research analysing corruption and its effects on FDI share a similar design. Such design includes an independent variable comprised by an index measuring the perception of corruption. Then, this independent variable is regressed against data measuring country-level FDI flows. Regrettably, Yackee (2010) points out that the results of these complex statistical methodologies are inconsistent due to their dependence on secondary data. Therefore, the return to the less cutting-edge, but probably more informative methodologies of interviews and surveys is advised to analyse this phenomenon.

*Firms Responses to Corruption*

Even though most studies analyse how corruption affects the decision-making process of allocating FDI to a foreign location at the macroeconomic level, there are others looking at this phenomenon from the firm-level perspective. For instance, Collins et al. (2008, p. 101) demonstrated that "the personal relationships of top managers with public officials are significant predictors of engagement in corruption." These authors also argued that support of political activities, from top managers, have a strong relationship with the willingness of such managers to engage in corrupt activities. Luiz and Stewart (2014) also studied how firms reacted to corruption when investing abroad and proposed that managers think of themselves as "institution takers" and that they only respond to the institutional conditions of the foreign locations. Nonetheless, the authors prove that firms can actually be proactive in changing the institutional environment of the location where they operate, specifically when instigating corruption.

Understanding corruption at the firm level and how likely managers are to engage in it has not yet been fully understood, as most studies dealing with entering new foreign locations only deal with issues of whether or not to engage in corrupt activities (Doh, et al., 2003; Galang, 2012). Though, some companies are being proactive in how they deal with corruption abroad, there is a dearth of research dealing with specific approaches that can be used to create strategies to deal with this problem. Therefore, we propose to analyse how managers react to high corruption abroad when deciding whether or not to invest in such location. In order to do so, we decided to analyse how managers from two different home locations (either more or less corrupt than the host country) rationalise their plans to enter a foreign location that is characterised by high levels of corruption. The rationale for this design is to study whether the strength of the home country institutional environment has an effect on engagement in corruption abroad.

FDI responds differently to various public policies if the host country is considered developed or developing (Goodspeed, et al., 2013; Godinez & Garita, 2016). Separating home countries based on their quality of institutions can provide a valuable insight into how firms create strategies to deal with corruption abroad. Based on this premise, we propose that the level of corruption of the home country might also play an important role when allocating FDI in a highly corrupt host country. Such differences might steam from knowledge developed at home about dealing with corruption and pressures from home constituencies regarding engaging in corrupt activities abroad.

**Research Design, Data, and Methods**

In order to analyse how the corruption level of the host country affects the decision-making process of FDI allocation, this research utilised a qualitative approach. The qualitative methodology was appropriate to generate inferences from the respondents in an inductive manner. Furthermore, a qualitative approach was more appropriate for this study since our aim was to analyse the perception of corruption and its effects on the decision making process of allocating FDI rather than a quantification of such effects. Therefore, to generate the data needed for this study we utilised semi-structured interviews. This format was preferred because it allowed us an informal setting for questioning to suit the needs of each participant. Also, the semi-structured interviews allowed us the flexibility to clarify responses or pursue emergent issues (Bryman, 2008).

*Setting*

Guatemala was chosen to conduct this study. The reason for using Guatemala as the setting for our study is because of its high corruption levels (Transparency International has ranked Guatemala in the 123rd place in the world, out of 177 countries) (Transparency International, 2014). In fact, several members of the Guatemalan government have been facing allegations of corruption, which resulted in the resignation and incarceration of the country's former president and vice-president (Malkin, 2015). Despite of Guatemala's high corruption levels, the country is the second largest recipient of FDI in Central America with a GDP of $53.80 billion in 2014 and receives the largest amount of FDI in the Central American region, which accounted for $1.308 billion during the same year (World Bank, 2014).

The high levels of corruption in Guatemala are explained by its levels of inequality and its transition from a lengthy civil war. According to Rose-Ackerman (2008), inequality within a nation is a predictor of high corruption. In the case of Guatemala, the United Nations Development Programme ranks it as one of the 20 most unequal countries in the world (UNDP, 2009). Also, scholars analysing corruption point out that nations transitioning from an internal conflict are usually characterised by weak institutions, which are fertile grounds for corruption (Rose-Ackerman, 1997; Rose-Ackerman, 2008). Thus, due to its levels of corruption and FDI inflows, Guatemala is an adequate location to analyse how the corruption level of the host country affects the decision-making process of allocating FDI to a highly corrupt foreign location

*Data Collection*

Data collection took place in two phases: from June to August 2012, and from June to July 2014. Data was collected by contacting all foreign firms that had invested in Guatemala since 2007. The reason for contacting these firms was to be able to talk to those individuals who had an active participation in the decision-making process of investing in the country. Once all firms were contacted, 28 firms agreed to allow us to interview managers who were involved in the decision regarding investment in a highly corrupt foreign location. The interviews were semi-structured in order to increase the focus and depth of the issue at hand. The interviewees had the choice of being interviewed in English or Spanish by the lead author. Those interviews conducted in Spanish were translated to English and then back to Spanish to corroborate their accuracy. Each interview lasted between 60 and 90 minutes and followed standard protocols to capture emerging themes in field research (Strauss & Corbin, 1994), and was recorded and transcribed.

After the first round of interviews (6 interviews), we decided to focus our data collection on a small number of steps used in the process of allocating FDI to a highly corrupt host location. To do this, a theoretical sampling was applied (Denzin, 1989), which is recommended for analytical induction (Bansal & Roth, 2000) in order to identify such steps. This approach was taken in order to capture a broad set of beliefs and practices during the decision-making process of allocating FDI to a corrupt location within the sample. In this manner, we followed Mair, et al., (2012) who propose to use the cases to arrange and stimulate data analysis, instead of using them as a method to expose variance.

After analysing the preliminary results of the first six interviews, five main steps were identified as the main process used by managers to invest in a highly corrupt foreign location. The investor's characteristics depending on the corruption level of their home country (more or less corrupt than the host country); previous knowledge of dealing with corruption; perception of corruption; uncertainty created by corruption distance; and strategy to deal with corruption. Once these areas of interest were identified, 22 additional interviews were conducted. Together with the first round of interviews, the data gathered was then used in a repetitive manner to compare information across informants and to analyse important points of synergy (Glaser & Strauss, 1967).

*Analysis*

The data was analysed in two phases in order to go back and forth between emerging theoretical arguments and the data, following Mair et al., (2012). Before any analysis, a narrative account of findings was arranged in a chronological manner. The historical account revealed a method to arrange the data around the steps utilised to invest in a highly corrupt host location. The qualitative analysis was carried out with the help of NVivo 9.0. The first six interviews included three from investors located in home countries with higher corruption levels than the host country and three from less corrupt host countries. In this manner, we developed a code system that allowed us to understand how the level of corruption of the home country affected the process of investing in a highly corrupt host location. After the data was collected, it was subjected to a manifest analysis of the condensed narratives, following Berg (2004). The analysis was carried out by identifying phrases commonly employed by the respondents, then by identifying justified descriptions. Based on these analyses we were able to examine how the difference in corruption levels of the home and host country affected the decision-making process of allocating FDI to a highly corrupt host country.

The first stage of formal analysis consisted of corroborating whether there were differences between how interviewees saw and responded to corruption based on the corruption level of their home country as compared to that of the host location with open coding. In order to carry out this stage, we relied on institutional theory that proposes that firms will seek legitimacy by conforming to their social context (Glynn & Abzug, 2002). Nevertheless, gaining legitimacy is a difficult process due to the different institutional environments in which such firms operate (Kostova & Zaheer, 1999). However, the data corroborated that those firms headquartered in countries with high levels of corruption were able to achieve legitimacy in a highly corrupt host country since such institutional environment resembled that of their home country. On the contrary, those firms located in countries with low corruption levels had a more difficult time adapting to the institutional environment of a host country characterised by high corruption levels.

The second stage of formal data analysis centred on investigating how managers rationalised their investment decision in a highly corrupt host country in relation to the two identified home countries, either more or less corrupt than the host country. The emphasis was placed on the remaining four steps of allocating FDI, even though it would have been possible to identify a greater number of activities. The rationale for focusing on these steps is because during the analysis, it became apparent that these areas were consistently emerging from all the interviews. Therefore, the decision was made to carry an extensive analysis of these steps. The analysis in this stage was carried out by creating provisional categories and first-code orders (Van Maanen, 1979). With the help of NVivo 9.0, it was possible to maintain a record of emerging categories and to see comparable coded texts concurrently, which was useful to manage the large dataset. Following Miles and Huberman (1994), the first categorical codes offered labels for different activities. The codes were created to mirror the words used by the interviewees, which included, for example, "being used to dealing with corruption," "problems associated with corruption," and "being prepared to deal with corruption."

After analysing the first order of codes, an axial coding was utilised (Strauss & Corbin, 1994). The second order of codes was used to provide meaning to how respondents rationalised their process of understanding corruption and creating a process to allocate FDI in a highly corrupt host country. In this procedure, an inductive process was utilised to identify a more abstract and theory rich construct of the data. In this stage, the data gathered and analysed was used to understand how managers allocated FDI to a highly corrupt host location and to provide the theoretical implications of this process.

## Results and Discussion

This study explores how corruption affects the decision-making process of FDI allocation. The analysis is comprised by the experiences and views of managers who had a direct role in deciding whether or not to invest in a highly corrupt foreign location, their previous experience and preconceived conceptions of corruption, and the conceptual and practical steps involved in minimising the effects of corruption when investing abroad, as presented in Figure 1. This section presents an analysis and decision-making model of allocating FDI in a highly corrupt host country. The results in this section emphasise the importance of the corruption level of the country where firms are headquartered when creating strategies to deal with corruption abroad.

### *Investors Characteristics*

The characteristics of respondents for this analysis are presented in Table 1. The names of respondents and MNEs are not shared to protect the identity of the participants due to the sensitive nature of this research. All respondents represent MNEs operating in the services industry. In other words, all the investments made in the host country can be classified as market-seeking. The respondents were identified as members of an MNE that had recently (within the last five years) established operations in Guatemala. Respondents also had to have actively participated in the decision-making process of investing and subsequent operations in the host country. As previously mentioned, the respondents were divided into two groups: MNEs headquartered in countries with lower levels of corruption than the host country and MNEs headquartered in countries with higher corruption levels than the host country. This distinction was made in order to compare how corruption abroad affects those foreign investors that are familiar with corruption at home compared to those without such experience. Also, the corruption distance and direction between the home and host country is provided, as well as the number of other subsidiaries in Latin America.

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### *Previous knowledge of dealing with corruption*

After conducting all the interviews with managers of firms with higher levels of corruption than the host country, it was evident that all of them had extensive experience with dealing with corruption. This experience was developed when operating in their home country as well as in other countries that had corruption levels similar to that of the home country. However, not all of them acquired such experience in the same manner. For instance, Investor 1 argued that "knowledge of how to deal with corrupt officials can be acquired at home." This view was supported by investors 2, 4, 7, 8, and 14, and supports previous claims that firms can learn to operate in challenging environments and deploy such knowledge abroad, as proposed by Buckley, et al., (2007) and Cuervo-Cazurra and Genc (2008).

All investors from home countries with higher corruption levels than the host country agreed that they acquired knowledge of how to deal with corruption at home. However, some of them did so implicitly (See Table 2 for a summary of illustrative comments from respondents). An example of this is Investor 10, who stated that "nothing can fully prepare you to deal with corruption abroad; but, after having operations in the country you learn what to expect." Investor 3 had a similar view to Investor 10, claiming that "no one can totally learn how to deal with corruption at home or abroad. But, the experience at home taught us where we should expect illegal claims." In a similar view, Investor 8 argued that "there is no need to know how to deal with corruption. You should learn to deal with people of different customs and that experience can be acquired at home."

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Table 3 presents a summary of responses from managers headquartered in countries with lower corruption levels than the host country when asked about acquiring knowledge to deal with corruption with varied responses. In this sense, many foreign investors argued that corruption is an important problem that is severely punished at home, even if the corrupt act is committed abroad. Thus, according to these investors (Investors, 18, 20, 23, and 26), they did not have the opportunity to learn how to deal with corruption either at home or in the other foreign locations where they operate. On the other hand, other investors from countries with lower corruption levels than Guatemala (Investors 15, 19, 22, 24, and 25), argued that corruption although bad, can be seen as a "means to an end." It is plausible that these investors argue for a more benign nature of corruption, since the corruption levels of their home countries are close to those of Guatemala, according to Transparency International (Transparency International, 2014).

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From an institutional theory point of view, these findings mean that the level of corruption of the host country, as compared to that of the home country, matters when analysing FDI flows to a highly corrupt host location. This finding validates, at the firm-level with a qualitative approach, the results proposed by Goodspeed et al., (2013). Also, these results suggest managers can develop the capacity to operate in a particular institutional environment (Johanson & Vahlne, 1977). Managers, in this sense, generate assumptions that influence how their firms operate in an external environment and are able to deploy them in similar foreign environments. In the case of MNEs headquartered in highly corrupt countries this means that a foreign environment that can be considered as 'challenging' by some managers, cannot be considered as such if a manager had the opportunity to learn how to operate in it at home. On the other hand, firms located in home countries with low corruption levels might face considerable problems achieving legitimacy in a foreign environment characterised by high corruption. The difficulties to achieve legitimacy arise from the complexity of the different institutional environments in which an MNE operates (Kostova & Zaheer, 1999). When talking about a firm operating in a highly corrupt host country, this means that MNEs without knowledge of how to operate in such conditions might have difficulties assessing their critical constituencies (Scott, 1995) and might face strong pressures at home to not engage in corruption abroad (Cuervo-Cazurra, 2006).

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INSERT FIGURE 1 HERE

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***Perception of corruption and engagement in corruption abroad***

Responses from MNEs headquartered in home countries with higher levels of corruption than the host country agreed that corruption was a problem. For example, Investor 1 declared that “corruption is morally wrong.” Other respondents argued that corruption is one of the most important problems they have to face when deciding to start operations in a foreign location and to continue their activities in such places (Investors 3, 5, 6, 8, 9, 10, and 12). These responses are in line with the general view that corruption has a negative effect on businesses (Doh, et al., 2003; Wei, 1997). Nonetheless, twelve respondents, out of fourteen, justified the existence of corruption. In this sense, respondents argued that even though corruption is detrimental for their businesses, they had to comply with it to remain in businesses. For instance, Investor 9 argued that “corruption is wrong but if I do not comply, we go out of business and we cannot offer employment.” This view was echoed by all respondents as summarised in Table 4, except Investors 2 and 7, who declared that "corruption should not exist" and that "firms should not engage in it."

Despite their negative views on corruption, all fourteen respondents from MNEs based on countries with higher levels of corruption than the host country, admitted to have had participated in corrupt deals abroad. In fact, to some degree, all respondents agreed that corruption was just part of doing business in Guatemala. Investor 4 is a good example of this finding by declaring that "if we wanted to be awarded contracts, we had to participate in corrupt deals". Investor 13 also said that "we had no choice but to comply with the local customs." This result might confirm that those foreign investors based in highly corrupt home countries might internalise knowledge of how to deal with corruption at home and deploy it abroad. Also, this finding shows that foreign investors from countries with high levels of corruption are aware that corruption is wrong but they choose to engage in it nevertheless, as illustrated in Table 4. Thus, this result may indicate that those MNEs headquartered in home countries with high levels of corruption might not face pressures from stakeholders at home to not engage in corrupt deals abroad.

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When talking to respondents from MNEs headquartered in countries with lower levels of corruption than the host country, it was evident that they also saw corruption as an important problem. Out of fourteen respondents, nine argued that corruption was detrimental for their businesses and for society in general. However, these investors disagreed on how much of a problem corruption really was. For example, Investor 20 declared that "corruption is a cancer of a society." Investor 16, on the other hand, argued that "corruption is a major impediment for conducting business abroad but it is not the only factor to be considered." Nevertheless, all respondents declared that corruption was detrimental for their businesses and that it even decreased the amount of investment allocated in a foreign location.

The main difference between MNEs headquartered in countries with lower level of corruption than the host country, and those with higher corruption levels, was that those MNEs with low levels of corruption at home were less likely to engage in corruption abroad, as presented in Table 5. According to investors 18, 20, 21, 23, and 26, they not only have regulations at home preventing them from engaging in corruption overseas but also internal policies to minimise the risk of engaging on corrupt deals abroad. Also, investors 15, 16, 19, 22, 24, 25, and 27 declared that they too "try to avoid" corrupt deals abroad when possible. An example of how foreign investors try to avoid corruption abroad was provided by Investor 27 who said that when it is necessary, they rely on their local partners to carry out certain operations that might not be perceived as totally ethical. This finding confirms the long held idea that corruption has a negative effect on MNEs. However, the negative effect of corruption on a business might be even more detrimental if the MNE is headquartered in a country with lower levels of corruption than the host country.

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The results of the perception of corruption depending on the corruption level of the home country as compared to that of the host country, means that the location where a manager spent his/her formative years has a direct influence on how such manager views corruption. Institutional theory has been utilised to understand how organisational structures and processes become institutionalised over time (Oliver, 1991). The fundamental premise of this theory is that MNEs have tendencies to conform to predominant norms and traditions of the location in which they operate (Meyer & Rowan, 1977). In turn, such tendencies lead to a homogeneity amongst the structures of an MNE and its activities, that is shaped by social pressures (Oliver, 1997). In the case of corruption, it means that a manager's perception of corruption is directly linked to the corruption level of their home country.

***Uncertainty created by corruption distance***

Corruption can be seen as a tax on MNEs (Mauro, 1995), but the greatest challenge it poses on firms might not be the costs themselves, but the uncertainty regarding the actual costs that the firm will need to pay to a corrupt foreign official (Wei, 1997). While previous studies agree that the uncertainty created by corruption might be more detrimental to foreign investors than the actual corruption level (Curevo-Cazurra, 2008; Fisman & Miguel, 2007), little is known about how such uncertainty affects the decision-making process of allocating FDI to a highly corrupt host country. In this research, the majority of respondents of MNEs based in countries with high levels of corruption agreed that uncertainty was not a characteristic of the Guatemalan market. According to these investors, they had previous knowledge of the corruption levels of the host country and how to manoeuvre through it. When asked a question regarding uncertainty, Investor 3 replied that "no one is surprised about the levels of corruption in Guatemala." To further this point, Investor 8 argued that its firm "knows how to do business where they decide to operate." This sentiment was shared by investors 5, 6, 7, 9, 10, and 11. However, even though most investors based in home countries with high levels of corruption declared that the uncertainty created by corruption was minimal in Guatemala, they agreed that corruption had detrimental consequences. According to Investor 7, "the uncertainty created by corruption was minimal but it did increase their operating costs." This finding, illustrated in Table 6, is in line with the conclusions reached by Cuervo-Cazurra (2008) and Uhlenbruck, et al., (2006) who argued that the levels of arbitrariness of corruption are more detrimental to foreign investors than its levels of pervasiveness.

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In general, respondents from MNEs headquartered in countries with lower levels of corruption than the host country declared that they had knowledge that Guatemala's was considered highly corrupt. Nevertheless, the uncertainty it created when deciding how to operate in the country was a great impediment for doing businesses there (Collins, et al., 2008), as presented in Table 7. In this study, nine respondents (out of fourteen) argued that uncertainty generated by corruption was a concern when deciding to start operations in Guatemala. These respondents also voiced that uncertainty was an obstacle to operate in a highly corrupt host country. In fact, respondents 15, 17, 19, and 20 argued that local officials in Guatemala can request unlimited bribes. Other respondents, such as Investors 16, 17, 25, and 28, agreed that the costs associated with corruption in Guatemala were predictable, and hence, uncertainty generated by corruption was minimal.

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INSERT TABLE 7 HERE

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Corruption is distinct in different countries in both the reach throughout the economy (Uhlenbruck, et al., 2006), and the uncertainty it creates (Chakrabarty & Bass, 2013). A host locations characterised by high uncertainty derived from corruption might require several ineffectual corrupt transactions from foreign firms. Moreover, under a weak administrative governance, government officials might be willing to change the set of necessary approvals without giving notice to receive maximal bribes (Shleifer & Vishny, 1993). Therefore, firms without previous knowledge of how to deal with corruption might suffer negative effects when operating in a foreign location characterised by high uncertainty created by corruption. However, this study finds that the uncertainty created by high corruption has detrimental effects on foreign investors when such investors are located in countries with low levels of corruption.

Furthermore, such negative effects are exacerbated with a higher corruption distance between the home and host countries. On the other hand, corruption distance appears to not have an effect on firms located in a home country that has higher corruption levels than an already highly corrupt host location. This finding is explained because such firms have been equipped with developed knowledge regarding operating in highly corrupt countries, and are able to deploy such knowledge to operate abroad. Also, this finding can be explained because firms located in a highly corrupt home country might not face strong pressures to not engage in corruption abroad from home country stakeholders.

***Strategic measures to deal with corruption abroad***

Most studies analysing corruption and FDI agree that corruption has a negative effect to various degrees on foreign investment (Cuervo-Cazurra, 2006; Doh et al., 2003; Habib & Zurawicki, 2002). In addition to market avoidance, mutational enterprises have made great efforts to explore different ways to lessen the sensitivity of the affects and to engage in FDI activities (for example, trading favours). However, fewer studies have analysed strategic responses of MNEs when the decision of investing abroad has been made. To address this gap in the literature, Luiz and Stewart (2014) argue that some firms have created anti-corruption policies with strict anti-corruption participation mandates even though the authors argue that for some companies, sometimes participating in corrupt deals is unavoidable. Building on their work, this study shows that there is a great difference between MNEs based in countries with low levels of corruption and MNEs based in highly corrupt countries, when talking about strategies to deal with corruption abroad. In general, MNEs based in home countries with high corruption levels do not have formal strategies to deal with corruption abroad. Of the fourteen MNEs studied, only four declared to have a strategy to deal with corruption abroad (Investors 1, 2, 5, and 6). Nevertheless, their strategy was to allocate resources to their budget to pay for bribes. Therefore, while these investors describe themselves as proactive, they are still participating in corrupt deals abroad, as exemplified in Table 8.

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INSERT TABLE 8 HERE

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The responses from MNEs based in countries with lower levels of corruption than the host country showed that in general these firms have strategies to deal with corruption abroad (Table 2). In line with Luiz and Stewart (2014) Investors 15, 16, 18, and 20 declared that their main strategy to deal with corruption was avoidance. These investors argued that they avoided conducting business with the local government when possible. Other respondents went further and declared that their organisational structure was designed to be as transparent as possible (Investors

21, 23, 24, and 25). These investors declared that they had the mandate from headquarters to adhere to a strict code of conduct, as Table 9 illustrates. Such code of conduct required that all negotiations with local government officials and/or business partners be recorded and attended by at least two members of the MNE. Moreover, these investors argued that they had clear transparency procedures in place to hire suppliers. However, there were investors that declared not to have strategic measures in place to deal with corruption abroad (Investors 17, 22, and 28), which might be because their levels of corruption, although lower than Guatemala, can still be considered high.

INSERT TABLE 9 HERE

Another approach used by firms from less corrupt countries when investing in Guatemala, was to have a decentralised approach. While some investors declared that their strategy to deal with corruption was to avoid it, others argued that they preferred their strategy to have some "room for interpretation" to account for variations in the host countries where they operate. This approach was put in place to adhere to the host country's local norms, such as the acceptance of hospitality. Nevertheless, these firms also had a high transparency requirement that made it necessary for managers to record and report all gifts received when conducting businesses there. Table 10 presents a summary of the main findings of this study

INSERT TABLE 10 HERE

## Conclusions

This study analysed how the corruption level of the host country affects the decision-making process of allocating FDI to a highly corrupt foreign location. Based on institutional theory this study analysed two kinds of corruption, public and organisational (Luiz & Stewart, 2014), and how such corruption affects MNEs investing in a highly corrupt foreign location. In order to answer the question, 28 interviews were carried out with managers of MNEs that had recently invested in Guatemala. Following the work of Godinez and Liu (2015), we divided the respondents into two groups: MNEs headquartered in countries with higher corruption levels than the host country, and MNEs headquartered in countries with lower corruption levels than the host country. The classification of home countries as either more or less corrupt than the host country was made to compare and contrast reactions to corruption abroad based on the experience foreign investors had at home regarding how to deal with corruption and if such experience could be utilised abroad (Goodspeed et al., 2013). The results show that firms based in home countries with lower levels of corruption than Guatemala were negatively affected by corruption in the host country. On the other hand, those MNEs based in home countries with higher levels of corruption than the host country were not as negatively affected when investing in a foreign country characterised by high levels of corruption.

Corruption is believed to have negative effects on economic growth (Halkos & Tzeremes, 2010). Corruption acts like a tax. Firms devote resources to manage corruption but those resources could be better allocated (Shleifer & Vishny, 1993). Corruption is also believed to have a negative effect on foreign investors (Godinez & Garita, 2015). However, building on the foundation that not all foreign investors are equal (Cuervo-Cazurra, 2006), we argue that those foreign investors based in home countries with lower levels of corruption than the host country might not be as likely to engage in corruption abroad. On the other hand, those investors from MNEs based in countries with high levels of corruption might be more likely to participate in corrupt deals in foreign locations. While studies analysing corruption and its effects on FDI have seen MNEs as institutional takers (Luiz and Stewart, 2014), we argue that MNEs can actually be more influential in the institutional arrangement of a foreign location than previously thought. We base this conclusion on the fact that those MNEs familiar with dealing with corruption at home can actually seek out other corrupt countries to establish new operations. On the other hand, those firms based in countries with low levels of corruption might try to avoid engaging in corruption abroad and actually have policies to ensure they operate corruption free abroad.

Finally, while firms should have strategies to deal with corruption (Luiz and Stewart, 2013), this study found, however, that those MNEs from countries with higher levels of corruption than the host country did not have strategies in place to deal with corruption abroad. Respondents from these firms argued that corruption was just a part of doing business and that no specific strategies were needed. On the other hand, those firms located in countries with lower corruption levels than Guatemala attributed their success in the country to their strategies to deal with the country's corruption. These investors argued that their strategies to deal with corruption included a clear policy to avoid doing businesses with the local government, as well as a well-designed organisational structure that allowed transparency.

*Limitations and Future Research*

This study has many limitations. Due to the qualitative nature of this analysis we were able to study in depth how corruption affects the decision-making process of allocating FDI to a corrupt foreign location. However, qualitative studies rely on a restricted number of respondents. For this reason, future studies should analyse this issue in a quantitative manner, and hopefully with more than one host country. This approach is necessary to develop testable hypotheses that can further our knowledge of the subject. Also, due to the large levels of corruption present in Guatemala, the number of home countries with higher corruption levels than the host country is limited.

Lastly, even though this study argues that those MNEs headquartered in countries with high corruption levels might not be negatively affected by corruption when investing and operating abroad, it is important to note that corruption is still a problem that affects them. As stated by Shleifer and Vishny (1993), resources allocated to dealing and complying with corruption could be more effectively and efficiently deployed to more productive operations. Firms from highly corrupt home countries should follow the lead of their counterparts from less corrupt countries and think proactively about this problem and how to avoid it. If they do so, they would not only utilise their resources more wisely, but they could also gain more goodwill from customers that demand higher standards from MNEs.

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## TABLES AND FIGURES

Table 1: Profile of Respondents

| Investor | Home Country | Corruption Distance and Direction | Amount Invested in Past 5 Years (US$) | No. of Subsidiaries in Latin America |
|---|---|---|---|---|
| I1 | Honduras | -3 | Up to 1 million | 2 |
| I2 | Vietnam | -1 | Between 10 and 20 million | 6 |
| I3 | Guyana | -2 | Between 5 and 10 million | 4 |
| I4 | Honduras | -3 | Up to 1 million | 3 |
| I5 | Vietnam | -1 | Between 5 and 10 million | 4 |
| I6 | Venezuela | -13 | Between 5 and 10 million | 5 |
| I7 | Nicaragua | -4 | Between 10 and 20 million | 8 |
| I8 | Honduras | -3 | Between 5 and 10 million | 4 |
| I9 | Russia | -5 | Up to 1 million | 3 |
| I10 | Paraguay | -8 | Between 5 and 10 million | 4 |
| I11 | Russia | -5 | Between 1 and 5 million | 3 |
| I12 | Turkmenistan | -15 | Between 10 and 20 million | 6 |
| I13 | Nicaragua | -4 | Up to 1 million | 2 |
| I14 | Nicaragua | -4 | Between 1 and 5 million | 3 |
| I15 | China | 4 | Between 10 and 20 million | 5 |
| I16 | Canada | 49 | Between 10 and 20 million | 7 |
| I17 | Mexico | 3 | Between 20 and 30 million | 9 |
| I18 | USA | 42 | Between 30 and 40 million | 7 |
| I19 | Mexico | 3 | Between 5 and 10 million | 5 |
| I20 | Canada | 49 | Between 20 and 30 million | 8 |
| I21 | Germany | 47 | Between 10 and 20 million | 6 |
| I22 | China | 4 | Between 30 and 40 million | 10 |
| I23 | USA | 42 | Between 5 and 10 million | 4 |
| I24 | China | 4 | Between 20 and 30 million | 6 |
| I25 | Spain | 28 | Between 10 and 20 million | 6 |
| I26 | USA | 42 | Between 30 and 40 million | 7 |
| I27 | Germany | 47 | Between 10 and 20 million | 6 |
| I28 | Spain | 28 | Between 5 and 10 million | 4 |

Figure 1: Corruption and how it affects the decision-making process of allocating FDI

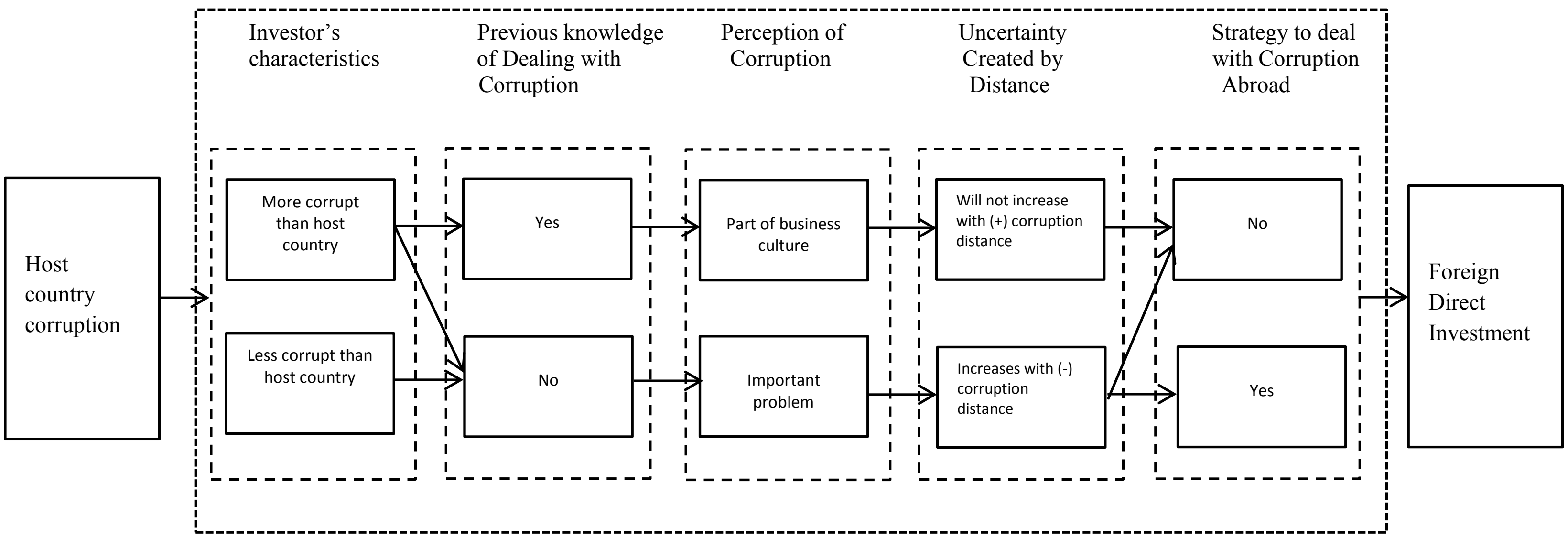

TABLE 2: Knowledge of dealing with corruption from managers headquartered in countries with higher corruption levels than the host country

| Investor | Illustrative Quotes |
|---|---|
| I1 | Of course knowledge of how to deal with corrupt officials can be acquired at home. We learned what corrupt officials want and how we can provide it. In this manner we ensure that we can remain in business |
| I2 | If you think of it, Vietnam and Guatemala aren't that different. Businesses want to operate and government workers want to supplement their income. In this sense, we have plenty of practice at home of how to help both parties reach their goals |
| I3 | Corruption is different in different places. This means that no one can totally learn how to deal with corruption at home or abroad. But, the experience at home taught us where we should expect illegal claims and how to deal with them |
| I4 | At home [Honduras] we have been dealing with corrupt officials since we started our business. That experience has definitely helped us operating abroad. We learned very early that there are certain expectations for businesses to be able to secure contracts and acquire licenses, for example |
| I7 | Yes, we have had to deal with many corrupt public officials at home. This experience gave us enough practice to know how to maneuver corrupt officials abroad, especially since our countries are very similar |
| I8 | Government officials are the same everywhere. We had the chance to learn to deal with them at home and we realized that officials abroad aren't that different |
| I9 | Companies should not be too worried about learning to deal with corruption. Instead, they should learn how to deal with people of different customs and that experience can be acquired at home |
| I10 | Nothing can fully prepare you to deal with corruption abroad; but, after having operations in the country, you learn what to expect and how to deal with different requests |
| I14 | We have had to learn to collaborate with corrupt officials at home. They have a goal and we have ours. It is the same in other countries. |

Table 3: Knowledge of dealing with corruption from managers headquartered in countries with lower corruption levels than the host country

| **Investor** | **Illustrative Quotes** |
| --- | --- |
| I15 | We had adapted to co-exist with corruption. Sometimes we have to comply but we try not to |
| I18 | Absolutely not. Of course there is corruption at home but nothing even close than Guatemala |
| I19 | We try to avoid doing corrupt deals as much as we can even though sometimes it is difficult, especially with low level officials asking for small bribes |
| I20 | I am sure there is corruption at home but we have a zero tolerance policy at home and abroad |
| I22 | Corruption at home is not uncommon. However, due to cultural differences I do not believe that corruption at home helped cope with corruption in Guatemala |
| I23 | Not interested in learning |
| I24 | We had learned to maneuver in conditions considered less than ideal |
| I25 | You could learn to deal with corruption if you wanted to. Either learn to engage on it or how to avoid it |
| I26 | No, at home it is known that there is corruption in government contracts but we do not participate in those |

Table 4: Perception of corruption and engagement in corruption abroad from managers headquartered in countries with higher corruption levels than the host country

| Investor | Illustrative Quotes |
|---|---|
| I1 | Corruption is morally wrong. However, sometimes it is necessary to continue in business |
| I2 | Corruption is deplorable and should not exist and firms should not engage in it. |
| I3 | Corruption is wrong, but it is understandable since some public officials need to complement their wages. |
| I4 | I do not believe that there is such thing as corruption. People only have different business cultures and it is our job to figure out how to operate in each one |
| I5 | Corruption is wrong but if I do not comply, I do not have a business and cannot offer employment |
| I6 | It should not be acceptable but it is the only way to do business sometimes |
| I7 | Corruption is wrong. It should not be acceptable |
| I8 | Corruption is part of doing business anywhere |
| I9 | Corruption should not exist but it does. If we do not participate we will go out of business |
| I11 | Corruption is wrong but that is how business is conducted |

Table 5: Perception of corruption and engagement in corruption abroad from managers headquartered in countries with lower corruption levels than the host country

| Investor | Illustrative Quotes |
|---|---|
| I18 | Corruption is wrong and should be combatted |
| I19 | Corruption is wrong and delays processes |
| I20 | Corruption is a cancer of a society |
| I21 | Corruption is morally wrong and affects an entire society |
| I22 | Corruption increases prices and diminishes reputations |
| I24 | Corruption should not exist and business should be transparent. That is not always the case |
| I26 | Corruption is illegal at home and anywhere we operate |
| I28 | Corruption is wrong and should not happen, but it does |

Table 6: Uncertainty created by corruption from managers headquartered in countries with higher corruption levels than the host country

| **Investor** | **Illustrative Quotes** |
|---|---|
| I2 | When investing in Guatemala we had knowledge of the problem in the country. Uncertainty was minimal |
| I3 | There is no uncertainty due to corruption. No one is surprised by corruption in Guatemala |
| I4 | There is no uncertainty if you know what you will encounter |
| I6 | There is no uncertainty when you know what to expect |
| I8 | Not uncertain, we know how to do business where we operate |
| I9 | Corruption increases prices but we know how to deal with it |
| I13 | Corruption expedites processes but increases prices |

Table 7: Uncertainty created by corruption from managers headquartered in countries with lower corruption levels than the host country

| Investor | Illustrative Quotes |
|---|---|
| I16 | Corruption occurs more often when doing business with the government. We try to avoid that |
| I17 | Corruption in Guatemala is very predictable as well as its costs |
| I19 | Uncertainty can be high but once officials see how we do business they do not bother us |
| I20 | We do whatever we can to avoid engaging in corruption |
| I23 | Corruption erodes an organization's image, increases costs, increases poverty |
| I25 | Increases costs and sometimes prevents us from doing business with the government (when we refuse to pay) |
| I26 | Corruption worsens poverty, promotes inequality and increases costs to everyone |
| I28 | Corruption makes access to permits and contracts more difficult. Those with connections have an advantage |

Table 8: Strategic Measures to deal with corruption abroad from managers headquartered in countries with higher corruption levels than the host country

| Investor | Illustrative Quotes |
|---|---|
| I1 | On our business plan we allocated money for payments to local officials |
| I2 | We already knew that several requests were going to be made. We had to account for those expenses when devising our plan |
| I3 | Our institution does not have a plan to deal with corruption abroad, as far as I am concerned |
| I7 | We know how to operate in these kinds of countries. There is no need to create formal strategies to do what we already know how to do |
| I13 | This company does not have formal norms about dealing with corrupt government officials |

Table 9: Strategic Measures to deal with corruption abroad from managers headquartered in countries with lower corruption levels than the host country

| **Investor** | **Illustrative Quotes** |
| --- | --- |
| I15 | Our main strategy is to avoid doing business with local government. If necessary, we hire a local company to do deal with them for us |
| I17 | Our company does not have clear strategic measures to deal with corruption abroad. We just try to do the right thing |
| I18 | Avoid doing business with local government. Clear code of conduct applicable to all of our employees |
| I20 | I am not sure if this is considered a strategy, but we have a clear code of conduct applicable to all of our employees which is zero tolerance to corrupt behavior |
| I24 | If my memory serves me well, we have a petty cash budget to deal with small requests mainly from low level bureaucrats |
| I26 | We follow the code of conduct when doing business abroad in place by our firm. We also exercise our discretion always acting ethically |

TABLE 10: Summary of Findings

| Characteristics | Previous Knowledge of Dealing with Corruption | Perception of Corruption | Uncertainty Created by Corruption Distance | Strategy to Deal with Corruption Abroad |
|---|---|---|---|---|
| **More Corrupt** | Generally acquired in the home country. Also acquired in other locations resembling home country institutional Environment | An important problem but "justifiable" | Corruption in the host country generates minimal uncertainty | Generally, no strategy in place. Only "strategy" allocate bribing money to the budget |
| **Less Corrupt** | Difficult to acquire knowledge at home. Also, home country formal and informal pressures to not engage in corruption abroad | A very important problem that needs to be eradicated | Corruption in the host country generates great uncertainty | Avoiding dealing with government officials. Codes of conduct. Understanding differences in culture but with transparency. |