

CORRUPTION:

Do we skip unpleasant issues of business interaction?

Asta Salmi
Center for Markets in Transition
Helsinki School of Economics and Business Administration
P.O. Box 1210
FIN-00101 Helsinki
Email: asalmi@hkkk.fi

ABSTRACT

Within the IMP-group and in related research, emphasis has been on long-term business relationships and cooperation. Although we do acknowledge competition as well and note that relationships may become liabilities as well as assets, we largely seem to forget personal interests and opportunism in business behavior. We rather focus on how social capital may enhance business relationships. At the same time, business press reports about corruption worldwide. Especially in the Russian, and to some extent more generally Eastern European context corruption has become the main characteristic of emerging markets. Analysts as well as businessmen are struggling to cope with corruption and opportunism there, and seem to lack tools for it. The paper discusses social capital and its relation to arm's-length relationships and to business relationships. Business norms in different countries is discussed as well. The paper raises the need for more explicit analysis of corruption when analyzing interaction and relationships in business markets.

INTRODUCTION

Recently, social capital has attracted an increasing interest among researchers. Also in IMP-conferences there have been some papers discussing personal relations and social capital (for instance, Araujo, Bowey & Easton, 1998; Salmi & Mattsson, 1998), although it is usually stressed that our task is to analyze business interaction and business relationships, and consequently, we should direct attention on inter-organizational rather than interpersonal relations. Social exchange plays only one role among others in business interaction. If and when social and personal relations are taken up, stress seems to be on their positive outcomes, e.g. how personal relations facilitate business exchange, enhance information exchange and play a role in trust building. We seem to forget that social capital is made up of obligations from and obligations to other individuals – therefore, personal gain and greed may start to play a role, too.

When reviewing research about inter-organizational relationships, Bengt Högberg pointed out that “opportunism does not surface in the articles; but in reality, we are not always nice people” (Högberg, 1999, oral presentation at 15th IMP conference). There is no doubt that greediness, opportunism and rent-seeking may sometimes be accurate descriptions of business interaction.

Also, news on corruption abound in mass media. To some extent, economists and political scientists have been interested in the phenomenon of corruption, but within business administration papers on corruption seem to be lacking so far. Why are we not more concerned about the illegal side of business? Should we direct more attention on the ethics in our scholarly discussions?

The aim of this paper is to raise the issue of the dark side of business interaction: to discuss the phenomenon of corruption in general, and to elaborate on its implications for research on inter-organizational relationships and business studies. The paper is organized as follows. First, the phenomenon and definition of corruption in general is discussed. Next section investigates corruption in different cultures and national contexts. Discussion part of the paper draws some implications for research.

PHENOMENON OF CORRUPTION

Corruption is an ancient problem and even today it is frequently discussed. This paper confines to the economic context, not, e.g., political corruption. A large proportion of corruption seems to arise in the area of public procurements. This paper tries to look into more common, everyday situations (involving smaller monetary exchanges) of business interaction and elaborate corruption in that context.

The arm's-length principle requires that personal or other relationships should play no role in economic decisions that involve more than one party (Tanzi, 1995:161). Within IMP research tradition we explicitly start from existing ties and relations between companies. Our analysis concentrates on situations where relationships abound, and to some extent we have analyzed also social relations, where individuals are involved in business. Even more generally, there has been a shift towards analysis of networks; to ties and bonds between business actors and specific attachments. Social capital is today's hot topic. Personal relations (*guanxi*) have been investigated especially in the Chinese context (Björkman & Kock, 1996, Xin & Pearce 1996), and in the Russian context (Salmi & Bäckman, 1999). E.g. legacies of the Soviet economy have been analyzed by looking into *blat*, which refers to the system of informal contacts and personal networks which was used to obtain goods and services under the rationing which characterized Soviet Union (Ledeneva, 1998).

Social capital is an asset to the individual who possesses it, and often it is an asset to companies as well. This asset can have several implications. Social capital links individuals in a network of obligations that both increases and reduces their individual freedom. Tanzi (1995) notes that existence of social capital is likely to interfere with arm's-length relationships and, in particular circumstances, it may lead to corruption. Scholars analyzing personal relations, *guanxi* and *blat*, have been struggling to differentiate personal relations from bribery and corruption (Ledeneva, 1998; Lovett et al. 1999; Xin & Pearce 1996). E.g. distinction has been made between *guanxi* and bribery. The former means relationship building, while the latter is simply an illicit transaction, and more specifically: 1) gain-and-loss calculation dominates the act of bribery, 2) bribery is for an immediate and specific purpose, and 3) there is no emotional content or affect involved in bribery. (Lovett et al, 1999) It is therefore stressed that maintenance and use of personal

relations, and e.g. gift-giving, is not necessarily the same as bribery and corruption, but may instead only act as symbols of friendship.

It is tricky to *define* corruption, the following are some attempts. Corruption is

- the intentional non-compliance with the arm's-length principle aimed at deriving some advantage for oneself or for related individuals from this behavior (Tanzi (1995, 167)
- the use of public office for private advantage, the latter term understood not only in a pecuniary sense but also in terms of status and influence (Palmier 1983, quoted in Ledeneva 1999, 42).

According to Tanzi (1995), the term corruption comes from the Latin verb to break, *rumpere*, implying thus that something is broken. It might be a moral or social code of conduct or an administrative rule. For the latter, there are several requirements: firstly, the rule that is broken is precise and transparent, second, the official who breaks it, derives some recognizable benefit for himself or some relevant person/group, and finally, the benefit derived must be a direct quid pro quo from the 'corrupt' act. (p. 168).

Corruption can be analyzed by looking into the supply side or demand side of corruption (Delbono 1995); supply concerns behavior of corrupted people. In addition, there may be demand, i.e. the corrupting people play a role. There are several incentives for the latter as well. E.g. the outcome of interaction, where an agent faces a multi-level organization, may include corruption at some or all levels of the hierarchy.

Some literature suggests that corruption may improve efficiency and help growth (for discussion see e.g. Bardhan 1997; Pirttilä 1999), because, for instance, corruption 'oils the system' or bribes serve as a 'speed money'. Mostly, corruption is seen as harmful for growth. Shleifer and Vishny (1993) give two broad reasons why corruption may be costly to economic development. First is the weakness of central government, which allows various governmental agencies to impose independent bribes on private agents seeking complementary permits from these agencies. When the entry of agencies is free, cumulative bribe burden increases to infinity. As an example, they give foreign investment in post-Communist Russia. To invest in a Russian company, a foreigner must bribe every agency involved in foreign investment (e.g. different ministries, agencies and levels of local government), and the obvious result is that foreigners do not invest in Russia. The second broad reason is the distortions entailed by the necessary secrecy of corruption. The demands of secrecy can shift a country's investments away from the highest value projects into potentially useless projects, if the latter offer better opportunities for secret corruption. This (i.e. over-invoicing) explains preference for advanced technology: Western observers often wonder about the preference for unnecessarily advanced rather than "appropriate" technology by Third World governments.

Shleifer and Vishny (1993) argue that economic (and political) competition can reduce the level of corruption and its adverse effects. If different agencies compete in the provision of the same services, corruption will be driven down (provided that agents cannot simply steal).

CORRUPTION IN VARIOUS COUNTRIES

Corruption is different in different countries. One explanation is that social norms are different. What is regarded in one culture as corrupt may be considered a part of routine transaction in another. E.g. it is widely recognized that in developing countries gift-exchange is a major social norm in business transactions. (Bardhan 1997) In societies with close social relationships frequency of corruption is likely to be greater, its identification more difficult, and its punishment more problematic. (Tanzi, 1995: 167)

If we look at the beliefs about corruption frequency and its actual incidence, we note that there is a self-fulfilling equilibrium of corruption. Spread of (dis)information that everybody is corrupt creates an atmosphere of corruption, people who believe they are living in a climate of corruption get corrupted themselves (see Bardhan, 1997: 1334). Moreover, the reputation of individuals and the groups they are part of (collective reputation) are interlinked, and bad reputation of past generation may explain persistence of corruption (Tirole, 1996).

There is a clash between an abstract definition of corruption and its application to a complex real world, and this has led to distinction between 'good', 'bad' and 'ambiguous' (white, black and grey) corruption (see e.g. Ledeneva 1998). It is very difficult to measure corruption, but one attempt has been made by Transparency International. Corruption Perception Index is published annually, and it usually receives publicity in media around the world. (For selected scores in 1997 see table 1).

TABLE 1. Perceived corruption ranking 1997, selected countries

Ranking	Country	Index
1.	Denmark	9,9
2.	Finland	9,5
3.	Sweden	9,4
4.	New Zealand	9,2
5.	Canada	9,1
13.	Germany	8,2
14.	United Kingdom	8,2
16.	USA	7,6
20.	France	6,7
21.	Japan	6,7
27.	Czech Republic	5,2
28.	Hungary	5,2
29.	Poland	5,1
30.	Italy	5,0
33.	South Africa	4,9
36.	Brazil	3,6
40.	Philippines	3,1
41.	China	2,9
49.	Russia	2,3
50.	Colombia	2,2
51.	Bolivia	2,1
52.	Nigeria	1,8

SOURCE: TRANSPARENCY INTERNATIONAL. TI Newsletter, September 1997, p. 3.

The rank relates solely to the results drawn from a number of surveys and reflects only the perceptions of business people that participated in these surveys. Score relate to perceptions of the degree of which corruption is seen by business people, 10,0 would be a totally corruption-free country.

Such information as presented in Table 1. shows that level of corruption is highest in transition and developing countries, but of course, there is corruption also in market economies. Moreover, corruption exists also outside the state organizations, in the market system and within private organizations.

In 1999, Transparency International has released its first Bribe Payers Perception Index. This index ranks 19 leading exporting countries by the degree to which their corporations are perceived as paying bribes abroad to senior public officials. Concerning propensity of corporations to use bribes (again, on scale 0 to 10, 10 representing a corrupt-free exporting

country) Sweden got the best score with 8,3, while China (including Hong Kong) received a score of only 3,1. (Transition, 1999)

DISCUSSION AND IMPLICATIONS FOR (ANALYSIS OF) BUSINESS INTERACTION

Lovett et al. (1999) make the point that both western and non-western (e.g. Chinese) economies are evolving towards new economic systems: the western model is placing increased emphasis on specific attachments and the eastern model on ability. For the eastern model (operating within guanxi-type systems), it is important to be able to rapidly accept new exchange partners on the basis of ability rather than the length of a relationship or similarity to oneself. Traditional western model of business dealings has lacked the concept of benevolence, i.e. the buyer-seller relationship is supposed to be reflected in its entirety in an impersonal contract stated in universalistic terms. For analysts of industrial markets and inter-organizational relationships (like in IMP tradition) the idea of specific attachments is not new. Both embedded logic of exchange and arm's-length ties seem to characterize and effect differently interfirm network structures (e.g. Uzzi 1997). And if the two basic models western and eastern, are converging, there are even more reasons for directing attention to the 'intersections', e.g. boundaries between gifts and bribes, 'black' and 'white' dealings between individuals, role of personal relations in different situations. Consequently, in addition to efficiency, we should be interested in the ethical side of business.

As was noted earlier, corruption is usually illegal and must be kept secret. This is obviously one reason for the lack of studies in this area. Although it is very difficult to analyze corruption empirically, probably, some indirect evidence could be collected about the role it plays in business relations. Corruption seems to be difficult also in conceptual terms; to start with, it is difficult to define. This aspect of business interaction is in many ways a grey area and it is not clear how it should be dealt with.

Social dimension has been acknowledged right from the beginning of analysis of buyer-seller relationships (e.g. Håkansson, 1982); it was noted that business activities are carried out by human actors and thus have a social component. Moreover, actors' interests have been considered. For the latter, social interests (goals, values, desires driving groups) – not individual interests are discussed. (Araujo, et. al 1998, 57). The present paper explicitly calls for consideration of individual interests; as we know from practice, some individuals are corrupt and prioritize their private interests. Analysis of social relations has noted that for business people there are two types of personal relations: those relating to their person (person-specific) and those relating to the firm (organization-specific). Recently, interaction of these two has been analyzed to an increasing extent (Marschan et. al 1996; Hallén 1992). Corruption relates to this: a person can use his position for personal gain. Thus, he/she is mixing the role relation and personal relation intentionally (Ring and Van de Ven, 1994).

Some implications of present discussion for business interaction are the following:

-It is often pointed out that both cooperation and competition are important for business. Competition is one way of evading too intimate and binding relations thus fighting corruption.

- Although informal side of business interaction is central, it should not lead to secrecy in such a way that it enhances corruption. Openness is crucial.
- Corruption is not limited to developing or transition countries, but is to some extent evident in market economies as well. At least, when operating in the former areas, western firms have to cope with this phenomenon.
- Corruption mainly concerns bureaucratic behavior, but even in these dealings business firms form the other side. Thus both demand and supply of corruption, or behavior on both sides of a corrupt act, should be analyzed.

As there is ongoing discussion about arms' length and other relations in business, and there is an increasing interest towards social capital of firms and interpersonal relationships, it would seem to be in order to look also into the less desirable sides of close linkages. This paper is a first preliminary attempt to understand corruption. It serves mainly as drawing attention to this phenomenon – rigid conceptual analysis and empirical studies are needed next.

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