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The "grabbing hand" or the "helping hand" view of corruption: Evidence from bank foreign market entries

Andreas P. Petrou [a,*], Ioannis C. Thanos [b]

[a] School of Management and Economics, Cyprus University of Technology, P.O. Box 50329, 3063 Limassol, Cyprus
[b] Adam Smith Business School, University of Glasgow, Glasgow G12 8QQ, United Kingdom

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ABSTRACT

This study adopts a resource perspective to explore a non-linear relationship between corruption and two measures of bank foreign market commitment, the capital invested and the share of equity, on a sample of 131 bank entries in forty host countries. Our findings support a U-shaped relationship providing evidence of the "grabbing hand" view at low to moderate levels of corruption and, supporting the "helping hand" view at high levels of it. In addition, market-seeking motives are found to have a positive moderating effect on this relationship. This study contributes to the long-standing debate about the effects of corruption on FDI.

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1. Introduction

Corruption, defined as the abuse of public power for positive gain, is a prominent issue all over the world, intensified by the globalization of commerce. Even though corruption is believed prevalent in developing countries (Hellman, Jones, Kaufmann, & Schankerman, 2000), it is encountered at different degrees in all countries. Consequently, many international organizations and countries adopt coordinated measures to curb it. Nonetheless, reports from Transparency International show that corruption is still widespread.

Most of the scholars studying the effects of corruption on Foreign Direct Investment (FDI) support the "grabbing hand" view of the phenomenon, arguing that corruption creates significant costs for foreign entrants and, as a result, negatively affects investment flows into a host country (Javorcik & Wei, 2009; Mauro, 1995; Voyer & Beamish, 2004; Wei, 2000). This is a result of the uncertainty that surrounds corruption, which unpredictably increases the cost of setting up and operating in the host country and consequently the attractiveness of foreign investment (Demirbag, Glaister, & Tatoglu, 2007; Uhlenbruck, Rodriguez, Doh, & Eden, 2006; Wei, 1997). Another stream of research advances the opposing view: that corruption acts as a "helping hand" to commerce, a bribing mechanism which facilitates transactions, speeds up procedures and ultimately helps FDI (Egger & Winner, 2005; Lui, 1985; Wheeler & Mody, 1992). Empirical findings are inconclusive, with studies reporting results in both directions (Al-Sadig, 2009; Barassi & Zhou, 2012; Egger & Winner, 2005; Habib & Zurawicki, 2002; Helmy, 2013; Nguyen & van Dijk, 2012; Wheeler & Mody, 1992). An explanation which accommodates both theoretical arguments may be that the relationship between corruption and FDI is not linear and that, both theoretical views hold at different levels of corruption.

Moreover, the current literature mostly focuses on the impact of corruption on FDI patterns across countries (Brouthers, Gao, & McNicol, 2008; Egger & Winner, 2005; Habib & Zurawicki, 2002). Given that a key decisive attribute is the perceived uncertainty in the host country created by corruption, it may be appropriate to examine this relationship at firm level in order to consider firms' strategic motives and managers' perception of the local environment (Brouthers et al., 2008). Hitherto, scholars have paid little attention to MNE resource commitment strategies which deal with host country corruption (Rodriguez, Uhlenbruck, & Eden, 2005; Uhlenbruck et al., 2006). A firm level approach may also shed light on the findings of some country-level studies which suggest that highly attractive markets tend to mitigate the negative effect of corruption on FDI (Voyer & Beamish, 2004; Wei, 2000).

The setting of this study is the banking industry. In the last two decades, banks faced with saturated local markets have looked overseas for growth (Petrou, 2009). However, Multinational Banks (MNBs) are susceptible to host country corruption because their operations are supervised by local authorities (Buch, 2003); a state of affairs which gives corrupt officials the chance to engage in bribery. Moreover, government officials try to control banks in order to influence lending decisions. In light of this, scholars put forward the following two competing theoretical arguments: (1) the "political" view, suggesting that corrupt government officials

* Corresponding author. Tel.: +357 99375522; fax: +357 25002854.
E-mail addresses: andreas.petrou@cut.ac.cy (A.P. Petrou), Ioannis.thanos@glasgow.ac.uk (I.C. Thanos).

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influence the funding of projects in favor of politically connected firms, thus contributing to the increase of bad loans; and (2) the "development" view, proposing that government officials aim to direct projects in line with their strategy for economic development, which helps banks where corruption is prevalent and information asymmetries are high to identify the best projects (La Porta, Lopez-de-Silanes, & Shleifer, 2002). Despite the theoretical and managerial challenges identified above, current research is silent about the influence of corruption on bank commitment to foreign markets.

The objectives of the present study are two-fold: first, to investigate the effect of both views of corruption, the "grabbing hand" and the "helping hand," on the relationship between corruption and FDI at firm level; and, second, to explore how market-seeking motives moderate this relationship. We consider Pagano (2008), who investigates a non-linear relationship between corruption and lending rates in relation to the "political" and the "development" views, and we test a non-linear relationship between corruption and MNB market commitment. We adopt a resource perspective and draw on the resource dependence theory (Pfeffer & Salancik, 1978) and institutional theory (DiMaggio & Powell, 1983; Scott, 1995) to support our hypothesis that the effect of corruption on MNB commitment is U-shaped. In addition, we examine the moderating effect of market-seeking motivation, arguing that this dominates decisions about market commitment.

We test our hypotheses on a sample of 131 bank entries in forty host countries. Data on bank motives are collected through a mail survey sent to 385 multinational banks identified in the 2004 issue of the Banker's Almanac. Corruption is measured using the Transparency International CPI Index and market commitment is measured by the capital invested in the host country. The findings support a U-shaped relationship. A significant and negative linear coefficient suggests that, at low to moderate levels of corruption, the "grabbing hand" view prevails, and a significant and positive quadratic coefficient indicates that, at high levels of corruption, the "helping hand" view dominates. In addition, there is a significant and positive interaction between market-seeking and corruption for both the linear and the quadratic terms, indicating that the relationship is positively moderated by market-seeking motives at both the descending and the ascending parts of the curve. Similar results are found when the share of equity is used as an alternative measure of market commitment, attesting to the robustness of our findings.

This study makes a number of contributions. First, the findings indicate that both opposing theoretical arguments hold, but at different levels of corruption, a finding which may contribute to the resolution of a long-standing debate on the effect of corruption on FDI. Second, responding to calls to investigate firm strategies for dealing with corruption (Rodriguez et al., 2005), the study draws on the resource dependence theory and the institutional theory to examine how banks manage the costs of corruption through their capital investment decisions. This approach complements the transaction cost or institutional theory arguments of those scholars who examine the choice of mode of entry in conditions of corruption. Third, this study adds to our understanding of the types of risk and cost involved in bank foreign entries and the way in which these interplay with growth motives to influence market commitment. This is the first study to investigate how corruption affects bank strategies regarding foreign markets contributing this way to the literature on bank internationalization.

2. Literature review and hypotheses

Corruption is seen as a tax on foreign firms (Mauro, 1995; Voyer & Beamish, 2004; Wei, 2000). Nevertheless, the greatest challenge for most MNEs is not the magnitude of the cost in itself but rather the difficulty to assess the actual cost the MNE will have to pay as a result of the uncertainty associated with corrupt conditions (Wei, 1997). Besides bribes to government officials, foreign firms may encounter transaction costs due to poor contract enforcement (Doh, Rodriguez, Uhlenbruck, Collins, & Eden, 2003; Fisman, 2001), may face information asymmetries when vital information is withheld, and may encounter difficulties in gaining legitimacy due to reduced transparency (Javorcik & Wei, 2009). On this basis, two theoretical views have arisen on the influence of corruption on FDI: the "grabbing hand" view, suggesting that corruption creates uncertainty about the use of resources in the host country, an obstacle to FDI; and the "helping hand" view, which supports that corruption, at a cost, assists transactions and speeds-up procedures, thus helping FDI (Egger & Winner, 2005).

Most scholars who examine the effect of corruption on aggregate patterns of FDI suggest that corrupt countries receive less foreign investment because the covert bribing system acts as a "grabbing hand", creating additional costs and risks for investors (Brouthers et al., 2008; Habib & Zurawicki, 2002). A number of empirical studies support these arguments (Habib & Zurawicki, 2002; Nguyen & van Dijk, 2012; Voyer & Beamish, 2004; Wei, 2000). For example, Javorcik and Wei (2009) show that reducing corruption by 4.7 points (on a scale of 1 to 10) would increase FDI by 15%. Another stream of research suggests that high levels of corruption foster FDI, since corruption "greases the wheels" by facilitating transactions and investments which otherwise would not take place (Aidt, 2003; Leff, 1964; Lui, 1985; Wheeler & Mody, 1992). In contrast to the above empirical research, some studies support this positive perspective (Barassi & Zhou, 2012; Egger & Winner, 2005; Helmy, 2013). Egger and Winner (2005), for example, taking a sample of 73 countries over the period 1995–1999, find clear evidence of a positive relationship between corruption and FDI. These inconclusive empirical findings about the effect of corruption on FDI are further supported by other studies, which they find insignificant results (Alesina & Weder, 2002; Al-Sadig, 2009; Wheeler & Mody, 1992).

As regards banking, scholars advance two contrasting theoretical arguments, the "political" view and the "development" view (La Porta et al., 2002). Proponents of the political view (Becker, 1983; Kornai, 1979; Shleifer & Vishny, 1994, 1998) argue that in corrupt countries government officials intervene to influence lending decisions in favor of politically connected firms, thus distorting lending rates (La Porta et al., 2002), and shifting funds toward bad projects (Stigler, 1975; Park, 2012). As a result, corruption contributes both to the increase of bad loans and to lowering the quality of private investments (Beck, Demirgüç-Kunt, & Levine, 2006; Pagano, 2008). Some empirical studies testify to the "political" view (Beck et al., 2006; Pagano, 2002; Park, 2012). For example, Park (2012) in a cross-sectional study of data from over 76 countries finds that corruption contributes to the increase of bad loans and the re-direction of funds from normal to bad projects. The "development" view (Gerschenkron, 1962) suggests that, in corrupt countries, governments try to control the banking system so that they can influence the funding of socially desirable projects, thereby promoting financial development and growth. Pagano (2008) explores these two competing views by assessing the effects of corruption and government intervention on commercial lending rates, using a non-linear model. He finds that low to moderate levels of corruption relate to lower lending rates, providing evidence for the "development" view, whereas high levels of corruption are associated with higher credit rates, pointing toward the "political" view.

Given that the corruption-related uncertainty perceived in the host country may be an important factor for foreign investment, a firm level setting is required to capture the underpinning motivations, such as firms' strategies and managers' perception

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