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Arbitrariness of corruption and foreign affiliate performance: A resource dependence perspective

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ABSTRACT

Adopting a resource dependence viewpoint, this study investigates how the arbitrariness of corruption in a host country affects subsidiary performance. Analysis of bank foreign affiliates in 37 host countries shows that the negative effect of arbitrariness on affiliate performance is positively moderated by the strength of the sub-unit's corporate link, and the average number of expatriate managers appointed at the sub-unit. This study extends the literature on corruption by exploring a subtle but damaging dimension for foreign entrants and provides cues to managers for the proactive measures to take when they are likely to experience the arbitrariness of corruption.

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1. Introduction

The non-market strategy literature has identified the challenges faced by Multinational Enterprises (MNEs) due to the diversity across countries in political systems, government structures and societal views toward business (Baron, 1995; Doh, Lawton, & Rajwami, 2012; Rajwani & Liedong, 2015; Rodriguez, Siegel, Hillman, & Eden, 2006). In addition, this literature has recognized that the non-market environment can be influenced through MNE non-market strategies and activities (Hillman & Wan, 2005; Oliver & Holzinger, 2008; Sun, Mellahi, & Thun, 2010). One such activity is the engagement in bribery since foreign subsidiaries seek government and political support to gain legitimacy and access to local resources (Rodriguez et al., 2006). Nevertheless, corruption is a complex phenomenon, which often creates additional difficulties for MNEs rather than opportunities to benefit from the non-market environment.

Corruption is a widespread phenomenon, and thus MNEs have to deal with it in most of their international operations (Galang, 2012; Hellman, Jones, Kaufmann, & Schankerman, 2000). Corruption, defined as the abuse of public power for private gain (Bardhan, 1997), is often represented by the frequent demands from government officials for bribes (Doh, Rodriguez, Uhlenbruck, Collins, & Eden, 2003). Nevertheless, scholars recognize that the biggest challenge of operating in a corrupt environment is the uncertainty associated with corruption, given that the MNE is never certain of whether the service for which it is paying a bribe will be delivered as promised, or whether additional bribes to other government officials will be needed for the same service (Doh et al., 2003; Shleifer & Vishny, 1993; Wei, 1997).

This type of uncertainty, termed the arbitrariness of corruption (Shleifer & Vishny, 1993), is defined as the inherent degree of ambiguity associated with corrupt transactions in a host country (Rodriguez, Uhlenbruck, & Eden, 2005). As a silent attribute, it renders important features of corrupt transactions less transparent and less predictable (Uhlenbruck, Rodriguez, Doh, & Eden, 2006), and hence arbitrariness is thought to diminish the potential benefits of corruption (termed the 'helping hand' view) and to highlight the negative effects of corruption (termed the 'grabbing hand' view) (Petrou & Thanos, 2014). In addition, due to its opacity, arbitrariness is difficult to assess accurately before it appears, thus adding to the complexity of developing proactive ways of mitigating it. Surprisingly, despite the importance of arbitrariness in understanding how corruption affects the MNE's foreign operations, research on this aspect is scant. A few studies that examine the effects of the arbitrariness of corruption at firm level implicitly suggest that arbitrary corruption negatively affects subsidiary performance, because the foreign entrant may not fully comprehend and respond to the local institutional environment (Petrou, 2014; Rodriguez et al., 2005; Shleifer & Vishny, 1993;

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Uhlenbruck et al., 2006). Nevertheless, the exact nature of this relationship has not been investigated.

The objective of this study is to examine how the arbitrariness of corruption affects a foreign subsidiary's performance. To develop our hypotheses we draw on two theoretical perspectives: the resource dependence theory (Dowling & Pfeffer, 1975; Pfeffer, 1981; Pfeffer & Salancik, 1978), and the intra-network resource exchange view (Gupta & Govindarajan, 2000; Roth & Morrison, 1992; Szulanski, 1996). Specifically, we suggest that arbitrariness of corruption will create legitimacy issues for the subsidiary that may constrain access to local resources and increase operating costs. Moreover, we argue that the negative effect of arbitrary corruption on the affiliate's performance will be contingent on the foreign entrant's ability to access resources internally. The intra-network resource exchange view may qualify two factors that determine the efficiency of internal resource transfers to a subsidiary that operates in an opaque environment: (1) the strength of the corporate link, defined as the extent to which the focal subsidiary is linked to the parent's network of sub-units for the on-going exchange of resources (Luo & Zhao, 2004), and (2) the average number of expatriate managers present at the subsidiary.

In this study we examine the affiliates of Multinational Banks (MNBs), because their operations are closely supervised locally (Petrou & Thanos, 2014). The dependence of the MNB on decisions and approvals by local bureaucrats could provide corrupt officials with the opportunity to demand bribes, which could expose the bank to the arbitrariness of corruption. Previous studies found that exposure of MNBs to corrupt countries may translate to real financial losses for them (Pagano, 2008; Park, 2012). Therefore, the influence of arbitrary corruption on the performance of MNBs' affiliates merits examination.

This study makes a number of theoretical and managerial contributions. By investigating how the arbitrariness of corruption affects the performance of subsidiaries, this study explores a subtle dimension of corruption, which is found to be damaging for business (Rodriguez et al., 2005). In this way, it extends the literature on corruption beyond the traditional view which regards corruption merely as incidents of bribing. In addition, this study draws on two theoretical perspectives, the resource dependence theory and the intra-network resource exchange view, to identify certain factors that mitigate the negative effects of arbitrary corruption. Thus the theoretical approach contributes to the literature on intra-network resource transfers, since it sets criteria for the facilitators/inhibitors of resource exchange. Moreover, the findings that a strong corporate link and the average number of expatriates moderate the negative effect of arbitrary corruption on affiliate performance contribute to practice, since they provide managers with guidance on ways to obtain resources from the parent's network, when access to external resources is constrained by arbitrary corruption. Admittedly, the MNB suffers unpredictable costs from these activities, and as a result, its performance may be negatively affected. Consequently, the MNB may need to consider the arbitrariness of corruption when deciding to enter a foreign country.

2. Literature review and hypotheses

The most pronounced challenge of corruption is the uncertainty over the costs involved in operating in the host country (Petrou & Thanos, 2014; Shleifer & Vishny, 1993; Wei, 1997). For example, Shleifer and Vishny (1993) have shown that the costs of corruption increase when government officials impose or modify regulations independently to maximize their personal revenue from bribes. Recognizing this attribute of corruption, Rodriguez et al. (2005) have suggested a more comprehensive view of the nature of corruption with two dimensions: pervasiveness, denoting the frequency of corruption, a similar concept to the corruption index developed by Transparency International or the World Bank; and arbitrariness, which is the opaque feature of corruption. Uhlenbruck et al. (2006), who empirically examined how these two dimensions of corruption affect entry mode decisions, found that arbitrariness is associated with the choice of a joint venture. They argue that a local partner will assist the MNE manage the environmental complexity and alleviate the firm's resource dependence.

Resource dependency is a key issue for MNEs, given that in a foreign market most critical resources are controlled by local competitors, which increases the liability of foreignness for MNEs (Zaheer, 1995). The resource dependence theory holds that such reliance creates uncertainty about the firm's survival (Pfeffer & Salancik, 1978) and that managers act to reduce environmental uncertainty and resource dependence (Hillman, Withers, & Collins, 2009). One way of doing so, is by gaining legitimacy within the local institutional environment (Kostova & Roth, 2002). Legitimacy is defined as a generalized perception that the actions of the organization are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions (Suchman, 1995).

Resource dependence theorists, assuming managerial control over the legitimation process, argue that managerial action can significantly influence how organizational activities are perceived within any social context (Pfeffer, 1982; Pfeffer & Salancik, 1978), and therefore, organizations have choices of how to respond to institutional constraints. Organizations rely on two general means to gain legitimacy: substantive management or symbolic management (Ashforth & Gibbs, 1990; Pfeffer, 1981). Substantive management involves material change in organizational goals or practices to the extent that signal the fitness of the organization to fulfill constituents' expectations (DiMaggio & Powell, 1983). This practice is particularly effective when expectations cannot be easily assessed (Ashforth & Gibbs, 1990). For example, to achieve legitimacy within the institutional context of a foreign country, MNE subsidiaries follow local business practices, imitate the strategies of local competitors and comply with local regulations and social norms (Scott, 1995). In contrast, organizations that pursue legitimacy through symbolic management use communication to portray that organizational goals and practices are consistent with social values and expectations (Richardson, 1985). For example, organizations identify themselves with symbols or values that have a strong base of social legitimacy (Dowling & Pfeffer, 1975). Using similar means, sub-units within the multinational organization gain internal legitimacy, a form of acceptance and approval by internal constituents, by creating a perception of conformity to the organizational goals, norms and values (Kostova & Zaheer, 1999).

Similarly, non-market strategy proponents regard the non-market environment as a context which is susceptible to manipulation by firms (Frynas, Mellahi, & Pigman, 2006; Nell, Puck, & Heidenreich, 2015). More specifically, this literature suggests that multinationals engage in financial, relational and informational strategies, which include activities such as building political connections, funding of political or special interest group campaigns or lobbying (Doh et al., 2012). The objective of these strategies is to develop political and social capital (Rajwani & Liedong, 2015), which they may use to negotiate and socially construct their legitimacy (Nell et al., 2015).

Nevertheless, in an uncertain host country environment gaining external legitimacy becomes a complex process, since both the organization and the legitimizing actors may lack sufficient information that is required to evaluate each other (Kostova & Roth, 2002). As a result, the organization's activities may not gain approval and trust from potential partners, who, in their turn, may

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