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Family businesses in Eastern European countries: How informal payments affect exports

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ABSTRACT

This article investigates the effect of corruption on the export share of family firms in Eastern European countries. Using the Business Environment and Enterprise Performance Survey and panel data methods, we find that, in contrast to non-family firms, family firms are rather sensitive to corruption. In particular, the export share of family firms is positively associated with informal payments that aim to facilitate business operations. There are at least three compelling explanations for these results. First, if family firms are more risk averse than non-family firms, informal payments may represent additional export risk insurance. Second, informal payments may help family firms compensate for the lack of managerial capabilities to export. Finally, when institutional inefficiencies obstruct business, corruption may be a tool for family firms to protect their socioemotional wealth.

1. Introduction

Does corruption affect the export share of family firms in post-Communist countries? Can Eastern European economies develop competitive family business (FB) sectors? Because export is an important channel for supporting and enhancing economic growth in newly industrialized countries (Chow, 1987) and family firms are the prevalent form of business worldwide (Klein, Astrachan, & Smyrnios, 2005), the answers to these questions have important policy implications for transition economies.

Currently, globalization forces enterprises of all types and sizes to expand broadly (Parker, 1998; Zahra & George, 2002; Zahra, 2003); however, even if export is recognized to be an important channel of boosting the growth of firms, only a small fraction of firms engage in export (Lawless, 2009). This occurs because both internal and external factors affect the export decision of firms. Internal factors are those idiosyncratic characteristics that enhance or hamper a firm's productivity, such as innovative capacity, managerial capabilities, attitude toward risk, ability to make quick decisions, and other specific factors (see Gallo & Sveen, 1991; Gallo & Pont, 1996; Kontinen & Ojala, 2010; Melitz, 2003). Among external factors, institutions influence the transaction costs of firms, and thus their profitability and survival in an open market (Gaffney, Cooper, Keida, & Clampit, 2014; North, 1991). This is particularly true in transition economies, where business strategies strongly depend on how institutions affect transaction costs (Clague, 1997; Hoskisson et al., 2000).

When institutional inefficiencies persist over time, a market based on informal payments may arise for overcoming these inefficiencies. Johnson, Kaufmann, McMillan, and Woodruff (2000) argue that the informal economy may be a consequence of an inadequate institutional environment; as a result, bureaucratic inefficiencies may become an input that generates additional costs associated with export operations. According to Rose-Ackerman (1997), in a corrupt system, export licenses are a source of bribes, and the acquisition of these licenses or the observance of other complicated regulations may generate informal barriers that limit the export capacity of firms.

If bureaucratic delays threaten the survival of firms, then family businesses and non-family businesses (NFBs) may react differently to these threats. In particular, if family businesses are more risk averse than NFBs (Mishra & McConaughy, 1999; McConaughy et al., 2001), or if family businesses own additional resources related to

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certain tangible and intangible assets (Gómez-Mejía, Haynes, Núñez-Nickel, Jacobson, & Moyano-Fuentes, 2007; Habbershon & Williams, 1999), they will be more inclined to bribe public officials in order to increase their probability of survival. In this sense, corruption may represent a form of insurance against bureaucratic inefficiencies. Moreover, corruption could help family businesses recover the lack of specific managerial capabilities (Graves & Thomas, 2004) by facilitating export operations.

The present article aims to shed light on this important issue, testing whether corruption facilitates the exports of family firms in highly corrupt countries. In particular, by using the Business Environment and Enterprise Performance Survey (BEEPS), we investigate this phenomenon in a sample of firms located in Eastern European countries (EECs) because transition economies represent a good model for investigation given their high levels of corruption (Radaev, 2004; Tonoyan et al., 2010).

In general, corruption can be defined as the abuse of public power for private benefit (Choi & Thum, 2004; Tanzi, 1998). However, as business corruption is of interest, we focus on informal payments, that is, payments made outside official channels to public officials with the aim of influencing or accelerating a governmental outcome or decision (Shleifer & Vishny, 1993). Therefore, hereafter, corruption and informal payments are used as synonyms. In our analysis, we consider two different types of informal payments: informal payments to get things done and informal payments to secure public contracts. While the former also include payments aiming to facilitate export operations, the latter are specifically made to secure domestic contracts. After being controlled for several econometric issues, two important results were obtained. First, the export share of family businesses and their amount of informal payments for facilitating business operations are positively related. In EECs, this indicates that the internationalization of family businesses is mediated by a system of informal payments to get things done, which supports the idea that corruption is a tool for overcoming institutional inefficiencies in some cases, thereby greasing the wheels of economic development. Second, the possibility of bribing a bureaucrat to secure public contracts is weakly related to the export share of family and non-family firms. Moreover, serious endogeneity issues dampen this relationship and reverse causality may occur because domestic-oriented firms are more exposed to this second type of corruption. These results seem to suggest that the relationship between corruption and family firms depends on the type of corruption considered here.

To the best of our knowledge, this study represents the first attempt to explore the relationship between the export share of family businesses and corruption in transition economies. In a positive light, because most of the published studies explore the influence of the characteristics of firms, and especially of family businesses, on export decisions and international strategies (Fernandez & Nieto, 2006; Gallo & Pont, 1996; Gallo & Sveen, 1991; Kontinen & Ojala, 2010; Sciascia et al., 2013; Zahra, 2003), our research contributes to the debate of corruption being an important channel, at least for EECs, through which family businesses increase their export share. Based on these findings, future studies should consider the varying reactions of different types of firms to the informal economy. From a normative point of view, our study has some important implications for the timing of anti-bribery policies and other institutional reforms in EECs. If family businesses are forced to pay additional costs to facilitate business operations due to the lack of strong and efficient institutions, effective anti-bribery policies could selectively damage export-oriented family businesses. Therefore, before fighting these informal practices, policy makers should remove market and institutional inefficiencies that hamper business operations. With respect to our initial question, the administrative efficiency must be improved to develop strong family sectors in EECs. In this respect, with the project "Improvement of Administrative Efficiency on National Level," the Republic of Croatia represents an encouraging start.[1]

The remainder of this article is organized as follows: In Section 2, the relevant economic literature is reviewed and the main research question is developed. In Section 3, the dataset is described. The econometric methods used in this study are illustrated in Section 4, while our main findings are presented in Section 5. Finally, the discussion is concluded in Section 6 by highlighting some important policy implications.

2. Literature review and research question

2.1. Post-Communist countries and corruption

The quality of institutions is a crucial factor affecting the long-term economic development of a region (North, 1990). However, a territory's development is truly hampered not by the institutional environment that shapes its character but by those institutional arrangements that create pockets of inefficiencies and interfere with other factors influencing economic development (Rodríguez-Pose, 2013). In this context, corruption is a suitable example of detrimental arrangement to poor and inefficient institutions. In particular, corruption discourages both domestic and foreign investment, distorts the allocation of public expenditures in favor of activities that are susceptible to bribery-related manipulations, lowers the productivity of public investments, and reduces the accumulation of human capital (Ampratwum, 2008; Campos et al., 1999; de la Croix & Delavallade, 2009; Hall & Jones, 1999; Mauro, 1995; Robertson & Watson, 2004).

Corruption is a major issue in post-Communist countries where institutions are still perceived as highly corrupt and unreliable even after 20 years of democratic transformations (Borowski, 2014; Diaby & Sylwester, 2015; Meyer, 2001). Although the extent and the forms of corruption differ across EECs (Frye & Shleifer, 1997; Johnson et al., 2000), according to Karklins (2002), the disorganization of the democratic transition process represents the major cause of the current corruption in post-Communist countries. Karklins argues that, during the transition to a market economy, the change in the establishment may create room for corrupt bureaucrats. This is especially true in the case of the concession of licenses and permits.

2.2. Corruption and the decision to export

In its Fraud and Corruption guidelines, the European Bank for Reconstruction and Development (EBRD, 2015) defines corruption as "the offering, giving, receiving or soliciting, directly or indirectly, of anything of value to influence improperly the actions of another party." However, as argued by Sequeira and Djankov (2010), corruption can be "coercive" or "collusive." While coercive practices result from the predatory economic activity (extortion) of public officials, collusive practices arise when bureaucrats and private agents agree on sharing rents generated by illegal transactions. This second form of corruption is the basis of the so-called "grease-the-wheels" hypothesis. According to this hypothesis, if institutions are weak or inefficient, informal payments to bureaucrats act like oil greasing the wheels of

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