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Corruption: A Corporate Perspective

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ABSTRACT

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CORRUPTION: A CORPORATE PERSPECTIVE

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SUMMARY

This paper offers a framework within which the corporate' corruption may be analyzed and a comprehensive road map to understand the role played by corporation on corruption. Despite corruption is a field with a long tradition and a common topic of many researches, disagreements persist about definitions, causes, consequences and policies. Divergences are specially wide in relations with the role played by corporations. This article realizes a literature review about relationship between corporation and corruption, showing causes of discrepancies and it explains and justifies the differences adding to classical explicative elements —legality and efficiency—, the alignment and the principal-agent problem.

I.- INTRODUCTION

Corruption —the abuse of discretionary power for personal profit (Cf. Senturia (1931; Vishny, 1993; Bardhan, 1996; Tanzi, 1998)— is an ancient (Cf. Bardhan, 1997), wide (Transparency International, 2004) and pervasive (Cf. Sheifer and Vishny, 1993) problem that continues being a factor of live around the world (Persson, 2002) in both developed (Della Porta and Mény, 1997), underdeveloped and in transition (Paldam, 2002; Levin and Satarov, 2000) countries.

Despite this phenomenon is a field with a long tradition, and many empirical and theoretical researches exist (Cf. Jain, 2001; Rose-Ackerman, 1999; Klitgaard, 1988), the analysis of the corruption is far from simple. Disagreement persist even about

definitions. For instance, Jain (2001:104) certifies that “everyone that writes about (corruption) first tries to define it”.

Despite corruption is hard to be observed in the field (Cf. Abbink et al, 2002), in the substantial literature, the corporation is often cited as a main agent (Cf. Rose-Ackerman, 2002). However, its role in the dynamic of the corruption (Cf. Beets, 2005; Argandoña, 2003), which is the central focus of this paper, is not clear.

Looking across time and place, the conduct of corporation has simultaneously been proscribed by certain law and applauded by certain other (Cf. Bac and Bag, 2001; Graham, 1984). Some cases, structural conditions of market are cited as major cause of problem (La Porta et al. 1999) viewing corruption as a second best solution for firms while, other cases, the exploitation of high incentives and opportunities is presented encouraging corporate criminal purposes (Aidt, 2003).

In short, corporation has been viewed as (a) a guilty agent as well as (b) an innocent victim (Schneider and Enste, 2000).

Specially in the context of international intolerance of corruption, corporation has been presented as an active, powerful, predatory and self-interested agent (Cf. Beets, 2005; Rodriguez et al, 2005) which contributes to illegal activities by pressuring governments or by encouraging and facilitating corrupt behavior of bureaucrats looking other way (Daboud et al, 1995, Needleman and Needleman, 1979). Cases as Kockheed (1994) or Montedison (1996) are habitually cited.

On the opposite, in the long tradition in economics about the potential efficiency of the corruption (Cf. Leff, 1964; Romer, 1994; Aidt, 2003) and the second-best solution (Cf. Demsetz, 1978), links between politician/bureaucrats and enterprise managers (Cf. Boycko, Shleifer and Vishny, 1996) give a picture of corporation as a participant that is forced to pay a cost of doing business in many imperfect markets (Wilhelm, 2002), having no exit option (Hirschman, 1970; Rose-Ackerman, 1999:257; Ades and Di Tella, 1997:502).

Both impressions are often mixed. For instance, Rose-Ackerman (2002) presents the global firm’s justification for paying bribes to get business signaling at the same time the cost of *grand corruption*. She concludes that, in essence, corruption must be viewed as an ethical issue for business. In an experiment with a group of marketing managers, in relation with paying bribes try to penetrate in the Asian market, Fritzsche and Becker (1984) found that 39% of the asked managers tended to reject extortion because paying bribes was viewed as an unethical behavior. On the opposite, 41% of the inquired

tended to place greater weight on economic values relative to ethical values justifying that bribe is not hurt and it is acceptable practice in some countries.

In this confusing scenario, we need to understand. However, existing a large literature on aspects of corruption, a current comprehensive survey about the role of corporations on corruption is still lacking.

There are two main reasons which explain disagreements: on the one hand, discrepancies in the framework; on the other, the monopolistic application of a judicial approach.

Attempts to describe the role of corporation on corruption first face the problem of framework (Argandoña, 2001). Literature on corruption has mainly emphasized on political and economic aspects, analyzing connections between institutional rules of game and anti-corruption legal reforms. Both approaches have conceptualized corporation as a *black box* paying off bribes to public bureaucrats in an imperfect market (Svensson, 2000; Calhoun, 2002). Many of the explanations have ignored the inner nature of the firm.

It is true that many of the existing literature on corruption's determinants contain supply side reasons, however, answers arise from extra-organizational factors. For instance, the OECD Convention on combating bribery (2001) recognizes the responsibility of companies in paying bribes or benefiting from them, but in its recommendations there are only general references to corporate governance. Clarke et al (2004) in their strong analysis of the bribe givers find that more profitable enterprises, corporations that have greater overdue payments to utilities and de novo private firms appear to be paying higher bribes, but in their work there are not references to corporate governance. In this sense, corporation is viewed as a closed compact which does not need especial analysis (Cf. Argandoña, 2003).

However, private corporation greatly differs from both political and macro-economic institutions (Cf. Lozeau et al, 2002). Private and public institutions differ, for instance, in the use of performance indicators and profit-channel accounting; in the use of incentives and controls to wt down the problems around principal-agent conflicts; in the financial or political description of institutional goals or in the system to elected officials (Cf. Becker and Connor, 2005; Parhizgari and Gilbert, 2004; Savas, 2001).

From a political point of view, the element of personal gain has been emphasized because initial hypothesis underlies the honest principal (Cf. Bardhan, 1997; Shleifer and Vishny, 1993). In economics, the agent is assumed to be looking for his own

interest, relegating the analysis of the behavior in order to understand the competence between agents. Corporate view, the reciprocal and reiterate exchange inside organizations (Chendall, 2003) “could transform arm’s length relation in market into an embedded social tie” (Uzzi, 1996:67).

Groenendijk (1997:210) supports that one of the reasons why corruption is understudied as a management issue may be that the element of personal gain is superfluous while it enters a new agent —the corporation as moral actor—whose collective action may produce widespread changes in behavior (Rose-Ackerman, 2002; Wirl, 1998).

Thus, in order to understand appropriately the phenomenon, corporate corruption needs its own definition and models. Those definitions and models have not been explained.

The second reason for a lack of understanding in a management analysis on corruption has to do with the judicial focus. Lawyer’s approach has often been adopted as monopolistic view, emphasizing on the illicit character of corrupt practices from a *judicial point of view* (Cf. Kurer, 2005). However, the relationship between corporation and law, and between political or economic institutions and law disagree. On the one hand, not whichever corrupt behavior evokes violation of the judiciary rules (Cf. Bardhan, 1997). For instance, Thompson (1993) suggests that mediation —political take money from contributors, who hope to receive back favors from them when elected—, which is a legal practice in many countries could be corruption.

Favoritism (Prendergast and Topel, 1996), voluntary lack of monitoring from supervisors (Bag, 1997), seeking self-interest with lie or deceit (Williamson, 1985) and others organizational practices have been qualified as corrupt practices being legal practices.

Indeed, no every intra-firm transactions are governed by court-enforced contracts (Cf. Crocker and Masten, 1988) but by the implicit law of forbearance (Williamson, 1994; 1991). “While courts will routinely hear disputes over prices, delivery, quality, etc., in transactions between firms, these same courts will refuse to be drawn into identical disputes between divisions within a single firm. In effect, hierarchy becomes its own court of ultimate appeal” (Williamson, 1994:153).

Both factors —political/economic views and judicial focus— have often propitiated that literature uses interchangeably the terms fraud and corporate corruption and that the analyzed cases of corruption between individuals inside organization (corporate corruption) have been mainly associated with criminal practices (Beasley et. al., 2002), neglected the analysis of the *legal but unethical corporation practices*.

From organizational control, it is largely suggested that fraudulent and illegal practices are often preceded by some forms of questionable practices (Merchant, 1987). Moreover, evidence advises that questionable but legal actions that include the intent of the parties to deceit, produce strong costs for corporations and societies (Trevino and Victor, 1992; Rosanas and Velilla, 2003).

Because problems with the focus and with the framework, the role of the corporation on the corruption process in confuse.

In this paper an attempt to integrate corporation in the corruption literature is presented, providing a “road map” to understand the role of the corporation on corruption which permits to reduce the mentioned problems. Setting out this framework, I attempts to show how to insert corporation in the existent literature and how to add new designs when the analysis is lacking, i.e., the legal but unethical corporate behavior.

This paper proceeds as follows.

Disagreements in corruption literature are often explained as result of the complexity of the phenomenon. While its is widely believed that corruption is too complex to be presented at once and that it is not possible to offer a closed list of causes and consequences, most of the existing literature has not offered concrete reasons for complexity which permits to analyze its influence in the corporate perspective. **Section II** illustrates main dimensions of the complexity which may contribute to a confuse and nebulous view of the role of corporation in corruption.

Section III proffers, in broad terms, a literature review of the perspectives that have been adopted in the study of corruption. With few exceptions, literature, emphasizing political or economic circumstances on corruption, has combined two traditional explicative factor: legality and efficiency. Our work adds a new factor own of business: alignment/ misalignment.

Section IV concludes showing how the corporate role has been defined in each category employing principal-agent models. This methodology has been largely used in the issue, however, corrupt conflict of interests differs from a standard problem of agency. Firstly, paper shows how and why the implication of a “third part” and the inadequacy of the control systems distinguish corrupt conflict from a typical agency problem. Secondly, it employs the analysis of the “ third part” to show the diversity of the corporate roles.

II.- CORRUPTION AS A COMPLEX PROBLEM

It is obvious that literature is plenty of notions and interpretations of the causes and effects of corruption and that often there is not consensus concerning the effect of anti-corruption efforts. Jain (2001:104) shows that “everyone that writes about it first tries to define it”.

The main reason argued by both international organisms, governments and researchers to explain why it results so difficult to offer a compact and complete definition and framework for corruption (Davis and Ruhe, 2003; Argandoña, 2003) as well as to isolate those activities that must be included in or even to suggest a complete list of causes and consequences are the inherent difficulties in studying a highly complex issue (Cf. TI; 2004).

Complexity is often cited as a problem for corruption studies but few researchers offers a catalogue of reasons for —or dimensions of— complexity.

A revision of the literature suggests four main dimensions in viewing complexity: corruption is an (a) interrelated concept that runs (b) in a dynamic, (c) hierarchical and (d) cultural system.

A) Corruption as an interrelated phenomenon

Firstly, the status of corruption as extremely complex problem is found upon the general nature of the phenomenon, because the interdependence between factors is the unique possibility to understand it. Thus, the first dimension of complexity is the number of elements being pursued within the corruption.

Literature has showed that corruption is a *many-faceted* (Cf. Aidt, 2003), a *multidimensional* (Von Alemann, 2004; Doig and McIvor, 1999) and a *multidisciplinary* (Jain, 2001) *phenomenon*. In fact, literature and empirical researches (Cf. Kurer, 2005; Wilhelm, 2002) have showed that various determinants of corruption are correlated with many variables: political and institutional elements; economical aspects, as well as ethical and sociological that “interact in various and complex ways” (Gaviria, 2002:248).

On the one hand, empirical and theoretical researches confirm links between corruption and institutional framework (Jain, 2001; Hill, 2003; North, 1990; Williamson, 1985), in relation with the speed of the institutional change (White, 1996), with the structure of government institutions and the development of the political systems (Shleifer and

Vishny, 1993, La Porta et al, 1999) and with the quality of the government (Getz, 2001; Brinkerhoff, 2000; La Porta et al, 1999, Rose-Ackerman, 1999), as in the common law system as in the prevailing expectations and practices .

On the other hand, literature shows relationships between corruption and the type and degree of the development of the national and international market's rules (Ades and Di Tella, 1999). Corruption and level of the government's intervention (Acemoglu and Verdier, 2000; Bardhan, 1997) or corruption and bureaucratic interference in economy (Kaufmann and Wei, 1999; Shleifer and Vishny, 1993) have been also linked.

Moreover, empirical researches confirm significant contacts between corruption and economic development (Bardhan, 1997; Kaufmann, 1997; Wei, 1997, 2000; Ehrlich and Lui, 1999; Tanzi, 1998), growth (Volkema, 2004; Husted, 1999; Mauro, 1995), foreign direct investment (Wei and Shleifer, 2000; Mody and Wheeler, 1992), level of unofficial economy (Johnson et al, 1998) or level of economic competition (Bliss and Di Tella, 1997).

Because obvious differences among cited elements, the treatment of the phenomenon on both academic and political fronts continues to present many difficulties. The discourse of corruption must be articulated through interdisciplinary studies but its nature is itself a new source of complexity.

Besides the difficulties in obtaining a manageable definition of corruption, the problem in measuring it (Jain, 2001:76) must be cited. As a part of the shadow economy (Friedman et al, 1999; Schneider and Enste, 2000), corrupt activities are unregistered and take place on unofficial roads. The habit of selective disclosure of information that characterizes illegal activities is here a vital instrument to conserve rents (Mauro, 1998) obligating to involve the least possible number of individuals.

In this sense, despite international (World Economic Forum, Business International, Transparency International) or private (Cf. Kaufman et al, 1999; Mauro, 1995) attempts to measure the phenomenon, the level of opacity is maintained high. Following Richardson's terminology (1972), we can have a *knowing that* —facts and often relationships— but we cannot have a *knowing how* because “the ability to perform the appropriate actions to achieve a desired result” (p. 895) is far. Even obtaining data about dishonest behavior results very hard and, if there are links between corruption and crime or international theft, the complexity increases (Cf. Schneider and Enste, 2000).

B) Corruption as an dynamic phenomenon

Bardham (1997) shows corruption as an ancient and tenacious problem which has always been with us. However, he certifies that in different times at different places the phenomenon varies. Ades and Di Tella (1997) uses the terms “frequency” and “intensity” referring political corruption. In fact, because corruption takes place on scenarios formed by legal, economic, social and political elements (Cf. Andving and Moore, 1990), the phenomenon is necessarily opened to institutional dynamism (Cf. Hodgson, 2002). For instance, in their analysis about the tax collection, Hindriks et al. (1999) show how the intensity of the corruption in a country depends on the formal tax system and that, by changing the design of the effective tax collection mechanisms, the real effects of corruption varies.

Literature has often showed that corruption is a *dynamic event* (Choi and Thum, 2003; Rinaldi et al, 1998; Bicchelli and Rovelli, 1995) in both spatial and time aspects.

For instance, Wirl (1998) shows that the acceptance of a bribe depends as on the size of the bribe and the costs (punishment, integrity of the agents, etc) as on the behavior of peers and colleagues. This “social pressure” may cover networks associated with corruption which produces myopic expectations and a high degree of behavior complexity (Cf. Treisman, 2000).

Nelken and Levi (1996:4) supports that it is wrong “regarding corruption and anti-corruption as independent phenomena”, because there are cycles of mutual dependency in between. Passas (1996) shows that scandals “represent opportunities to reform”. Thompson (1993) concludes identically in relation to the “mediated corruption”. In this line, Lui (1986) and Bicchieri and Rovelli (1995) defines an evolutionary *corruption cycle*.

Moreover, as it has been showed (Klitgaard, 1988), corruption comes in many guises in fact. Bribery (Williams and Beare, 1999), extortion and evasion (Hindriks et al, 1999), fraud, trafficking (Tocker, 2001; Bowles et al, 2000), embezzlement (Peterson and Gibson, 2003), nepotism and cronyism (Prendergast and Topel, 1996), etc., are all different manifestations of it. Campaigns to minimize the opportunities and incentives of a concrete form of corruption may induce the growth of another form because corrupters may adapt quickly their behavior in order to minimize the cost of penalties or social pressures. Thus, campaigns and corrupt efforts may be correlated (Lui, 1986) and the “absolute integrity” is very difficult (Anerchiarico and Jacobs, 1996). Because the

legal society is slower than corrupters, corruption may continually expand its capacity to create new opportunities.

C) Corruption as a hierarchical phenomenon

Although it is from the decisions of self-interested individuals that corruption stems (Cf. Husted, 1999), the phenomenon presents a social nature. A decade ago, political and sociological studies were focused on the broad range of individual behavior (World Bank Group, 2001) and the official vice, acting or not in “organized” (Cf. Celantani and Ganuza, 2002) or mafia groups (Gambetta, 1993). For instance, Hillman and Katz (1987) show the extra social costs and complexities when a modest official is obligated to pay a part of his bribes to his superior.

Nowadays, most of the economic analysis on corruption focuses on collective corruption entailing voluntary collaboration among self-interested accomplices. Many of those researches employ the principal-agent models (Lambert, 2001; Banfield, 1957; Rose-Ackerman, 1975, 1978, 1999; Klitgaard, 1988, 1991), viewing the social nature as a hierarchical nature (Mishra, 2002; Bag, 1997; Bac, 1996; Mookherjee and Png, 1995; Kofman and Lawarree 1993; Basu et al, 1992).

Controlling corruption in hierarchies introduces new complexity in the analysis of this unethical behavior (Brass et al., 1998; Bag, 1997; Bac, 1996) because the supervision procedures are added (Bac, 1998) and models must include dissemination mechanisms from upper levels to lower levels, and vice versa due corruption can extend in both directions (Cf. Goudie and Stasavage, 1997).

If corruption came up not only from the aggregation of corrupt isolated individual acts but also forms a form of organized corruption (Cf. Celantani and Ganuza, 2002; Sheifer and Vishny, 1993) then the analysis *bad apple* must be completed with an analysis *bad barrels* (Cf. Nielsen, 2003), such as bad bureaucracy or corruption networks (Cartier-Bresson, 1997).

D) Corruption in cultural systems

Theoretically, institutions, such as law or government, are shaped by clean and objective international principles. However, in the real world, and at least in the description of the acceptable models of behavior (Cf. Donaldson and Dunfee, 1994), they are also shaped by local influences in lifestyles, beliefs, customs and values which differ across nations being organized around extra-law institutions. From Weber (Cf.

Stulz and Williamson, 2002), culturally diverse view of institutions cannot be ignored, nor in examining corruption because “long-lived aspects of countries’ cultural or institutional traditions affect the level of perceived corruption more significantly than current state policies” (Treisman, 2000: 439).

In some occasions (Cf. discussion in Husted, 2003), literature has employed culture as an independent variable explaining corruption (Cf. Putman, 1993); in most of the cases (Cf. Collier, 2002; Husted, 1999), the cultural analysis has shaded general models with analysis about the social foundation and functioning of institutions. Thus, cultural idiosyncrasy (Husted, 2002; Winch and Millar, 1997), familial prototype and colonial tradition (Treisman, 2000) or religion (Guiso et al, 2003; Paldam, 2001; Treisman, 2000; La Porta et al 1999; Lipset and Lenz, 1999) have been largely correlated with perceived corruption.

In this sense, efforts against corruption from political authorities are always incomplete strategies (Cf. Banerjee, 1997) if cultural factors are not included. Nevertheless, this set of factors is not easily understood and the required information is not always available many times. Those factors may widely disguise the scenario where transaction runs (La Porta et al. 1999)

Furthermore, the international or supra-territorial economic integration based on an increased market openness (Cf. Husted, 2003b; Bartlett and Ghoshal, 1989; Segal-Horn and Faulkner; 1999) has changed the structure of the last general equilibrium economics, creating new rules of game. Multinational firms may effect and may be affected by the own cultural system in a new dynamic cycle (Cf. Luo, 2004). The type and scope of its influence is actually unknown.

In summary: corruption is a extremely complex phenomenon and, therefore, it is possible to affirm certainly that corruption is a symptom of bad governance but it is impossible to report with identical degree of certainty what are its causes, and consequences and what are the best policies to combat this endemic social problem (La Porta and Mény, 1997).

Obviously, in this complex scenario corporation’s role appears confuse.

III.- CORPORATE CORRUPTION: A ROAD MAP

An overview of the vast literature relevant to the analysis of corruption shows how the complexity of the problem has been translated to literature.

As *interrelated problem*, corruption' literature is originated in different perspectives. Papers on corruption are found in political science, governance, sociological analysis, economic models, criminal practices and theories, or ethical issue. Each discipline speaks about corporation in its own language describing the role played by firms in its own scenario. In this sense, it is obvious that in proposing discussions and eliciting suggestions, corporate perspective needs to offer previously a comprehensive framework.

Moreover complexity, offering a compact framework is far from simple, because the corruption as a *dynamic and social problem* suffers from occasional and structural changes which are translated to literature.

For instance, until the 1980's, and in consonance with a significant amount of U.S. legislation—especially the Foreign Corrupt Act (1977) and the preparation of the Anti-kickback Act (1986)—, theoretical research on corruption (Cf. Abed and Oupta, 2002) was largely cramped into the “rule of law”. Mainly confined to the fields of political science, sociology and criminal law, researches focused on weaknesses in public institutions.

The fall of the Berlin Wall, the collapse and posterior transformation of many socialist economies and the accelerating trend of globalization opened new debates, introducing in the discussion the market mechanism, the concept of competition and the bureaucrat's incentive scheme (Cf. Celantani and Ganuza, 2002; Ades and Di Tella, 1996; Leff, 1979). Besides, a considerable number of academic writing on the economics of corruption emerged (Wei and Shleifer, 2000; Acemoglu and Verdier, 2000; Rose-Ackerman, 1999) employing new hypothesis and methods, and among them, principal-agency models.

The field of corruption has still been increasing the attention over the last years (Abbink, 2004; Hillman, 2004; Ganuza and Hauk, 2004; Weippert, 2004; Bose, 2004). A survey from *The Economist*, *The Financial Times*, and the international coverage of *The New York Times*, revealed that articles mentioning “corruption quadruplet between 1984 and 1995” (Cf. Leiken, 1997).

Corporate corruption's scandals occurring in developed countries have obligated to enlarge newly the focus. For instance, in the last decade, *Journal of Business Ethics* has included about thirty articles focused on corruption. Analyzing it (Cf. Cadre I), it is possible to note how researches focused on country corruption and cross-cultural

corruption analysis decrease, while papers that explore the corruption's phenomenon itself, grow without East/West or developed/underdeveloped references.

Recent time, empirical data and theoretical researches reinforce the role played by corporations in the corruption and on the steep cost that corrupt corporate behavior impose on both firms and societies (Beets, 2005; Ashforth and Anad, 2003; Levy and Nelken, 1996). However, the literature has not developed a framework with the "new" player.

The goal here is to built a "road map" to understanding corruption types and a framework for the analysis of corporate corruption.

Corruption: a comprehensive road map

In broad terms, two perspectives have been adopted in the study of corruption phenomenon, which we name as *environmental* and *organizational* perspectives. In turn, each perspective must be classified in attention of the discipline core approach. The environmental perspective has a long tradition while the organizational is recent and presents a less developed theoretical framework

Environmental approach focuses on connections between levels of corruption and political, social and legal rules of game that established the basis for production, exchange and distribution (Kurer, 2005; Brinkerhoff, 2000; Davis and North, 1971; Williamson, 1993), while *organizational approach* analyzes the logical to the corrupt exchange among individuals (agents) located inside units of cooperation (organizations).

• *Environmental approach*

Generally speaking, literature on environmental corruption can be divided according to the prominence of political or economic forces.

a) Political point of view (Cf. Williams, 2000a, 2000b; Heidenheimer et. al, 1998), corruption is understood as *official corruption*, that is, as an "*illegal and clandestine exchange between two "markets": the political/administrative market and the economic/social market*" (Ades and Di Tella, 1997:4) being the exchange for personal gain (Shleifer and Vishny, 1993).

Inside official corruption, *elite corruption* (Cf. Jain, 2001; Rose-Ackerman, 1999) and *administrative corruption* are distinguished. Both include the use of the public discretionary power for pecuniary gains but the first includes one also includes the purpose of remain in power (Rose-Ackerman, 1978; Heidenheimer, 1970).

Evidences show that some countries present much more corruption's cases than others. Political approach supports that the structure of the government institutions and of the political processes could explain diverse degree of corruption (Banfield, 197, Kitgaard, 1988) and puts the emphasis on the political circumstances which affect the rules, permitting or preventing the enforcement of contracts. Legal and political weakness and lack of transparency and accountability are specially analyzed.

b) In the economic' approach, corruption is understood as a market distortion as such as a form of economic risk and uncertainty (Glynn, Kobrin and Nain, 1997; Elliot, 1997). For instance, in his analysis of extortion, Demsetz (1967; 1971:444) argues that this practice would be an economic problem only if didn't exist competence in the supply. Economic discourse emphasizes on the organization of the exchange, and specially relates the function of the economic forces —supply and demand— in non-competitive or semi-competitive market conditions.

Inside economic approach, a demand-side approach has been mainly adopted, being the official corruption analyzed as if the bureaucrat has a monopoly over the service (*parochial corruption*) and as if the bureaucrat could compete with other bureaucrats or other services (*market corruption*) (Cf. Lambbsdorff, 2002).

Both political and economic environmental' focuses are essentially united, studying the same topic from different points of view. For instance, Mauro (1995) underlies the importance of economic rents for corruption. Economic approach studies, as key element, how rents emerge in semi-competitive or non-competitive arena while political approach analyzes how public officials have discretion in allocating those rents, and how the process of allocation becomes corrupt.

- ***Organizational approach***

Organizational approach to corruption is not centered in the environment, but in the behavior of the agents (Cf. Argandoña, 2003). This approach analyzes the logical of the corrupt exchange among individuals (agents) located inside public (bureaucracies) and private units of cooperation (organizations) as such as anti-corruption control and control outcomes. Thus, this approach to corruption extends the previous analysis of the official corruption to the internal alignment problem, describing a *personal corruption*, that is corruption in which the principal's interest is sacrificed.

In the organizational context, two types of organizations —the public and the private— have been distinguished. Comparisons between public (bureaucracies) and private (businesses) have habitually lied on five criteria (Cf. Becker and Connor, 2005;

Parhizgari and Gilbert, 2004; Savas, 2000; Silfvast and Quagliari, 1994): (1) high (private) or low (public) use of performance indicators and profit-channel accounting; (2) high (private) or low (public) use of incentives and controls to reduce the problems around principal-agent potential conflicts; (3) goals are financially (private) or politically (public) driven; (4) consumer oriented (private) or regulatory practice oriented (public) organizations and (5) self-oriented stakeholders selection employees (private) no self-oriented stakeholders elected officials.

A) Public organizations

The potential for corruption appears from the areas of discretionary power which have economic value. In public organizations, this economic incentive is identifiable as individuals or as groups (Jain, 2001:100). In this sense, two categories has been distinguished:

- a) The *external corruption* responds to the corrupt behavior from isolated employees (Bac, 1998; Tirole; 1996; Laffont, 1990; Tirole, 1986; Nielsen, 2003). For instance, Bag (1997) exposes the behavior of an individual employed by the principal engages in an illegal transaction with an external client or other street-level individual.
- b) On the opposite, the *internal corruption* lives mainly inside the borders of the business. Despite the fact that it is possible that the last implicated individual was in an street-level, the corruption is described and developed inside.

As social institutions, organizations present social corruption but it is possible to distinguish between passive an active behavior:

b1) *Internal passive corruption.*

In this type of corruption, the reason for principal-agent conflict arising for effort evasion by the agent (Cf. Lambert, 2001; Jensen and Meckling; 1976). Supervisor does not apply an optimal effort when completing his/her monitoring. For instance, Bag (1997:322) models a supervisor that chooses “not report to the principal even after detecting a subordinate’s involvement in external corruption”. No reporting implies a corrupt connection between supervisor and supervised employee.

b2) *Internal active corruption.*

Active corruption adds that the agent uses his work/power situation to acquire as a “form of collusion transforming the organization into an internal market of systematized sharing of corrupt proceeds” (Bac, 1998:102)

Normally internal active corruption become systematic responding to the behavior of informal groups (Kofman and Lawarrée, 1993; Bac, 1996) or organized

networks (Gambetta and Reuter 1995; Roze-Ackerman, 1999: 23-5; Nielsen, 2003). Tirole (1992) and Laffont (1990) extended the simple agency's relationship to complex chains of principal-agent relationships. Bac (1997) includes, in some cases, the possibility of collusion between the members, amplifying the internal corruption to collusion.

B) Private organizations

Unfortunately, most of the formal studies of corruption have been applied only to public organizations (Colombato, 2003). Despite the fact that authors from environment corruption analysis have suggested that in both, business and government, there are many opportunities to the parties to take corrupt advantage of each principal (Husted, 1994), few theoretical works develop the corporate corruption inside private organizations.

It can be easily explained. Theoretically, private corporations are designed to create alignment and to prevent employees acts that harm the organization (Argandoña, 2004). On the one hand, private corporations are constructed basing on the hypothesis that the incentive problems will emerge and, hence, the principal selects a performance evaluation system which links performance and compensation. The design is based on a prototype of agent which includes (1) the effort aversion; (2) the misuse of resources for private consume or use, (3) the differential time horizons, and (4) differential risk aversion (Lambert, 2001:5-6).

On the other hand, the principal, knowing that there is not perfect incentive system designs, adds a set of control devices “to help to ensure the proper behavior of the people in the organization” (Merchant, 1985:4; Cf. Das and Teng, 1998).

Thus, the conduct of individuals in business is restricted by (a) organizational routines (Nelson and Winter, 1982) and process control (Ring and Van de Ven, 1994); (b) by compensation systems and (c) by result and personnel controls (Davila, 2004).

However, it is also true that “personal loyalty may deviate from organizational interest and may even lead to corruption or embezzlement” (Nooteboom, et. al, 1997).

Recent and unexpected corporate scandals (Sims and Brinkmann, 2003) —i.e. Enron Corporation, WorldCom Inc., Tyco International, Global Crossing, Adelphia Communications, Parmalat, filed for bankruptcy in last years (Cf. Padgett, 2005; Koehn; 2005)— have showed that a certain number of companies does not follow inward socially and corporately established moral standards. Cases illustrate the vulnerability of the firm at least in both corporate accountability and organizational trust

because clean attestation on internal control and effective control system might not be well correlated (Carson, 2003; Cohan, 2002).

While detail may vary from one case to another, one basis typical of each managers' scandal remains the same: the use of other people's money to finance their control and profits (Gosselin, 2002; Knapp and Knapp, 2001). Indeed, such as public organizations, firm's agents may attempt (and obtain) to make (and to conceal) unethical and/or illegal activities. The opportunism —“self-interests seeking with guile” (Williamson, 1985:30)— is also presented in intra-firm relationships (Cf, Romar, 2004).

The 2004 report from the “Association of Certified Fraud Examiners” (ACFE) supports that the archetypal organization loses 6% of its annual revenues to deliberate misuses or misapplications of the employing organization's resources or assets, procuring some private benefit. Authors (Greenberg, 1998; Greenberg & Scott, 1996; Hollinger & Clark, 1983; Murphy, 1993; Trevino and Victor, 1992) quantify the costs of the employee theft as extremely costly to organizations. Greenberg (2002) finds that while in occasions thefts might occur as a reaction to inequity, in many another cases theft is not generated by underpayment (Cf. Moberg, 1997) but exclusively by rent-seeking. In other cases, it is the superior who misuses resources, for instance with subjective opinions or favoritism (Cf. Prendergast and Topel, 1996).

ACFE (2004) also suggests that, despite the implementation of the strong and expensive control systems, in private companies, one-third of all frauds were detected accidentally. It is possible to understand it being a collateral effect of the control system itself, however, the fact that the most common method of detection was by accident suggests that private organizations are vulnerable to corruption and that it may be a gap between what the organization feels it looks for and what the organization's members feels it should look for: an alignment problem (Cf. Niehoff and Paul, 2000). The limited effect of internal controls in detecting fraud was particularly evident when we measured the method of detection in cases committed by owners and executives (Ashforth and Anand; 2003; Anand et al. 2004).

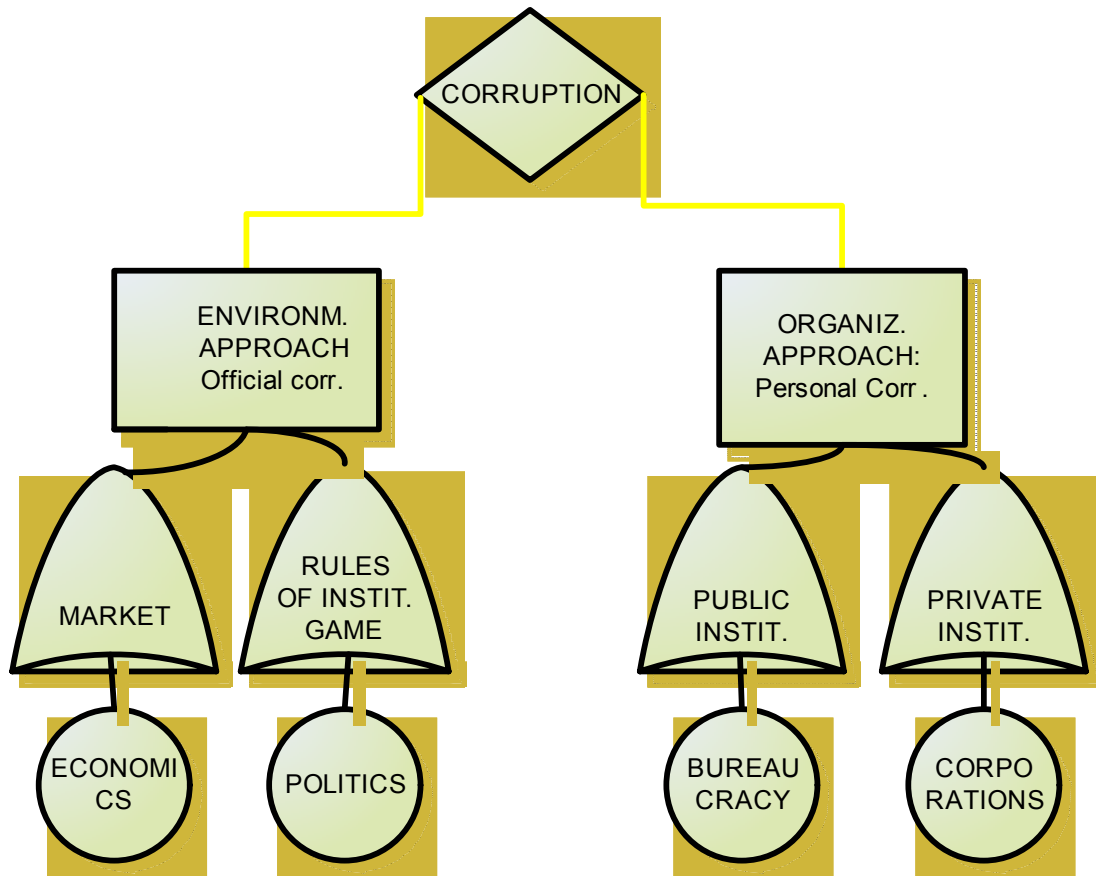
However, the impact of corruption on firm's organization is an issue that has not found the required attention. While country and industry (Cavaglia et al, 2000; McGahan and Porter, 1997) factors doing influence in competitive advantage, performance and success have been analyzed, the influence on the internal organization has not been explained.

It is possible that those examples are rare events (Cf. Anand et al, 2004) caused by deviant individual behavior that happened in very restricted contexts —i.e. deregulation of market, quick process of firm internationalization or law gaps.

According to the “bad apples” argument (Cf. Nielsen, 2003) organizational corrupt behavior can be attributed to the personal characteristics of individuals (Cf. Brass et al, 1998). Thus, some of those scandals can be explained as the misconduct of some executives (Carson, 2003). For instance, Daboud et al (1995) find that individual characteristics of the top management team influence the likelihood of illegal corporation behavior. Cerety and Lehn (1997) discover that internal forces, as corporate governance structures or compensation schemes, are unimportant in affecting the decision to commit accounting fraud.

However, it should be possible that those deviant behaviors in organization were because of a previous organizational deficiency (Cf. Levy, 1985). According to “bad barrels” argument, unethical behaviors are preceded by organizational and societal bad designs. For instance, Sims and Brinkmann (2003) support that, despite the fact that unethical Enron’s top executives behavior explains a lot of things of the phenomenon, “Enron’s culture create and atmosphere ripe for the unethical and illegal behavior that occurred”. Anand et al (2004) believe that corporate corruption does not result from the actions of single individuals but from a structure of cooperation which includes processes of rationalization and socialization that can establish enduring corruption in organizations.

In both answer, however, the premise that internal control and incentives reduce the risk of employee deceit to a tolerable level is questioned. Both approaches show that the corruption could take place in business as a structural problem. Thus, the previous classification to public corporations can be extended to private so.



Cadre I: Corruption: a comprehensive “road map”

IV.- THE ROLE OF THE CORPORATION IN THE CORRUPTION PHENOMENON

As agent of corruption, the role that private corporations play in the concern presents complex nature (Argandoña, 2001). In this section, and following the previous road map, we will offer an explanatory scheme to understanding the corporation's role.

We will draw upon principal-agent theory. Literature has showed that corruption, from both environmental and organizational approaches, can be regarded as a specific manifestation of principal-agent conflict (Cf. Aidt, 2003; Rose-Ackerman, 1999, 1978; Bardhan, 1997; Ales and Di Tella, 1999; Luis and Ehrlich, 1999; Klitgaard, 1988; Banfield, 1974; Becker, 1968).

In every country, civil servants —agents or bureaucrats— are employed by a government —principal— because direct intervention in collecting information and implement policies and decisions is not possible (Cf. Acemoglu and Verdier, 2000; Banerjee, 1997). Nevertheless, as inside organizations, the relationship between the principal and his agents could be conflictive.

A standard problem of agency is reduced to an agent possessing a discretionary power whose actions cannot be totally observed, and a principal who focuses on designing an efficient contract with incentives and monitoring in order to minimize potential conflicts of interests (Jensen and Meckling, 1973; Cf. a wide review in Lambert, 2001). However, in the corrupt agency problems, at least two especial factors differ from typical problem. On the one hand, the external incentives and the implication of a “third part”, and, on the other, the inadequacy of control systems.

a) External incentives and the “third part”

In a typical principal-agent problem, the monetary utility received by the agent is identify exclusively with compensations from the contract. Normally, compensations present two main forms: a *standard compensation*, united with the regulation of the residual right (Fama and Jensen, 1983), which is called to cover the minimal acceptable level of the agent —i.e. his next best employment opportunities (Lambert, 2001:10)—, and an *incentive*, united to the design of decision processes, which attempts that agent, with discretionary power and asymmetry of information in his advance, chooses the principal's desired action. In this standard scheme, the incentive design linked to agency problem remains as a *bilateral bargaining* between principal and agent. For instance,

reasons for conflict of interests and implementation of incentive' system are the effort aversion of the agent or the "horizon problem" (Cf. Eisenhardt, 1989, Davis, Schoorman and Donaldson, 1997)

However, in the corrupt transactions, both sources of compensation are separated: principal offers standard compensations being infrequent the use of explicit incentives in the public sector (Cf. Burgess, 2003), while a "third part" offers incentives.

Basing in data suggesting stronger relationship between public agent wages and corruption (Cf. Van Raach and Evans, 2000; Besley and McLaren, 1993), civil servant systems have attempted to reduce corruption paying adequate salaries, however, the affectivity of the policy has not been clear. Literature is ambiguous in its implications for optimal wage policy. For instance, Van Rijckeghem and Weder (2001) support that there is a negative relationship between civil-service pay and corruption, while La Porta et al (1999), Treisman (2000) and Di Tella and Schargrotsky (2003) found not clear evidence in the trade-off between wages and corruption (Cf. Acemoglu and Verdier, 2000).

In all case, by own nature, the civil servant's work creates opportunities for corruption. The agent does not maximize expected income whichever wage (Cf. Becker and Stigler, 1974). Unless the probability of detection and the associated punishment are very high, being not a normal characteristic on corrupt environment, the utility is maximized with incentives.

For instance, Bac (1996) models a risk-neutral agent who is paid by a principal for a service. The agent receives the wage w but he can misuse his discretionary power obtaining a bribe z , which is accepted with a probability b . In the absence of the monitoring, the expected utility of the agent is defined as:

$$EU = b(w + z) + (1 - b)w \geq w$$

In the absence of the monitoring and with a potential bribe, the expected utility is always superior or equal to the amount of the wage, which "shows that accepting bribe is the dominant strategy of each agent" (ibid. p. 280) except if the agent is perfectly honest ($b=0$). The expected utility of the agent is presumably maximized if the agent collect z as monopoly rent (Cf. Wirl, 1998).

Rose-Ackerman (1999:15) defines bribes as an incentive payments, but the bribe is offered by a “third part” in order to obtain certain preference. Thus, in a corrupt environment, the incentive problem is not a bilateral but a *trilateral problem*.

The importance of the third part in the corrupt principal-agent relationship has been signaled by literature (Rose-Ackerman, 1999, 1978; Klitgaard, 1988). However, in spite of corporations often being third part, they are usually ignored.

The theory of the common agency initiated by Bernheim and Whinston (2001) has showed a trilateral problem of agency in which an agent decides upon an action which affects himself as two principals. Martimort (1996) describes the government organization as a multi-principal nature in which different incentive mechanisms compete with each others. However, in models of common agency, principals may offer a menu of incentives to agent (Cf. Fredriksson and Svensson, 2003; Laussel and Breton, 2001; Gifford, 1999) while in a corrupt environment first principal (government) cannot compete in incentive contract with the “third part”.

Tirole (1994) has showed the specificity of the public sectors in the design of incentives emphasizing the unclear definition of goals and its performance measures. Burgess and Ratto (2003), who have investigated those differences in the UK public sector, find in the incentive schemes that there is a gap between the economic analysis and the policy-makers. In the under-developed and in transition countries the gap is increased.

Therefore, we understand that the different origin of the wages and incentives must be accepted.

b) The inadequacy of control system

The second main difference between a typical agency problem and a corrupt agency problem is the inadequacy of control. Direct monitoring of bureaucratic agencies by their principal is often low (Cf. Mauro, 1998; Hammond and Knott, 1996). Bureaucracies are indeed “beyond the control of politicians” (Kiser, 1999: 153) who, in the opposite to economic view (Cf. Giddens, 1983), design compensation systems supporting that the behavior of the civil servant is not necessary opportunistic but honest, and that the agent is able to follow no pecuniary goals (Cf. Langfield-Smith and Smith, 2003). In this sense, control is less exhaustive. Even supposing mistrust of public official (Mèny, 1997) the public control, being merely formal, is frequently impossible or inefficient. A correct personnel control (Cf. Davila, 2005) results expensive and, thus, principals are strong incentives to change direct monitoring by other strategies, as stronger sanctions (Cf. Becker and Stigler, 1974).

Goel and Rich (1989) show how high sanctions as longer prison deter corruption (Cf. Montinola and Hackman; 2002; Hill, 2003). However, the weakness of law-apparatus in developed countries does not permit the application on contracting “in the shadow of the law” (Lambsdorff, 2002).

On the other hand, studies by Friedman et al (1999) suggest that countries with more corruption have a higher share of unofficial (and uncontrolled) economy. Schneider and Enste (2000) conclude positive correlation between large shadow economies and corruption and bribery. Shadow economic activity, by definition, escapes from detection in the official estimations (Schneider, 1994) and, therefore, it escapes from control.

Trevino and Victor (1992) shows that unethical behavior is particularly difficult to control because of the high cost and the difficulty of monitoring employee behavior. As hierarchical phenomenon, the case of corruption increases the difficulty.

To sum up, in order to understand appropriately the principal-agent problem in corrupt environment, it is needed observed that:

- a) As in the standard problem, the agent has a favorable position because his action is unobservable to the principal and the asymmetry of information is to his advance. Bureaucrat with a certain degree of corruptibility can largely exploit his discretionary power. For the exploitation of most of those opportunities, bureaucrat needs to design a cooperative alliance with a third part, which must have beneficial effects in both agent and third part.
- b) On the opposite of the typical principal-agent problem, principal cannot always prescribe the pay-off rules and design control systems to obtain alignment.

c) The “third part”

The corporation’ role in corruption is linked with this third part. However, what he nature of the illegal bargain between agent and corporation is, or, on the other world, what the nature of the corrupt form of alliance is, differs from environmental and organizational types of corruption, and, inside environmental type, from political and economical approaches.

a) Environmental perspective

As it has been exposed, environmental perspective has focused on environments which permit corrupt behavior. This approach supports that, for the purpose of the corrupter, a third part (i.e. corporation) is needed because *official corruption* is a transaction

between public accountable officials (elite or bureaucrat) and external agents —third parts— that hide illegal payments which suppose the violation of the initial principal-agent agreement. Goals of the principal —the public common interest (Cf. Nas et al, 1986)— are abandoned, and the service is exerted in order to maximize personal gains. In dispensing service, agent receives a direct or indirect benefit while the third part obtains a certain economic value.

As part of the environmental approach, political and economical views support that the third part (i.e. corporation) plays a main role in the game. However, both approaches differ in the nature of this role. Corporation is understood as active partner in the political approach while, in the economic approach, it is viewed as passive partner.

A) Political view

Perhaps with the thought that moral reflections cannot possibly have a significant role in business (Cf. Melé, 2003; Hausman, 2002), for a political point of view the self-interest of firms is not ambiguous: the corporation pursues profits being governed in consequence. Corporations tend to overweight economic performance rejecting many ethical analysis and accordingly they will be bribe players if bribe is an efficient price mechanism (Cf. Clarke and Xu, 2004).

This general argument is reinforced because the global corporation (Cf. Ricks, 2003) and the global strategy of the firms (Husted, 2003), specially in the multinational enterprise with sub-units and global hierarchies, operate to optimize firm-wide performance (Cf. Rangan, 1998). Thus, the inefficiencies associated to business conduct in the context of corrupt environment are contemplated “bribe-giver” side and, in the end, susceptible officials are bribed by corporations.

In this sense, a second principal-agent agreement —is added to the first problem. Thus, corrupt agent will have two different principals: on the one hand, the government, who pays his wage being unable to monitor or incentive his behavior; on the other hand, the corporation which, by paying bribes, hopes to obtain its goals.

The second informal and illegal contract between agent and corporation differs highly from the first, as it presents high transaction costs.

Corruption increase all the efforts required to contract. Corporation incurs in costs not only due to the payment of bribes but as a result of the increasing of transaction costs (Cf. Lambsdorff, 2002). On the one hand, while the agent has pre-contractual information in his advance, the principal’s efforts to distinguishing opportunities for utilities, seeking the corrupt official able to offer the source of utilities, (usually with

non verifiability of information) and finding the relevant prices increases with the secrecy of agreement and the risk of being denounced or discovered by authorities, agents or other principals (Cf. Lambsdorff, 2002). Clarke and Xu (2004) find that novo private corporations pay higher bribes than other enterprises because they have less political influence. When the relations between corporations and bribe-takers is consolidated over time, the transaction information cost as well as the amount of bribes are reduced. Della Porta and Vannucci (1997,1999) show how corporations invest in the creation of hidden channels of communications, including the figure of the “middlemen”, in order to reduce adverse selection and the moral hazard, describing multiplicity of relationships between agent and both principals.

On the other hand, in determining the conditions of the contract, new problems arise. Specially in the licenses whose development requires high installation costs as well as certain inversion (i.e. plants, specific equipment, etc.) or, even in actives with high degree of specificity (Williamson, 1985), the design’s costs of the contract increase (Husted, 1994).

Primary and secondary environmental uncertainties (Dunn, 2000) must be evaluated and the unpredictability combated by specific trade-off. Nevertheless, probably the highest costs associated to corrupt deal was the enforcement because both, the potential strategic behavioral uncertainty (Williamson, 1999) and the unavailability of the legal resource.

Mauro (1995) shows how corruption and instability, and therefore, uncertainty, are intrinsically linked. Strategic literature suggests that uncertainty is a central component in explaining organization behavior (Sutcliffe and Zaheer, 1998). Literature on corruption has largely signaled that “ruler’s corruption introduce an additional element of uncertainty into the investment climate”: the lack of credible commitment mechanism (Rose-Ackerman, 1999:32). Officials and firms who receive or pay illegal bribes are exposed to the legal penalty associated to the corrupt behavior and to the public disapproval, if it exists. However, the main cost for business is the enforcement. Minimizing some costs of corrupt agreement is possible by specific features in relationship (Cf. Crocker and Masten, 1988) based in a “quid pro quo”, however, the dynamic of the corruption presents problems of ex-post opportunism (Williamson, 1985) without legal resource and renegotiations. Choi and Thum (2004, 2003) present as main problem the arbitrariness that corporation often faces in a corrupt environment. Doh et al (2003:118) emphasize the arbitrariness of the disorganized corruption

networks with agents that act “independently and capriciously”. The power of the corrupt official does not finish with the concession of the license. As it is an illegal and secret relationship, official can change a posteriori conditions and exigencies (Gaviria, 2002).

Corporation is always obligated to minimize transaction costs and to avoid uncertainty. Lambsdorff (2002b) suggests that if corrupt deals cannot be enforced, then itself can act as a deterrent to corruption. It is, in general, true, however, it is often possible to combat the lack of the confidence ascending across the public hierarchy. In this sense, if the probability of ex-post opportunism is high, corporation is motivated to abandon the agent in favor of the structure where it is embedded, by paying bribes to agent’s superiors: for example, with incentives in favor of politicians or top government’s directors (Aidt, 1998). Della Porta and Vannuci (1997) suggest that, due to agent’s arbitrariness, corporations tend to link to the centers of power looking for a reinforced monopoly position, for instance, with invisible and illegal entry barriers. The “protection for Sale” model (Grossman and Helpman; 1994) underlines that gifts made by corporations are not so much as instruments but more as a sign of influence in governments policies. The ability of politicians to supply or sell protection against bureaucratic arbitrariness can be employed by corporations to reinforce monopolistic situations (Cf. Alesina and Rodrik, 1994).

It is an evidence that corruption is not only confined to level of official hierarchy but to the entire structure, including the elite (Rose-Ackerman, 1999; Gillespie and Okruhlik, 1991). In the end, the net result is that the arbitrariness of public bureaucrats concludes with high connections between corporations and politicians. Politicians remain engaged with the corporations and accommodate political goals to corporate profits (Cf. Levi and Nelken, 1996)

In the principal-agency models, the situation can be explained as a trilateral correlation between both principals and the agent, being the corporation and the government linked to an equilibrium of the power.

In this sense, political view supports that every strategy for curbing corruption must include actions from both participants: elite and corporations. The strategy must be double, including as the political development as the corporate intolerance for corruption. For instance, the philosophy subjacent in the Foreign Corrupt Practices Act is that the efficiency in the prevention of the corruption requires ethics to be defended in

the firstly position for corporation as a compact which includes central and foreign subsidiaries (Cf. Hines, 1995; Graham, 1984).

Making a crime for any American corporation to offer, promising or making illegal payments or gifts to foreign officials or politicians, North-America government recognizes that economic development, market efficiency, democratization and extension of moral values (Cf. Lamsdorff, 1998) —which are distorted or inhibited by corruption— are more important for societies than the profit of the businesses. In this sense, corrupt corporation is conceptualized as the principal agent of an evil. Its activity is motivated by self-interest having less economic motivation to seek alternatives (Cf. McChesney, 1997; Thompson, 1995).

B) Economic view

Corporations enter markets in order to see opportunities for profit. There is always a risk of economic failure in market. However, corporation knows that the risk increases in corrupt environment (Doh et al, 2003). Corporation that suffers the “excess” of risk, and understand how corrupt markets work, implement success strategies. Kirzner (1997) suggests that the entrepreneurship should be a mechanism that makes possible the discovery and mitigation of economic inefficiencies and consequent failures. In this sense, for instance, paying bribes may be an answer mechanism to market and government failures (Cf. Acemoglu and Verdier, 2000; Becker and Stigler, 1974; Leff, 1964). “In general —Rose Ackerman (2002:1891) says— firms, bot, domestic and foreign, justify their behavior as a means to their greater goal of the creation of economic value and as a necessary, if unpleasant, response to the weakness and venality of governments”. Thus, economic view points out the passive form being corruption connected with market malfunction. Economic approach neglects and scorns the judgement about the unethical practices, being omitted the interplay between internal ethical decision-making and corruption.

The agency problem is viewed as a problem of a monopolistic agent and two principals, the government and a collection of businesses, which should be resolved increasing the openness of the market or its order.

Mauro (1995) notes that high levels of corruption constitutes a several obstacle for corporate investment because of the bribes and transaction costs. Indeed, corporations must bribe to stay competitive in emerging market and, besides, the trade-off between corrupt agent and corporation must be contemplated from the “bribe-taker” view, emphasizing on the critical role of the competence.

In summary, the discourse of economic provenance appeals to the economic environment: that is, the concept of competition and organization (Ades and Di Tella, 1999). Corrupt behavior (i.e. to restrict entry or to affect the size of the concessions) eliminates the employ of markets and introduces a new kind of resources assignation. Economists analyze the new degree of efficiency and predictability of the transactions and the transaction costs. Thus, firm has been analyzed as the agent that work in an environment which required a flow of resources to operate. Firm must support the cost of corruption —cost of doing business in many countries (Doh et al, 2003; Wilhelm, 2002)— and treats to minimize it in order to protect the self-interest.

In this view, there are not bad men but bad market's rules. While the political view refers the honesty, the economic views suggests that the quality of society depends of the type of market' transactions. Despite the partial conclusions by Bliss and Di Tella (1997), assumption is that countries that have improved their market access and transparency, have reduced corruption (Cf. Evenett and Hoekman, 2005; Bardham, 1997; Hillman and Moser, 1996). In relation with the bribe takers, Clarke and Xu (2004) suggest that asking for bribes or for lower amounts is reduced when competition is greater (Ades and Di Tella, 1999; Rose-Ackerman, 1978 and Shleifer and Vishny, 1993).

In this approach, leadership's reputation for integrity does not suffer from paying bribes. The ambivalence among ethical internal decision-making and global business ethics does not exist (Cf. Jansen and Glinow, 1985) at least in countries where corruption is largely extended. Because assumptions, corporate corruption in rich countries with developed markets is understand as incongruent with ethical standard and legality.

Political and economical approach differ in the role of the corporation, however both environmental approaches agree with the hypothesis that *corporation itself does not present or suffer an alignment problem*. In both cases, the agent who acts illegal or unethically is “in serving his principal's interest,” (Carvajal, 1999; Bandfield, 1975).

In spite of the fact that firms may pay-off official, bureaucrats or high politicians to access to below market supplies, those actions occur without violation of the firm principal-agent contract. Behavior, attitudes and rules of both, corporation and its employees, are congruent and the corrupt strategy does not create alignment problem.

In this sense, in the environmental approach to corruption, the third part is a external part which is added *a posteriori*. In short, the environment is firstly corrupted and afterwards the corporation, as a closed agent, which is voluntary or forcedly corrupted.

Inside this view, the difference between political and economical approach is that, being both illegal, the first understands the corporation as a second principal (Cf. Groenendijk, 1997), while the economic approach believes that corporation is an especial kind of client for bureaucrat ((Klitgaard, 1991).

b) Organizational perspective

While in the *environmental approach*, organization does not suffer from internal problem of agency, *organizational approach* to corruption is characterized by the presence of personal corruption, actions in which the interest of the organization is sacrificed by its corrupt members.

While the misuse of the discretionary power for personal profit is contemplated in public organizations (Cf. Besfamille, 2004), in private firms, it is not fully appreciated and incorporated in managerial decision-making (Doh et. al, 2003). Argandoña (2003:253) suggests that “the private sector will be much more efficient at protecting its own interests, and so corruption (private-to-private) will be much less likely to occur in private sector”

Klitgaard’s (1988:75) definition of corruption—“*monopoly+discretion–accountability*”— sheds large light on the explanation. Private organizations, specially business firms, being developed in a free market doted by the rules of game, which include internationally harmonized accounting and standard auditing (Beasley et al, 2000), exert a great discipline over the firm, which reduces possibilities for corruption. Firms seems to be internally well equipped across own control systems and routines to fight against corrupters (Nelson and Winter, 1982; Williamson, 1991).

Indeed, despite being generally admitted that the hierarchical solution presents both, technical and behavioral problems (Williamson, 1996: 311), hierarchies have been described as the most invulnerable organization to the cancer of corruption. Being the agents tidied up to very real cognitive limits (Simon, 1958), which suggests routine failures of alignment, firm’s institutional design has developed efficient and clean incentives and control systems, which, theoretically, permit to evade the corruption.

Some researches (Cf. Romer, 2004) have suggested that opportunism —“self-interest seeking with guile” (Williamson, 1975:47-8)— normally views as significant in inter-firm relationships, can also be a problem within organizations. However, this is a minority thought and, the ability of the agents to act opportunistically inside corporation is often understood as small.

Nevertheless, recent scandals evidence that they may exist significant —quantity or quality— lacks in internal controls, which redirect money from organization to private pockets or produce misapplication of key ingredients of strategy that reduce efficiency and increase costs. In his analysis about the opportunism in emerging markets, Li (2002) concludes that ownership or vertical integration does not eliminate channel opportunism. It simply transfers channel opportunism from independent distributors to employees. As Speklé (2001:421) argues, “managerial coordination, the required administrative apparatus and information systems are imperfect and hardly costless. The almost innate limitations of accounting information systems don’t need any elaboration here, and the all too familiar bureaucratic inertia and politicizing making are just a few examples to illustrate that hierarchical governance is no panacea”.

We think that corruption can live in corporation.

Corruption is difficult to define and measure. However, there is a strong consensus that corruption requires at least three elements to co-exist (Jain, 2001:77) : (1) an agent with a discretionary power over the allocation of resources; (2) higher rents associated with the misuse of that discretionary power and (3) low probability to evade regulations and/or penalties associated with the wrongdoing.

Organizations and institutions are created and structured in order to realize some purposes and goals by division of labor and specialization, legitimating power over others individuals and resources (Bargh and Alvarez, 2001:43). Aidt (2003:633) supports that “the agent must possess the authority to design or administer regulations and policies in a discretionary manner”. In fact, the discretionary power arises in the hands of agents from specific *delegation* of decision-making authority (Litwack, 1991), being essential the *discretion* of the agent, which becomes from the information asymmetry (Groenendijk, 1997:214).

Corporations attempt to reduce the potential pervasive effects of the discretionary power by legal order, formal contracts and trust. Rules of law and contracts are called to fight the expected uncertainty of the individuals. Trust is called to combat the unexpected and *ex post* opportunism.

The selection of a specific governance structure determines most of the substantive parts of the internal organization of the firm, such as the set of control and coordination mechanisms (Cf. Menàrd, 1996). Although, theoretically, institutional form tends to respond to the necessities and possibilities of an uncertain future, indeed, the governance structure is built on the present information and data, being chosen to

develop the predicted opportunities and to attenuate potential and expected problems (Mocnik,2001). The purpose of rules and routines is to define the way the game is played if the environment does not change. They reduce uncertainty by providing a structure of behavior to every day life (North, 1990).

However, changes exist creating opportunities for take advances by agents. While organization evolves and creates new ways to new situations, agent with discretionary power has a monopoly, which can offer rents (cf. Dunn, 2002). High rents are not habitual in firms, but it is possible that, in new situations or situations without routines, rents are produced.

Control mechanisms are prepared by predictable behavior in expected situations. Only strong personnel controls could prevent those situations. Nevertheless, personnel control is very expensive (Merchant, 1987; Davila, 2004).

After organization evolves, it is possible that those deviant behaviors were detected but also in attention to the judiciary point of view. In this last sense, corruption is a criminal act or does not exist.

The called *criminal corruption* engages insiders in a relationship which is derived from a failure of alignment typified by courts, normally because concrete or general third parts —i.e., a shareholder, a tax-collector or the own society— are affected. Fraudulent financial informs, financial fraud, overstatement of revenues, etc., are some examples of criminal corruption (Beasley et al, 2000; Merchant, 1987). As illegal act, criminal corruption must be judged as undesirable actions which present significant costs for both, corporation and society (Cf. Dechow and Skinner, 2000).

Most of the unexpected corporate recent scandals have been interpreted as the result of a double failure: on the one hand, in the rules of game; on the other, in monitoring. Because of the first cause, Enron, Parmalat— (Cf. Carson, 2003; Cohan, 2002)— and other have received a quick response of lawmakers. The Sarbanes-Oxley Act (2000) in U.S.A, and other anti-fraud provisions of the securities law have been implemented. Besides violating the rules, scandals have been interpreted as an *incidental* failure in monitoring (Cf. Anand et al, 2004). Thus, corruption has been understood as the result of a bad dynamic function of the control mechanism, which has permitted “the company allowing fraud to exist” (Beasley et. al, 2000), although, it must note that better control is not always economically desirable (Merchant, 1982:44).

Actions which involve fraud are legally condemned by courts. Actions which do not involve fraud are not. However, they may also damage business.

Management literature has neglected the analysis of those legal but unethical actions which include an alignment problem, the rent-seeking and the discretionary power. It is a great failure because not every intra-firm transaction is governed by court-enforced contracts (Cf. Masten, 1988) but by the implicit law of forbearance (Williamson, 1994; 1991).

Legal but unethical behavior is a deviant behavior which produces both economic and ethical conflicts. On the one hand, the effects of the organizational corruption damage economic performance because it produces high costs (Wilhelm, 2002; Amba-Rao, 1993; Merchant, 1987). On the other, it imposes a constraint on governance because of the changing standard norms.

Corporation develops norms and routines which prevent acting from opportunistically (Williamson, 1991). Across a socialization process, norms and routines are internalized (Nelson and Winter, 1982). Corruption supposes a lack of these norms and routines. If corrupt agent is detected and punished, corruption is not a high problem. However, Glinow and Novelly (1982) find evidence that organizations have few institutionalized penalties for violating ethical standards. If there is not a systematic combat against unethical behavior, the corporate behavior will deteriorate over the years. May and Pauli (2002) suggest that when situation gets somebody to respond to an ethical *dilemma*, the agent evaluates at less six variables —magnitude consequences, social consensus, probability of effect, temporal immediacy, proximity and concentration of effect. One of those factors, the social consensus, which is the degree of social agreement that a proposed act is evil, can reflect the problem of the ambivalence in corporations.

If attitudes and behaviors of the managers are denying the payment of bribes and other corrupt demands, it is easy for the social consensus about corrupt attitudes and behaviors to be maintained and shaped by organization's business. If a corporation is a bribe-giver the social consensus is brooked.

Many violations of principal-agent relationship, many legal but unethical behavior may exist in corporation. The variety is infinite. However, in our opinion, the main problem of organizational corruption is that the intent of the parties to deceit was included.

Individual and organizational goals may not match perfectly existing a "lack of goal congruence" (Merchant, 1982:44). However, if the intent of the parties to deceit is included, the potential alignment problem is transformed in real corruption's problem. The legal or illegal qualification is not relevant. Seeking self-interest with deceit present significant costs for corporation (Trevino and Victor, 1992). Moreover, as Merchant

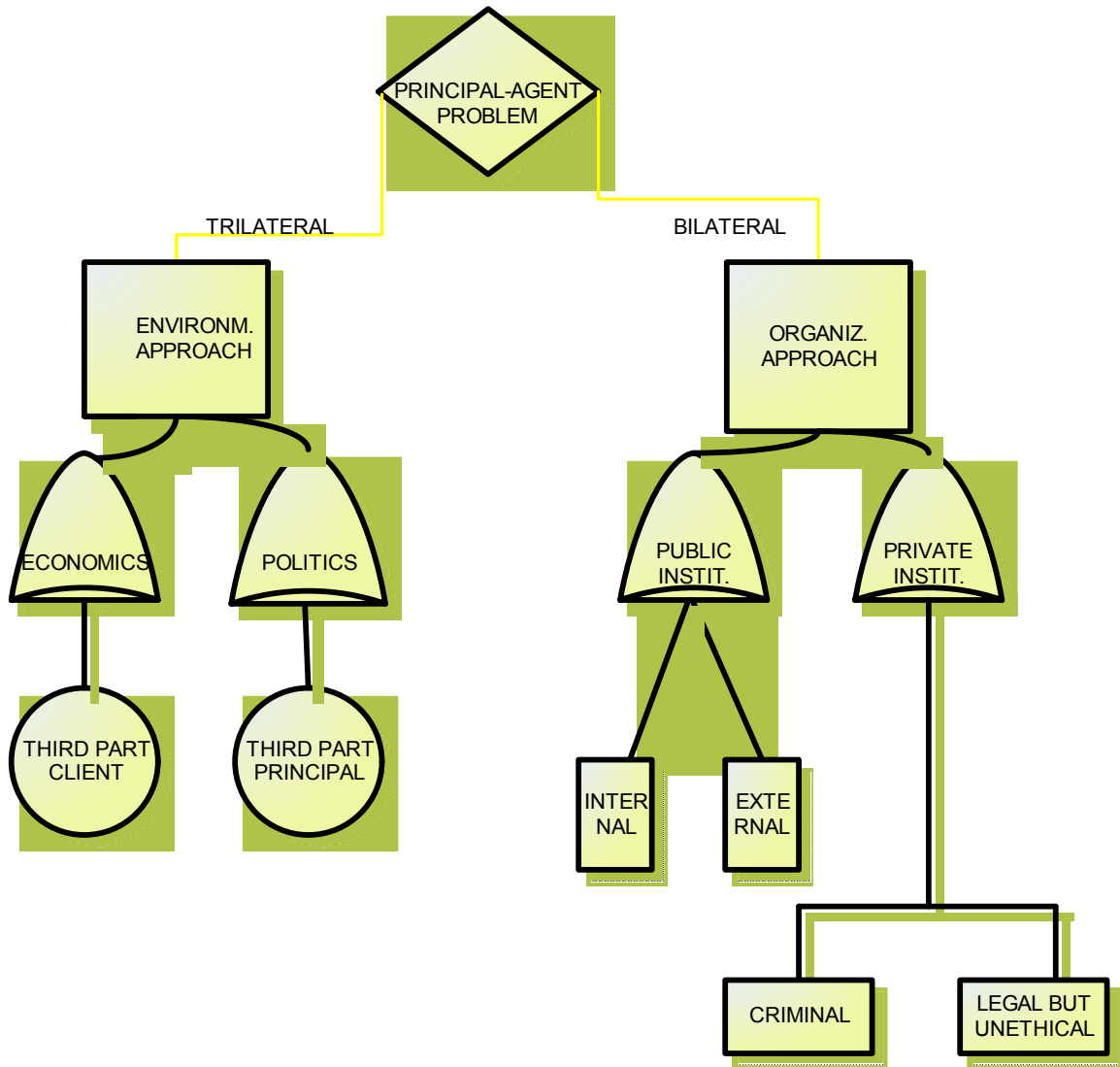
(1987:10) argues many cases of fraudulent and illegal practices “are often preceded by one or more forms of questionable practice”.

If principal means of curbing opportunism or corruption —instruments for governance to coercion (monitoring, hostages, contract itself) and incentives— and the private ordering of calculate trust (Williamson, 1993) do not go beyond (Cf. Nooteboom et al, 1997), only trust makes sense (Cf. Langfield-Smith and Smith, 2003) and the deceit is a betrayal of trust (Cf. Elangovan and Shapiro, 1998).

Making personal profits motives corruption, which must addressing to intentional actions. Results of the corporation may be expected because controls and incentives, but individual moral or unmoral attitudes and actions may not. In fact, corruption is directly related with moral attitudes and moral attitudes cannot be guaranteed by contracts (Rose-Ackerman, 1999), which are always incomplete (Cf. Tirole, 1999). The deceit itself is a violation of the essence of the firm (Cf. Dirks and Ferrin, 2001).

The potential advantage of the corrupter —alone or in a hierarchical corruption network— is not economically important but organizationally, because the deceit is the cancer of the organization’s essence.

Organizational view of private corruption must be united with the develop or misgovern of trust.



Cadre I: Corruption: a comprehensive “road map”

Summary and conclusions

Corruption is an ancient phenomenon which has been always with us, being a field with a long tradition. Despite many empirical and theoretical studies have analyzed the phenomenon, because it is an extremely complex phenomenon, analyzed by different sciences and different methodologies, disagreements about definitions, causes, consequences and politics persist.

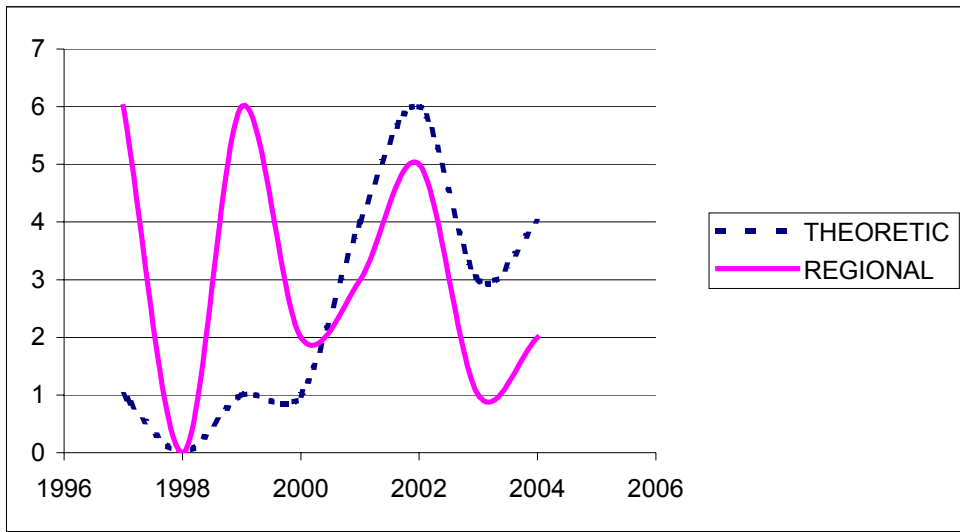
Discrepancies are specially important in analyzing the role played by corporations on corruption. Some researches suggest that corporation is an active and guilty agent looking for profits. Other studies support that corporation is a innocent victim obligated to paying bribes in order to doing business.

Principal approaches, political and economic points of view, have viewed corporation as a “black box” invulnerable to corruption. Models of management have underlined the efficiency of performance incentives and control systems in curving contractual failures in intra-firm relationships, interpreting recent corporate scandals —Enron, Worldcom, Parmalat, etc.— as failures of legal environment or simply as bad apples in a good barrel. This view has neglected the analysis of the legal but unethical corporate behavior.

This article examines how corruption has been viewed in literature, building a framework that permits to understand the role of the corporation in corruption. The paper uses three explanative factors —legality, efficiency and alignment— in order to contemplate also legal but unethical corporate behavior.

CORRUPTION CLASIFICACION	LEGAL BUT UNETHICAL ACTION	ILLEGAL ACTION
NOT FAILURE OF THE ALIGNMENT	Reputation problem Corporate Social Responsibility	<i>Political corruption</i> <i>Economic corruption</i>
FAILURE OF THE ALIGNMENT	<i>Behavioral corruption</i>	<i>Criminal business corruption</i>

Cadre III. General framework



Cadre IV. Topic of Corruption in Journal of Business Ethics

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