Strategies by Multinational Companies in Coping with Corruption in the Philippines

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Abstract

There have been studies supporting the theory that government corruption reduces foreign direct investment (FDI), but few literature that assess the impact of corruption on investing organizations. An article by Doh, Rodriguez, et al. (2003) shows corruption's impact on firms by employing a framework incorporating *pervasiveness* and *arbitrariness* as the two dimensions of government corruption and proposes five broad strategies for multinational companies to consider. It shows how some countries can rank high on one measure and low on another, and give examples of five countries in each of four cells. High on both dimensions are Egypt, India, Indonesia, Pakistan and Russia.

Building on the above-stated framework, this researcher proposes to investigate how multinational companies (MNCs) doing business in the Philippines are coping with government corruption. A survey will be conducted among senior executives of American multinational companies doing business thereat.

Introduction

Corruption is considered as following a formula: C = M + D – A (Klitgaard, 1998), where corruption equals monopoly plus discretion minus accountability. It is viewed as the misuse of office for unofficial ends, listing corrupt acts which include bribery (Stockhouse, 1993), extortion, influence peddling, nepotism, fraud, the use of "speed money," and embezzlement. Multinational companies (MNCs) and multinational enterprises (MNEs) are affected by laws against corruption and bribery. In many countries, particularly among developing countries, payments or favors are a way of life and "a greasing of the wheels" is practiced in return for government services. Warlick's research (2005) implied that "corruption increases the investment transaction costs for foreign direct investment."
Another study by Dorhoi (2005) found evidence "that increased political competition taking the form of increased turnover in government and increased party fragmentation in parliament has been beneficial for anti-corruption strategies."

The June 1997 issue of Management Accounting reported that according to the British Chamber of Commerce, bribery and corruption was a problem for 14 percent of exporters. In 1977, the Foreign Corrupt Practices Act was passed in the U.S. making it a crime to bribe a foreign official in order to obtain business. This Act was clarified in 1988 (Gatti, Margaret M., et al.) to assist the manager in distinguishing between reasonable ways of doing business globally or complying with foreign expectations and outright bribery and corruption. According to the Act, the Manager must know when he is in violation or simply facilitating routine governmental actions and governmental policy decisions such as obtaining permits and licenses, processing governmental papers (like visas and work orders), providing mail and phone service, and loading and unloading cargo. On February 15, 1999, the Organization for Economic Cooperation and Development (OECD) adopted a treaty criminalizing the bribery of foreign public officials (http://www.answers.com/topic/foreign-corrupt-practices-act-of 1997). Likewise, the Organization of American States (OAS) also officially condemned bribery. It has also been reported that the World Trade Organization has considered placing bribery rules on its agenda. A private organization called Transparency International conducts publication that highlights corruption and bribery and ranks countries on a Corruption Perceptions Index (www.transparency.de). The score assigned to each country relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts. It ranges between 10 (highly clean) and zero (highly corrupt). While the highest score in its last report was 9.7 for Finland (ranked #1) and the lowest score was 1.3 for Bangladesh (ranked #133), the Philippines (along with Albania, Argentina, Ethiopia, Gambia, Pakistan, Tanzania, and Zambia) scored 2.5 (ranked #92).

It is a well-known fact that corruption in the Philippines is rampant today and prior to the Marcos martial law. In a special report by the Economist, July 3, 2004, entitled "Democracy as Showbiz," it said that "awash in money, celebrities and corruption, Philippine politics is fun to observe – but desperately in need of reform." On May 15, 2004, *The Economist*, p. 38, also mentioned "after protests against corruption forced him (Joseph Estrada) from office – allowing Mrs. Arroyo, the vice-president, to take over – he bullied his friend Mr. Poe into running as a sort of avenging understudy." Despite this kind of environment, multinational companies (MNCs) and multinational enterprises (MNEs) thrive in that global market. How do they cope and what are their strategies knowing the prohibited foreign corrupt practices provision of the 1988 U.S. Foreign Corrupt Practices Act (FCPA) prohibits corrupt payments to foreign officials for the purpose of obtaining or keeping business? This researcher proposes to conduct a survey of some multinational companies (MNCs) doing business in the Philippines to find out their strategies or practices in said global market. Costs of government corruption can be divided into direct and indirect costs and separating them helps isolate the ways in which corruption affects business decision-making. Doh, Rodriguez, et al. (2003), showed them in table forms as follows:

TABLE 1
Direct Costs of Government Corruption

Type	Explanation
Bribes	Monetary and non-monetary payments to those with some degree of public power as a response to extortion or in exchange for some misuse of public power.
Red Tape/Bureaucratic Delay	Non-monetary and opportunity costs of dealing with corrupt officials or of complying with the illegitimate bureaucratic requirements of corrupt regimes.
Avoidance	Efforts to avoid and limit the firm's exposure to extortionary behavior by corrupt officials, including hiding output and opting out of the official economy.
Directly Unproductive Behavior	Investments in channels of influence to gain advantage in dividing up the benefits of economic activity; includes lobbying and more direct vote and influence peddling.
Foregoing Market Supporting Institutions	Costs imposed on the firm as a result of foregoing the use of courts for the enforcement of contracts, local financial operations, etc.
Engagement with Organized Crime	Monetary and non-monetary costs imposed on firms as a result of willing or unwilling engagement with organized crime.

TABLE 2
Indirect Costs of Government Corruption

Type	Explanation
Reduced Investment	Reduced public and private investment flows. Lower rates of foreign direct investment for the formation of a robust commercial environment.
Reduced and Distorted Public Expenditures	Reduced taxes as a result of the deterrence of business activity and recourse to the unofficial economy. Selection of privately beneficial and publicly costly expenditure projects.
Macroeconomic Weakness and Instability	Reduced rates of macroeconomic growth, weak commercial environment, and greater susceptibility to financial crises.
Weak Infrastructure	Inadequate, expensive, and intermittently supplied infrastructure services such as telephony, electricity, and transportation. Weak infrastructure foments opportunities for small bribes and may indirectly reduce public trust.
Squandered/Misdirected Entrepreneurial Talent	Engagement of entrepreneurial and otherwise talented individuals into the socially unproductive avenues of advance afforded by corrupt environments.
Socio-Economic Failure	Increased poverty, income inequality, and reduced income growth for the poorest in society. Increases demands on already weak central governments.

Discussion

According to Doh, Rodriguez, et al., firms "choosing to comply with or even exploit local corruption often neglect significant long-term costs." They cited examples of officials or employees of MNCs charged with corruption involving millions, sometimes billions, of dollars. It is believed that corruption is far more pervasive than reported. The research by Doh, Rodriguez, et al. suggests that the "magnitude of both direct and indirect costs of corruption is driven by two key dimensions: the pervasiveness (or level) of corruption and its arbitrariness (uncertainty)." They explained pervasiveness as the number and frequency of transactions or individuals with which (whom) the firm deals over the course of a fixed time period that involve illicit activities. They described arbitrariness (uncertainty) by stating that firms are uncertain of whom to pay, what to pay, and whether the payments will result in receiving the promised goods or services when government agents act capriciously and independently to "maximize their own bribe revenue." The researchers measured the pervasiveness and arbitrariness of corruption based on the World Business Environment Survey (WBES) published by the World Bank in 1998. The survey focused on perceptions of environmental factors facing firms, with a sample of 8,000 firms

representing approximately 100 companies of various sizes in each of 80 developing countries. From the two sets of questions on corruption in the WBES, the researchers draw the measure of the two dimensions showing their framework with five representative countries in each of four cells reflecting basic combinations of pervasiveness and arbitrariness. The figure drawn by the researchers shows how some countries can rank high on one measure and low on another (shown below), and concluded that corruption is a more complicated phenomenon.

Pervasiveness	Arbitrariness: Low	Arbitrariness: High
High	C1 Argentina China Mexico Nigeria Venezuela	C2 Egypt India Indonesia Pakistan Russia
Low	C3 Brazil Chile Italy South Africa South Korea	C4 Czech Republic Hungary Malaysia Namibia Poland

*Note: Countries have been placed in four cells in alphabetical order and do not reflect specific ordered rankings within the cells.

FIGURE 1
The Two Dimensions of Corruption

They found that while individual firms may benefit from corruption, the damage to society is substantial. They likewise found that a firm may not have sufficient incentives to avoid or report corruption because the "benefits" of corruption are concentrated, whereas many of the costs are diffused. They claim that firms may participate in corruption due to competitive pressures, respect for local cultural norms, extortion, or the difficulty in monitoring individual employees. If they do not participate, firms may find themselves at a disadvantage against their competition (Gatti, M., 1997). Many firms, however, have developed strategies in dealing with corruption. Shown below in a table form, researchers Doh, Rodriguez, et al. described the various strategies used by firms they surveyed showing the targeted cost, the dimension, advantages and problems:

TABLE 3
Strategies for Coping with Corruption

Strategy	Cost Targeted	Effective Against	Advantages	Problems
Avoidance	Direct	Pervasive & Arbitrary Corruption	Bypasses problem	Forego opportunities
Adjusting Entry Mode	Direct	Pervasive & Arbitrary Corruption (different strategies for each)	Allows firm to maintain participation in market while avoiding exposure to corruption Allows firm to avoid opportunity and other costs of foregoing markets	Denies firm some advantages of entry-mode options, including acquisition of local resources Denies host country some benefits
Corporate Codes of Conduct	Direct & Indirect	Pervasive & Arbitrary Corruption	Could incorporate major MNEs around the world	Viewed as lacking "rigor" Local firms unlikely to sign on, generating differential costs/benefits
Training, Development, and Public Education	Direct & Indirect	Pervasive, but less for Arbitrary Corruption	Regional-focused programs could make progress easier For government-sponsored programs, participation could be tied to World Bank loans and aid Makes policies clear and gives employees practical examples	Training initiatives may lack "teeth" in terms of enforcement Company-sponsored initiatives affect only one company Company-sponsored initiatives may have uneven application throughout subsidiaries
Social Contributions/ Public Donations	Direct	Pervasive Corruption	Provides needed services without breaking law or ethics	May be difficult to determine when "line has been crossed" May raise expectations of continued and rising payment
Laws and Agreements	Indirect	Pervasive & Arbitrary Corruption	FCPA includes strict rules with penalties OECD agreement relatively comprehensive Some developing countries now adopting OECD principles	FCPA may disadvantage U.S. firms vis-à-vis competitors Initially covered only OECD and a few developing countries Lack of enforcement and uneven implementation in developing world creates free-rider problem

The research being proposed will make use of the above-described strategies through a survey of some MNCs doing business in the Philippines. A questionnaire will be developed showing the various strategies shown on the above table with the addition of "Other Strategy…..Explain." Senior executives of these MNCs will be asked to choose among the listed examples of direct cost of corruption, the number and frequency of transactions/individuals over a time period, and approximate costs. Secondary data will be obtained from survey organizations or institutions such as the Development Bank of the Philippines and the Central Bank of the Philippines.

Limitations of the Research

The research will focus only on foreign direct investment. It will not include other types of capital flows such as bank lending, bonds, and equities.

Summary and Conclusions

Results of the survey will be summarized and recommendation for further research will be provided.

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