Corruption and SMEs

Exploring the business case for western SMEs to counter involvement in administrative corruption in developing countries

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Abstract

Despite the fact that many developing countries offer highly attractive markets to foreign investors, the business environments in such countries are often characterised by systemic levels of administrative corruption - a situation where bribery and facilitation payments are used to resolve bureaucratic and administrative processes between companies and state agents. According to research, this type of corruption constitutes one of the most important investment barriers for foreign companies investing in developing countries as it raises the cost of doing business and thereby limits the prospects for business growth and development.

The companies that suffer mostly from corruption are small and medium sized enterprises (SMEs) due to the liability of size and thus limited resources and capabilities to avoid it. As a result, many SMEs simply accept corruption as a normal element of doing business and use it as a mean to 'get things done', despite knowing that it is both illegal and that it raises the cost of doing business. However, corruption and bribery in such markets may also open doors to 'easier' and preferential investment conditions, which ultimately represents a dilemma for SMEs when weighing the advantages and disadvantages of engaging in corrupt behaviour.

By exploring the interaction between western SMEs and public officials in selected developing markets, this thesis intend to contribute to the understanding of the causes of administrative corruption in different institutional settings and to assess the potential role of both SMEs and governments in fighting it. By analysing the risks, costs and potential benefits of administrative corruption, it particularly seeks to assess whether a 'SME business case' to avoid involvement in corruption exists for western SMEs and how an anti-corruption strategy for SMEs may look like.

Table of Contents

1. Introduction

During a panel discussion at an international conference on compliance, fraud and corruption held in Copenhagen in April 2011, vice president of internal audit at the Danish brewery Carlsberg caused the participants to raise their eyebrows as she proclaimed that the company made regular use of small facilitation payments to cut bureaucratic corners in developing markets. This was said despite the fact that such payments are illegal by law and that Carlsberg has a policy against it, but the vice president argued; "*it is naïve to think that one can run a global company without making use of such payments*". Among the attendants was a reporter from a Danish newspaper who chose to bring the story a week later under the heading "*Carlsberg pays small facilitation payments*"[1]. The following day, the story was published in newspapers around the world, and leading figures of Carlsberg subsequently had much explaining to do.

The reason why Carlsberg's comment attracted this level of attention is because it revived a decades' old debate about whether it is realistic for international companies to avoid involvement in this type of *petty* or *administrative* corruption when operating in markets where it is widespread. While the world has witnessed a growing criminalisation of foreign bribery and facilitation payments as well as the broad range of initiatives to curb corruption in global trade over the past two decades, most business surveys on this matter generally reveal that the use of small facilitation payments to 'ease' rigid bureaucratic processes continue to be a widespread practice in many developing countries[2]. This situation therefore represents a general dilemma in global trade as such payments can partly be viewed as an additional operating cost, and partly as a facilitating factor which opens doors to 'easier' and preferential investment conditions.

While the above debate clearly reveals that administrative corruption continues to feature as an important problem area in international business, this thesis does not intent to carry out the discussion from the perspective of multinational companies. Instead, it will focus on those millions of internationalising small- and medium-sized enterprises (SMEs) that face the exact same problems

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[1] See for example: www.business.dk/foedevarer/carlsberg-betaler-smaabestikkelse and www.bloomberg.com/news/2011-04-14/carlsberg-pays-small-facilitation-fees-berlingske-says.html - Both articles found 16 April 2011.
[2] See for example the World Bank & IFC's Enterprise Surveys; www.enterprisesurveys.org – Especially the country indicator: "% of Firms Expected to Pay Informal Payment to Public Officials (to Get Things Done)", and the Global Corruption Barometer 2010 by Transparency International; www.transparency.org/policy_research/surveys_indices/gcb/2010

of corruption in developing markets, but that often do not have the same options available to avoid it due to limited resources, knowledge and experience vis-à-vis larger companies. SMEs are therefore particularly vulnerable to the negative effects of corruption, and research find corruption to be among the most constraining factors for successful SME internationalisation in foreign markets as it complicates and raises the cost of standard business operations (Beck & Demirguc-Kunt 2005 and Aterido et al. 2007 and 2009).

While much has been written on the scope, impact and possible solutions to business corruption, only very little research has been conducted on SMEs, which is relatively hard to justify when taking into account their large global representation and importance to the world economy. The European Commission (2005) estimates SMEs to represent 99% of all enterprises in the European Union, and they are thus often linked to a range of positive externalities related to employment, innovation, potential poverty alleviation and economic growth. So in order for SMEs to fully unleash their proclaimed potential as a major economic catalyst, corruption affecting SMEs must be targeted and sought reduced (UNIDO & UNODC 2007).

With the above argument in mind, it is the primary aim of this thesis to analyse whether it is possible for western SMEs to avoid involvement in administrative corruption in developing countries despite their resource constraints and general vulnerability. Because administrative corruption can also facilitate business transactions, there will also be a particular focus on whether a business case exists for SMEs to avoid it.

1.1. Research Area

While high-profile corruption cases involving USD millions paid in bribes typically get most attention in the media, the most prevalent type of corruption in cross-border trade is often referred to as *administrative corruption* – a situation where bribery and facilitation payments are used to resolve or speed up administrative processes between companies and state agents. This can for example be in relation to the clearance of goods through customs, company inspections or the issuing of business approvals and permits. Many researchers agree that this type of corruption is holding back the development of both countries and companies by discouraging investments, increasing the costs of doing business and thereby negatively influencing incentives for entrepreneurship (e.g. Damania et al. 2004, Seligson 2002). Those which are mostly affected by this type of corruption are internationalising SMEs as they suffer from a range of resource constraints that make it very difficult for them to avoid it (UNIDO & UNODC 2007, Beck & Demirguc-Kunt 2005).

Carlsberg's argument that facilitation payments cannot be avoided in developing markets has recently revived the debate about administrative corruption[3]. Supporters generally agree that companies need to set aside their western ethical standards and act in accordance with the 'informal rules' of a given market in order to stay competitive, while opponents argue that international companies must set ethical examples for common business behaviour and act in accordance with the law. Steel giant Ancelor Mittal's representative at the Copenhagen conference proclaimed that his company had managed to root out the use of such payments during global operations and indicated that curbing corruption can in fact be done with will and dedication. For SMEs, however, the situation is often very different. Because of their limited financial means, experience and bargaining power compared with multinational companies, it can be very difficult for SMEs to avoid involvement in administrative corruption.

It is therefore the primary aim of this thesis to explore what options internationalising SMEs have to avoid involvement in this type of corruption. This will imply an explicit focus on internal anti-corruption strategies and integrity systems to explore what internationalising SMEs can do themselves to avoid involvement in corruption. Different developing country business environments

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[3] See for example: www.business.dk/debat/debat-er-det-i-orden-at-carlsberg-betaler-smaabestikkelse - Found on www.b.dk on 16 April 2011

will also be analysed to assess the impact of the pervasiveness and varying nature of administrative corruption on SME operations and their ability to avoid it. The level of administrative corruption may be so pervasive in a given market that SMEs are not in a position to avoid it themselves, which thereby implies a focus on the governmental role in reducing corruption and thus improving operating environments for SMEs.

Another important focus area of this thesis will be the facilitating aspects of the nature of administrative corruption. While the widespread use of facilitation payments to speed up administrative processes in many developing countries increases the cost of doing business, it can be even more costly for SMEs to avoid such payments as it will cause delays and prolong operations. This therefore raises the question about whether administrative corruption is at all 'worth' avoiding for SMEs? By reviewing different aspects of costs and possible advantages of engaging in administrative corruption, I will analyse whether an apparent business case exists for SMEs to actively seek to avoid it.

1.2. Research Question

Based on the above outline of the research area, the main research question that will be dealt with throughout this study is:

- **To what extent are western SMEs operating in developing countries able to avoid involvement in administrative corruption?**

I am well aware that it is impossible to reach a straightforward answer to the above question since the nature and characteristics of both western SMEs as well as developing markets vary greatly. However, it will enable me to look into both strengths and weaknesses of western SMEs and how administrative corruption affects their decisions and actions in developing markets. It will also let me assess particularities of administrative corruption and how it unfolds in different developing market contexts and between the actors involved. By analysing administrative corruption from a western SME perspective at individual, organisational and societal levels, it is the main aim of this thesis to be able to provide some generalising answers about the main factors that determine whether they are able to avoid it in different market settings. A guiding question which will be

highly important for the analysis is whether a business case to avoid involvement in administrative corruption exists. This is important because if involvement in administrative corruption is found to benefit SMEs more than it impedes their operations and possibilities for growth and development, there will be no reason for them to seek to avoid it.

1.3. Research Method and Delimitation

Whereas much has been written in recent decades within the field of anti-corruption as well as on SMEs in international business literature, there has been a very limited focus on how corruption affects SMEs, resulting in a general lack of research and thereby narrow understanding as well as explanations to this research area. Through reviews, discussions and analysis of relevant articles, studies, surveys and case studies, it is the primary aim of this thesis to contribute to an enhanced and broader understanding of this particular research area. Therefore, in order to cover a not yet clearly defined problem area, the nature of the research has been conducted as an exploratory desk study. In order to help clarify the nature of administrative corruption and how it is practiced and experienced differently in developing markets, I have also applied some explanatory case studies based on studies and surveys from different developing markets. Explanatory case studies can be a valuable approach to explain and make generalisations about a specific research area (Yin 2009: 6), and in this study they have been of great assistance for letting me clarify and talk about important problems.

Because a very limited amount of research has previously been conducted on how SMEs are affected by corruption and what their options are to avoid it, it has also been a challenge to decide upon an appropriate method and structure for this thesis. I have chosen to apply a broad and generalising view on SMEs and administrative corruption in order to sketch and investigate the field. I have for example not limited my analyses to study SMEs from a specific industry or of a specific nationality. I have only limited my focus of study to western internationalising SMEs which do business in developing countries – i.e. SMEs from the OECD region with sufficient resources and capabilities to engage in cross-border trade - and the primary aim has been to assess the particularities of such internationalising SMEs as compared with larger multinational companies. I am well aware that such broadly defined subject of analysis has limited my ability to point out many context-specific details about how corruption affects SMEs from a certain industry,

nationality or with a specific business culture, etc. However, due to the relatively scarce and unstructured existing research on this topic, I have instead felt the need to conduct an exploratory desk study to review and compare the existing literature and related theory with the intention to map out a generalised picture on administrative corruption and SMEs and subsequently their options to avoid it. It is for the same reason that I have chosen not to conduct interviews or surveys with a few companies myself. Should a follow-up be made on the basis on the findings of this thesis, I would regard interviews and surveys as the preferred research method in order to generate more context-specific findings.

To assist my exploration of the research area and analysis of research question, this thesis will be based on a multi-level theoretical approach which will serve as an overall framework and structure for my analysis. This is very important since corruption is a highly complex phenomena consisting of many diverse types, and with just as many ways and motives to engage in it. In short, I have chosen to apply individual, organisational and societal views on corruption which will help explain and analyse aspects of costs derived from administrative corruption, anti-corruption strategy and the impact of the external business environment. Ultimately, this will help me assess whether a business case exists for SMEs to avoid involvement in administrative corruption.[4]

1.4. Use of Sources

In order to assess the options as well as the business case for SMEs to avoid involvement in administrative corruption, I have searched for information within various academic fields. First, I have explored sources on general SME information and empirical data on trade barriers affecting SME internationalisation within the international business literature. Secondly, a large body of anti-corruption literature has been reviewed, compared and analysed in order to help clarify different problem areas regarding administrative corruption, including the effects and costs of corruption on SMEs. Most notably, within the anti-corruption literature, I have emphasised the use of empirical studies that could help illustrate how SMEs experience corruption. Throughout the thesis, I have held these empirical findings against my own theoretical approach.

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[4] The choice and application of theory will be explained in much more detail in section 3.

Because I use existing literature as the primary source of knowledge instead of gathering own empirical research, one may then ask how this study intends to contribute to any new and deeper understandings of administrative corruption and SMEs. First, most existing studies that seek to explain how corruption affects SMEs have primarily been conducted by international policy institutions or development agencies, and often with a policy-oriented aim. While these studies have been very useful in providing quantitative empirical data, they often fail to deliver in-depth and qualitative explanations to why things happen. I have thus compared such studies with my theoretical approach and background information in order to derive more in-depth meanings, for example about the causes of administrative corruption. Secondly, hardly any surveys on SMEs and corruption use references from other and similar studies, and have often been carried out in isolation from each other. I have therefore taken the opportunity to gather results from the sources found on SMEs and corruption to investigate the similarities and differences of the existing results.

I have also been personally involved in generating some of the research behind the sources used throughout the thesis, since some have been conducted by the anti-corruption consultancy firm, Global Advice Network, for which I have worked a number of years. Through this company, I have had access to a large amount of internal and external research and sources, including some which I have co-written over the years, such as the elements taken from the Business Anti-Corruption Portal[5]. Through this work, I have acquired a comprehensive knowledge and understanding of corruption, which has also been a driving factor for my choice of research area. However, working on a daily basis with anti-corruption research has also had implications for my research process, approach and preliminary attitude about corruption strategy. For example, I started out with a confident belief that corruption can be combated in most situations by private companies, and that it is primarily a matter of the right strategy and willingness. Throughout the research process, however, this attitude has been confronted many times, and I have continuously had to adjust it in accordance with my findings.

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[5] www.business-anti-corruption.com - See footnotes and references for the various elements used.

2. Background – Introduction to the Study of Corruption

Corruption in international business has received increasing attention within the last 15-20 years. Among the reasons for this may partly be due to globalisation and subsequent changes in investor demographics around the world, where companies of all sizes have internationalised at a rapid pace in their quest to explore new market opportunities and to remain competitive. This has driven many companies to seek reduced operating costs in low-income countries where business rules, practises and culture are very different from domestic markets. This has increased encounters with new operating constraints for companies, including corruption (Eicher 2009).

Another reason for increased focus on business corruption may be due to the many high-profiled fraud and corruption scandals and subsequent collapses of multinational companies that have occurred in the wake of financial crisis and bursting financial bubbles within the last decade, such as those of Enron, WorldCom, Parmalat, etc. (Hamilton & Micklethwait 2006). Intense coverage of such cases by the mass media has made the general public aware of the magnitude of the consequences of large-scale corruption cases, which often involve many innocent victims in terms of lost jobs and pensions as well as huge financial losses (which is often covered with taxpayers' money).

Finally, business corruption has gained attention alongside recent years growing trend in promoting business ethics. While environmental and socially responsible business practises have been promoted through corporate social responsibility (CSR) programmes by international organisations, private companies and business organisations around the world, so has the promotion of more transparent business practises. This has additionally gone hand in hand with a growing criminalisation of business corruption through both local legislation as well as global and regional anti-corruption conventions, which means that companies around the world are now increasingly pressured to comply with anti-corruption laws.

Such trends have all increased the amount of attention given to business corruption and, as a consequence, a large number of scholars, international organisations and NGOs around the world now conduct research and run advocacy projects with the intention to combat corrupt business practises. With this thesis, I will join this expanding group of researchers which has an interest in examining the causes of corruption, how it affects businesses and, in particular, what options

businesses have to avoid involvement in corruption. In the following section, I will provide introductions to typology, categories and definitions of corruption with the primary aim of explaining the type of corruption that will be explored throughout this thesis, namely administrative corruption. This will be followed by different theoretical approaches which will be helpful for examining my research question.

2.1. Definition

When recognising that corruption comes in a large variety of types, shapes and sizes and that the causes for it to occur vary due to differing interpretations, it also becomes clear that it is very hard to agree upon a 'one-size-fits-all' definition. This is further manifested in the fact that there is no globally accepted definition of corruption and bribery, despite the existence of several international anti-corruption conventions[6]. Definitions of corruption are sometimes discussed at length in related literature but such discussions rarely bring much value added to the reader (Lambsdorff 2007: 15). Because of this, he notes that researchers have started to avoid definitions of corruption altogether, claiming that most observers rarely disagree on what corruption is anyway when studying specific cases. This is similar to saying that "we find it hard to define corruption, but we know what it is when we see it" – and while this may seem as a too simplistic 'escape' from an academic discussion, I would still argue that it has some truth to it.

Corruption has often been defined as *the abuse of public office for private benefit* (e.g. by the World Bank[7], U4-Anti-Corruption Research Centre[8], Lambsdorff 2007: 16, Spector 2005: 5 and Tanzi 1998), and while this definition goes a long way in defining many types of corruption, it also has its limitations. The most obvious limitation is its sole focus on deviant behaviour of public sector employees, whether this being high-ranking politicians or lower-level officials, thereby leaving aside abuses for private gain on part of private actors. For example, this definition does not cover an employee at a private company offering kickbacks to win a large public contract since his position of power was not provided by the public. Therefore, when exploring the motives for both private and public sector employees to engage in corrupt behaviour, as in the case of this thesis, it is often

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[6] www.business-anti-corruption.com/about-corruption/vocabulary
[7] www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm
[8] www.u4.no/themes/pfm/Revenueissue/revenue1.cfm

more appropriate to use the similar but broader definition provided by Transparency International (TI); *the abuse of entrusted power for private gain.*[9]

Mainly due to the many varieties and interpretations of corruption, however, the TI definition also has its shortcomings. For example, the term '*for private gain / benefit*' can in some situations be disputed since some individuals may not engage in corrupt activity to seek personal profits, but instead seek benefits for political supporters, family or friends (Johnson 2004: 3, Ashforth et al. 2008). Moreover, some authors further complicate the use of standard definitions by applying a social constructivist view on corruption, saying that ideas or interpretations of what is being considered corrupt is not universally shared by everyone around the world (Johnson 2004: 3-6 and De Graaf 2007). De Graaf (2007), for example, argues that corruption is not always a matter of black and white, but instead what is being considered corrupt at a certain place at a certain time. Just as it is easy to find shortcomings of the proposed definitions of corruption, it also seems impossible to find a universal definition covering all its varieties and aspects. While the TI definition very well covers the type of corruption that is so often read about in newspapers – e.g. large scale fraud schemes where politicians and businessmen illegally pocket huge sums of money – it does not fully cover the type of corruption that is being dealt with in this thesis, namely administrative corruption. Therefore, for the purpose of this thesis, a more precise definition of this type of corruption could be: *the solicitation or offering of facilitation payments or gifts during the interaction between private companies and public officials for personal or collective gain.*

2.2. Typology of Corruption

Corruption is a broad and often complex term that covers a large variety of practises and behaviours. While bribery often gets most attention in the media, many other variations of corruption are also commonly practised. Below is a list of so-called 'recognised forms' of corruption which is by no means exhaustive, but offered to provide a glimpse into the typology of corruption[10]. Only the types that are interesting in relation to administrative corruption will be explained in detail.

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[9] www.transparency.org/news_room/faq/corruption_faq

[10] Explanations of the various types of corruption included in the list have partly been lent from the Business Anti-Corruption Portal's corruption vocabulary: (www.business-anti-corruption.com/about-corruption/vocabulary), and the U4 Anti-Corruption Research Centre's description of Revenue Administration and Corruption: (www.u4.no/themes/pfm/Revenueissue/revenue1.cfm).

2.2.1. Types of corrupt practices

- **Abuse of Office** (office holders acting outside the boundaries of their legal remit)

- **Collusion** (agreement, usually secret, which occurs between two or more persons to limit open competition)

- **Embezzlement** (often defined as plain theft)

- **Extortion** (unlawful use of one's authority to obtain something through coercion or threats)

- **Kickbacks** (a form of bribery in exchange for an illegal advantage, where a 'slice' of the contract is 'kicked back' to the person who gave the undue advantage)

- **Nepotism and Cronyism** (shown to family members (nepotism) and friends (cronyism) typically without regard to merit and qualifications)

- **Patronage** (system where political supporters are rewarded for their support)

2.2.2. Types Related to Administrative Corruption

- **Bribery** is often described as the most common and frequently occurring corrupt practise (e.g. Johnson 2004: 2 and Heidenheimer 2002: 141). It is almost as broad a term as corruption and covers a large variety of types, spanning from smaller bribes in the form of facilitation payments or gifts, to extortion, kickbacks or large bribes paid to win contracts worth USD multi-million. Bribery occurs during an interaction between two parties, and both the giving and the receiving party of the bribe commit a crime. Therefore, a legal distinction is often made between *active* or the *supply side* of bribery (offering) and *passive* or *demand side* of bribery (receiving)[11]. Although legal definitions of bribery vary between international anti-corruption conventions and individual countries' legislation, there is no country in the world which does not treat bribery as a criminal offence (Cullen et al. 2007).

- **Facilitation payments** (also referred to as *speed money*) are a form of small bribes made with the purpose of expediting or facilitating the performance of a routine government service. Facilitation payments are typically demanded by lower level officials in exchange

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[11] See for example the Council of Europe's Criminal Law Convention on Corruption, chapter 2 http://conventions.coe.int/treaty/en/treaties/html/173.htm and the UN Convention against Corruption, article 15 a & b www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf

for speeding up often deliberately slow administrative procedures and services to which one is legally entitled without such payments, which is also the main distinction between facilitation payments and outright bribery. In many countries, it may be considered normal to provide small unofficial payments under certain circumstances, although this practice is illegal by law in most countries.

- **Gifts** are in the context of corruption a form of bribe offered or solicited to acquire an undue advantage, such as a benefit in return. Gifts may include cash or assets given as presents, political or charitable donations, and hospitality in the form of expensive meals, hotels, travels, entertainment or sporting events. Gifts are often characterised as a so-called 'grey area' of corruption as it is often very difficult to make a clear distinction between legal and illegal gifts[12]. This is further aggravated by the fact that the exchange of gifts is normal business practise in some cultures and an essential mean for building business relationships, especially in Asia and Africa (Hooker 2010). However, gifts may be seen as illegal when they are given with an explicit purpose of getting something in return, such as a contract.

2.3. Categorising Corruption

Because corruption comes in many forms and types, many categorisations have also been made in order to explain and talk about it in broader terms, as well as to make distinctions between different forms of corruption. According to Caiden (2001: 21), the many varieties of corrupt behaviour as well as the underlying factors that contribute to corruption have often been sought explained, and so many explanations have been offered that it is difficult to classify them in any systematic manner. Below I have chosen to highlight some categories that will ultimately help explain the type of corruption that will be dealt with in this thesis, i.e. administrative corruption.

2.3.1. Grand versus Petty Corruption

Grand- and petty corruption are among the most widely used categories in the literature. **Petty corruption** can be described as the type of daily corruption which takes place at the implementation end of politics, where public officials solicit small payments from citizens and private companies in

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[12] See www.business-anti-corruption.com/about-corruption/grey-areas/

exchange for facilitating government services or for speeding up administrative processes. Petty corruption typically only involves smaller illegal payments, such as facilitation payments and gifts. It has also been described as 'survival' corruption, since it is most often carried out by lower-level and underpaid officials who may rely on such illegal rents to provide for their families[13]. **Grand corruption**, on the other hand, usually involves senior and higher-ranking officials, and much larger amounts of money. Examples of grand corruption may include large-scale embezzlement of state funds by politicians arranging large tax exemptions for companies in exchange for bribes, or companies paying large bribes to win lucrative contracts.

2.3.2. 'According to the Rule' and 'Against the Rule' Corruption

These two categories have primarily been promoted by the international anti-corruption organisation Transparency International (TI). TI makes a distinction between *according to the rule*- and *against the rule corruption[14]*, where the former constitutes a situation where an individual receives an illegal payment for something he/she is required to do by law – for example when a state official solicit bribes from a company for expediting a routine public service. The latter refers to a situation where a bribe is paid to obtain a service that the receiver is not authorised to provide.

2.3.3. Black, White and Grey Corruption

Heidenheimer (2002: 152) has made a classification reflecting an individual's or a community's tolerance towards corruption and deviant behaviour illustrated in colour-coded categories of *black*, *grey* and *white*. Within Heidenheimer's typology, **black** corruption refers to the type of corruption that most people would condemn and would want to see punished. An example of black corruption could very well be the Enron case where top executives swindled for USD billions and victimised thousands of shareholders, employees who lost their company pension funds as well as millions of ordinary citizens whose taxes were used to cover the losses (Hamilton & Micklethwait 2006: 33-53). **Grey** corruption refers to a type that some may want to see punished, and others not. Examples could range from the widespread use of gifts and facilitation payments between state officials and companies in many developing countries to the widespread practise of 'moonlighting' in Denmark, which most politicians condemn as a tax-depriving action, but many citizens find acceptable. Grey

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[13] The U4 Anti-corruption Research Centre: www.u4.no/themes/pfm/Revenueissue/revenue1.cfm#0
[14] www.transparency.org/news_room/faq/corruption_faq

corruption (in Heidenheimer's typology) is thus to a large extent determined by culture since the general level of tolerance towards different types of (semi-) illegal behaviour often vary between countries (Hooker 2010, De Graaf 2007 and Johnson 2004: 3-6). **White** corruption refers to a type of deviant behaviour that is commonly shared as 'acceptable' by everyone within a community.

2.3.4. Political, Private and Administrative Corruption

Based on the above descriptions and classifications of the corruption typology, it is clear that some types of corruption primarily take place within a political context (e.g. embezzlement of public funds or electoral fraud), while other take place between businesses (e.g. collusion and establishing cartels). Most often, however, corruption is practised where business meets politics, involving both public and private actors. While such public-private collusion often involves one-time, one-of-a-kind and high-value transactions (O'Higgins 2006) in the form of illegally awarded public contracts for kickbacks or large bribes paid by companies to influence policy making, the most practised type which takes place every day around the world, is often referred to as *administrative* or *bureaucratic* corruption (e.g. Webster 2005: 133).

Thanks to the previous descriptions of corruption typology, administrative corruption is now quite simple to explain; it can be described as the type of corruption that takes place during the interaction between lower-level public officials and private companies. The U4 Anti-corruption Research Centre classifies it as the type of corruption that occurs at the implementation end of politics whereas political corruption is practised at the formulation stage[15]. It therefore typically involves facilitation payments or gifts paid to, or solicited by, an official in order for him/her to facilitate a routine government service or to speed up an administrative process. Administrative corruption can therefore be classified as 'petty' and 'according to the rule' corruption, and many may also regard it as 'grey' corruption since it is often widespread in most developing countries and thereby tolerated by citizens as a 'fact of life' (Schwenke 2005: 161) and perceived by many companies as normalised business practise. That this type of corruption primarily takes place in the developing world has been illustrated in various surveys and reports[16]. In addition, although highly criticised for its comparative strengths (e.g. De Graff 2007, Søreide 2006, Chadda 2004: 121-125),

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[15] www.u4.no/themes/political-corruption/introduction.cfm

[16] e.g. the World Bank & IFC's Enterprise Surveys' corruption indicators (www.enterprisesurveys.org) and in country reports provided by the Business Anti-Corruption Portal (www.business-anti-corruption.com/country-profiles) and Global Integrity (http://report.globalintegrity.org/)

the Corruption Perception Index (CPI)[17] issued by Transparency International also concludes annually that most corruption continues to take place in Africa, Latin America, Asia and the Middle East.

The conditions that enable administrative corruption have by Klitgaard (1988: 88) been described as monopoly power (e.g. over an entrusted regulatory area such as tax collection) *times* discretion of public officials *times* the absence of accountability. In addition, Schwenke (2005: 156), Damania et al. (2004) and Broadman & Recanatini 2001, among others, identify the main reasons for petty and administrative corruption to take roots in a society to be poor leadership, where political leaders fail to show concern for public interests as well as to set examples of integrity. Social and political institutions in such countries are often weak, which open the possibility for lower-level officials to carry out their duties with large discretion. In addition, among public officials, there is often a high probability of not being punished for engaging in corruption due to inefficient legal systems and general lack of adherence to formal rules. Schwenke (2005: 156) further notes that such weak institutional settings in a country, coupled with a lack of oversight and meaningful sanctions, makes public officials lack the motivational weight to refrain from corrupt practises, and the receiving part (citizens and private companies) may therefore find it very difficult to accomplish any task involving interaction with public institutions without having to play along. On the other hand, in countries characterised by a well-established web of strong state institutions, a system of efficient checks and balances and a well-functioning regulatory environment, administrative corruption rarely finds roots and become systemic (Broadman & Recanatini 2001). This is also why private companies are least likely to encounter demands for facilitation payments in their interaction with low-level public officials in most OECD countries.

2.3.5. Is Administrative Corruption Good or Bad?

In the past, there has been and, to some degree, still is disagreement among researchers about whether corruption is good or bad for business development. In relation to this thesis' research area, where I seek to find out to what extent western SMEs are able to avoid involvement in administrative corruption, it would also be highly relevant to take up this discussion because if

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[17] www.transparency.org/policy_research/surveys_indices/cpi

research shows that corruption primarily benefits SMEs, there would be no rationale for them to avoid it.

Nonetheless, most researchers studying corruption today generally agree that it hampers business operations and growth (e.g. Damania et al. 2004, Seligson 2002, Broadman & Recanatini 2001, Tanzi 1998). In the past, however, there has been much debate over whether petty corruption and facilitation payments are essential in order for companies to conduct business in difficult markets, thus acting as a facilitating and enabling mechanism. For example, Leff (1964) and Huntington (1968), as well as more recent literature, have promoted the argument that companies operating in environments characterised by high levels of administrative corruption need to bribe in order to circumvent rigid rules and deliberately time-consuming. From this perspective, bribery is thus seen as an efficiency-enhancing mechanism that 'greases the wheels' by enabling companies to manoeuvre more easily through cumbersome regulatory environments - see also Tanzi (1998; 578-582) and Getz & Volkema (2001; 11-13) for a more detailed discussion on the *pro's* and *con's* of this approach.

A generally broad consensus prevails today, however, that bribery and facilitation payments solicited or paid to promote business transactions hamper the development of both companies and markets. In recent years, the effects of corruption on society have frequently been investigated by researchers and found to correlate negatively with variables such as productivity and quality of public services, growth of GDP, income per capita and with regulatory quality (Beets 2005 and Lambsdorff 2007; Ch. 3). As for the effects of corruption in business transactions, researchers and policymakers generally agree that it raises the cost of doing business in a country and negatively affects market attractiveness, price levels and competition. For example, bribery can be seen as money not put into productive use and instead serving as an additional 'tax' on business which, in turn, is passed on to consumers in the form of higher prices or lower product quality (Sullivan & Shkolnikov 2004). One example of this is during a procurement process, where the firm that pays the highest bribe and thereby wins a contract, may not be the firm best suited for the job nor the most efficient (Getz & Volkema 2001). Also, around 50% of international business managers surveyed by Simmons & Simmons in 2007 estimated that corruption increases project costs by 10 to 25 per cent. In addition to direct financial costs and lost business opportunities, corruption may also bring about substantial damages to brand, staff morale and external business and government

relations if discovered (Transparency International 2009). Moreover, continuously giving in to demands for bribes may sustain the corrupt behaviour of public officials, and time is wasted in negotiating with bureaucrats. Méon & Sekkat (2005) and Lambsdorff (2007) conclude that administrative corruption should therefore not be seen as an efficient mean to overcome cumbersome regulation, but instead as a factor that generates incentives for public officials to create artificial bureaucratic bottlenecks within the regulatory area they have been trusted to oversee.

In sum, administrative corruption may be seen as a factor that challenges and distorts the concepts of fairness and legality in market behaviour. Bribery may indeed benefit the participating actors, but it is also likely that it will negatively affect or even exclude the remaining market participants, either directly or indirectly. This can for example be in relation to lost contracts or simply by sustaining the corrupt behaviour of both regulators and companies, which subsequently increases the cost of doing business for every company in a given market. Therefore, although facilitation payments will expedite bureaucratic processes for a company in some situations, a business environment without administrative corruption will always be preferred.

Having been through an introduction to the typology, categories and definitions of corruption with the intention to clarify my research area, I will in the following sections continue with a presentation of selected theory, which should ultimately help explain and support my research question.

3. Theoretical Approaches to the Study of Corruption

As it has been established in the previous sections, corruption comes in many forms and can be analysed from many angles. Similarly, a myriad of theoretical approaches spanning multiple analytic levels can also be found throughout the vast literature dealing with corruption. For example, some literature primarily seek to explain corruption from the perspective of the individual corrupt agent, e.g. in criminology literature (Punch 2000) or in organisation literature dealing with psychology or organisational behaviour and structures leading some individuals to become corrupt - the so-called 'bad apples' approach (Ashforth & Anand 2003, De Graaf 2007, Pinto et al. 2008). Other literature focuses on corruption at the organisational level; for example, some organisation and management literature seek to explain how corruption can become 'normalised' within an organisation (Ashforth & Anand 2003, Cullen et al. 2009). Finally, other groups of researchers use institutional and governance approaches to explain the causes of corruption as originating at a societal level, for example, as a dysfunctional interplay between- and governance of economic and political institutions, and are not interested in the corrupt individual (Damania et al. 2003, O'Higgins 2006). As it turns out, there is no lack of analytical and theoretical approaches to corruption; however, much of the literature and theoretical views have been criticised for being atomised, diffuse and inconsistent as well as for lacking contingency and coherence with related studies (De Graaf 2007, Ashforth et al. 2008). They argue that the result has been a profusion of overlapping and sometimes conflicting concepts, models and findings with few deep-rooted understandings of the concept and causes of corruption.

According to De Graaf (2007), there has always been tension in corruption research between the study of actors as autonomous agents making bounded rational decisions and explaining corruption by causes beyond individual control. In some studies, the individual is the centre of analysis whereas other studies tend to analyse the surrounding environment that enable corruption, thereby removing the corrupt agent along with the type of corruption that is being studied. I order to explore corruption in a more balanced way, De Graaf thus proposes that more contextual corruption research is needed. Other authors have come to similar conclusions; for example, Ashforth et al. (2008) argue that much current management and organisation literature on business corruption tend to focus on rather static individual behaviours and the individual-, interpersonal-, or group-level factors that influence them. This, they argue, has resulted in a relatively narrow focus and neglect of the important role of processes and systems as well as the dynamic interplay between various levels

of analysis, which is essential for understanding why corruption occurs in some situations and under certain conditions. In relation to this, Getz (2006) argues that it is essential to understand and take into account both the demand- and supply-side of bribery (i.e. the motives of both the giving and receiving end of the bribe) as it encourages us to look at the entire system in which the corrupt act unfolds, and to better comprehend how bribery between two parties can be sustained over time. Ashforth et al. and Getz also propose more contextual corruption research; that is to reach a more holistic and dynamic understanding of the interplay between individual, organisational and societal forces that facilitate corruption in a given situation. In addition, Cullen et al. argue that multi-level analysis can be particularly useful when studying firm-level bribery (2007). For example, they find that the bribery activity of SMEs varies significantly with contextual conditions in different countries and is highly influenced by cultural values and institutional characteristics at both company- and country-level.

In sum, although western SMEs are the central object of analysis in this thesis, it may thus not be sufficient to focus entirely on corruption from the perspective of an individual firm when examining what options SMEs have to avoid involvement in administrative corruption. Having the above discussion in mind, a deeper understanding and thereby better examination of my research question will be reached when applying a multi-level perspective, taking individual, organisational and societal factors into account in the analysis. After all, the more we know about the causes of a particular type of corruption, the better we can propose comprehensive ways and instruments for controlling it (De Graaf 2007; OECD Observer 2000) – and this is exactly what this thesis intents to do; examine to what extent it is possible for western SMEs to avoid involvement in administrative corruption in developing economies. In the following sub-sections I will propose some theoretical views that work at various analytical levels and which will be helpful for exploring this thesis' research question.

3.1. Micro View – Corruption at the Individual Level

Rational Choice and Public Choice theories provide interesting approaches to how corruption may unfold at the individual level. More specifically, they can be used to describe the decision-making process regarding the costs and benefits of corruption when companies are interacting with public officials. In general, the theories only differ with Public Choice theory being limited to explain only

public sector decision-making (Herrnstein 1990); however, they are similar in the sense that they emphasise individual actors' calculation of costs and benefits to maximise personal advantages (De Graaf 2007). Central to this is thus that an individual makes a rational decision leading to a predetermined outcome; he/she chooses to become corrupt when the expected outcome of bribery outweighs the expected disadvantages. The term 'rationality' should therefore simply be seen as a cost-benefit analysis - that is the balancing of costs against expected advantages to reach the best possible outcome. In this line of thoughts, this view offers one approach to administrative corruption; i.e. a public official would solicit facilitation payments, or a private employee would resort to active bribery, if the advantages or gains of such transaction are expected to exceed the disadvantages.

As first applied to the investigation of corruption by Rose-Ackermann (1978: 6), and later used by scholars such as Klitgaard (1988: 69-74) and Lambsdorff (2007: 62-65), the Principal-Agent (PA) theory is closely related to the above approach to corruption. In short, it explains how corruption arises due to problems between a principal (e.g. the government) and an agent (e.g. public official) who ultimately serves a client (citizen or company). Principal-agent problems may arise due to the lack of the principal's oversight and thereby control over the agent's tasks, or due to information asymmetries between the two parties which enable the agent to carry out his/her duties with large discretion (Lambsdorf 2007: 63). Under such conditions which lower the probability of getting caught, the agent may choose to supplement his/her salary by soliciting bribes from clients if he/she does not suffer any moral complications in doing so – or as Klitgaard (1988: 70) states; the agent will rationally choose to be corrupt if the benefits of corruption *minus* the moral costs and probability of getting caught *times* the severity of the penalty *are greater than* the benefits of not being corrupt (i.e. the official salary and moral satisfaction of not being corrupt).

PA theory has often been used to explain political corruption, hence its main focus on government-official relations. However, based on the above description, it is not restricted to this perspective, and can also be applied to a similar situation between an employer and an employee in a private company. The only difference between the public-private approaches in relation to administrative corruption is that the first deals with the demand-side of bribery, whereas the latter deals with the supply-side. Due to its focus on individual actors' cost-benefit calculation while interacting, it provides one way of explaining how administrative corruption unfolds. Yet, while the cost-benefit

analysis may have a considerable weight in determining individuals' (employee or official's) approach to engage in a corrupt situation, this group of theories, as many other economic models, have also been criticised for being too static and for not accounting sufficiently for the larger social context. For example, they do not consider social or cultural factors of the surrounding environment that enable corruption, and which are beyond individual control (De Graaf 2007). Seeing Rational Choice/PA theory in relation to my research question, a SME would only choose to avoid involvement in corruption if the gains of corruption were expected to be less than the costs. This naturally leads to a focus on corruption control that maximises the costs of corruption and minimises its benefits. In this thesis, and in relation to the above, I will review different aspects of the costs of administrative corruption in order to explore whether such costs are high enough for SMEs to 'rationally' seek to avoid corruption, for example by establishing mechanisms to control the potential corrupt conduct of its employees.

3.2. Meso View – Corruption at the Organisational Level

In relation to this thesis, it is also highly relevant to look for explanations to corruption at the organisational level since this thesis' main unit of analysis is carried out among SMEs. Anomie theory provides a very interesting approach for exploring different conditions that may enable corruption to 'infect' an organisation and lead it to gradually become a normalised part of the conduct of its members. In contrast to rational choice/PA theories, anomie theory is not a predictor of individual pathology and decision making, but a sociological explanation of external and internal conditions that give rise to increased rates of deviance within organisations (Cullen et al. 2009).

Anomie theory was originally developed by the French sociologist, Émile Durkheim, and introduced in his work "Suicide" from 1898/1951. According to Durkheim, anomie is a condition of 'normlessness' at a collective level – in an organisation or society - which arises due to major societal transformations associated with modernisation and industrialisation. Such transformation, he argued, may lead to a collective disruption with socially held norms and beliefs and a subsequent decline of social controls based on family and communal relationships whereby society fails to impose adequate regulations and control mechanisms. As a result of deteriorating social norms and adequate regulatory systems to accommodate the formation of new norms, members of an organisation or society are more likely to turn to deviant means of reach their desired ends (Cullen

et al. 2007 and 2009). Robert Merton (1968) later used the concept of anomie to emphasise the condition that exists when there is inconsistency between desired economic goals and the social structures for accomplishing them. According to Merton, anomie is a condition of normlessness and social disequilibrium where the rules that once governed social conduct have lost their meaning and force (1964:226). Like Durkheim, he emphasises that the lack of institutional norms and rules for legitimate goal achievement lead to increased rates of deviance. From Merton's perspective, pressure to use deviant means may particularly arise in a society or an organisation when something blocks the legitimate achievement of economic goals. Such blockage could for example be facilitated by unemployment, lack of a skilled workforce or by access to education – or from the perspective of this thesis; deliberately cumbersome and time-consuming bureaucratic procedures imposed by public officials acting with large discretion.

With the purpose of studying corruption at the firm-level, Cullen et al. have developed a conceptual framework (see figure 1 below) which couples anomie theory, organisational change, ethical climate theory and corruption. In short, the framework proposes that changes originating from the internal or external environment can trigger a reconfiguration of organisational processes and architectures which may subsequently enable anomic conditions within a company. Change in organisations may be triggered by internal factors such as organisational restructuring, replacement of top managers, implementation of new technology, etc. or by external factors related to new industry regulation, new competitive pressures or the confrontation with new business practises and culture related to internationalisation. The framework further proposes that when a reconfiguration takes place in response to internal or external changes, this process may lead to a disruption with both formal and informal norms, beliefs and rules and create anomie, which causes a deinstitutionalisation of the company's normative control system. The normative control system is manifested in a combination of different ethical climates (the *Ethical Climate Mix*) within the organisation, which are anchored in its members' shared perceptions that certain ethical reasoning and behaviour are the expected norms for decision making in the company.

According to Cullen and Martin (2006), the ethical climate mix is composed of three dominant types of ethical climates which can be traced in most organisations, typically with one of them being the most dominant; that is *benevolent*, *principled* and *egoistic* climates. In short, they propose that benevolent climates involve utilitarian ethical norms where the intent of decisions and

operations is to achieve outcomes that generally enhance the well-being of others. Principled climates involve the perception that decision making should be based on rules and codes, meaning that organisational members' ethical reasoning and conduct are influenced by adherence to national laws and the organisational codes of conduct. Egoistic climates, in turn, primarily involve norms that promote the pursuit of self-interest so that organisational members perceive decisions and actions as means to advance their own or the organisation's interest.
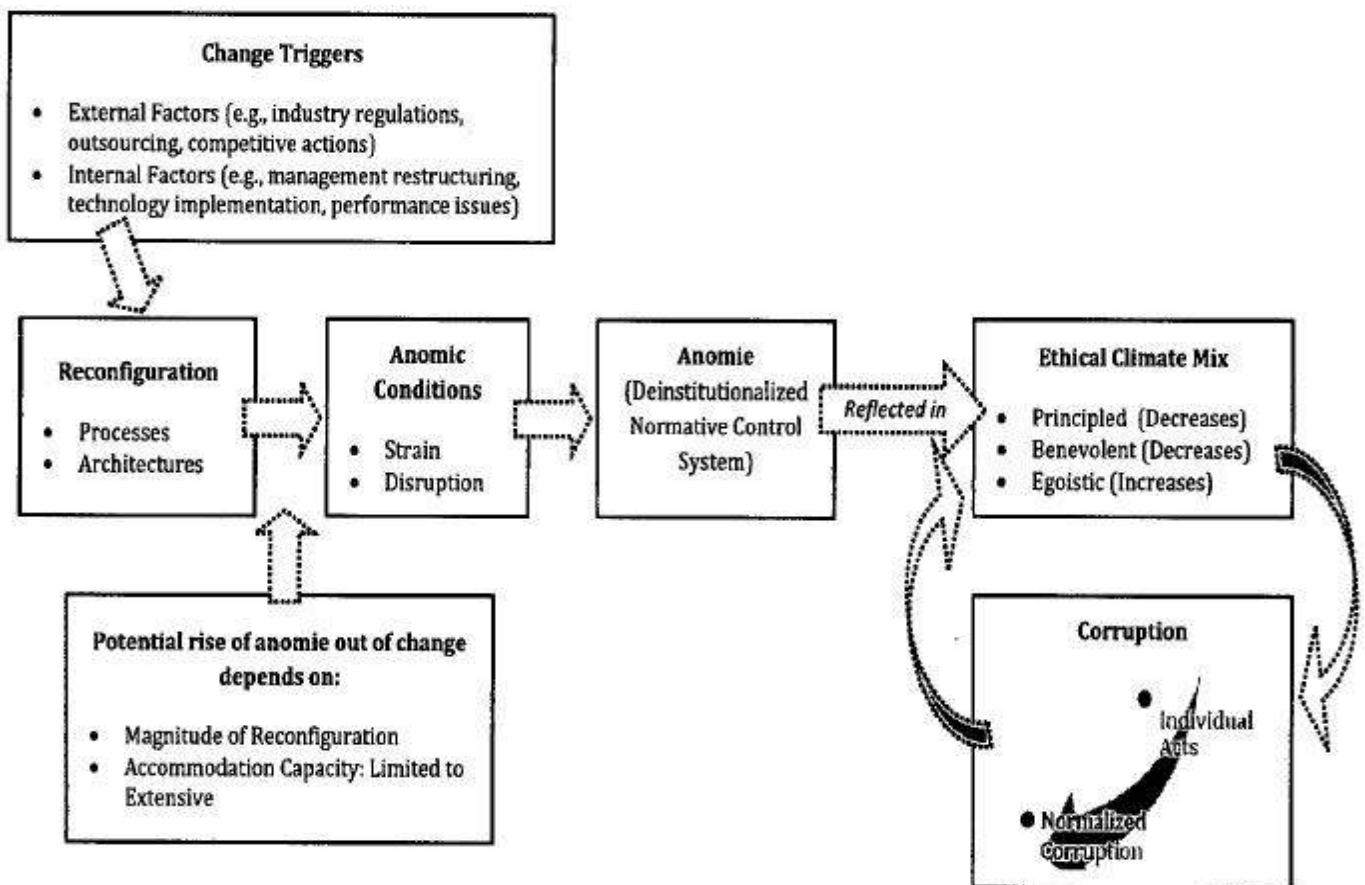
Figure 1: Conceptual framework for Organisational reconfiguration, Anomie and Corruption (Cullen et al. 2009)

When anomie arises due to organisational reconfiguration, it leaves its members disillusioned because of the disruption of shared norms and systems that once guided decision-making processes. Such process is thus reflected in the ethical climate mix where benevolent and principled norms and beliefs decrease while egoistic norms increase which can subsequently lead to increased rates of deviance and corrupt behaviour among its members. It should be said, however, that the extent to which anomic conditions will arise due to internal or external factors depends first of all on the magnitude of the reconfiguration and secondly, on the capacity of the organisation to accommodate

such changes and reconfiguration. Likewise, organisations with more outspoken benevolent and principled ethical climates may also be more resistant to the creation of anomie.

I believe that this framework provides a highly suited approach for studying how corruption may arise in smaller organisations, such as in western SMEs that operate in developing countries. Anomic conditions can easily be imagined to arise as a result of the meeting with an unknown business environment, for example, when a western SME for the first time decide to move its operations to an environment characterised by market and institutional failures. In addition, as will be highlighted in the following sections of this thesis, SMEs are generally found to be more vulnerable to constraints originating from the external environment than large companies due to their limited resources and capacities (e.g. Busquets & Fliess 2006 and Aterido et al. 2007). This, according to the framework, makes them especially predisposed for the rise of anomie which may lead to increased involvement in corrupt practises, reflected in the propensity to actively supply bribes to public officials, or to pay when demanded, in order to get around bureaucratic bottlenecks in countries with high levels of administrative corruption. What is equally important about this framework is that it has an embedded focus on organisational corruption control. An organisation suffering from anomic conditions needs to strengthen its capacity to accommodate the reconfiguration triggered by external change as well as to re-build and nurture benevolent and/or principled ethical climates. This naturally leads to a discourse of corruption control in which the emphasis is to influence the organisational culture, for example through integrity systems, ethical codes of conduct or by changing leadership structures (De Graaf 2007).

In sum, this leads to a view of the individual organisation where it is able to counter corrupt practices itself, and not merely being a victim to the external environment as well as social, cultural and political processes – this is at least the case when it come to countering the supply-side of corruption. However, it is much harder for a company to counter the demand-side of corruption as it involves an influence over the decisions made by public officials. As parts of my analysis will show, a SME may therefore not be able to control corruption in every business environment due to variations in how administrative corruption unfolds in different social and political settings. As noted before, this also implies that some causes of corruption may be beyond individual and organisational control.

3.3. Macro View – Corruption at the Societal Level

Some of the factors that enable administrative corruption to find roots and flourish in a society have been identified by various authors to originate from poor and unaccountable government leadership, weak regulatory institutions and lack of effective checks and balances (e.g. Cullen et al. 2007 and Schwenke 2005: 156). In turn, such societal characteristics make it easier for politicians and lower level state officials to carry out their duties with large discretion, thereby setting the stage for the occurrence of both grand and petty corruption. In addition, Damania et al. (2004) emphasise that political instability in the form of political unrest, rivalry and frequent changes of market policies may also lead to a weakening of judicial efficiency, subsequent impunity and ultimately, to increased bribery activity among state officials. What is fundamental about such social, institutional and political causes to corruption, is that they seem beyond individual and organisational control, and thereby constrains the ability for individual companies to actively avoid involvement in corruption.

Such societal factors have also been theorised by Cullen et al. (2007) to create anomic conditions in companies. They primarily emphasise the lack of institutional safeguards in the form of various protective government and market services as well as the lack of governmental checks and balances and subsequent discretion among state actors, as the main drivers behind the creation of anomie and increased bribery activity by companies. They argue that when a country do not have an institutional framework that can mute the effects of these anomie-driving characteristics and values, companies are more likely to resort to bribery to reach their goals. In relation to Robert Merton's notion of anomie, the consequences of a weak and unaccountable institutional set-up in a country should also be seen as creating a blockage of companies' goal achievement, thereby leading the way for alternative and deviant ways of achieving desired goals. An important question to ask in relation to the research question of this thesis is then whether individual private companies are able to root out their involvement in corrupt activities entirely when operating in countries with the above described institutional and political weaknesses?

Exploring the causes of corruption at the societal level leads to a discourse of corruption control that emphasises better enforcement of both national and international anti-corruption legislation as well as reforms aimed at strengthening the accountability of government institutions and policies to change cultural values that may lead to corruption in a society. While this thesis' primary analytical

focus is kept at the firm level, the societal approach is still important to take into account when exploring what options that SMEs have to counter involvement in administrative corruption - especially because it suggests that there are factors that companies – and in particular SMEs - are not in a position to change them selves. So, depending on the overall level and pervasiveness of corruption in a society, there can be limits to how well a SME is able to avoid corruption in a given market.

3.4. The Application of Theoretical Approaches

The reason for utilising a multi-level theoretical approach on corruption is to provide a broader view that should lead to a more comprehensive understanding of its causes and effects. It is therefore also implied that every individual theoretical approach has its limitations regarding the extent to which it is able to provide in-depth understandings. However, what is common for all approaches as well as important for this thesis, is that they all lead to a discourse of corruption control which I will briefly summarise below:

- At the individual/micro level, the main focus was on the costs of corruption versus its benefits. From this perspective, corruption should be sought controlled if its costs exceed the expected advantages or benefits. While the micro view does not propose any specific ways of controlling corruption, except from making corruption so costly that agents will not engage in it, it still serves as an appropriate introduction to the discourse of corruption control, as it focuses on whether corruption is at all 'worth' controlling. In this thesis, I will go through some aspects of costs of administrative corruption, including financial, reputational and legal costs, in order to better identify ways for western SMEs to control it.

- The organisational/meso level focuses on how corruption can arise due to internally and externally induced changes in the organisation and lead to the creation of anomie. In relation to corruption control, this leads to both curative measures that an organisation must take if corruption arises as well as defensive measures that should be implemented to prevent anomie from emerging. More specifically, this leads to a focus on ethical codes of conduct and subsequent anti-corruption strategies. In this thesis, I have devoted a section to explore different

aspects of internal corruption control systems for SMEs.

- The societal/macro level suggests that anomie can be created by societal forces and institutional deficiencies which are beyond individual companies' control. This leads to a view where corporate policies and ethical codes may not be sufficient for controlling corruption in every business environment. In this particular context where private companies are not able to avoid systemic corruption in societies, the controlling forces may rather come from reforms aimed at strengthening weak regulatory institutions and the application and enforcement of relevant anti-corruption legislation. In a later section of the thesis, I will assess some empirical data on how corruption affects SMEs in different societal settings in order to find out whether avoiding administrative corruption is mainly a matter of having an appropriate policy against it, or whether it also matters where they operate and do business?

I will analyse the above areas in much more detail throughout the thesis, and based on my findings, I will conclude whether there is an apparent business case for western SMEs to not only avoid corruption, but also to actively fight it. Before exploring the above elements, I will in the following sections first provide an introduction to this thesis' main unit of analysis, namely western SMEs. More specifically, I will highlight characteristics of SMEs vis-à-vis larger companies. By reviewing SME studies and empirical data on perceived trade barriers and other problems related to the internationalisation process of smaller firms, I will explore how corruption affects western SMEs operating in developing countries and identify factors that make them particularly vulnerable to corruption.

4. Small and Medium-sized Enterprises in a Global Economy

During the last 10-15 years, much attention has been directed towards the significance of small and medium-sized enterprises (SMEs) in local economies. Both academic researchers as well as policymakers have increasingly acknowledged SMEs for being a primary engine of growth in virtually all market economies, and growing political and financial support has been established by governments and financial institutions to foster SME development. The economic importance of SMEs has been emphasised in various statistics and surveys:

- SMEs are estimated to represent roughly 95% of all businesses worldwide and are thus of huge importance to the global economy (Burns 2009). Almost similarly, Jeppesen (2005) writes that SMEs represent around 90% of registered firms in an economy and even more if informal sectors are included.

- SMEs are estimated to provide for some 75 million jobs and represent around 99% of all enterprises in the enlarged European Union of 25 countries. Moreover, the average European enterprise employs no more than six individuals (European Commission, Enterprise and Industry Publication 2005).

- Data from the US Department of Commerce in 2001 found that 89% of all US exporting companies were characterised as being 'small', 8% as 'medium' and only 3% as 'large' (OECD 2008).

4.1. Defining the SME

No universal definition of SMEs exists. Some countries have their own definition of SMEs, which is typically based on number of employees and/or annual turnover. The most commonly used definitions are those set by the European Commission and the Small Business Administration (SBA) Size Standard Office in the US.

- The European Commission divides SMEs into three categories, i.e. micro enterprises (1-10 employees and an annual turnover below EUR 2 Million), small enterprises (11-50

employees and an annual turnover below EUR 10 Million) and medium enterprises (51-250 employees and an annual turnover below EUR 50 Million).

- In the US, the SBA divides SMEs in two categories, i.e. small enterprises (1-100 employees) and medium enterprises (101-500 employees). The definition of annual turnover is not as straightforward as the one used in the EU, but divided into a long list of industry specific categories.[18]

4.2. SME Characteristics and Role in the Global Economy

The immense representation of SMEs in global markets has been associated with a wide range of positive externalities. Most notably, researchers tend to focus on the dynamic role of SMEs in creating economic growth and employment and for being producers of a large share of the world industrial output (Jeppesen 2005, OECD 2008, Kabongo & Okpara 2009). The European Commission (2005) cites that SMEs play a central role in the European economy, and that they are a main source of entrepreneurial skills and innovation. Some literature finds that SMEs enhance entrepreneurship and competition and thus contribute positively to innovation and economic and productivity growth. Moreover, it is argued that SMEs boost employment more than large firms because they are more labour intensive and contribute positively to a competitive market system (Beck & Demirguc-Kunt 2005, Aidis 2005). Due to such positive externalities or spill-over effects, Kabongo & Okpara (2009) and Beck & Demirguc-Kunt (2005) highlight the potential role of SMEs in a fairer distribution of economic growth and thus in potential poverty alleviation if supporting policies are directed towards SME growth and development. On SME contribution to economic growth, Beck & Demirguc-Kunt (2005) find that a large and vibrant SME sector is a characteristic of economic growth, but argue that an effective business environment with regulatory conditions that favour SMEs is a necessary factor for SMEs to thrive and prosper.

Other research, however, suggests that the positive contributions of SMEs to the environment in which they operate should not be exaggerated. For example, Beck & Demirguc-Kunt (2005) highlight some sceptical views which argue that large companies contribute more to economic growth than do SMEs. Some perceive large firms to be more innovative than small firms due to

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[18] See www.sba.gov/sites/default/files/Size_Standards_Table.pdf

their intensive investments in research and development (R&D). Others see them as more cost-effective (i.e. better at achieving and benefiting from economies of scale) and thus more efficient. In addition, large companies offer more stable employment, higher wages and other non-wage benefits than SMEs, and whereas multinational companies often have good government relations or lobby activities to advocate their interests, SMEs are rarely in any position to influence trade policy due to limited resources and leverage. For such reasons, Fatma (2010) also argues that it is analytically important to point out that SMEs are not merely smaller versions of large corporations. This is mainly due to various resource constraints:

- SMEs have limited financial and managerial resources, staff and capabilities, including experience and knowledge (e.g. managerial inexperience and limited information-gathering capabilities).

- SMEs are often owned and managed by founders as opposed to large corporations which are managed by professionals. This naturally results in more centralised decision-making for SMEs.

- SMEs are less innovative than large companies and easier influenced by the external environment. This is also referred to as the 'liability of smallness' (Fatma 2010), i.e. difficulties in obtaining critical resources and larger vulnerability to environmental changes.

- Compared to large firms, SMEs are often less competitive. They may not be able to capture market opportunities due to inferior products, lack of finance and limited administrative capacity. Moreover, foreign activities will take a larger proportion of resources than for large companies.

Despite many positive externalities, it is clear from the above characteristics that SMEs particularly suffer from a range of resource constraints, which is also what separates them analytically from large multinational corporations. I will later show how such factors related to the liability of size can make SMEs more vulnerable to corruption – both in terms of how corruption affects SMEs and how it limits their ability to avoid it. Yet, I will first extend my review of SME characteristics to

include some of the internal as well as external challenges and required adjustments related to SME internationalisation and subsequently how trade barriers, including corruption, affect them.

5. SME Internationalisation and Investment Barriers

Progressive globalisation over past decades, declining barriers to trade, improved communication systems and increasing competition have put pressure on both non-exporting and international SMEs. Domestically bound SMEs are increasingly pressured by international competitors on their respective markets, and those of which that expand their activities to international markets may find it difficult to operate in new environments. Nonetheless, such trends in global trading patterns have created incentives for SMEs in all industrialised markets to export, or even to establish themselves abroad in order to remain competitive and, ultimately, to stay in business (Fernández-Ortiz and Lombardo 2009). SMEs can be engaged in international trade in various ways, for example through exporting, as part of global supply chains, joint ventures, etc. Research has shown that western SMEs are internationalising at a rapid rate, and that many newly established SMEs increasingly start out with cross-border activities in mind – the so-called 'born-global' trend (OECD 2008). This trend is backed by statistics generated by the US Department of Commerce which shows that the number of exporting SMEs in the US grew almost twice as fast in the 1992-2001 period in comparison to large companies, where SME export revenues also surged from USD 103 billion to USD 182 billion (OECD 2008). Other research also finds that there is an obvious competitive rationale for SMEs to engage in international trade activities. For example, based on various performance and efficiency measures (such as profit, production and wages), both Isgut (2001) and Biesebroeck (2003) find that exporting SMEs by far out-perform non-exporters.

Apart from the competitive advantages of internationalisation, a large amount of research has also been conducted on the difficulties and constraints that SMEs encounter when they enter new markets. Such constraints are both associated with internal and external factors. **Internally**, some SMEs may suffer from poorly developed administrative and accounting procedures as well as unsystematic decision-making processes (OECD 2008). The same source also finds that an entrepreneur with a good idea may experience fast growth in the start-up phase, but may not possess the professional experience to sustain growth over time. Moreover, in a study of managerial capabilities to manage SME internationalisation, Fernández-Ortiz and Lombardo (2009) find the

level of international business experience among managers as well as the knowledge of host-country language to be particularly valuable in the internationalisation process of SMEs. **Externally**, Beck & Demirguc-Kunt (2005) argue that various market failures and weak institutional arrangements in international markets often act as constraints for SMEs to unleash their full potential, which in turn may hamper their growth and development possibilities. In order to operate successfully in international markets, SMEs thus need to acquire a set of capabilities that often varies much from those needed to manage their domestic activities. Amongst other things, a company will have to learn how to manage its overseas operations from a distance by the use of new informal and formal contractual business relationships and how to gain familiarity with new business regulations, bureaucracy, cultures and languages (OECD 2006).

Acquiring such capabilities to operate abroad applies to companies of all sizes, but the main reason for researchers and policymakers to focus specifically on SMEs, is due to the assumption that smaller companies are particularly vulnerable to trade barriers due to their limited resources, knowledge and experience (Beck & Demirguc-Kunt 2005; Coolidge & Jacobs 2005; Busquets & Fliess 2006; OECD 2006; Aterido et al 2007; Burns 2009; Richmond 2009; Fatma 2010). Taking the external environment into account adds an additional dimension to this discussion; namely that SMEs are in special need of a well-functioning business environment due to resource constraints and liabilities of size. This thus implies an explicit focus on developing countries and emerging markets as investment destinations, since they are most commonly plagued by cumbersome regulatory barriers and non-transparent business practises.

5.1. International Learning and the 'Shift' in Perceived Trade Barriers

Companies of all sizes need to acquire new capabilities and adjust their operating strategies when entering new markets. A SME that decides to operate in another country will thus have to go through an important learning process. The 'Athens Action Plan for Removing Barriers to SME Access to International Markets', introduced at the OECD-APEC Global Conference in Athens 2006, identifies international inexperience as one of the key challenges faced by SMEs:

"SMEs appear to go through a learning process when they engage in international activities. This process can be shaped by the size and the industrial sector of the firm. Each step of this learning

process presents special challenges for SMEs. The set of firms that are not yet active exporters often underestimate the barriers present in the external business environment, such as those associated with financial matters and access to markets. They may also lack awareness of how their capabilities match the challenges of operating in international markets and also the knowledge about how to evaluate their capabilities in this respect. However, when these firms become engaged in international trading activity, there is increased awareness that the key barriers relate to the business environment and their own management capabilities rather than finance and access" (OECD 2008; 193).

Evidence of this learning process has been presented by Busquets & Fliess (2006) who explored challenges perceived by SMEs to affect their internationalisation process. They found that SMEs with no export activities rated internal constraints as well as financial and access barriers as the most significant challenges to internationalisation, while barriers related to the external environment was perceived to be less important.[19] The opposite occurred when SMEs with trade experience were asked, as they showed increased concerns about the business environment in which they operated. Breaking down the results between experienced and inexperienced exporting SMEs, it is not only clear that SMEs go through a learning process as they gain international experience, but also that the main operating challenges change from internal constraints to barriers caused by the external business environment. This is also consistent with empirical findings of Tonoyan et al. (2006), who find that the external environment is the dominant feature influencing the nature and pace of entrepreneurship in developing and transition economies.

The fact that SMEs with international experience perceive constraints originating from the external environment to constitute the main challenges also fit the context of my earlier review of theory at the organisational level. The above is at least an indicator that change triggers originating from the external environment would be the main driver behind the creation of anomie in small internationalising organisations[20]. In the following section, I will examine which external trade barriers that SMEs identify as the largest constraints to their operations abroad.

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[19] In fact, no barriers related to the external environment were chosen by the non-exporting respondents on a top-ten list out of 47 possible barriers to internationalisation.
[20] See Figure 1, p. 27

5.2. Evidence of External Trade Barriers Affecting SMEs

That SMEs are vulnerable to trade barriers originating from the external business environment have long been a focal point for both researchers and policymakers, and many resources have been spent on identifying the barriers and constraints that may hamper the internationalisation of SMEs. Over the past decade, several international policy-oriented organisations have been active in conducting research, surveys and establishing databases on trade barriers[21], and governments have established special programmes to foster SME growth and internationalisation by facilitating access to finance or providing information on regulatory requirements in foreign markets. This growing attention has contributed to an increased knowledge about the obstacles faced by SMEs in cross-border trade. For example, by aggregating results from several business surveys, Busquets & Fliess (2006) suggest that SMEs with trade experience face three main categories of barriers to trade:

- High import tariffs in foreign markets which limit the ability of SMEs to increase export sales. OECD work on tariffs in merchandise trade finds that SMEs often face tariffs that are three times higher in developing countries than in OECD markets.

- Non-tariff barriers are also found to be highly problematic, with customs procedures and domestic regulation being particularly impeding. For example, OECD carried out a comparative analysis of 12 business surveys on trade barriers and found that technical measures and customs rules and regulations are commonly regarded to be obstacles. Other kinds of barriers included taxes, charges and competition-based restrictions to market access.

- Indirect and less visible procedural barriers to trade were also identified as constraints – especially by SMEs that have tried to enter a developing country or emerging market where business practices differ much from those prevalent in their domestic business environment. The typical barriers met include policy implementation procedures, discriminative behaviour by regulatory authorities and public officials, poor administrative practices promoting corruption and weak institutional environments.

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[21] In particular the OECD, the European Commission, the World Bank and the International Finance Corporation (IFC) have conducted much research on SME trade barriers.

The above mentioned barriers to trade affect internationally oriented SMEs in various ways. They may have to bypass markets due to high import tariffs and thus become more vulnerable to import pressure on the home market, and non-tariff barriers may incur additional costs that can severely hamper their competitiveness and opportunities for growth. Further evidence of the consequences of such trade barriers is presented in the following.

5.3. Trade barriers by Firm Size

Based on data from the World Business Environment Survey[22] (WBES), Beck & Demirguc-Kunt (2005) find that small firms consistently report higher growth obstacles than medium and large firms. It is generally found that the barriers most impeding to growth are access to financing, corruption and problems with the legal system. For example, financing obstacles are found to affect the annual growth of SMEs almost twice as much as large companies, and that corruption and problems with the legal system affect them three times as much. Improving the quality and transparency of the overall business environment is believed to have a positive impact on SME growth. For example, it is shown that SMEs grow faster in Germany compared to Ivory Coast, while the opposite holds for large companies. Another study referred to by Beck & Demirguc-Kunt (2005) shows that obstacles to firm growth are smaller in countries with well-functioning financial and legal systems. They conclude that SMEs not only suffer more than large firms from various market failures, additional transaction costs and information asymmetries, but that such obstacles also have a disproportionately larger effect on the growth of smaller firms operating in countries with less developed institutions.

Aterido et al. (2007) also investigate the assumption that constraints originating from the business environment may not be neutral across firm size. By using firm-level data taken from the World Bank and IFC's Enterprise Surveys[23], they find that SMEs are particularly vulnerable to market failures and policy created distortions as this generally adds to the cost of doing business, and that SMEs have less access to formal finance, face significantly greater interruptions in infrastructure services, and pay more in bribes (as a percentage of sales) vis-à-vis larger firms. Especially

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[22] A firm-level survey conducted in 1999-2000 by the World Bank, including more than 10,000 companies of all sizes from 80 countries. See: http://info.worldbank.org/governance/wbes

[23] Enterprise Surveys - www.enterprisesurveys.org - is a database covering firm-based perceptions of regulatory constraints by country. Results gathered in this study are taken from a sample of approximately 70,000 enterprises in 102 developing countries and five high-income economies.

corruption is found to be an area where SMEs complain more and being more inclined to pay bribes when compared to micro and large firms. This may be because SMEs often feel that they have no options available to avoid demands for bribes, and are thus easier targets for officials seeking additional funds. The exact same results were found in a methodologically similar but more recent World Bank research paper[24] carried out by Aterido et al. (2009). Here they also find that the relationship between the regulatory environment and corruption varies across firm size. For example, small firms that are not able to evade formal regulations by 'hiding' in the informal sector generally find regulations to be negatively affecting growth, but that bribery offers an effective way to mitigate such effect. On the other hand, medium-sized firms generally find regulations to be less constraining, meaning that bribery is subsequently less beneficial. Almost similarly, Kabongo and Okpara (2009) find that the main obstacles for SME growth in developing countries are access to financial resources, lack of management experience, corruption and poor infrastructure. In particular, they argue that corruption is troublesome, as it imposes extra costs on doing business in terms of bribery, and that it undermines trust and confidence in the judicial system, national integrity, the regulatory system and in business owners in general.

Apart from internal barriers, such as limited capabilities, resources and experience, the above studies generally conclude that SMEs identify obstacles originating from the external business environment to constitute the main constraints to their operations in foreign markets. Especially corruption was emphasised in all the studies as a highly impeding factor for SME business operations, and SMEs are commonly found to have their foreign operations seriously constrained when operating in markets plagued by arbitrary policymaking and cumbersome regulation. How this type of constraints affects SMEs in practise, how it leads to corruption and why SME are particularly vulnerable to corruption, will be analysed in the following sections.

5.4. SME Vulnerability to Corruption

It has now been hypothesised as well as empirically confirmed that SMEs are affected more by the detrimental effects of corruption than large companies. Due to lower cash-flows and tighter profit margins, SMEs may not always afford to resist paying bribes in corrupt markets if it means that they otherwise cannot get their products through customs or acquire the necessary operating

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[24] Results in this study uses firm-level data generated from a sample of more than 56,000 enterprises in 85 developing countries and 5 high-income countries.

licenses. In relation to anomie theory, companies that face performance pressures to grow and survive are also more likely to engage in bribery to remove such obstacles when constrained financially (Cullen et al. 2007). Relatively lower financial resources and the cost of corruption are often mentioned as key factors influencing SME vulnerability, but other reasons may also contribute to heightened vulnerability and thereby probability to use bribery as a survival mechanism:

- **Preparedness and strategy**: As previously shown, inexperienced SMEs generally do not consider corruption and other external trade barriers to constitute an important entry barrier, which is why it is often not included as a strategic concern in their entry strategies. On the other hand, empirical findings reveal that SMEs generally perceive corruption to constitute a major obstacle after they have entered a market with substantial levels of corruption (Busquets & Fliess 2006). However, a SME will be more vulnerable when entering a high-risk market without being strategically prepared to deal with the challenges deriving from corruption.

- **Corporate culture**: If a SME has no strategy for dealing with corruption, the often informal and centralised structure and leadership style of SMEs relative to larger companies may generate a corporate culture where corruption is more easily tolerated throughout the company (UNIDO & UNODC 2007).

- **Short-term vision**: Many SMEs in foreign markets operate with short-term strategies and visions relative to larger companies. This may prevent them from getting a clear overview of the accumulated costs of bribery over a longer period of time (UNIDO & UNODC 2007). The underlying assumption here is that continuous bribery and facilitation payments made as part of the firm's everyday operations are often not economically viable in the long run.

- **Limited exposure to the 'public eye'**: Large companies are under ever increasing public pressure for acting ethically correct and their operations are often monitored by professionals, mass media and thereby the public. They are therefore more visible than SMEs, which also increases the risk of jeopardising their reputation if caught in a corruption scandal. The fact that SMEs are relatively less exposed in the media, less closely monitored by stakeholders, and thereby have less direct reputational risk at stake may facilitate the

perception that bribery is less risky, which can nurture a culture and tolerance for corruption as 'a natural way of doing business.'

- **Limited bargaining power**: Due to their international experience, financial resources and larger investments with potential job creation, large companies often generate close political relations in the markets in witch they invest (Busquets & Fliess 2006, UNIDO & UNODC 2007, OECD 2008). This sometimes gives them substantial leverage to influence local trade policy in those countries, and their complaints over requests for bribery by local regulators may additionally be acted upon by authorities. SMEs, on the other hand, do not have the same bargaining power with officials and high-level bureaucrats which, in turn, make it harder for them to appeal for a fair treatment. This situation may then generate more opportunistic market behaviour among SMEs.

- **Limited access to information**: Corruption limits the access to information about policy-making, rules and regulations, thus making business harder to conduct (OECD 2008, p.193). For example, in some countries, legislation on trade and investment is changed frequently. Such changes are often not communicated and/or updated on government websites, nor are public officials sufficiently trained in relation to the changes and able to provide clarifications about them. This results in an arbitrary legal environment and creates opportunities for public officials to impose unjust penalties or demand facilitation payments from SMEs. In the same way, the lack of access to information also works as another transaction cost since it contributes to uncertainty about how a company should conduct business on a market. Access to information should be seen as a problem area for SMEs relative to large corporations, which typically have much closer relations with the government and relevant ministries, and thus to market information.

As highlighted above, there are several factors that may limit SMEs' ability to resist bribery and thus increase their vulnerability to corruption. Such factors both relate to internal limitations as well as external constraints over which they have less influence, and dealing with the problem of corruption confronting internationalising SMEs thus requires attention on both sides of the equation. Internally, some SME managers may need to adjust their strategies, mind-set and, in some instances, even corporate culture, so that corruption is not tolerated throughout the enterprise. This

can be difficult since many SMEs may not have the capabilities, resources and time needed to train employees and to develop and incorporate anti-corruption policies into their daily operations. Externally, SMEs may be in special need for outside assistance to avoid corruption since it is often too big a challenge for them to handle themselves. Although primarily limited to western SMEs, special government programmes have been established to assist companies in fighting corruption, anti-corruption tools and guidelines are available for free on the internet, and some embassies and consulates offer investment guidance to difficult markets, including how to avoid corruption[25]. However, making use of such assistance depends on SME knowledge of its existence, as well as own willingness to seek help.

While having established that SMEs are particularly vulnerable to the effects of corruption as well as suggesting how and why this is so, I will now look forward and explore the extent to which it is possible for western SMEs to avoid involvement in administrative corruption in developing countries. I will do this from various perspectives; first, I will go through different aspects of the costs of corruption in order to find out whether it is at all 'worth' avoiding for SMEs. Secondly, I will discuss how and to what extent anti-corruption strategies can be used by SMEs to mitigate the negative effects of corruption, and third; I will review and analyse empirical data from SME surveys from selected developing countries in order to see how they are dealing with it in practise and how various societal factors affect the possibility for avoiding corruption in different ways. My discussions will ultimately lead to an assessment of whether there is a business case for SMEs to avoid corruption.

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[25] See for example anti-corruption tools and counselling offered by the Danish General Consulate in Dubai: www.gkdubai.um.dk/da/menu/Markedsinformation/AntikorruptionsRaadgivningOgVaerktoejer/ and by the Danish Embassy in Cairo, Egypt:
www.ambkairo.um.dk/en/menu/CommercialServices/MarketOpportunities/TodobusinessinEgypt/Anti-corruptionTools/

6. Exploring Aspects of Costs of Corruption for SMEs

As indicated by the Rational Choice and PA theories, an individual will weigh the costs of corruption against the benefits, and only decide not to engage in corrupt activities if the expected costs or consequences outweigh the benefits. Below, I will investigate three different aspects of costs of corruption; 1) financial and operational costs deriving from administrative corruption, 2) reputational costs, and 3) legal costs and penalties. I am well aware that it is impossible to provide a one-size-fits-all answer to whether the costs of administrative corruption are so high that all western SMEs should seek to avoid it, as this depends on contextual factors such as the level of pervasiveness of corruption in a market and the overall experience, knowledge and attitude towards corruption of individual companies. However, I shall seek to provide a generalised overview of such costs to determine whether corruption is 'worth' avoiding for SMEs.

6.1. Corruption and Inefficient Bureaucracy: a Costly Mixture for SMEs

Results from the previously reviewed studies on perceived trade barriers show that SMEs primarily encounter corruption in markets with unstable state institutions, weak rule of law and arbitrary regulatory environments. In addition, the type of corruption that SMEs are most likely to encounter was identified by SMEs of various sizes to be related to petty bribery and requests for facilitation payments by public officials (Beck & Demirguc-Kunt 2005; Aterido et al. 2007 and 2009). Such payments are typically paid as part of companies' normal operations, for example to speed up the clearance of goods through customs, to pass inspections, to comply with operational requirements, or to obtain various licences and documents, etc. The total cost of these payments adds to the cost of doing business by taking a considerable proportion of a company's resources when measured in time and money.

Although corruption has been found to hamper business operations and growth, it continues to be widespread in many markets and avoiding it seems a difficult task – especially for SMEs for the reasons previously described. In addition, many SMEs operate with tight cash-flows and budgets that do not allow losses over a longer period of time which, in turn, leaves them particularly vulnerable to any unforeseen constraints to their operations. For example, in order for a manufacturing SME with limited financial resources to sustain an efficient production in a foreign country, it is thus essential to have a clear knowledge of the time and cost involved in importing and

exporting goods, since any delay or interruption may result in additional costs in terms of lost production or sales. However, delays do often occur in countries with weak and cumbersome regulatory institutions. The most frequently cited costs associated with red tape and bureaucratic bottlenecks among SMEs are found to be related to delays at customs (Aterido et al. 2007), but many other bureaucratically induced constraints also add to the cost of doing business; e.g. long waiting periods and arbitrary processing of essential operating licences or approvals which interrupt or postpone the operations of a company.

Among the main reasons for this, is that government agencies in charge of handling regulatory processes in many developing countries often suffer from various resource constraints, such as lack of funding and insufficiently trained and underpaid personnel. This contributes to creating an uncertain operating environment since agencies are not capable of carrying out their duties as required, nor to provide companies with clear guidance on often complicated regulatory requirements. Moreover, in such business environments it is not uncommon that several government agencies have overlapping mandates governing the same regulatory areas, which helps create uncertainty about where to turn for guidance, and opens the possibility for officials to interpret rules differently and sometimes arbitrarily. Not surprisingly, this also increases the risk of corruption significantly. Due to weak law enforcement, widespread impunity and often widely discretionary powers of public officials, facilitation payments are often solicited for faster processing of important documents or for letting goods through customs, thereby creating incentives for companies to pay in order to jump the queue and avoid operational delays. This situation represents a dilemma regarding the cost of doing business which is similar to what Rational Choice theory prescribes; a company can either choose to engage in corrupt transactions with officials to get around the bureaucratic system which includes the risk of getting caught, or it can choose to operate without paying bribes which consequently may include additional time spent on administrative tasks and subsequent interruptions in production.

As Rational Choice theory would predict, the company will most likely balance the advantages of bribery against the potential costs and chose the solution that will save it the largest amount of money. The choice made by the company can thus be narrowed down to a simple calculation between the costs spent on required facilitation payments versus the cost of operational delays if no payments are made. For a SME whose operational stability, for example, depends on getting

imports and exports through customs without long delays, it may thus be compelled to pay the required bribes. However, apart from the fact that such actions are illegal and the company risk getting caught by authorities at one point in time, the accumulated costs of sustained bribery over time may be so high that an alternative no-bribery strategy will prove more cost-beneficial in the long run. This conclusion also supports an argument put forward by Webster (2005); namely that the operating environment outlined above characterised by weak institutional set-ups and uncertain rule of law, encourage the kind of short-term focus on day-to-day business survival that makes bribery appear more beneficial that it actually is.

6.1.1. Case Study: 'The Life of a Container'

The above described environment can be even further clarified by applying a simplified comparative example of two very different business environments. The example is intended to illustrate how the institutional set-up for regulating business activity (in this case customs administration) can either limit or facilitate the occurrence of administrative corruption in a country. Moreover, I wish to show how administrative corruption can affect the cost of doing business and how bribery may be the most cost-beneficial solution for a SME operating in such an environment. Imagine a small or medium-sized company with limited financial resources that needs to import a container of standard goods for production into Sweden and Nigeria respectively:

Sweden is generally regarded to be a clean country in relation to the occurrence of corruption in business transactions and its institutional set-up and regulatory environment to be highly efficient. According to 2011 data from the World Bank and IFC[26], it takes an average of 6 days and requires 3 documents at a cost of USD 735 to import a standardised shipment of goods into Sweden, which is even lower than the OECD average. In addition, getting a container into Sweden generally just includes contact with one authority, the Swedish Customs Service (*Tullverket*). Moreover, a company may qualify to become an Authorised Economic Operator (AEO) - a joint EU certification programme designed to promote security, safety and simplification of customs-related operations within the European Union. Apart from lowering the risks of having a shipment of goods stopped for examination in and out of the EU as well as easier access to customs authorisations and permits,

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[26] Data is taken from the Doing Business database 2011 (www.doingbusiness.org). The data includes an average of all official procedures involved in trading a standard shipment of goods to each country – from the contractual agreement to the delivery of goods.

being an AEO also entitles the company to ship a container within a few hours after landing at the harbour of Gothenburg – a process which only includes one single administrative document[27]. In this process, the administrative burden imposed on companies in terms of negotiation and contact with customs officials, as well as the time that the container is kept in the harbour have been reduced to a minimum, which significantly reduces the possibility of encountering demands for facilitation payments. This is highly related to the integrity, internal control and oversight of the employees at the Swedish Customs Service. Another critical element for effectively upholding such a system relates to institutional cooperation, meaning that companies can effectively report abuses by corrupt customs officials to the police; that the police can be trusted to investigate such cases and, subsequently; that the legal system will take necessary action.

Nigeria, on the other hand, is generally regarded by most observers to be a highly difficult market to navigate, and where corruption is deeply embedded in the regulatory processes governing business transactions. The World Bank and IFC report that it takes an average of 39 days and 9 documents at a cost of USD 1,440 to import a standardised shipment of goods in Nigeria if all formal rules are followed. This data clearly indicates that the company has to go through a much longer bureaucratic process when importing goods into Nigeria vis-à-vis Sweden. In addition, several studies suggest that corruption is widespread in Nigerian ports and that demands for facilitation payments by port officials often occur during this process. For example, according to the Nigeria Country Profile on the Business Anti-Corruption Portal[28], Nigerian customs administration suffers from many of the same deficiencies that were outlined in the previous section. For example, customs officials are typically not sufficiently trained, resulting in mismanagement and misinterpretation of customs regulations and legislation, which is aggravated by not being uniformly enforced. While the Nigeria Customs Service (NCS) and the Nigeria Ports Authority (NPA) are formally in charge of exercising customs rules, a large number of other non-cooperating government agencies are also allowed to operate in Nigerian harbours, but many with overlapping mandates, resulting in lack of oversight, thus making it possible for officials to operate with large discretion and thereby creating incentives for customs officials to demand unofficial payments from clients. In addition, importing and exporting companies are also presented with incentives to bribe officials. For example, due to massive problems with duty evasion and smuggling of goods from and into Nigeria, the government has required all goods to be inspected in the Port of Lagos which, in turn, has resulted in large

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[27] Ibid: the Swedish Customs Service website: www.tullverket.se
[28] www.business-anti-corruption.com/en/country-profiles/sub-saharan-africa/nigeria/

congestion and delays. The importing company, on the other hand, is desperate to get its cargo out of the port in order to secure its goods and to avoid delays and consequent piling up of demurrage and container rental fees. Such delays may incur substantial costs for companies with tight cash-flows, and the way to mitigate that is to actively bribe a customs official. According to an internal report carried out by UNODC and Global Advice Network for the NCS in 2009/2010, customs clearance time can be reduced by approximately 20 days if bribes are paid in the Port of Lagos.

The purpose of this example is to illustrate how inefficient bureaucracy and complex regulations create an environment where bribery becomes a 'rational' choice as well as the primary solution to obstacles encountered during normal business operations. Bribery increases income and reduces the workload for customs officials, and it saves valuable time and expensive rental fees for companies. For SMEs that are pressured to lower their operating costs due to tight budgets, the 20 days they save by paying a bribe may be far more cost-efficient than following the formal procedures and subsequent delays. If faced with financial constraints, the decision to pay facilitation payments may therefore be more easily justified despite the illegality of the act. However, compared to the Swedish example, the Nigerian situation only brings about additional operating costs no matter what solution the company chooses, either in terms of waiting periods or money spend on bribes. Seeking to reduce such costs also leads to a focus on solutions that are beyond the control of individual SMEs, as the main reason for administrative corruption to occur is rooted in the weak and unaccountable regulatory system; a system which has earlier been theorised to contribute to the creation of anomie in companies. As the examples illustrates, by reducing the possibilities for corruption to occur, which goes hand in hand with efficient and accountable regulatory institutions, the cost and time of doing business are also likely to decrease.

6.2. Reputational Costs of Corruption

Alternative costs of corruption may also arise for a company from reputational damages caused by exposed or perceived involvement in corruption. As an example of this, a survey carried out among 390 business executives revealed that more than half of the respondents perceived that the most severe impact if corruption was discovered would be damages caused to the corporate reputation (PricewaterhouseCoopers 2008). The risk of reputational damages increases significantly for a company operating under the difficult conditions that are exemplified above. Large corporations

may generally have more reputational risk at stake than smaller companies due to their increased economic importance as individual companies, larger stakeholder interests and thereby a greater public exposure. However, while there generally may be more circumstances that can damage the reputation of a large company, it does not mean that it is less important for a SME to manage its reputational risks.

While a company's reputation can be viewed as an intangible asset at first glance, the damages made to it may quickly be turned into very tangible costs. Examples of costs originating from reputational damages are most often exemplified by large multinational companies whose decisions occasionally have resulted in negative press coverage, civil society protests and subsequent boycotts of products by their customers, amounting to immense costs for the company. A good example of this is the extensive boycotting of Shell products and outlets, public protests, negative publicity and subsequent financial losses following its plans to dispose the Brent Spar oil container in the North Sea in 1995 (Power 2009). Individual SMEs rarely have the same leverage and thereby impact on society and markets in which they operate. However, just as in any human relationship, having a good reputation based on accountability, integrity and professionalism is crucial for building business partnerships, and in this sense companies of all sizes need to manage their reputation to some extent. The IMF/IBM-sponsored SME Toolkit – South Africa also recommends SMEs to manage their reputation and that it is of major importance for building competitive advantages[29]. For example, if a SME being considered by a larger buyer as a supplier, but it finds the SME unreliable or in other ways questionable during the vetting process, it may be bypassed, resulting in lost income for the SME. Moreover, if a SME have previously been sentenced for corruption, is being investigated or even just perceived to be involved in corruption, potential partners will most likely not use it as a business partner, as they do not want their own reputation tainted by being affiliated with the company. This constitutes a large rationale for a SME to have a dedicated anti-corruption policy and no-bribery strategy in place, as it will most likely strengthen its reputation towards stakeholders and make it a more attractive and 'safe' business partner.

In sum, whether involvement in corruption is direct or just perceived by other market actors, it can result in reputational damages for companies of any size. Such damages may also lead to increased costs in terms of lost business opportunities. On the other hand, if a company can convince its

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[29] SME Toolkit South Africa: 'A solid reputation is as good as gold',
http://southafrica.smetoolkit.org/sa/en/content/en/5422/A-solid-reputation-is-as-good-as-gold

stakeholders, competitors and other market actors that it is committed to avoid involvement in corruption – for example, by implementing an anti-corruption strategy – it may also boost its reputation which can lead to new business opportunities. In the following section, I will focus on costs deriving from non-compliance with anti-corruption legislation.

6.3. Legal Liabilities and Potential Costs of Non-Compliance

An aspect of private sector corruption which is becoming increasingly relevant is that of individual companies' legal liabilities. Due to international progress in developing and strengthening anti-corruption legislation, companies of all sizes are now subject to a growing body of legislation aimed at imposing stricter penalties for corruption in business transactions. Being caught for corruption can result in high costs and may be particularly devastating for a SME; the legal liability is therefore a factor that should be taken into account before engaging in corruption. Recall for example Robert Klitgaard's equation for PA theory; an agent will rationally choose to be corrupt if the benefits of corruption *minus* the moral costs and probability of getting caught *times* the severity of the penalty *are greater than* the benefits of not being corrupt (1988: 70). This section emphasises the part of the equation that deals with the probability of getting caught and the subsequent penalties. I will first introduce the current trends in anti-corruption legislation and its enforcement, and next some potential costs for perpetrators.

During the last decade, there has been an increasing focus on the criminal aspects of corruption and subsequent legislative measures to curb corruption in international trade. The primary rationale for such a focus to arise has primarily been due to pressure by the US government throughout the 1980s and 1990s to promote a more level playing field for western companies in cross-border trade. In 1977, the Foreign Corrupt Practices Act (FCPA) was enacted in the US, prohibiting US companies from receiving and offering bribes in foreign countries. Most European countries, however, did not have the same kind of legislative framework, and many governments did not only allow overseas bribery of foreign public officials, but had also made it tax-deductible if the expenses were reported to the national financial authorities (Sung 2006). This situation increasingly led to complaints by US companies that claimed to have lost business contracts and thus market shares in foreign markets because their European counterparts had offered bribes.

A more level playing field was created in 1997, with the establishment of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, introducing legally binding standards to criminalise bribery of foreign public officials in international trade for its signatories. In addition, while first adopted in 2003, the United Nation Convention against Corruption (UNCAC) came into force in late 2005 as the most comprehensive convention in terms of provisions and in scope of state parties, amounting to 140 signatory countries out of 151 state parties by early-2011[30]. By introducing legally binding anti-bribery rules for signatories who have also ratified the conventions, the concept of *extra-territorial jurisdiction* has been established, making it possible via legislation to cooperate across state borders on matters such as retrieving lost assets, investigation and extradition of suspects. This also means that a company can be sentenced in its home country for acts of corruption committed abroad. Moreover, the newly adopted UK Anti-Bribery Act 2010 presents yet another step towards stricter enforcement of anti-corruption laws. This Act criminalises both bribing of any public official as well as bribery between two private parties, and it encompasses any company with any sort of activity in the UK[31]. In principle, this means that a foreign company can be tried in a British court for corruption committed in any other country as long as it also has some kind of commercial activity in the UK (e.g. a subsidiary or just import/export). Such provisions will make the Act the strictest piece of anti-corruption legislation in the world (Chene 2011).

While the introduction of common legislative frameworks is meant to increase transparency in business transactions and thereby a more level competitive business environment by introducing more comprehensive law enforcement, this trend has also been criticised for being far from flawless (e.g. Sung 2006). For example, many developing countries have problems implementing anti-bribery provisions into national law and even more are dealing with inadequate enforcement resources, thus making it close to impossible for laws to be upheld in practice (Chene 2011). In addition, there are so far no general signs that the prevalence of corruption in business transactions has been reduced on a global scale, with the estimated global loss due to corruption having hovered at an annual USD 1 trillion for almost a decade[32]. Yet, while some developing countries are still

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[30] UNCAC signatories can be found on www.unodc.org/unodc/en/treaties/CAC/signatories.html
[31] Ethical Corporation: 'The UK Anti-Bribery Act: How global companies should prepare', www.ethicalcorp.com/content.asp?contentid=7075, (found 28 March 2011).
[32] See for example: The World Bank: 'The Cost of Corruption', 8 April 2004 - http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190187~menuPK:34457~pagePK:34370~piPK:34424~theSitePK:4607,00.html, (found 20 February 2011), and

only in the process of ratifying the provisions required by the conventions (most notably the UNCAC) into national law, we have still only seen the short-term effects of the conventions in developing countries, and it has yet to be shown whether they will prove more effective over a longer period of time. However, there are many indications that anti-corruption enforcement is in progress in most western countries, where an increasing number of individuals and companies are being sentenced every year, and where penalties are gradually getting harder. This is most notably exemplified with the FCPA, where a number of US institutions have intensified its enforcement significantly in recent years (Cook & Connor 2010) and, although to a lesser degree, with the OECD Anti-Bribery Convention, where 148 individuals and 77 entities were sanctioned between 1999 and 2009, and with 280 ongoing investigations in 2010[33]. In general, while evidence of effective legislative enforcement is still lacking in much of the developing world, enforcement is only getting more efficient and stricter in the OECD region. For western companies, this means that they are under increasing pressure to comply with domestic anti-corruption laws even when they operate in developing countries. Below, I will look into the potential costs and implications for non-complying SMEs.

6.3.1. Potential Costs of Legal Sanctions

Partly due to their smaller size and relatively little attention given to them by the public and mass media, and partly because law enforcement and regulatory authorities in corrupt markets are often very weak on enforcing rules, some SMEs operating in corrupt environments may feel relatively 'safe' from being caught. However, western SMEs are still operating under domestic legislation abroad, and can therefore still be sanctioned by domestic courts if corrupt acts are discovered.[34] Despite how difficult it may be to resist involvement in corruption in some markets, general compliance with national and international legislation may also prove beneficial for SMEs since no criminal paragraphs differentiate between company sizes when it comes to measuring sentences in courts. In general, the consequences of being sentenced for corruption can be devastating for a

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The World Economic Forum: 'Global Anti-Corruption Initiatives Call for more Companies to Fight Corruption', 8 December 2010 - www.weforum.org/node/66473?fo=1, (Found 20 February 2011).

[33] OECD: 'Data on Enforcement of the Anti-Bribery Convention', June 2010 - www.oecd.org/document/3/0,3746,en_2649_34859_45452483_1_1_1_1,00.html – Found 29 March 2011.

[34] I.e. they are operating under the Extra Territorial Jurisdiction principle.

company, and for a SME it will often mean that it will have to turn the key. Below are some of the reasons why:

- **Imprisonment**: No country allows bribery of its officials and, according to most countries' criminal codes as well as to the provisions established by the OECD and UN anti-corruption conventions, bribing a public official can lead to imprisonment. In addition, Cook & Connor (2010) refer to many examples where business managers have been imprisoned under the FCPA in 2009, and note that SEC and DOJ[35] officials have stated that they intend to intensify investigations in 2010-2011 which should lead to even more prosecutions and eventual prison sentences.

- **Investigation**: Being suspected of and investigated for corruption are associated with high costs since companies, if found guilty, may be required to cover the costs of the investigation. Moreover, costs associated with legal counselling and reputational damages are unavoidable.

- **Debarment**: A company sentenced for corruption may also be excluded from participating in public tenders for a number of years. Being debarred thus results in lost business opportunities and the criteria for being accepted again as a business partner are not entirely clear. Under UN and World Bank regulations, a company can be black-listed from participation in projects funded by them solely on suspicion, and therefore without the need of an official court sentence. According to an EU directive, companies with a court sentence must be debarred from public procurement in all EU member states.

- **Disgorgement**: Apart from potential fines, a company must also repay the profits obtained through corruption as well as publicly-backed loans granted by export credit agencies.

- **Post-investigation requirements**: If sentenced for corruption, a company may be required to develop or improve internal security systems for corruption detection and training programmes for employees. There may also be a need for external auditing of company finances.[36]

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[35] SEC = Securities and Exchange Commission / DOJ = US Department of Justice. These are the two main agencies involved in enforcing the FCPA in the US.
[36] Ibid www.globaladviceacademy.com – an internal E-learning module provided by the consulting company, Global Advice Network – to be available online in mid-2011 on www.business-anti-corruption.com.

As it appears from the above consequences, it is clear that SMEs with tight budgets are likely to go out of business if sanctioned for corruption. Another practical rationale for taking preventive steps to fight corruption and bribery is due to the fact that the level of compliance and means of corruption prevention can be used to measure a potential sentence in court. For example, the United States Sentencing Commission issued a Federal Sentencing Guidelines Manual in 2010[37] stating that "*seeking to prevent and detect criminal conduct has a direct bearing on the appropriate penalties and probation terms for the organization if it is convicted and sentenced for a criminal offence.*" In general, the manual sets forth guidelines on how a company should implement an effective compliance and ethics programme for the prevention and detection of criminal conduct. It also states that smaller companies "*may meet the requirements of this guideline with less formality and fewer resources than would be expected of large organizations.*"[38] Another example is from the UK Bribery Act 2010, Section 7, which states that "*it is a defence for the commercial organisation to show it had adequate procedures in place to prevent persons associated with C from committing bribery offences.*[39]" When taking this legal aspect into consideration, as well as the negative consequences of being investigated and sentenced for corruption, it makes sense for a SME to seek to avoid corrupt practises.

Having been through aspects of financial, reputational and legal costs of corruption, it now seems clear that there are several good reasons for SMEs to seek to avoid involvement in administrative corruption. However, as it was illustrated in the example from Nigeria, administrative corruption can also be so prevalent in a market that it seems virtually impossible to avoid. In addition, for SMEs doing business on tight budgets, administrative corruption may also present an alternative and very tempting incentive to lower the cost of doing business in the short run, despite the risk of being caught and sanctioned. Over a longer period of time, however, the accumulated cost of facilitation payments may constitute a substantial part of the overall budget. It can thus be concluded that the cost-benefit approach of the Rational Choice and PA theories are very difficult to apply in practice when it comes to measuring the most cost-efficient choice. There are many contextual factors that must be taken into account, and for a SME seeking to avoid involvement in corruption, it also depends on where it does its business. In the following section it will discussed in

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[37] See www.ussc.gov/Guidelines/2010_guidelines/Manual_PDF/2010_Guidelines_Manual_Full.pdf
[38] See Application Note 2, C for prevention by firm size.
[39] 'C' is for 'Commercial Organisation' – see the 2010 Bribery Act in full text:
www.opsi.gov.uk/acts/acts2010/ukpga_20100023_en_1#pb3-l1g7

more detail how a focused anti-corruption strategy may help SMEs to fight corruption if implemented comprehensively.

7. Anti-Corruption Strategy

As mentioned earlier, western SMEs may be particularly vulnerable to the rise of anomie as they embark on operations in a developing country where business practises differ much from what they are accustomed to. According to the framework presented in section 4.2[40], adapting to a new business environment is very likely to induce changes in an organisational set-up – a process which may deinstitutionalise a company's normative control system and lead to the creation of anomie. Whether this leads to increased rates of deviance among organisational members and a growing acceptance of corruption as normal business practice depends on the magnitude of reconfiguration of organisational processes and on the capacity of the organisation to accommodate such changes. For example, if an inexperienced Danish company decides to operate in a country with very cumbersome regulatory systems and high levels of administrative corruption (like Nigeria), the magnitude of reconfiguration ought to be large and the acceptance of corruption as normal business practise may easily be cultivated among employees. However, the company can seek to mute anomic effects by nurturing benevolent or principled ethical climates, for example through dedicated leadership and by implementing ethical codes and strategies to avoid corruption in practise. SMEs often do not have the leverage to influence the demand side of corruption, but by building a corporate culture that does not tolerate corruption and supported by anti-corruption policies and strategy, a company can at least influence its own engagement in supply-side corruption.

Due to liabilities of size, it could be assumed that many SMEs do not have the capabilities, knowledge and time needed to develop and incorporate an anti-corruption strategy, as well as to train employees in acting in accordance with it. Today, however, a large amount of freely available online guidance material aims directly at supporting SMEs in that regard,[41] making it possible for

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[40] See Figure 1, p. 27
[41] For example, the Business Anti-Corruption Portal – a multi-stakeholder platform aimed at providing SMEs with freely available information and assistance in their fight against corruption - provides due diligence tools as well as guidance documents on how an SME itself can develop, structure and implement an integrity system (www.business-anti-corruption.com). Similar guidance and inspiration for developing an anti-bribery programme have been issued by

SMEs to develop and implement their own strategies without much outside assistance. Below is a compilation of recommendations taken from the above sources about important elements that could be included in an anti-corruption programme.

- A company should adopt an **anti-bribery policy**; i.e. a clear message from the board to stakeholders, including clients, employees, agents, public officials and the general public that the company will not participate in any kind of corruption. Moreover, a **code of conduct** on corruption and bribery should be adopted, outlining a set of value-based guidelines for employees to follow.

- A company must establish an **anti-bribery programme** explaining how it strategically intends to deal with different kinds of corruption; e.g. demands for facilitation payments, hospitality, gifts, political contributions, protection money, etc. The programme could also clarify how the company intends to cooperate with business relationships in a transparent manner (e.g. with subsidiaries, contractors, suppliers, distributors and agents). Individual responsibilities must also be carefully clarified as well as who to contact, in case an employee has any questions or doubt regarding ethical conduct during his/her representation for the company.

- A company can also benefit from having a general **risk assessment procedure** in place to assist management in evaluating the risks associated with different operational challenges. This can be an assessment of the risks of corruption when entering a new market, or of the country and sector in which it operates. A risk assessment helps identifying 'hot-spots' where corruption occurs and may facilitate the creation of strategies for how to practically deal with it. A company may also have to develop procedures for how to carry out

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Transparency International in its comprehensive '*Business Principles for Countering Bribery – SME Edition*' (www.transparency.org/global_priorities/private_sector/business_principles), by the International Chamber of Commerce; '*Rules of Conduct and Recommendations for Combating Extortion and Bribery*' (www.iccwbo.org/uploadedFiles/ICC/policy/anticorruption/Statements/ICC_Rules_of_Conduct_and_Recommendations%20_2005%20Revision.pdf), and by TRACE in its '*The High Cost of Small Bribes*' (www.traceinternational.org/documents/TheHighCostofSmallBribes.pdf), just to name a few. In addition, the OECD has issued a '*Good Practise Guidance on Internal Controls, Ethics, and Compliance*' (www.oecd.org/dataoecd/11/40/44176910.pdf), suggesting practical steps that a SME can take to effectively comply with the OECD Anti-Corruption Convention

appropriate **due diligence** in different situations, such as screening and evaluation of agents, contractors, consultants, suppliers, joint venture partners and during procurement processes.

- Another important element is **training of employees.** Training in the company's code of conduct, anti-bribery programme, roles and responsibilities and other practical procedures is essential in order to clarify doubts that employees at every operational level may have. Since a company can be held accountable for the actions of the use of third-parties, agents and intermediaries also need training, and contracts must be signed where they state that they intend to comply with the provisions of the company's anti-bribery programme. It is equally important to establish a **reporting mechanism** to which employees can contact to report misconduct, to receive advice or to have any doubts clarified. In some situations, it may be necessary to guarantee the anonymity of the whistleblower in order to reduce the possibility of retaliation. A reporting mechanism may also be a useful tool for capturing key experiences from employees about where and how corruption is met. This could be used to improve the overall programme.

- In order for a corporate integrity system to be effective, top management needs to be fully committed to **enforcing**, **following-up** and **improving** the programme. First of all, if top management demonstrates genuine dedication to the principles of its programme, it will help letting stakeholders know that the company is serious. Secondly, working to reduce a company's involvement in corruption is a team effort, so leading by example is the best way for top management to let its employees know that they also have a responsibility in making the programme work. If this is not the case, the programme will most likely be useless or only have limited effect.

Many problem areas need to be taken into consideration when tailoring an anti-corruption programme, but if the above steps are considered by a company, it may be able to lower the risks related to corruption and bribery during its practical operations in many situations. For example, companies with such programmes report that the hardest part of the process is actually focusing attention on the problem of paying small bribes and then committing to stop – not to implement the programme itself (TRACE 2009). Moreover - although not clearly specifying the size of the

companies included - a 2007 survey carried out by PricewaterhouseCoopers[42] found that companies with anti-corruption programmes and ethical guidelines in place experienced around 50% fewer incidents of corruption, and were less likely to suffer from lost business opportunities than companies without such mitigating measures.

One has to keep in mind, however, that having an anti-corruption programme based on some of the above recommendations does not remove all problems originating from corruption *per se*. For example, Ashforth et al. (2008) warns that formal control systems can easily be decoupled from a company's daily operations and act as mere 'window-dressing' if not embraced by informal systems such as commonly held values. In addition, they highlight the importance of not treating the control system as mere 'compliance', but the extent to which employees, leaders, the reward system and ethics codes all support ethical behaviour, while discouraging misconduct. In a similar vein, Cullen et al. (2009) point out that formal codes, rules and policies have little weight in them selves, but work dynamically and in duality with informal structures, such as corporate culture, values and collectively held norms. From a theoretical point of view, anti-corruption strategies will have most effect if both benevolent and principled ethical climates are nurtured, and as will be dealt with in the sub-section below, top management have the main responsibility in this regard. Moreover, some markets suffer from systemic levels of corruption where it is questionable whether an anti-corruption strategy and a dedicated culture for avoiding it are sufficient. For example, in the case of Nigeria, deciding not to pay facilitation payments would only result in long delays and subsequent lost income, thus questioning the business case for having a dedicated strategy. However, a strategy may serve as a systematic approach for learning from mistakes, gather data and to come up with solutions for gradually reducing the company's involvement in corruption over time. By using employees' experiences and knowledge of *where* demands for facilitation payments are met and *how* such activities take place during daily operations, it becomes easier to implement an efficient anti-bribery strategy in terms of knowing *where* to focus strategic attention and *how* corruption affects the company's operations in practice. Collecting information on where and how bribery and extortion are encountered will for example allow a company to account for potential delays at customs caused by rejected demands for bribes by transporting its goods weeks before actual deadlines for delivery (Krogstrup & Mulvad 2006).

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[42] Survey mentioned in Transparency International: 'Global Corruption Report: Corruption and the Private Sector', 2009

As mentioned earlier, having a principled stand against corruption may also have positive reputational effects as it demonstrates to stakeholders and potential business partners that it does not tolerate corruption, and can thereby assist the company in becoming a more attractive business partner. In relation to this, SMEs are increasingly being required to have ethical standards and anti-corruption measures implemented in their corporate strategies in order supply goods to leading buyers in supply chains, since legislation such as the FCPA and the UK anti-bribery Act prescribe that the buyers are legally liable for the conduct of third-parties, such as intermediaries, agents and first-tier suppliers (e.g. Arnold & Porter 2011). Many large companies therefore impose supplier codes to suppliers to better comply with such legislation and to reduce the risk of being indirectly involved in corruption. For example, in a survey of 277 Danish SMEs participating in global supply chains, 32% reported that they were required by buyers to have anti-corruption measures in place (Jorgensen & Knudsen 2006). As of early-2011, this percentage has undoubtedly risen due to increasing attention given to corporate anti-corruption compliance issues since this study was conducted. Another example is from the US, where Hewlett Packard (HP) required from all its 154.000 global partners and suppliers in 2009 that they should take a compliance training programme on anti-bribery, so that HP would better comply with the FCPA. Despite the modest cost USD 120 per training programme, this demand came with the message that companies should pay for the training themselves, and those that did not take the programme would risk loosing their status as a HP partner[43]. In sum, having an integrity system can have many advantages for a SME; it may prevent a supplier from getting an unpleasant surprise from its buyer as in the HP case if it can demonstrate that it already has the required training and procedures. It can also help a small company to obtain a status as 'preferred supplier' – a sign of approval which implies that it will not be subjected to additional checks or evaluation processes by a customer/buyer in the supply chain.[44]

7.1. The Role of Top Management

A large body of management and organisational literature emphasise the importance of top management in implementing and enforcing anti-corruption codes and policies. Cullen et al. (2009), Ashforth et al. (2008) and De Graff (2007), for example, commonly note that the 'tone from the top' must not only provide formal rules and behavioural guidelines for its employees, but also

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[43] CNR: 'HP Charging Partners for Anti-Bribery Training', 2 October 2009. www.crn.com/news/channel-programs/220300914/hp-charging-partners-for-anti-bribery-training.htm?pgno=1 – article found 20 January 2011.
[44] See e.g. IBB Solicitors: 'Preferred Supplier Status', September 2007. www.ibblaw.co.uk/downloads/brochures/2010-05-27-15-13-00-preferred_supplier_status.pdf - article found 28 April 2011.

integrate such measures into daily action by cultivating informal systems in the form of a corporate culture and commonly held ethical values that condemn corruption. The level of commitment of top management towards its integrity system is therefore among the main drivers for whether it becomes successful or not.

Changing the behaviour of employees by developing and implementing integrity procedures and policies is the responsibility of management - not the individual employee. In a company without clearly formulated and enforced policies and guidelines it easily becomes the responsibility of individuals to handle demands for bribes in day-to-day operations. Such conditions may for example be dominant in companies where management emphasises the maximisation of short-term profits as the index for measuring individual employee performance. In such corporate environments, illegal means can easily be preferred to reach this goal and from the perspective of employees, making routine facilitation payments may thus be the rational response to meeting demands from company headquarters despite company policies communicating otherwise (Krogstrup & Mulvad 2006). It is also management that can create an open environment within which employees can seek guidance on operational issues concerning corruption. If no such system is present, employees' choices are limited. Unless internal policies and procedures communicate otherwise, the responsibility for using bribes becomes the burden of the individual employee, who, faced with a request for a bribe, has little chance of choosing alternative courses of action. Payments of bribes can thereby be seen as the result of a lack of incentive structures for countering corrupt practises, and management must through dialogue with its employees identify the incentives that work so that individuals do not feel the need to pay bribes while representing the company.

When implementing a strategy aimed at curbing employees' involvement in corruption, it is also the responsibility of management to strike a balance between sufficient reporting and guidance mechanisms for employees and punishment/reward structures (eg. Ashforth et al. 2008 and Krogstrup & Mulvad 2006). If management implements a zero-tolerance policy on corruption with serious consequences for violators, but has no implemented mechanisms enhancing dialogue between management and employees, there is a large risk that the practical outcome of the overall policy will be skewed. In a worst case scenario, this may create a 'slippery slope' situation where employees will refrain from reporting instances of bribery in order to comply with the policy and thereby avoid punishment (De Graaf 2007). This is also an example of the integrity system cheating

itself; as employees stop reporting on instances of corruption, the company's involvement in corruption will gradually disappear – at least on paper. This will greatly satisfy top management who attribute the success to its well-functioning integrity system without knowing that corruption simply continues 'below the management radar'. At the same time, information which could have been used to improve the strategy to avoid corruption in practical situations is lost. Such gap between management policies and employees' everyday practises may thus become a vicious circle that undermines the company's long-term competitiveness. For the above reasons, it is thus of crucial importance that management is aware of such pitfalls when tailoring an integrity system to fit organisational needs.

In sum, developing and implementing anti-corruption programmes and ethical codes can in many situations enable SMEs to actively avoid administrative corruption. However, establishing a control or integrity system is not only a matter of adopting formal rules and guidelines to comply with legislation. In order for it to have any weight, most researchers emphasise the need to implement ethical rules and codes into daily routines by breeding a corporate culture and values that condemn corruption – a process that takes time to implement and takes full commitment from top management.

8. Avoiding Corruption – Impact of the External Business Environment

To answer my research question, I have so far been looking at the costs of administrative corruption to see whether it is worth avoiding for western SMEs, and subsequently at strategies which can enable them to actively learn to fight it. In this section, I will examine how the external environment can affect the ability of SMEs to avoid administrative corruption. The reasons for administrative corruption to occur are rooted in weak formal and informal institutions and corrupt culture among state officials, which are all beyond the control of SMEs – especially due to their limited bargaining powers. This poses challenges to all SMEs as it limits the extent to which strategy and dedication to avoid corruption will be effective, thus increasing the possibility for anomie to be created. In the following section, I will analyse the impact of the external environment in avoiding administrative corruption through country-specific examples involving empirical SME data in order to investigate how the regulatory environment and culture affect SMEs. I will also comment on how developing country governments could seek to reduce the level of corruption affecting foreign companies.

8.1. Cost of administrative compliance in Russia and Georgia

As the following examples will show, compliance issues where SMEs do not meet the regulatory obligations required by law are a direct factor that increases the cost of doing business. Whereas non-compliance with regulatory requirements related to taxation, formal operating documents, industry standards, etc. would be settled in a well-functioning bureaucracy by a state agent issuing some kind of formally prescribed punishment, it is often common practise in many developing countries for state officials to extort facilitation payments form SMEs in order to 'allow' them comply with regulations.

Golovshinskii et al. (2004) and Bearing Point, GEGI & USAID (2005) have studied the impact of corruption and other market barriers affecting SMEs in Russia and Georgia respectively through in-depth interviews with SME entrepreneurs, and found that they are subject to intense regulatory attention by a large number of controlling state agencies whose agents are able to carry out their duties with absolute discretionary powers. In practice, this means that officials from state inspecting agencies related to fire-fighting services, quality of goods and standards inspections, etc. abuse their authority by extorting facilitation payments from weaker economic actors in exchange for their

'services'. In order to receive more relaxed treatment by inspectors, SMEs explain that they need to build good informal relations with state agents by 'tipping' them off with gifts or informal payments – otherwise they may impose penalties or threaten to close down the business. Moreover, while the need to pay protection money to organised crime reportedly has fallen in recent years for SMEs in Russia, such practise is now increasingly being taken over by the police (Golovshinskii et al. 2004). Legal provisions authorise the police in Russia to undertake practically any kind of inspection of SMEs, and entrepreneurs often complain that police inspectors will always find some kind of 'formal irregularity' if no informal payment is made. In addition, during a meeting between a Danish consultancy and a private Russian company, it was explained that companies faced with competitive pressures could sometimes 'hire' Russian police to close down competing businesses. It was explained that the only way to prevent this from happening was by having connections in higher political circles.[45] It is obvious that this type of corrupt environment induced by excess and arbitrarily enforced regulations generally drive up the cost of doing business for SMEs. It is also clear that in markets where state officials are able to act with such levels of discretion and impunity, an anti-corruption strategy will not have much effect. To make matters even worse, judicial systems in such countries typically also suffer from high levels of corruption and possibilities for influence peddling, thereby removing possibilities for SMEs to resolve disputes with state agents in courts.

This example clearly illustrates why many domestically bound SMEs in countries plagued by such conditions often prefer to operate in the informal sector - 'under the government radar' - in order to prevent visits by state agencies and thereby lowering their operating costs (Okpara 2009, Richmond 2009). Operating informally/illegally, however, may also be one of the main reasons why domestic SMEs experience growth and development constraints, since they are inhibited from formal access to financing and other supporting mechanisms. Western SMEs which are not 'born' into such environment are also vulnerable to the above conditions and additional operating costs as they typically settle within the formal economy, thus leaving them completely exposed to arbitrarily enforced regulations. Whereas domestic SMEs may lower their costs by operating informally, foreign SMEs may seek to influence decision-making processes by building personal relations with state agents which implies direct involvement in corruption. Western SME operating under such conditions may otherwise try to collaborate with their government (through the embassy) or a powerful business association in order to increase their influence over the system. However,

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[45] Information obtained during a meeting held in January 2011, between the Danish consultancy Global Advice Network and a Russian company.

exercising influence over the Russian system is not easy, as discovered by the Swedish multinational furnishing retailer, IKEA.[46] After having invested USD 4 billion over 10 years in Russia, IKEA decided to halt its operations in 2009, as it refuses to pay bribes to local safety inspectors who have repeatedly withheld the opening of big outlets. IKEA has continuously appealed its experiences to authorities and politicians, but so far without any results. The essence of this example is that if a large enterprise like IKEA find it difficult to appeal for a fair treatment by state officials, it will be outright impossible for a SME with much lower bargaining power. As the next example will show, however, adjusting the attitude towards corruption may be a powerful tool for SMEs that want to resist demands for facilitation payments.

8.2. Reducing costs of administrative corruption in Egypt

Other evidence suggests that corruption may complicate the bureaucratic process even further for SMEs as well as augmenting the costs of doing business. In a 2009 survey conducted by CIPE among Egyptian SMEs operating in Egypt[47], it was found that 1) the average time required, 2) the number of licences and permits to be obtained and 3) the number of government departments to be contacted in order to establish a business in Egypt were consequently higher for SMEs that had paid facilitation payments during the process compared with companies that did not pay. This suggests that it can be profitable for an SME to resist bribery, as it not only saves valuable time in the start-up phase, but also money spent on gifts or facilitation payments to public officials. Another interesting finding in the survey relates to the attitude of bribe-paying SMEs, as respondents were asked whether they were prepared to pay bribes when starting a business: 7% said that they were '*willing to pay*', 13% '*wanted to resist*', 36% were '*prepared to adapt*' and 41% '*did not think about it beforehand*', (3% *NA*). Interestingly, the large majority of SMEs that ended up paying bribes were found among those who were '*prepared to adapt*' and '*did not think about it beforehand*', indicating that having a laissez-faire or 'take-it-as-it-comes' attitude towards bribery also exposes a SME to additional corruption and costs. In addition, out of the four categories surveyed, the group of SMEs that '*wanted to resist*' bribery were also able to establish their company faster than the bribe-paying SMEs by almost a month.

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[46] Bloomberg: 'Russia Repels Retailers as IKEA Halt Curtails Medvedev Goal', 2 March 2011-
www.bloomberg.com/news/2011-03-01/russia-repels-retailers-as-ikea-halt-curtails-medvedev-bric-goal.html – Article found 4 March 2011
[47] The survey covers a sample of 797 Egyptian SMEs operating in Egypt.

Although these findings are encouraging, one has to keep in mind that the results only apply to the Egyptian market. While Egypt apparently offers a business environment where it is possible to resist paying bribes to officials, the same may not be true in countries where corruption is even more institutionalised and regulatory processes more complicated. Another limitation to this survey is that is carried out among Egyptian SMEs operating in their home market. Other results may have been collected if the respondents were foreign SMEs seeking to establish themselves in Egypt and not being familiar with the business environment and regulatory processes. Despite these limitations, the overall results primarily suggest that bribery increases the cost and time of SME operations in an Egyptian context and, secondly, that it may pay off to have a strategy for dealing with bribery when seeking to establish a presence in a market traditionally affected by corruption. This finding also correlates positively with the findings of survey carried out by TRACE (2009) among 100 companies engaged in cross-border business activities which all had implemented strategies to avoid paying facilitation payments to public officials (the size of those companies is not specified). The surveyed companies all found that it was possible to eliminate the practise and none of those which had approached the issue comprehensively reported any significant or prolonged disruptions of their activities.

8.3. SME Potential for Avoiding Corruption

Results from the case studies used in this thesis, are generally mixed regarding SMEs' potential for avoiding involvement in corruption and demands for facilitation payments. Especially in the cases of Nigeria and Russia, grim pictures are drawn of business environments where corruption has reached systemic proportions and is highly institutionalised, thus making it virtually impossible for SMEs to conduct business without having to pay informal payments to state agents. Moreover, formal and informal incentives are given to both SMEs and public officials to resolve all interaction with such payments. Officials are given far-reaching discretionary powers, either by law or due to weak and corrupt law enforcement systems, and SMEs are often presented with no other alternative but to bribe in order to 'get things done'. As an example, Golovshinskii et al. (2004) evaluate SMEs' potential for avoiding corruption in Russia to be nearly impossible because it has reached a level where bribery has become so embedded in the national business culture and thereby an accepted business practise, that companies see it as nothing but an additional business overhead. The only way for SMEs to circumvent the most negative consequences of corruption is to have

informal relations with state officials, or at higher political places. This will make them able to gain additional business advantages through less predatory treatment by state officials, but it will not reduce the need to pay bribes, gifts and other informal expenditures to run their businesses. The study from Egypt was more encouraging when it comes to the potential for avoiding involvement in corruption, as it was shown that SMEs were able to reduce the regulatory burden and establish their company faster if they resisted paying facilitation payments. Moreover, it was shown that SMEs that were strategically prepared to resist bribery were also able to do so while saving both time and money, thus advocating for the benefit of operating with an anti-bribery strategy.

An additional survey carried out among Lithuanian SMEs in 2002 compliments the above findings very well; while the large majority of SMEs had been victims to bribery, hardly any had reported it nor appealed for help. The reasons given by the surveyed SMEs were related to 1) '*a general lack of trust in institutions*', 2) '*bribery as an expected consequence of business operations*', 3) '*bribery as an assisting factor for business*', 4) '*widespread corruption in society*', 5) '*no time for fighting bribery – pay bribes voluntarily*' (Dobryninas & Zilinskiene 2002). These responses clearly illustrate the multifaceted problem of avoiding corruption for SMEs. Lithuanian SMEs evidently feel disillusioned by high levels of corruption in their operating environment and have thereby accepted corruption and bribery as a natural part of doing business – some to a point where they even feel that bribery is assisting their operations. However, some of the responses also reveal that the attitude towards fighting bribery suffers from the same kind of laissez-faire-approach which was found among the bribe-paying SMEs in the Egyptian survey. In sum, the problem of trying to conduct business without corruption is double-edged for SMEs operating in high-risk markets; while the external business environment may be discouraging and they feel vulnerable as well as incapable of changing it, the laissez-faire attitude eliminates any possibility left for them to play an active role in reducing the level of corruption they are involved in.

Because the studies used in this section are not methodologically similar, it is not possible to make direct comparisons and conclude that if a SME has an attitude that condemns corruption coupled with a well-functioning strategy, it will also minimise its involvement in corruption *per se*. However, it can be concluded that markets are different, suffering from various types and levels of corruption, and that corruption can constitute various degrees of institutionalisation and embeddedness in national culture and thus affect the behaviour of market actors differently. One

way to approach the differences of the level of corruption is to make a distinction between the level of *pervasiveness* and *arbitrariness* associated with corruption in a country, sector or industry (Uhlenbruck et al., 2006). Whereas the level of *pervasiveness* of corruption can be explained as the average company's likelihood of encountering corruption and demands for facilitation payments in a market, *arbitrariness* characterises the level of uncertainty associated with corruption, thus reflecting the degree of ambiguity of corrupt transactions in a country. For example, while the level corruption affecting private businesses in both Russia and Egypt can rightfully be characterised as *pervasive*, the level of arbitrariness associated with corruption seems to be higher in Russia. In practise, this also means that no matter how strategically prepared to face the challenges of corruption a SME may be, it will not be able to avoid corruption in every developing market. However, in the context where SMEs have - or perceive that they have - no other alternative but to pay bribes when demanded, the focus should rather be on ways to reduce the amount of corruption SMEs need to be involved in (UNIDO & UNODC 2007). As already discussed, a minimum requirement for this to be done is first and foremost for business managers to have an attitude that condemns corruption, but also a corporate strategy which instructs employees in how to practically deal with the problem. In sum, having a strategy for dealing with bribery may not change the external operating environment and behaviour of public officials, but it may help the company to become better at finding solutions to avoid corruption in the long run and thereby gradually reduce the level of corruption it needs to be involved in.

8.4. Administrative Corruption – Scope, Causes and Incentives for Reduction

Based on the above studies and discussions, it should be clear that administrative corruption generally raises the costs of doing business for SMEs. However, eliminating the practice seems to be very difficult due to the complexity and general nature of the problem. As it has been demonstrated in this thesis, administrative corruption takes place between the private and public sector – where business meets politics – and the reasons for it to occur are multiple. According to Caiden (2001: 21-26), the 'sources' facilitating corruption can be psychological, socio-cultural, political, economic, etc. and the complexity of the phenomena makes it difficult to provide a comprehensive account of its causes. This also means that two different business environments will never display the exact same kind and level of corruption, thus making it impossible to find any universal and standardised solution to the problem. What makes it even more complex is the

number of actors and thereby interests involved. The three main categories making up the equation of business corruption have been identified in this thesis; private businesses, low-level public officials and high-level regulators or politicians who all play their part, either directly or indirectly, in order for corruption to occur:

- Businesses - in this case SMEs – are often seen as victims in a corrupt business environment as they must adapt to the given rules, legislation and market conditions, but they certainly play an active part when they give in to demands for facilitation payments. Others actively engage in corrupt practices to gain favourable treatment, to cut bureaucratic corners or to bribe their way to contracts in order to enhance competitiveness and gain market shares or other business advantages.

- Low-level public officials are driven by various other factors. A conventional explanation is that they abuse their authority to solicit informal payments from companies to supplement their often very low salaries, which are sometimes found to be less than sufficient to support a family in many developing countries (e.g. Schwenke 2005). Multiple national anti-corruption strategies that have been tried out around the developing world have included higher wages for state officials, but it has rarely limited the abuse of authority, thus suggesting that the problem runs deeper. As already mentioned, the often poor organisational structures within the institutional set-up in many developing countries create direct incentives for public officials to solicit bribes (e.g. Klitgaard 1988). Due to often insufficient resources, oversight and accountability among government agencies as well as corrupt law enforcement systems, officials can also carry out corrupt activities with large discretion and impunity.

- The last category - politicians and government regulators – are responsible for eliminating, or at least limiting, the incentive structures that may lead to corruption in their country. There is no universal formula for doing this and anti-corruption measures can be of both reactive, preventive as well as of more holistic natures (Miller et al. 2005: 126). Various corruption country profiles on the Business Anti-Corruption Portal reveal that developing countries are adopting different approaches; for example, a national anti-corruption campaign could be launched to create awareness about the problem, including the drafting of relevant legislation, professional training for public officials and directing public funds to strengthen vulnerable state institutions. However, although such anti-corruption measures

are increasingly being implemented by governments around the developing world, they often fail to fully materialise and reduce the overall level of corruption. This is often due to corruption being so widespread that it takes on systemic character and thereby penetrates all layers of a society. Corruption can therefore not be eliminated over a short period of time since the political and organisational culture gradually need the change, together with the corrupt behaviour of state officials as well as the general attitude or acceptance of corruption among members of civil society. Such long-term change requires long-term strategies, political consensus- and stability, and the mitigating policies therefore need to survive presidential terms and changing governments which constitutes a weakness for many developing countries. This is especially evident in the Sub-Sahara African region where many countries are notoriously plagued by conflict-induced instability and political rivalry. This is also supported by Damania et al. (2004) who studied the impact of political instability on corruption and found that it often lead to a weakening of judicial efficiency, subsequent impunity and to increased illegal behaviour among state officials. Another crucial political reason why corruption occurs is due to the lack of genuine political will to fight it; many politicians personally benefit from corrupt deals themselves while others promise to fight corruption only to win votes and to gain public popularity, but without turning rhetoric into action.[48]

While there are various reasons and incentives among different actors for engaging in administrative corruption, it is also clear that various solutions are required within different problem areas to reduce it. Is it for example worth sanctioning internationalising companies for paying facilitation payments if nothing is being done to reduce the demand where the crime took place? The sanctioned company may indeed have learned a lesson the hard way, act as an example for other companies and refrain from doing it again, but sanctions against companies will not change the nature and causes to administrative corruption where it takes place. A political focus must therefore also be applied and solutions must be found both by companies and by government regulators through strengthening regulatory and enforcement institutions. While administrative corruption may bring imitate benefits to SMEs in some situations and under certain circumstances, both corporate and political arguments for reducing the level of participation in corruption in difficult markets are also evident:

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[48] The above factors contributing to sustained corruption in a society are supported by almost all 60 corruption country profiles on the Business Anti-Corruption Portal, www.business-anti-corruption.com/country-profiles/.

The main argument for businesses – whether large or small - to reduce their involvement in corrupt dealings is straightforward, as corruption has been found to raise the cost of doing business and prolong bureaucratic processes in some situations. Moreover, involvement in corruption can be extremely costly for SMEs operating in global markets in terms of reputational and legal consequences. The political argument is related to the pursuit of a better and more attractive business environment. For example, high levels of administrative corruption significantly reduce the possibility for SME growth and development. This fuels a broader political and economic debate; namely that if a healthy private sector is regarded as a main source for economic development (as it has been done by virtually all market economies for at least two decades), there should also be a serious political focus by developing country governments around the world on reducing the possibilities for corruption to occur. A vibrant and prosperous SME sector has indeed been found to be a characteristic of economic growth (Beck & Demirguc-Kunt 2005), but if foreign SMEs are exposed to high levels of corruption some may bypass the market and invest elsewhere, while others may find it necessary to escape such burdens by operating in the informal sector, thus depriving states from tax income. Political stability and reforms are required for this to take place, but it cannot be done without a genuine dedication of political leaders.

An inspiring example which many policy makers and political leaders may want to study is that of Chile - a country located in a region of the world that is otherwise plagued by widespread corruption, but which has gradually managed to reduce the level of corruption to the point where it can be compared *on par* with many OECD countries in terms of good governance. Although its path to reaching this state of development is highly complex and requires an in-depth analysis in itself, it has broadly been accomplished through political stability, professional leadership and political consensus on important long-term policies. During the last two decades of democratic rule, Chile's central governments have continuously taken strong legal action and passed new laws aimed at preventing corruption; to improve and professionalise the civil service and public administration; to regulate political party and candidate financing, and established caps on election spending; to improve standards for disclosure and transparency of public information; and to protect public employees who expose corruption (Global Integrity 2008, US Department of State 2010). Such measures have contributed to Chile's reputation as Latin America's best-governed country with the safest investment climate foreign investors, where administrative corruption is least likely

to be met. Both public and private corruption still takes place in Chile as in any other country, but it still stands out as an encouraging example which illustrates that a country can gradually limit its level of corruption through political commitment and stability as well as respect for state institutions and the rule of law.

9. The SME Business Case for Countering Corruption

As a concluding element of this thesis, it is logical and highly relevant for my research question to discuss whether there is a business case for western SMEs to avoid corruption which extends beyond pure moral and ethical intentions of the company. The business case for fighting corruption should thus be understood as whether western SMEs have anything to gain from seeking to avoid corruption, either in relation to cost savings, reduction of operational risks or other competitive advantages. According to some of the examples presented in this thesis, the universality and effectiveness of a practical business case have been questioned, as it turns out that SMEs are not able to avoid corruption in every business environment. However, other examples support a business case for SMEs and below are some of the main reasons why it can make sense for SMEs to avoid corruption:

- **Reduced operating costs**: As the example from Egypt revealed, avoiding corruption can be cost-beneficial for a company. In this example, SMEs had managed to lower the bureaucratic burden on their operations which enabled them to do business more efficiently while saving money that would otherwise have been spent on facilitation payments. By effectively implementing integrity systems, some experiences also reveal that companies have lowered their involvement in corruption and gained new business opportunities.

- **Reputational effects**: Being investigated for corruption, knowingly involved in, or even just perceived by other market actors to be engaged in corrupt activities can cause large reputational damages to a company. The level of reputational risk at stake often varies by company size, impact on society and media coverage and many small companies may consider them selves relatively 'safe' in that regard. However, with recent years' growing focus on 'ethical business' by authorities, supply chain leaders and the private sector in general, the reputation of a SME is an increasingly valuable asset when being considered as

a business partner. Being known for not engaging in corruption may significantly strengthen a SMEs reputation by bringing positive attention to their activities and thereby become a more attractive business partner. This can ultimately contribute to building competitive advantage.

- **Integrity systems**: Implementing integrity systems, strategies and internal procedures can be a costly affair involving high consultancy and auditor fees. In addition, an integrity system takes considerable resources to implement (for example in relation to training of employees), but such costs may consequently be far lower than the many costs associated with corruption, and an integrity system can be an effective safeguard against many related risks. Moreover, a large variety of freely available guidance material and comprehensive manuals for structuring integrity systems, strategies and policies exist and can in some cases cut the high costs of consultancy advice. Having a policy, strategy and ethical code stating a zero tolerance of corruption is also becoming increasingly relevant for being selected by larger companies as their supplier/business partner, and it may help them achieve status as preferred supplier.

- **Legal liability**: Regardless of size and resources, a SME is subject to the same legal liability and compliance issues as any other company according to present day's national and international anti-corruption legislation. This also includes a broadening of the scope of jurisdiction, meaning that a company can now be prosecuted in its country of origin for acts of corruption committed abroad. Being investigated or sentenced for corruption always involves high costs for a company and may therefore be devastating for a SME. As an additional defence of the business case for SMEs, some legislative frameworks include provisions that will reduce companies' potential sentences if they can prove that preventive measures were taken to avoid the illegal act. This should especially be seen in relation to SMEs' corporate liability which extends to the potential illegal conduct of individual employees and third-parties (agents, consultants, business partners, etc.) working on behalf of the company. Such legal responsibility can only be avoided by SMEs through actively carrying out measures to prevent corruption, such as implementing policies, carrying out due diligence and training and implementing clauses in contracts to third-parties.

- **Long-term benefits**: While facilitation payments undoubtedly open doors to immediate gains in most situations, such short-term benefits may also prevent a company from reaching higher long-term profits. As noted earlier, many SMEs suffer from short-term planning and vision, which makes them unable to calculate the long-term benefits from avoiding bribery as well as the accumulated cost of bribery over time. The essence of this argument is that the often very difficult operating conditions experienced by SMEs in developing countries make bribery appear more beneficial that it actually is (Webster 2005). The dilemma of committing to stop paying bribes, however, is that it may imply short-term losses and lost business opportunities to reach the long-term gains. This dilemma will be discussed in more detail below.

- **Contribution to improved business environment**: This element of the business case for SMEs does not have any immediate impact for the individual company but concerns the business environment. Seen from a broad perspective, it is of every company's interest to operate in a corruption-free environment as this will enhance the efficiency of its operations, lower the operating costs and bring stability to its planning. Corruption breads corruption and giving in to demands for a bribe once will continuously lead to future demands. It therefore pollutes business environments and contributes to sustaining the corrupt behaviour of both public officials and companies. By working to reduce its involvement in corruption, a company therefore contributes to creating a better and more efficient business environment for itself as well as for every other company with the implied prospect of lowering operating costs.

So is there a business case for internationalising SMEs to counter corruption? From the above perspectives, there surely seems to be, but there are especially two conditions that have been pointed out in this thesis which will neutralise or altogether eliminate a business case to avoid corruption. The first and most obvious condition is when corruption has reached systemic proportions as in the case of Russia where even large multinational companies seem unable to operate without engaging in corruption. In such business environments where rule of law and regulations are arbitrarily enforced and where nothing can be accomplished without 'buying' influence from- or being favoured by authorities, it is simply naïve to think that SMEs will gain anything but operational delays, financial losses and even potential acts of retaliation by authorities

from not abiding to the informal rules of the system. The second condition that can neutralise the business case is when company management lacks the will and dedication to avoid corruption, if a company lacks the capability and knowledge about how to do so, or if a company has a culture that simply accepts corruption as normalised business practise. Without genuine will and the necessary knowledge and tools to avoid it, the business case will not be realised. A revealing example was the case of Egypt, where SMEs with a laissez-faire attitude towards corruption were subject to more time-consuming regulations and thereby higher costs than those that did not make facilitation payments. In sum, SMEs only seem to have the possibility to reap potential gains from avoiding involvement in administrative corruption if they operate in markets where they to some extent are able to influence decision-making processes with state officials, and when they are dedicated as well as strategically prepared.

An efficient integrity system and anti-bribery strategy may be the best way for any company to actively achieve gains from fighting corruption if implemented comprehensively. This is especially so when seen in comparison with the strategies – or rather survival techniques – used by many SMEs that are operating in highly corrupt markets. For example, based on findings from the cases of Georgia and Russia[49], the most conventional strategies among domestic SMEs to mitigate the negative impact of corruption were:

- To seek refuge from predatory behaviour of state officials in the informal economy, but thereby depriving the company from formal access to financial support at the expense of enhanced competitiveness, growth and development, or;
- To co-opt and benefit from the formal system by establishing close relations with corrupt government officials to gain preferential treatment, but at the cost of continuing the vicious cycle of having to bribe to gain such advantages.

Compared with such *ad hoc* survival strategies, an integrity system, including practical corporate policies and strategies against bribery, will generally empower an internationalising SME with a much more systematic and comprehensive approach to reducing its involvement in corruption. However, adopting an anti-corruption strategy is not costless and the business case may not be immediately evident due to the dilemma of bridging the gap between long-term benefits and short-

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[49] See page 58-60.

term costs. While fighting corruption can bring financial gains to a company in the long run due to the aggregated savings of funds spend on bribes over time, it may be at the expense of immediate costs which can make some companies believe that fighting corruption is too costly (Krogstrup & Mulvad 2006). Companies implementing a principled stand against corruption may for example experience losses in the short run due to the reduced ability to meet delivery deadlines when goods are delayed in customs, or compensation claims may arise from contracts not being fulfilled resulting in business opportunities lost to competitors. This may especially be the case if a company is a so-called 'first-mover' in its industry or sector when it comes to adopting a non-bribery strategy, while the remaining companies continue to benefit from corruption.

Such dilemma may be approached with a second strategy which has not yet been dealt with in this study – namely collective business action. The term collective action was popularised by Mancur Olson (1971), who explored free-rider problems in business associations. Applied to the study of anti-corruption, the concept of free-riding means that individual companies will benefit from a more competitive and transparent business climate, but few will be willing to invest own resources and risk to achieve such a climate. A solution to solving this problem can be collective action based on private sector incentives (World Bank Institute 2008). The idea of collective action against corruption is the a number of companies group together in an association – sometimes in collaboration with civil society groups, international business organisations or the public sector - with the goal of fighting corruption through commonly agreed upon business pacts, principles and strategies. Apart from seeking to establish common guidelines on ethical market conduct to facilitate a more level playing field among the companies involved, collective action may also strengthen individual member's leverage in their negotiations with governments as well as their bargaining power vis-à-vis corrupt public officials. In addition, joining forces can also be used for exercising pressure on governments to appeal for fair treatment against corrupt behaviour of public officials. In theory, collective action may thus be a very powerful tool for SMEs to overcome their resource constraints and vulnerability to corruption as well as the first-mover dilemma mentioned above (Krogstrup & Mulvad 2006, World Bank Institute 2008). If groups of SMEs were to join forces with other important market actors in corruption-ridden countries with the common goal of reducing the level of corruption they are confronted with, the business case described in this section would also gain even more strength and apply to a larger number of companies.

10. Conclusion

With a point of departure in related reports, articles, surveys and case studies, I have explored the extent to which western internationalising SMEs are able to avoid involvement in administrative corruption in developing countries. The concluding answer, however, is neither uniform nor straightforward as it has been found to depend on contextual factors such as the nature and level of corruption in a given market, societal and cultural characteristics of a country and its regulatory institutions, as well as on the willingness and capacity of a company to avoid it.

That fighting corruption is a highly context-dependent and complex task was anticipated, which is why a multi-level theoretical approach has been applied to explore its causes and potential mitigating factors at individual, organisational and societal analytical levels. From a Rational Choice/PA theoretical perspective, different aspects of administrative corruption costs have been analysed to see whether it is at all 'worth' avoiding for SMEs or whether the benefits of engaging in this type of corruption simply exceed the costs. The financial costs of administrative corruption were very difficult to measure as facilitation payments will often benefit SMEs in terms of reducing bureaucratic constraints and save valuable time during daily business operations. However, the accumulated sum of such payments can also constitute a substantial part of the overall budget, and a SME can thereby in many circumstances benefit financially from avoiding such payments altogether in the long run. Alternative costs related to reputational effects and the possibility of legal consequences have also been explored and can potentially bring very negative outcomes in terms of lost business opportunities and legal sanctions. From this perspective, it makes sense to avoid involvement in corruption for internationalising SMEs which intend to prosper in developing markets - especially due to recent years' increasing strengthening of legislative enforcement in western countries which for example implies that any company can be tried in their home country for corruption committed abroad, and due the fact that a growing number of multinationals require from their suppliers to have a 'clean slate'.

While the above findings generally support a business case for SMEs to avoid corruption as it will help them build competitive advantages, they do not answer my research question; namely to what extend it is possible for SMEs to avoid corruption. I have therefore investigated what SMEs can do themselves to prevent anomie-driving factors from arising at the organisational level. An essential factor for avoiding corruption is to have an integrity system embedded into the corporate culture

and daily practical routines; i.e. to train employees in the company code of conduct, to be strategically prepared to deal with corruption by carrying out comprehensive risk analyses, and that top management is deeply committed to eliminating all kinds of corrupt practices. However, while a committed strategy may be the best way to avoid corruption in many situations, my review of surveys and practical experiences of SMEs has shown that an integrity system is not a magical safeguard against involvement in administrative corruption. As indicated in the theoretical section of this thesis, there are causes to corruption which are beyond companies' control and influence – especially for SMEs due to various resource constraints – and whether they are able to avoid corruption depends very much on the nature and level of corruption in developing markets.

While, it may be possible for SMEs to learn to curb their involvement in administrative corruption at the individual and organisational level through control systems, purposeful incentives and committed management, my reviews and analysis of the societal context have shown that corruption simply cannot be avoided in all business environments. As outlined in the business case, there are plenty of incentives for SMEs to actively work to reduce their involvement in corruption, but it must be concluded that avoiding corruption in societies where corruption is systemic cannot be done alone by the private sector. It therefore makes no sense to focus exclusively on the moral standards of business entrepreneurs when seeking to reduce the level of corruption in business transactions as it requires equal levels of political commitment and reform. It is very difficult to circumvent systemic levels of corruption in countries plagued by market failures and a lack of political will, but the political argument for reducing the level of administrative corruption should be clear; because SMEs are found to represent up to 99% of all businesses worldwide, they are thereby of large economic importance in both developed and developing market. Seeking to reduce the impact of administrative corruption on SMEs is therefore of huge importance as it would improve their competitiveness and possibilities for growth and development, which will thereby positively affect overall economic growth.

10.1. Suggestions for Further Research

The primary intention of this thesis has been to find a way for studying SME vulnerability to administrative corruption and their options and a subsequent business case for avoiding it. In order to do so, I have proposed a multi-level analytical approach for studying (1) costs and risks of engaging in administrative corruption, (2) anti-corruption strategies to be used by SMEs, and (3) the impact of the external business environment. This analytical approach has enabled me to investigate, sketch and organise this relatively complex and unexplored research area and to provide some generalising conclusions to how SMEs are affected by administrative corruption, what they can do to mitigate its negative effects, and why it is important to also study the external business climate. On the basis of my general findings, however, it would be highly appropriate to carry out case studies to provide more in-depth and context-specific answers and solutions to how administrative corruption works, how SMEs are affected by it and what their options are to avoid it. For example, studying a group of SMEs from the same country, same industry and which are doing business in the same developing country, would allow more in-depth explorations of how administrative corruption works in practice in specific developing market and industry contexts and how it affects SMEs differently. Moreover, it would serve as comprehensive approach for studying which anti-corruption strategies that works best in specific situations. I hope that this thesis can serve as a comprehensive point of departure for future context-specific case studies about SMEs and administrative corruption.

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