

Impact of corruption on fdi



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Corruption is a major problem in many of the world's developing economies today. World Bank studies put bribery at over \$1 trillion per year accounting for up to 12% of the GDP of nations such as Nigeria, Kenya and Venezuela. Though largely ignored for many years, interest in world wide corruption has been rekindled by recent corporate scandals in the US and Europe.

Corruption in the developing nations is said to result from a number of factors. Mass poverty has been cited as a facilitating condition for corruption just as an inability to manage a sudden upsurge in mineral revenues has been credited with breeding corruption and adventurous government procurement among public officials in countries like Nigeria and Venezuela.

Corruption has played a major role in business environment as it believed that higher level of corruption may result to numbers of business failure particularly in a developing country and this might lead to many multinational companies pulling away from such environment. Most of the time such corrupt can harm business shareholders interest, managers, as decision makers, in corruption related situations may fail to understand the impact of their decisions in such situation for they operate from a position dependent objectively (Sen, 2002) focusing on economic objective usually. They fail to understand that their involvement in corrupt acts can lead to violation of fundamental stakeholder issues such as human rights as in the cases of Shell.

Distinctive forms of corruption and bribery are identified and the political dimensions of 'corruption' are duly noted. The prevalence of corruption throughout the world is then indicated, together with the shortcomings of some current institutional responses. Some evidence regarding MNC

managers experiences with corruption and bribery is then set out, together with several evidence based approaches and techniques for reducing corruption. These include the analysis of consequences by individual decision makers, principle based reasoning at the managerial level and balanced changes at the political level.

This research examines the impact of corruption on foreign direct investment (FDI). First, the level of corruption in the host country will be analysed. Second, the absolute difference in the corruption level between the host and the home country is examined.

CHAPTER ONE

INTRODUCTION

1. 1 Background

Corruption is a complex and multifaceted phenomenon, which characterize the global economy. According to a World Bank study of 2002, the world spends some \$1 trillion on bribes each year. These bribes are worth a full 3% of the GDP of nations of the world. For countries like Nigeria and Kenya, bribes account for between 8 and 12% of the GDP (Clay, 2004).

Corruption can be defined as the abuse of power for private gain. Corruption is attracting a lot of attention around the world, and is a growing international and regional concern. Corruption came second on a list of the biggest problems facing the world, the survey of BBC viewers worldwide found. Conflicts – war and terrorism – ranked third, with 50%, followed by hunger, 49%, and climate change with 44% (World Bank, 2004). The

question now is why is there so much attention on corruption these days? Did people ignore corruption in the past? Or is it because there is more corruption now than in the past? Some of the main reasons could be:

- As countries trade more with each other, fair trade is expected and unfair business or political practices are being paid more attention.
- The media is reporting much more about corruption cases, especially in emerging market countries such as China and India.

However, corruption has been around for long time. From old Greece to modern Japan, it is hard to find a generation in human history where corruption does not exist. Especially now at the time of intense globalisation, where multinational companies have much greater opportunities to trade and invest than ever before. Countries are becoming more and more interdependent to one another, while communication and information transmit quicker. It is one of the major concern nowadays about the means of monitoring and regulating the way international companies conducting their businesses. However for multinational corporations operating in emerging market will act to make the moral of the business that will contribute to the country's economic growth and raise business levels in a long run, as well as increasing the employment and economic or alternatively sometimes companies tends to opt for short term plan to only maximise their profit but the result might not be welcoming, such companies much find themselves at the center of government investigation even by certain international organisations as a result of practising some of the unethical business and corruption could be the most common one.

In regards to the business environment chosen, Nigeria is one of the most corrupt countries in the world. The constant dictatorial regimes, political instability, large amount of poverty, economic instability and disregard of human rights have all significantly contributed to cast Nigeria in a bad light internationally. All these also have undermined the economic growth of the country and of any potential development. In addition, Nigerian educational system once regarded as the best among the sub-Saharan Africa, but this is in deep crisis as well as the Public health services are inadequate, also there is large unemployment which subsequently lead to crime in the country.

Despite the country wealthy oil production or Despite it been one of the largest producer of oil in the world, this has not reflect on the development of the Nigeria particularly on infrastructure and this is largely due to bad management within the political system. In fact as oil been a blessing, it also has been a curse on the nation. The blessing provide the country with easy access to international capital markets. It also allowed Nigeria to embark on large scale of private and public sectors projects. This (Oil) has also lead to rent seeking activities and corruption in both private and public sectors of the economy. The oil also lead to political unrest and change Nigeria politics which lead to ethnic rivalry as manipulation of the government spending process has become the gateway to fortune.

In general, this thesis will be focusing on how multinational corporation survive or cope with all these barriers in Nigeria to become successful in business operation, because despite all the issues and problem Nigeria still posses booming or fast moving economy in Africa and Foreign Investors tends to look in establishing their subsidiaries to maximuxim profit as well as

gaining the hegemony over their main competitors. The next paragraph will be concentrating on the objectives of these study.

1. 2 Objectives of study

The major objective of this research is to analyse how multinational corporation establish in some of the most corrupt countries in the world, their strategies to been successful and methods used. Also analysing various case studies of multinational companies in Nigeria, the impact corruption has on each companies and how each organisation has cope with the issues of corruption in the country to succeed in the business environment. Some more specific objectives are:

- Identify methods used by each companies to tackle corruption
- Study companies in different corporate environments
- Compare the companies strategies from one another
- Identify Key performance measures
- Examines the countinous efforts to improve within these companies

In addition, This study is conducted to address the following research questions:

Research Question one: The analysis and corruption of organisations in various corporate environments.

Research Question two: Experience of managers within multinational organisations.

Research Question Three: Impact of corruption on the image of Nigeria in the international business world.

Research Question Four: The solutions implemented to tackle these cases of corruption.

Research Question Five: Identify various forms of corruption within the business environment.

1. 3 Scope of study

The scope of the project is to compare various corruptions that have affected companies using both qualitative and quantitative approaches. The focus is limited to companies from different manufacturing sectors in Nigeria such as airline companies (British Airways and Virgin Atlantic) and energy and petrochemicals company (KBR and Shell). In addition, the focal point process in this research is how corruption impacts these companies in their performances.

1. 4 Methodology

This study aims to finding the effect of corruption on multinational corporations within Nigeria business environment and the way which large corporation dealt with the problem to been successful. The nature of this research required a methodology that could be flexible to allow open questions to collect information since the organizations under study have many different settings.

The methodology suitable and will be using for this project is the case study approach, which allows a model to build up that, illustrates relationships and patterns of interaction between variables. The data used in this research are mainly collected through different sources of evidence organisations written

procedures, websites, and Journal articles, books and various companies' records, this will enable the researcher to be able to analyse the impact of corruption on multinational organisation in developing countries.

This research is based on a research hypothesis and data is obtained from secondary sources to test the validity of this hypothesis in context of case study approach selected for this research. The main reason for choosing secondary sources of data collection is because it will quiet easier for the researcher to collect data from this research area and also because the primary sources have limited resources due to the fact that primary source have been left un-research in the past and the research area is quite sensitive for both organisation and government.

1. 5 Structure of Report

This research is organised in the in following order. The first chapter covered background of the subject; objectives of the study, scope of the study and methodology are presented. The following chapter, chapter two discuss the Literature review, where explanation on the meaning of corruption, type of corruptions such as (bribery and lobbying, Favouritism and Nepotism, Marketing commission and facilitating payments), History of corruption on FDI, causes and effect of corruption, and factors that influence corruption will also be analyse in length, also corruption and bribery within international business. Chapter three, includes the introduction on the methodology, research framework, case study approach overview which include four multinational firms that have operate in Nigeria, also case study settings, case study methodology and closing this chapter with conclusion on the

methodology. Chapter four contains all four companies involved in this study including their particular sourcing strategy, their various ways of dealing with corruption issues and evaluation criteria, comparison with ISO standards and discussion of the outcomes. The last chapter of this report, chapter five presents the conclusions, Research contribution, components of an Anti-corruption strategy and the overall future work of this research.

CHAPTER TWO

LITERATURE REVIEW

2.0 Background Review: Corruption

Corruptions in any shape of form and manner have been widely accepted as universal phenomena by different writers, read (Johnston, 1982; Klitgaard, 1988, Theobald, 1990). Majority of writers have studied the causes of corruption, its likely impact and its occurrence as a part of political structures as well as the public official's role in corruption, read (Klitgaard, 1988; Theobald, 1990; Mauro, 1995; Johnston, 1997; Harris, 2003). Corruption has also been seen and viewed as a matter of "embedded local cultures" and as a result of "political structures and institutions" (Heywood, 1997).

Although the literature on corruption dates back many decades ago, the specific topic of how to measure corruption, anti-corruption performance, and good governance began to come into focus in the late-1970s through the work of some of the modern day pillars in the field, including Robert Klitgaard (1988), Michael Johnston (1982). Much of early work began to provide a definitional and conceptual clarity of the phenomenon of

corruption by applying a political-economy analysis to the problem.

Corruption was viewed as fundamentally rational rent-seeking behaviour more likely to occur where transparency and oversight were low; discretion was high, and accountability mechanisms weak. That framework not only made intuitive sense but could helpfully be applied to a variety of sectors, countries and cultures. It largely remains the foundation of much of the ongoing analytic and programmatic work in the anti-corruption community today.

In certain situations corruption has been seen as a positive occurrence. Altman (1989) considered corruption and black market in the erstwhile Soviet Union as a “ market correction mechanism”, correcting the Soviet government’s price and distribution control policies. Kiltgaard (1988) finds corruption useful in some organizational situations to cut down bureaucracy and save time. However, authors such Scott (1972), Klitgaard (1988) and Theobald (1990) have extensively argued against corruption asserting that the negative side of corruption far outweighs its perceived contextual benefits.

Corruption has also been considered as a matter of culture tracing its origins to paying homage to the tribal chief or paying obeisance to a monarch (Wraith & Simpkins, 1963) but this argument is considered outdated by the stakeholder community and in particular in the anti-corruption efforts of Transparency International and the United Nations.

In recent times, scholars have studied the impact of corruption on society (eg: Alatas, 1990). Empirical studies, such as Mauro (1995) linked the corrupt

institutions with the perpetuation of inefficiency. Mauro (1997) provide tentative evidence about the economic effects (i. e. lowers growth and investment) of corruption. Mauro (1998) provided the first cross-country (across sovereign nations) empirical evidence that corruption affects the composition of government expenditure and adversely impacts government expenditure on education. Perry (1997) views corruption as a part of human activity in the geographical context and has discussed the causes, proximate, characteristics and functions of political corruption. Harris (2003) in his study of political corruption has distinguished between nations of low corruption and high corruption.

Elliot (1997) mentions three different actors in the arena of corruption, namely: elected officials and politicians, non-elected officials (identified as judiciary and the bureaucracy) and private actors (which includes business). Elliot (1997) also distinguishes between “ grand corruption” and “ petty corruption”. She describes ‘ grand corruption’ as corruption occurring at the highest levels of government involving decisions such as “ procurement of military equipment, or broad policy decisions about the allocation of credit or industrial subsidies” (Elliot, 1997: 178). While “ petty corruption” according to Elliot, occurs when private actors interact with non-elected government officials for transactions such as taxes, regulations, licensing requirements and the discretionary allocation of government benefits. In countries such as United Kingdom, Italy, Spain and Japan, allegations of corruption play more prominent role in politics nowadays than in recent memory. Corruption is hardly an obstacle to developing nations or countries in transition. The fact

or reminder is that corruption exists everywhere both in the private as well as the public sector.

The literature on corruption in developing countries generally suggests five strands of hypotheses as explanations for the causes of corruption, namely, rent-seeking, cultural relativity, low salary, imitation and institutional or political centralization.

Becker and Maher (1986) argue that corruption could be used as a useful practice for competitive bidding for the allocation of licenses to organisation who offer the highest bribes. Others contended that corruption could facilitate efficient allocation of resources because it was a cheap way to share wealth amongst politicians and agents in the private sector (Shleifer and Vishny, 1993), thus allowing the private sector to buy their way out of some of the inefficiencies that would have otherwise been introduced by politicians. On the contrary, others such as Klitgaard (1988), Mauro (1995), Knack and Keefer (1996), Kallon (2003), and the various studies by IMF, TI, World Bank, and UNDP show negative impacts of corruption on investment, growth of the economy and the political process.

Nigeria is not significantly dissimilar to many developing countries. However, this research focuses on Nigeria for the following many reasons. Although most of the studies on corruption focus on developing countries, there is lack of or limited studies on corruptive practices and its debilitating impact on Nigeria. Nigerian is the most populous country in Africa, with an estimated population of 144. 7 million in 2006. The economy is heavily dependent on petroleum, which sustains corruption activities (US Senate Kerry Report,

1993). According to TI Report (2005), corruption accounts for about 20 percent of its Gross Domestic Product. It has been acknowledged in large part that corruption is Nigeria's worst Dilemma, which is responsible for its woes, such as the instability in the Niger Delta, the debt overhang, barrier to democratic elections, and impediment to flow of foreign direct investment (Ribadu, 2007). Corruption was partly responsible for the collapse of the first and second republics. These interesting facts make the choice and significance of Nigeria especially as it is one of the few countries in Africa that has taken a bold step to set up the agency to investigate and prosecute perpetrators of corruption activities.

Over the years various administrations in Nigeria have articulated policies and measures designed to combat corruption. Examples include General Murtala Mohammed crusade of confiscation of assets illegally acquired by Nigerians; Shehu Shagari's ethical revolution to combat corruption through the introduction of code of conduct for public servants, Late General Buhari's operation war against indiscipline, General Ibrahim Babaginda's ethical and social mobilization crusade and so on. These efforts have been largely cosmetic attempts to address a systemic problem that is deep rooted in the fabric of the country.

In addition, more recently in the effort to fight corruption and create credibility to attract international investments, during the tenure of most recent president Major Olusegun Obasanjo government among other things established the Economic and Financial Crimes Commission (EFCC) Act 2002. The EFCC is charged with wide-ranging responsibilities within the context of

preventing, detecting, investigating, and prosecuting all cases of economic and financial crimes in Nigeria.

2. 1 Meaning of corruption

Corruption is a term of many meanings, and indeed the beginning of wisdom on the issue is to subdivide and unpack the vast concept. At the broadest level, corruption is the misuse of office for unofficial ends. The catalogue of corrupt acts includes bribery, extortion, nepotism, fraud, speed money, embezzlement, and more. Although we tend to think of corruption as a sin of government, of course it also exists in the private sector. Indeed, the private sector is involved in most government corruption. In a broader sense, corruption can be explain as the arrangement that involves an exchange between two parties which has an influence on the allocation of resources either immediately or in the future; and involves the use or abuse of public or collective responsibility for private ends (Macrae, 1982, p. 678).

Alatas (1990) categorises corruption into seven distinct types: transactive, extortive, investive, defensive, nepotistic, autogenic and supportive and provides a context specific insight into corruption in public office.

Huntington (1968) defines corruption as, “ behaviour of public officials, which deviates from accepted norms in order to serve private ends.” Huntington highlights the private nature of gain made through a corrupt transaction by public officials, Huntington (1968).

Corruption, whether given a narrower or a broader definition, is not of course peculiar to developing countries, empirical, evidence shown that some

developing countries have a better record, in this respect, than developed countries (Mauro 1995). Substantially, the development of appropriate regulatory structures features prominently, alongside promotion of the rule of law and the constraint of corruption, in the agenda for developing countries articulated by the World Bank and other financial sponsors. And Western models of regulatory arrangements are often preferred as ideals which developing countries are advised to follow. The next phase will be discussing the various corruptions that exist within the business.

Types of corruption:

Corruption is not just the clearly bad cases of government officials skimming off money for their own benefit. It includes cases where the systems do not work well, and ordinary people are left in a bind, needing to give a bribe for the things they needed or that needs to be done. All the above are examples or types of corruption either in public or private, public corruption involves the misuse of public office for personal satisfaction in the case of government official benefiting at the expense of an ordinary or average citizen or tax payer while private corruption is normally a process between an individual and private sector, in such a way that middleman or mafia will be collecting money from local business (The World Bank, 2005).

Furthermore, there are many types of corruption within International business and many corruptions that effect business and organisations around the world. According to Michael Johnston, an expert on the subject of corruption, the types and amounts of corruption vary in accordance with a

number of factors affecting the relationship between government and civil society (Johnston, 1982). In this research,

few aspect of types of corruptions will be covered and extensively discuss some of the corruption that exist in the world business today, amongst types of corruptions discuss in this research are Bribery and Lobbying, Favouritism and Nepotism, Marketing commission and Facilitating payments.. All these corruption listed above are the major obstacle for large organisation in operating successfully in developing countries. Each one of the types of corruption will be discuss further below.

2. 2. 1 Bribery and lobbying

Bribery can be classified as to when individual or an organisation offers money to influence a public official i. e. government representative, police and so on. Also lobbying involves creation of favourable public opinion or legislative direction to serve group interest or individual interest of the lobbyists. It is achieved unnoticed, usually to the detriment of public interest or common good. A bribe can also be termed as a gift or donation with a view to extract a corrupt act. Multinationals get around bribery legislation by donating money to a trust that the bribe-taker nominates as in case of Lockheed and Prince Bernhard of Holland where Lockheed made donations to the Prince's wildlife trusts in exchange for aircraft orders (Jacoby, 1977).

Often, corrupt top public servants use the willing accomplices of multinationals corporations to deprive their national economies of huge sums of money. For instances, Adax Petroleum Company is alleged to have conspired with top government officials to defraud the Nigerian government

sums of \$1 billion during the period 1996 and 2002 in crude oil exploration and also KBR, the company was fined a sum of \$579 million for bribing Nigerian government officials in order to secure construction contracts. The bribery scheme included a sum of \$180 million which was managed by the former CEO and Chairman of KBR Albert Stanley (FRONTLINE/World 2009).

Similarly corrupt practices occur when multinationals bribe public officials in order to win government contracts and patronage. Kellogg, Brown and Root, a subsidiary of Halliburton is now being investigated in both Nigeria and the United State over allegations that the company paid out \$200 million in bribes to win a contract for the construction of a Liquefied Gas Plant in Nigeria (Agande, 2004).

In the context of business and its interaction with the government (public officials) corruption occurs and bribes are paid or given by a corporate executive. According to Noonan (1984, “ in a modern society corporate bribers may be more powerful than the officials they bribe” and the “ bribe-takers are among the power holders in society that is why they are bribed.” The bribe given by a corporate manager to a public official is to achieve a favourable disposition and line of communication with the public official who has dispensing powers and whose dispensation is sought by the corporate. As Noonan clarifies, “ The bribe is intended to reflect or create an overriding obligation (Noonan, 1984).

For international organisations that are aiming to operate in developing countries, they may pay bribes and deal with official extortion. Many multinationals may gain an advantage of business because of the bribes

they offer. However, According to Shang Jin Wei research in corruption and globalisation (2001), while such organisations obtain profits from bribery, the country loses and for every dollar the company gain from its business, the country suffer hundreds of dollars in potential foreign investment. Therefore the perception would be organisation are less likely to invest when a country is been considered corrupt (Shang Jin Wei, 2001).

2. 2. 2 Favouritism and Nepotism

Favouritism is another form of corruption that exists within the international business both from government representative towards multinationals companies. Favouritism can result from how successful is the lobbying activity by an individual or certain group of people. There is wider believe that favouritism occur when people in power make decision to favour one particular group or certain interests individual. Nepotism is a form of favouritism. Abueva (1966: 534) defines nepotism as arising from “ kinship claims” in certain cultures and is expanded to include “ non-kin on the basis of other personal or partisan considerations” (Abueva, 1966). More so, Nye describes nepotism as and quote “ bestowal of patronage by reason of inscriptive relationship rather than merit” (Nye, 1967).

Examples of nepotism is a situation when political parties award a post to a particular person without given other candidate or people chance to compete for the post.

In addition, taking the case of Nigeria political system, nepotism and favouritism are two form of corruption that exists within Nigeria political system which subsequently results in conflicts, unrest and political

instability. Therefore, as a result of these unrest and bias approach by the government, this subsequently will have impact and prevent foreign companies from operating in the country which will as a result affect the economy development of the nations. The impact of political instability is nevertheless unbearable because it leads to denial of human rights, abuse, and insecurity.

2. 2. 3 Marketing commission and facilitating payments

These types of corruption critically important and any activities perform with this methods of corruption have direct impact on the economy of a nations and can slow down growth which will result in poverty. Marketing commissions have been used in the past as a sophisticated version of bribery where such commissions are paid to either the direct beneficiaries or towards middlemen. These payment are not account for and not declared in public documentation, this are payment made in cash or in form of providing free goods services. Examples, Lockheed Corporation made such transaction from a market contingency fund as Lockheed described it. Lockheed used its “ market contingency fund” to pay Saudi Arabian Middlemen in order to win the deal to supply planes to Saudi Arabia (Sampson, 1977). All the contract Lockheed win or gained, three different contracts were discovered for the same transaction in course of investigations and obviously none of the three were in public documents (Noonan, 1984).

Facilitating payments is very much exists in business environment of Nigeria, where Multinational corporations face situations when they have to pay bribe or suffer business losses as a consequence. In a country such as Nigeria

where political corruption is rampant at different levels, it becomes part of multinationals business agenda to plan or put into consideration of what to bribe the public officials, if not their business could suffer.

Furthermore, Bhagwati argues that is called rent seeking, a situation where payment has to be made to public official who can interpret law, rules and regulations in a way that will benefit multinational businesses to grow or else suffer time delays and loss (Bhagwati, 1982). More so, below are more aspect of corruption that has affected and still in existences within Nigeria Business. The next phase of this research will be discussing about history of corruption on foreign direct investment within the country (Nigeria).

2. 3 Impact of corruption on FDI and development in Nigeria

Foreign Direct Investment (FDI) is growing faster than world Gross Domestic Product (GDP) and world trade, thus showing the rising importance of Foreign Direct Investment (FDI). The rising important of foreign direct investment can not be underestimated and for the better development, many country developing countries including Nigeria need FDI to invest within the country to boost the revenue and reduce poverty. Despite the significant level of corruption, Nigeria still attract posses huge interest to the multinationals around the world largely because Nigeria has huge deposit of human, natural and material resources. However, Nigeria has failed to achieve any significant development and rapid economic growth due to several factors, the most of which is an unstable political environment which was once long rule by military ruler. Under the military regime, Nigeria witnessed a decline in foreign investments as a result of various economic

sanctions imposed on the country by the international community (United Nations, 1991).

On the other hand, the country independence in 1960 was the catalyst to a lot of changes