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When MNEs Bribe More? The Role of Managerial Discretion

Abstract

Purpose - This paper builds upon managerial discretion literature to study the relationship between foreign ownership and bribery intensity.

Design/methodology/approach – Building on World Bank’s data of 9,386 firms from 125 countries over the period 2006–2018, this paper uses Tobit regression, ordered probit and logit models to empirically test the hypotheses.

Findings – This paper finds that firms have higher bribery intensity when executives have a higher level of managerial discretion. Smaller firms with slack financial resources tend to bribe more when they face more government intervention, munificent and uncertain industrial environment.

Originality - Extant corruption literature has addressed the effects of external institutional settings and internal corporate governance on bribery offering among MNEs. How much, and under what condition do top executives matter in bribery activities are yet to be answered. This paper integrates the concept of managerial discretion with corruption and bribery literature and offer a potential answer to the above question. In addition, prior corruption and bribery literature have primarily studied bribery through either micro- or macro-level analysis. This paper adopts multiple-level of analyses and elucidates the foreign ownership and bribery relationship from the organizational and industrial levels.

Keywords: Bribery, Managerial Discretion, Multinational Enterprises, Foreign Subsidiaries, Market Uncertainty

1. Introduction

Bribery, as a pervasive element of corruption, has gained increasing research attention following the expansion of multinational enterprises (MNEs) among emerging economies (Birhanu *et al.*, 2016; Cuervo-Cazurra and Genc, 2008; Eddleston *et al.*, 2020; Keig *et al.*, 2015; Kim, 2019; Lu *et al.*, 2023; Sampath and Rahman, 2019; Spencer and Gomez, 2011). Bribery refers to the illegal payment paid to public agents to obtain private benefits for an individual or a firm (Cuervo-Cazurra, 2016). In the corruption literature, there is an ongoing debate about the question: *under what conditions MNEs bribe more?* (Bahoo *et al.*, 2020; Martin *et al.*, 2007; Rabbiosi and Santangelo, 2019).

One stream of prior research has attributed bribery intensity to emerging economies' environment and culture, such as bureaucratic red tape (Frei and Muethel, 2017), malfunctioning formal institutions (Malesky *et al.*, 2015), culture dimensions (Baughn *et al.*, 2010; Jiang *et al.*, 2021). Some other researchers have provided insights into multinational firms and suggested that weak corporate governance acts as the antecedent of bribery (McKinney and Moore, 2008; Rabl, 2011; Ramdani and van Witteloostuijn, 2012).

Though important contributions, both streams of literature have not offered an explicit answer to the abovementioned question. Institutional and cultural norms reflect the external conditions under which bribes can be demanded or offered with more or less impunity (Cuervo-Cazurra, 2006). The corporate governance aspect views bribery as the result of conflicting goals among different groups of stakeholders (Chen *et al.*, 2015; Yi *et al.*, 2018) and suggests meticulous governance practices are essential to detecting and preventing bribery (Wu, 2009).

Extant corruption studies have examined the influence of institutions, social norms, corporate governance, and other inertial forces on firm-level bribery activities. A firm's

involvement in bribery is fundamentally determined by individual managers. Managers, through their choices, have a great role in affecting firms' actions and outcomes (Finkelstein *et al.*, 2009; Haj Youssef and Teng, 2019; Li and Tang, 2010; Wang *et al.*, 2019), including bribery (Collins *et al.*, 2009). Researchers have asserted that organisation's outcomes should be understood by specifying the input of individual managers (Barney and Felin, 2013; Haj Youssef *et al.*, 2020). This paper therefore invokes the concept of managerial discretion and examines when top managers of foreign subsidiaries have considerable leeway to substantially influence MNEs' engagement in bribery in the host countries.

This study makes two important contributions. First, we employ the concept of managerial discretion and add a new theoretical fulcrum for corruption and bribery research. Extant corruption literature has addressed the effects of external institutional settings and internal corporate governance on bribery offering among MNEs (Oh and Ryu, 2019). However, bribery activities are tacitly consented to or even conducted by the managers of the focal firm (Jiang and Min, 2023). Strategy and management literature assert that executives do matter and can significantly shape the outcomes of the firms (Mackey, 2008; Crossland and Hambrick, 2011; Wernicke *et al.*, 2022). How much, and under what condition do top executives matter in bribery activities are yet to be answered. This paper integrates the concept of managerial discretion with corruption and bribery literature and offers a potential answer to the above question.

Second, this paper adopts multiple-level of analyses and elucidates the foreign ownership and bribery relationship from the organizational and industrial levels. Prior corruption and bribery literature has primarily studied bribery through either micro- or macro-level analysis (Wu, 2009). Corruption levels and bribery intensity vary widely across MNEs and countries. Multiple-level

analyses of the firm, as well as the industrial environment of host countries, provide a systematic and comprehensive understanding of this phenomenon.

The remainder of the paper is organized as follows. Section 2 synthesizes the literature and proposes relevant hypotheses. Section 3 discusses the empirical method, data, variables and sample. Section 4 presents the empirical results and Section 5 provides the conclusion and policy implication.

2. Theoretical background and hypothesis development

Many emerging economies are perceived as among the most corrupted countries in the world, which poses huge challenges for MNEs to understand and adapt to emerging economies' contextual environment. Emerging economies generally are characterized by active government involvement, less established anti-corruption laws, and uncertain market environment (Meyer and Peng, 2016). Under the risky and uncertain environment in emerging economies, MNEs tend to establish informal relationships with local actors (Dorobantu *et al.*, 2017) and use those relations to access resources and avert investment risks (Jiang *et al.*, 2021). Bribery often serves as the tool for establishing informal relationship in emerging economies where the firm engages in various forms of payments to public officials to “get things done” with regard to governmental or public services, such as customs, taxes, licenses, regulations, and services (Chen *et al.*, 2008; Luo and Han, 2009; Yi *et al.*, 2018).

2.1. Foreign ownership and bribery intensity: Resource endowment vs. agency perspectives

Prevailing works have proposed the relationship between foreign ownership associated with MNEs and bribery intensity by either emphasizing the resource endowment aspect of foreign ownership

(Luo and Han, 2009) or the agency relationship between the headquarter of the MNE and foreign subsidiaries (Yi *et al.*, 2018). The resource endowment aspect invokes resource dependence theory to explain the relationship between foreign ownership and bribery intensity. Resource dependence theory asserts the impact of external resources on organizational outcomes and stresses that an organization can hardly generate all the necessary resources internally (Pfeffer and Salancik, 1978). Central to this theory is the power imbalance and unequal control over resources, which in turn constrain organizational behavior under a network of interdependencies within the environment (Hillman *et al.*, 2009).

The resource endowment aspect offers an externally focused perspective of bribery and implies that the crux of corruption among emerging economies is an MNE's dependence on necessary resources in the host markets. The important role that bribery plays is a mechanism for co-opting important external actors, especially government officials, to complement MNEs' resource dependencies towards the host markets. In other words, the resource endowment aspect proposes that the dependency on the host country's resources and other supports contribute to MNEs' bribery intensity.

From this perspective, researchers have argued that foreign ownership and MNEs' investment can reduce bribery offering, and to some extent, cure corruption. Luo and Han (2009) argue that MNEs often possess superior technological capabilities, managerial skills, and operational resources. These valuable resources *per se* are sufficient to enhance firms' power. Therefore, firms equipped with stronger resources through foreign ownership will have a reduced tendency to engage in bribery. Furthermore, Kwok and Tadesse (2006) suggest that subsidiaries of MNEs exert regulatory pressure, demonstration effect, and professionalization effect on the host

country, which educates emerging economies to modify their traditional business practices and hence reduces the level of corruption.

The resource endowment aspect of bribery is, however, challenged by the concept of liability of foreignness (Kim, 2019). The liability of foreignness stems from the spatial distance and psychic distance between the home and host countries (Johanson and Vahlne, 2009). The psychic distance, including cultural and institutional differences, implies a cost increase resulting from a need to adapt to the local context. Though MNEs are well equipped with technological and management know-how and other resources, international expansion inevitably encounters local variations in the globalization process. Bribery may act as a mechanism for MNEs to gain legitimacy with a new set of stakeholders, such as distributors, clients, and local governments to accelerate the adoption process.

Agency theorists, on the other hand, stress the agency relationship between MNEs' headquarters in the home country and foreign subsidiaries in the host country (Kostova *et al.*, 2016; Nohria and Ghoshal, 1994). Agency theory views foreign subsidiaries as agents of MNEs' headquarter and suggests that headquarters act as the principals and mandate decision-making authority to foreign subsidiaries (Filatotchev and Wright, 2011). Such a mandate is essential of an agency nature because the desires and motivations of both parties often conflict resulting in foreign subsidiaries not always behaving in the best interest of the headquarters (Hoenen and Kostova, 2015). Headquarters and subsidiaries are disaggregated entities (Steinberg and Kunisch, 2016). Although headquarters have a dominant influence on a subsidiary's operations and its strategy within the MNE's global production network (Filatotchev and Wright, 2011), the subsidiary may fight for operation autonomy as the parental objectives and decisions are suboptimal in local contexts (Kostova *et al.*, 2016). Furthermore, it may be particularly difficult to motivate top

managers of foreign subsidiaries in different countries to diligently embrace corporate goals and pursue the interests of the MNEs as a whole (Roth and O'Donnell, 1996). The inherent organizational complexity and geographic dispersion of the MNEs' activities exacerbate the monitoring costs (Buckley and Strange, 2011). In other words, MNEs' headquarters are unable to fully observe whether the subsidiary properly exercises the delegated authority due to the spatial distance and cultural variations (Meyer *et al.*, 2020).

From an agency theory perspective, bribery thus can be attributed to the conflicting interests and problem of monitoring between the headquarters and foreign subsidiaries (Cuervo-Cazurra, 2016). Managers of foreign subsidiaries are normally evaluated based on short-term firm performance and are likely to be replaced if they do not produce a satisfactory delivery (Chen *et al.*, 2015). Thus, it may be expected that the management can hardly behave altruistically and will favor the perceived interests of their national subsidiary in a short period of time (Filatotchev and Wright, 2011). Engaging in bribery can help the foreign subsidiaries to accelerate network building, gain competing financial capital, obtain appropriate policy information, and avoid cumbersome bureaucracy (Cuervo-Cazurra, 2006), which, in turn, enhances performance and reduces managers' employment risk (Jeong and Wiener, 2012).

Based on the above discussion, we argue that bribery offering is likely to be conducted by self-interested foreign subsidiaries who tend to serve their own objectives at the expense of MNEs' headquarters reputation and long-term performance. Therefore, we adopt the agency aspect and offer the following hypotheses:

Hypothesis 1 (H1): There is a positive relationship between foreign ownership and bribery intensity.

2.2. *The moderating role of managerial discretion*

If foreign ownership influences bribery intensity, then under what conditions would MNEs bribe more? Previous research has drawn on institutional theory (North, 1990) and studied the possible moderating roles of the culture and formal institutional factors on bribery offering (e.g., Haj Youssef and Christodoulou, 2018; Haj Youssef et al., 2019; Spencer and Gomez, 2011). MNEs' engagement in bribery and grafting in emerging economies is also likely to be shaped by the managers and their "freedom of action". The plurality of prior work asserts top executives have significant impacts on the decisions of the organizations they lead (Hambrick and Quigley, 2014; Haj Youssef and Christodoulou, 2017; Hewett and Leroy, 2019; Mackey, 2008; Wernicke *et al.*, 2022). Previous research has, however, offered little theoretical guidance or empirical evidence to investigate the effects of managerial action on bribery (Collins *et al.*, 2009). Therefore, it is important to consider the role of managerial influence and establish the boundary conditions from inside of the MNEs.

Managerial discretion refers to the latitude in executives' decision-making and was introduced to explain the effects that top executives can have on organizational outcomes (Hambrick and Finkelstein, 1987). Managers in low discretion conditions are bounded by heavier constraints, with a narrow array of strategic actions to choose from and as such are less likely to have a significant influence on their organizational outcomes. Whereas, in high discretionary contexts, executives enjoy greater leeway in decision-making and can choose from a wider array of strategic choices, which will ultimately be reflected in organizational outcomes.

Managerial discretion exists under the condition that executives' decision-making is less restricted and an array of alternatives are available from which executives can choose (Wangrow *et al.*, 2015). Furthermore, discretion exists to the extent that the principals lack live information

and power to justify and block the potential action that would contravene key stakeholders' expectations and ethics (Crossland and Hambrick, 2011). Therefore, managerial discretion can be viewed as a joint product of principals' open-mindedness and inability to block objectionable actions. Where managerial discretion is low, the role of the top-management team is limited, and environmental and organizational factors become more significant in influencing strategy and performance (Finkelstein and Hambrick, 1990; Gupta *et al.*, 2019). Higher-level managerial discretion reveals that the top management encounters fewer constraints in making decisions regarding the operation of the focal firm, which influences many organizational outcomes, from capital investment, compensation, to financial performance (Caza, 2012).

Extant studies on managerial discretion have examined the various consequences of managerial discretion on executive compensation (e.g., Finkelstein, 2009), organizational strategic change (e.g., Quigley and Hambrick, 2012), and firm performance (e.g., Crossland and Hambrick, 2011). We aim to advance bribery research by adding the role of the discretionary context in shaping bribery activities. Following Li and Tang (2010), the sections below examine the scope of managerial discretion at the industry and organization levels and test how these conditions moderate the relationship between foreign ownership and bribery intensity.

2.2.1. Industrial factors

Market munificence. Market munificence refers to the abundance of tangible resources and production factors available to firms that can support sustained growth (Dess and Beard, 1984; Hoehn-Weiss and Barden, 2014; Wan and Hoskisson, 2003). Market munificence reveals growth potential and availability of opportunities in an industry (Castrogiovanni, 1991; Feng *et al.*, 2017). In a high munificent market, a firm's operating environment is competitive and heterogeneous

because abundant supplies of production factors attract a larger number of competitors to exploit the magnitude of opportunities (Estrin *et al.*, 2018; Hambrick and Finkelstein, 1987). Market munificence amplifies managerial discretion, characterizing markets where managers may face greater freedom to alter resource deployment (Corwin *et al.*, 2022). In environments characterized by low market munificence, managers often face the challenge of accessing scarce resources and thus the array of alternatives is restricted (Wangrow *et al.*, 2015).

We argue that the relationship between foreign ownership and bribery intensity is likely to be strengthened by market munificence. Market munificent characterized by the magnitude of opportunities and intense competitive rivalry in the task environment increase the latitude of action enjoyed by the executives of foreign subsidiaries in the host market. Availabilities of resources and opportunities enrich the array of alternatives from which executives of foreign subsidiaries can choose. In addition, information in a competitive business environment about managerial actions and investment opportunities is costly, incomplete, and asymmetrically distributed between the headquarter and foreign subsidiaries, which makes managerial actions hardly be evaluated in a timely manner and blocked if inappropriate. This in turn will likely lead to higher levels of bribery intensity as a means of seeking additional competitive advantages (Robertson and Watson, 2004). Therefore, we propose that:

Hypothesis 2a (H2a): Market munificence strengthens the relationship between foreign ownership and MNEs' bribery intensity.

Market uncertainty. Market uncertainty refers to an unpredictable and unstable environment (Dess and Beard, 1984) and is recognized as an important component of the industrial factors that drive managerial discretion (Feng *et al.*, 2017; Finkelstein and Boyd, 1998). Uncertainty is created

by changes of industry structure, the instability of market demand and supply, and the probability of regulation changes which are related to the freedom executives have to manage resources portfolio (Sirmon *et al.*, 2007). Stable competition practices, reliable market information, and well-enforced market-supporting institutions remit ambiguity and constrain executives' range of options (Hambrick, 2007; Li and Tang, 2010). While many countries with established market-supporting institutions have laws and legal enforcement regulating competitive practices, other countries with weak institutions create an uncertain and unpredictable environment allowing some enterprises or business groups to yield high market power (Meyer and Peng, 2016).

We argue that the relationship between foreign ownership and bribery intensity is likely to be strengthened under an uncertain market environment. Uncertainty in the industry and unpredictable competitors' actions (both ethical and unethical) complicate the type and amount of resources needed and require sufficient capabilities to outperform rivals (Carpenter and Fredrickson, 2001). Uncertainty in the host market thus produces information deficits for the headquarter to understand the environment, which in turn unleashes the way subsidiaries manage resources to gain and maintain a competitive advantage (Li *et al.*, 2015; Rodriguez *et al.*, 2005). Under the situation of enduring uncertainty, we argue that foreign subsidiaries have more discretion and may engage more in corrupt transactions to seek value. Therefore,

Hypothesis 2b (H2b): Market uncertainty strengthens the relationship between foreign ownership and MNEs' bribery intensity.

2.2.2. Organization-level factors

Firm age and size. A firm's age is related to organizational inertia (Le *et al.*, 2015). Older organizations have more trouble adjusting their structures and adapting to changing environments

than younger ones (Gilbert, 2005) because older firms generally have well-established structures or even ossified routines to be followed in decision-making (Hambrick and Finkelstein, 1987). Hence, older firms lead to greater internal inertia, which, in turn, reduce the level of managerial discretion (Li and Tang, 2010; Xie, 2014).

Like firm age, firm size is another indicator of organizational inertia (Hambrick and Finkelstein, 1987). Empirical works have highlighted firm size constrains the firm's ability to change and alter core organizational functions such as goals, technology, or marketing (Josefy *et al.*, 2015). As firms grow in size, tasks and operations become more and more complicated (Jayaraman *et al.*, 2000). Organizational complexity requires well-designed routines and hierarchical structures to ensure effective management. Thus, large organizations normally have difficulty undertaking dramatic change.

We argue that older and larger MNEs, compared to younger and smaller ones, tend to have hierarchical organizational structures, institutionalized routines, and higher levels of specialization and formalization (Ahuja and Lampert, 2001; Shimizu and Hitt, 2005; Wickert *et al.*, 2016). These complex rules, routines, and structures may fossilize the decision-making process and reduce MNEs' responsiveness to change. Managerial discretion, therefore, is weakened by organizational path dependencies in which managerial behavior is restricted by organizational inertia. In terms of bribery intensity, long-established routines and organizational complexity of MNEs are likely to stand in the way of foreign subsidiaries executives' implementation of bribery activities. Therefore, we argue that firm age and size weaken the proposed positive relationship between foreign ownership and bribery intensity. We offer the following hypotheses:

Hypothesis 3a (H3a): *Firm age weakens the relationship between foreign ownership and MNEs' bribery intensity.*

Hypothesis 3b (H3b): *Firm size weakens the relationship between foreign ownership and MNEs' bribery intensity.*

Firm's financial slack. Slack is defined as the disparity between resources available to an organization and the minimum necessary to produce a given level of organizational output (Cyert and March, 1963). Slack resources refer to the resources which an organization has acquired, but has not been committed to expenditure; hence can be used in a discretionary manner (Titus *et al.*, 2022). Organizational behavioral theorists typically argue that, despite its costs, slack serves as a cushion, which buffers a firm from environmental turbulence to better deal with environmental uncertainties (Bradley *et al.*, 2011; Paeleman and Vanacker, 2015).

Slack financial resources increase managerial discretion because slack provides executives with discretionary funding to pursue new projects, generate new products, explore new ideas, and develop new markets (Bentley and Kehoe, 2020). In other words, slack resources equip executives of foreign subsidiaries to engage in opportunistic behavior without fully attending to the needs and expectations of the headquarters. Under a situation where managerial discretion is magnified by financial slack, we argue that MNEs are more likely to bribe in order to facilitate their operation experimentation and search broadly for valuable opportunities.

Hypothesis 3c (H3c): *Firm's financial slack strengthens the relationship between foreign ownership and MNEs' bribery intensity.*

Government intervention. In many emerging economies, the government plays an intervening role by providing restrictions to regulating firms' behavior and/or offering economic assistance to adjust and reconstruct other selected players in the fields (Estrin *et al.*, 2018). Extant international business studies have debated the positive vs. negative roles of the government in

shaping a firm's actions and outcomes in transitional and emerging economies (Boddeyn, 2016; Meyer and Peng, 2016).

We argue that government intervention enables top executives of foreign subsidiaries to form relationships with government bureaucrats, which enlarges executives' decision-making leeway and increases the level of managerial discretion. Government intervention can serve as a channel for MNEs to gain access to essential resources such as financial capital, distribution network, and personnel. In emerging economies, the government controls significant portions of strategic resources and has considerable power to influence allocation channels (Bruton *et al.*, 2015). Such resource dependence reveals political bureaucrats retain authoritarianism and the rule of law and market-supporting institutions remain weak, which generates great uncertainty (Haveman *et al.*, 2017). Because of information asymmetric raised by the spatial distances and uncertainty caused by underdeveloped market-supporting institutions, the headquarters of MNEs can hardly verify the appropriateness of foreign subsidiaries behavior and block any ethical actions. Thus, government intervention may facilitate (or even force) top executives of foreign subsidiaries to collude with local bureaucrats for seeking political support and resources. We propose:

Hypothesis 3d (H3d): *Government intervention strengthens the relationship between foreign ownership and MNEs' bribery intensity.*

3. Method

3.1. Sample and data

The data used for this study is mainly from World Enterprise Surveys (WES) developed by the World Bank in 2019. The dataset provides cross-sectional data from over 135,000 firms in 139 countries and includes a wide range of information related to firms' characteristics and

environmental factors. WES were carefully collected using a random sampling procedure to ensure a good representation in each country.

The survey's unique features offer three significant advantages for conducting bribery-related research. First, the World Bank employs a meticulous stratified random-sampling procedure to ensure representative samples of firms from diverse countries. The dataset provides extensive coverage of firms in terms of size, ownership, industry, location, business plans, and market orientations. Second, the survey gathers responses from senior business executives and entrepreneurs, who have a better knowledge about whether and how focal firms have conducted bribery activities. Third, this dataset has been widely adopted by prior research studying firm-level corruption and bribery (Birhanu *et al.*, 2016; Luo and Han, 2009; Uhlenbruck *et al.*, 2006), and the validity of the bribery items and the credibility of WES data have been tested by substantial studies.

Some of the hypotheses are related to the industrial-level measures across nations, we combine several datasets including World Development Indicators and the Ease of Doing Business dataset from the World Bank, Worldwide Governance Indicators (WGI) dataset. We carefully check the combined dataset and remove observations with missing values, although previous studies (e.g., Birhanu *et al.*, 2016; Goedhuys and Sleuwaegen, 2016) suggest that the missing observations in WES dataset do not change the result pattern systematically. Our final sample contains 9,386 firms in 3 economic sectors (including 43 industries) from 125 countries over the period 2006–2018.

In addition, we adopt the Heckman (2013) approach to mitigate the impact of missing values and test the potential selection bias. Such an approach is a two-stage estimation procedure which assumes that a regression equation is associated with a selection equation and the error terms of the two equations are correlated. The selection equation is estimated using a probit model, where

the dependent variable of this equation is a dummy variable coded as 1 if the dependent variable of the original regression equation (i.e., bribery) is observed. Following the previous studies (e.g., Jensen *et al.*, 2010; Yi *et al.*, 2017), we keep all the explanatory variables in the main model and include two instrument variables (control of corruption and the natural logarithm of GNI per capita) that are found to influence bribery intensity in the first stage of the estimation. An inverse Mills ratio can be obtained from the parameter estimates. The level of bribery intensity is observed only when the selection equation equals 1 and is then regressed on explanatory variables and the inverse Mills ratio. Adding such a ratio in the second stage estimation can eliminate the part of the error term correlated with the explanatory variable and thus effectively avoid the selection bias.

3.2. Measurement

3.2.1. Dependent variable

Our dependent variable is *bribery intensity*, measured as the ratio of informal payment to public officials (for “getting things done” including customs, taxes, licenses, regulations, services, etc.) to total annual sales from the WES dataset. Such a measure has been widely used in prior studies (e.g., Luo and Han, 2009; Lee and Weng, 2013; Shaheer *et al.*, 2017).

3.2.2. Independent variables

Foreign ownership. We use the ratio of the share owned by private foreign individuals, companies, or organizations to the total share as the measure of foreign ownership from the WES dataset (Lee *et al.*, 2010).

Managerial discretion. In previous empirical studies (e.g., Haj Youssef and Teng, 2021; Wangrow *et al.*, 2015) the concept of managerial discretion has been examined in different ways.

While some studies consider it as the underlying theoretical link between dependent and independent variables without direct measurement, others operationalize it by exploring its proposed antecedents, as suggested by Hambrick and Finkelstein (1987). The predominant approach focuses on theorizing the antecedents of discretion at the individual, organizational, and industry levels (Boyd and Salamin, 2001; Datta and Rajagopalan, 1998; Finkelstein and Boyd, 1998). At the individual level, scholars have examined executive characteristics, measuring variables such as locus of control, perception, commitment to the status quo, tenure, age, education, and risk-taking behavior (McClelland *et al.*, 2010; Miller *et al.*, 1982; Roth, 1992). On the organizational level, variables such as sales, firm size, slack, R&D intensity, company structure, advertising intensity, volatility, and strategic orientation have been used to operationalize managerial discretion (Kim, 2013; Quigley and Hambrick, 2012; Rajagopalan, 1997). Similarly, at the industry level, discretion has been measured using variables such as regulatory conditions, demand instability, market growth, product differentiability, attentional homogeneity, and industry capital intensity (Finkelstein, 2009; Halebian and Finkelstein, 1993; Keegan and Kabanoff, 2008; Peteraf and Reed, 2007). Therefore, managerial discretion can be measured at the firm-, industry/market-, and country-levels. Finkelstein and Boyd (1998) use market munificence, R&D intensity, advertising intensity, demand instability, capital intensity, industry concentration, and regulation as the measures of managerial discretion. Li and Tang (2010) adopt market munificence, market complexity, market uncertainty, firm age, firm size, R&D intensity, chair-CEO duality, and a few country-related variables to proxy managerial discretion. Considering the data availability, we focus on sources of managerial discretion from industry- and organizational levels.

We use *market munificence* and *market uncertainty* to capture the effects of market-related factors at the industrial level. *Market munificence* is measured as the growth in sales in one industry

(based on the Standard Industrial Classification code) within a given time frame. Natural logarithms are entered into quasi-time series regressions, with time serving as the independent variable. The antilogs of the resulting regression slope capture industry growth. *Market uncertainty* is measured as the instability of industry sales over the prior five years (Li and Tang, 2010).

Following previous studies (e.g., Finkelstein and Hambrick, 1990; Li and Tang, 2010), we use firm age, firm size, financial slack, and government intervention as our organization-level proxies for managerial discretion. *Firm age* is measured as the number of years since the establishment of a firm (Yi *et al.*, 2018). *Firm size* is proxied by the nature logarithm of total sales (Carpenter, 2002). We include *financial slack* using an indirect measure, availability and cost to access financing.¹ *Government intervention* is measured as the percentage of senior management's time spent in dealing with requirements imposed by government regulations in a week (Fisman and Svensson, 2007). All the aforementioned measures are drawn from the WES dataset.

3.2.3. Control variables

We include a set of control variables. *Export orientation* is measured as the proportion of product exports to total sales (Lee *et al.*, 2010). *Manager's experience* is proxied as the number of years working in the sector the top manager is employed (Birhanu *et al.*, 2016). We include state ownership, measured as the share percentage owned by the government/state of the total share (Shaheer *et al.*, 2017), to capture the influence of domestic ownership. We consider economic factors by controlling *real GDP growth* and *foreign direct investment (FDI) inflows*. The former is measured by the annual growth rate to capture the macro-environment of a firm and the latter is measured by the nature logarithm of inward FDI. Also, we control for institutional quality by introducing three measures, namely *business environment*, *legal institution* and *political stability*. The business environment represents the regulatory costs of starting a business (van Stel, Storey,

and Thurik, 2007), which is measured by the overall score of starting a business for each country in each year from the Ease of Doing Business dataset. We use the rule of law (reflecting the quality of legal institutions such as contract enforcement, property rights, and the likelihood of crime and violence) and the absence of violence/terrorism from the WGI dataset to measure the effect of *legal institutions* and *political stability*. In addition, we control for *industry-specific* and *year-specific* factors using dummy variables. Furthermore, we include an inverse Mills ratio estimated by using the Heckman test to eliminate the potential sample selection bias (Pan *et al.*, 2014).

Table 1 reports the summary statistics of each variable. The values of the means and standard deviations indicate that most of the observations in our sample are within reasonable limits (i.e., no outliers). The coefficients of the pairwise correlation suggest that there are no serious problems of multicollinearity among the independent variables.

[INSERT TABLE 1 HERE]

3.3. Stylized facts

Before discussing the empirical results we present some stylized facts about the relationship between foreign ownership and bribery intensity. In our sample, the values of foreign ownership average around 9.88% but have a considerable variation across the sample from 0% to 100%. Most firms in our sample (86% of the total observations) do not have foreign ownership while 622 firms (around 6.63% in the sample) are fully owned by foreign investors. The mean of bribery intensity is 1.05 with a range across the sample exceeding 4.86. The majority of the firms (84% in our sample) have zero bribery intensity but 19 firms reported that they had records to pay over half of their total annual sales to public officials.

Figure 1 displays the foreign ownership-bribery intensity nexus using a scatter plot diagram. Although the trend line confirms a positive correlation, the slope value is close to 0, implying that

such a correlation is probably statistically insignificant and there is a need to account for the importance of managerial discretion in the analysis to capture the potential nonlinearity in the foreign ownership-bribery intensity relationship.

[INSERT FIGURE1 HERE]

4. Results

4.1. Empirical results

We adopt Tobit regression for the empirical estimations because the censored dependent variable ranges from 0 to 100. To test our hypotheses discussed above, we include the main independent variable (i.e., foreign ownership) and control variables in column 1 and add managerial discretion measures in column 2. We report the estimated results of the interactions between foreign ownership and managerial discretion in columns 3-5. The results are reported in Table 2.

[INSERT TABLE 2 HERE]

The results of the first two columns in Table 2 show that the coefficients of foreign ownership are insignificant, showing that foreign ownership does not have a direct and linear effect on bribery intensity. The results do not support our Hypothesis 1 and indicate we need to further explore the boundary condition for the effects of foreign ownership on bribery intensity.

Column 2 includes all proxies of managerial discretion to test the direct effects of managerial discretion on bribery intensity. The results show that government intervention and firm size, as firm-level managerial discretion measures, have positive and statistically significant effects on bribery intensity at the 1% level. Financial slack has a significant and negative effect on bribery intensity at the 1% level. Regarding industry-level measures, however, market uncertainty has a significant and positive influence on bribery intensity at the 1% level.

In columns 3–5 of Table 2, we further include the interactions between foreign ownership and managerial discretion measurements to explore the contingency effects of managerial discretion on the relationship between foreign ownership and bribery intensity. As suggested by Brambor *et al.* (2006) and Berry *et al.* (2012), we now focus on the significance and sign of the interaction term only since the results of the constitutive terms and coefficient value of the interactions are not important when applying an interaction model.² We first test the moderating effects of the industry-level measure of managerial discretion in column 3; then examine organizational level measures in column 4. Column 5 includes both industry- and organizational level measures of managerial discretion to illustrate the combined results.

Column 3 tests the moderating effects of industry-level factors alone (i.e., market munificence and market uncertainty) on the relationship between foreign ownership and bribery intensity. The result of the interaction term between market munificence and foreign ownership is insignificant. The result of the interaction term between market uncertainty and foreign ownership is significant and positive at the 10% level. The results weakly support Hypothesis 2b and suggest that market uncertainty positively moderates the relationship between foreign ownership and bribery intensity.

Column 4 tests the moderating effects of organizational level measures of managerial discretion (i.e., firm age, firm size, financial resources slack, and government intervention) on the relationship between foreign ownership and bribery intensity. The result of the interaction term between firm age and foreign ownership is negatively significant at the 5% level, suggesting that the relationship between foreign ownership and bribery intensity is contingent on MNEs' age. The interaction term between firm size and foreign ownership exhibits a significant and negative effect at the 1% level, indicating that MNEs' size has negative moderating effects on the relationship

between foreign ownership and bribery intensity. The coefficients of interaction terms between financial slack, government intervention, and foreign ownership are positively and significantly associated with bribery intensity at the 5% level, revealing that both financial slack and government intervention positively moderate foreign ownership and bribery intensity relationship. Hence, Hypotheses 3a-d are all supported.

In column 5, we include both industry-level and organizational level measures to capture the full picture of the role of managerial discretion in bribery intensity. The results of interactions are broadly similar to those reported in columns 3 and 4. In addition, focussing on interactions of managerial discretion (at least statistically significant at the 5% level), we plot in Figure 2a-d to aid our interpretation of the moderating effects using interaction graphs.

[INSERT FIGURE 2A-D HERE]

Regarding the effects of control variables in Table 2, GDP growth, FDI inflows, and business environment are negatively correlated to bribery intensity across all the columns. Political stability records a positive and significant coefficient in columns 2-5. The rest of the control variables appear to be insignificant. Also, the inverse Mills ratio has a significant influence on the dependent variable, indicating that the selection bias has been effectively addressed after such a ratio is included in the regressions.

4.2. Robustness checks

To check the robustness of our main results reported in Table 2, we use alternative empirical methods with the same data sample and model specifications. We adopt the Poisson Pseudo Maximum Likelihood (PPML) approach to verify our results. PPML is a preferred method of estimation when there is a large proportion of zero values of the dependent variable and can allow

us to address the heteroskedasticity problem by clustering the standard errors at both industry and year levels. PPML has been increasingly used recently in the field of international economics (e.g., Biro et al., 2019) as well as bribery-related literature (e.g., Sylwester, 2019). The results are broadly similar to those in Table 2, except that *Foreign ownership*Market uncertainty* becomes insignificant.

We also conduct the estimation using the ordered probit model and ordered logit model and present the results in Tables 4 and 5 respectively. Again, the results are almost robust, except that the significances of *Foreign ownership*Firm age* and *Foreign ownership*Government intervention* in both tables reduce.

[INSERT TABLE 4 HERE]

[INSERT TABLE 5 HERE]

In addition, we further test the consistency of the results using an alternative proxy of foreign ownership. We run the regressions using foreign ownership as a dummy variable (i.e., when foreign ownership is high than 50 percent, we code the variable as 1; and 0 otherwise). The results below in Table 5 are broadly consistent with those reported in Table 2, apart from that the significance of *Foreign ownership*Firm age* vanishes.

[INSERT TABLE 6 HERE]

5. Discussion and conclusion

This paper aims to examine the role of managerial discretion in contributing to the bribery intensity of MNEs. Extant corruption and bribery research has dedicated much effort to the malfunctioning institutions and corporate governance system and illustrated different internal and external factors that spur bribery offerings (Bahoo et al., 2020; Rabbiosi and Santangelo, 2019). This paper, by

contrast, provides a new lens to study bribery activities by exploring the contingent role of managerial discretion on the foreign ownership and bribery intensity relationship.

Previous corruption literature has studied the effects of foreign ownership and bribery intensity from either resource endowment or agency theory aspects but yielded mixed results. The resource endowment aspect implies that the crux of corruption is a firm's dependence on external resources (Luo and Han, 2009). The agency theory aspect highlights the potential agency problems between MNEs' headquarters and foreign subsidiaries and suggests self-interested management of foreign subsidiaries is more likely to engage in unethical and illegal activities, such as offering bribery, to gain short-term financial returns without effective monitoring. However, the resource endowment aspect in explaining corruption has not fully addressed the environmental pressures from the host country for bribery. Agency theory emphasizes the agency relationship between MNEs' headquarter and foreign subsidiaries but views both actors as aggregate constructs. Therefore, agency theory fails to identify the role of the task environment towards bribery.

In line with agency theory, this paper proposes foreign subsidiaries are assigned the role of being the agents of headquarters. We suggest that foreign subsidiaries act as self-interested agents and may have conflicts of interest with the headquarters. The novelty of this paper is in inferring the management of foreign subsidiaries as the key entity of bribery engagement and explicitly explicating the contingency effects of managerial discretion in shaping the foreign ownership and bribery intensity relationship. Overall, this paper makes two contributions.

First, we integrate the managerial discretion concept with corruption literature and offer an answer to the question "under what conditions MNEs bribe?" MNEs are normally from developed economies where anti-corruption norms have been highly institutionalized (Kwok and Tadesse, 2006). The expansion of international business activities has pulled MNEs in emerging and

developing countries in which subsidiaries have to regularly encounter corrupted environments. MNEs endeavor to achieve transnational legitimacy and maintain global reputation, headquarters thus often impose pressure on subsidiaries to adopt the ethical practices used in their home country to avoid exposing their operation to corruption (Martin *et al.*, 2007; Rabbiosi and Santangelo, 2019). Subsidiary managers may, however, oppose such pressures when they perceive the practices imposed by headquarters run counter to their interests and local practices (Kostova *et al.*, 2016). In the context of corruption and bribery, this means that top managers of foreign subsidiaries may encounter significant pressures to engage in bribery in the host market while facing a mandate from headquarters to conform to home country expectations by avoiding such practices (Spencer and Gomez, 2011).

The top management can shape the anticipated outcomes of the organization and act on a continuum (Finkelstein *et al.*, 2009). Agency theory suggests that managers in charge of decision-making may be prone to implement decisions based on their interests, and not the interest of the organization (Filatotchev and Wright, 2011; Meyer *et al.*, 2020). It is, therefore, important to understand how much “freedom of action” is made available to executives of the foreign subsidiary because top managers can pass on decisions that they see fit or appropriate (Caza, 2012). In other words, high managerial discretion enables top managers of foreign subsidiaries with greater liberty to impact the strategic choices of the company, and to engage more in bribery activities (Crossland and Hambrick, 2011; Gupta *et al.*, 2019). This paper, therefore, contributes to corruption literature by arguing the managerial discretion of foreign subsidiaries’ executives is an influential power in shaping MNEs’ bribery intensity. Our results reveal the strategic importance of the top management team and suggest that managers from foreign subsidiaries are less likely to conduct bribery when they were given limited discretion in decision-making.

Second, this paper elucidates the foreign ownership and bribery link from the organization and industry levels. Previous studies have examined bribery by exploring the effects of external factors (e.g., institutions and culture) and internal factors (e.g., firm-level corporate governance) on bribery intensity. This paper, by contrast, leverages the managerial discretion concept and systematically integrates industrial conditions and focal firm's characteristics with the bribery activities of MNEs. Our results demonstrate that market uncertainty provides executives of foreign subsidiaries with more discretion, subsequently strengthening the relationship between foreign ownership and bribery intensity. Government intervention at the firm-level strengthens the foreign ownership and bribery intensity relationship. We also explored other firm-level factors and found managerial discretion is higher in smaller firms with more financial resources, which positively moderates foreign ownership and bribery intensity relationship.

5.1. Managerial and policy implications

Our finding has important implications for MNEs which seek to control bribery in the international markets. First, awareness of foreign subsidiaries' attitudes towards corruption and "freedom of actions" are pre-conditions to foster ethical conduct. Effective communication and monitoring processes are viable mechanisms to counterbalance managerial opportunism. Second, our findings reveal that the identity of the headquarter and foreign subsidiaries has important implications because they may have different objectives and decision-making horizons. Our finding thus contributes to the agency theory literature by explicitly explicating the underlying interests and objectives of a multinational firm's headquarter and its foreign subsidiaries, or how those objectives would consequently influence the firm's bribery. Third, we found that smaller firms with slack resources have a higher tendency to engage in bribery, which can be linked to their

governance structure and other market-related conditions. Smaller firms, particularly those in emerging economies or informal sectors, may lack formal governance structures and internal controls. They may have limited oversight mechanisms, weak transparency, and inadequate enforcement of ethical standards. The absence of proper checks and balances can create an environment conducive to bribery and corruption (Dacin *et al.*, 2007; Gomez and Jomo, 1999). Also, this may be related to limited market power and weaker bargaining positions compared to larger firms. In highly competitive industries or concentrated markets, small firms may feel compelled to engage in bribery to secure business opportunities, gain access to distribution channels, or influence decision-makers (Jancsik and Baksa, 2016; Le and Oh, 2015). Such findings trigger the importance of understanding the different motivations in engaging in bribery activities, how regulatory frameworks and informal norms along with societal expectations shape bribery behaviour and how policymakers should tackle this aspect from not only a large MNC perspective but also small cross-border business activities.

5.2. Limitations and future research directions

This paper has three limitations, which require further studies in the future. First, our measurement considers one aspect of bribery. Bribery, nevertheless, can be offered in many other different forms, such as personal favor, gifts, etc. Further research can develop a more comprehensive measure for bribery to better capture the nature of this unethical behavior.

Second, Hambrick and Finkelstein (1987) have proposed a set of individual determinants of managerial discretion, such as personal commitment, cognitive complexity, and tolerance of ambiguity. In addition to the environmental and organizational determinants of managerial discretion, personal characteristics may play significant roles in influencing the engagement of

bribery and corruption. Corruption literature can be enriched by examining what kind of personal characteristics affect both the managerial discretion of foreign subsidiaries and the propensity of bribery offers.

Third, the dataset used for our empirical estimation is survey-based and the variable is time-invariant. Therefore, we cannot use panel-data estimation methods (e.g., fixed-effects or System Generalized Method of Moment) to control for the heterogeneity among the firms. Future research may re-access the effects of foreign ownership and managerial discretion on bribery intensity when an alternative source of panel data is available to capture the effect of firm-specific factors.

Notes

1. Hadlock and James (2002) find that development of external capital market can provide financial slack. Although traditional measures such as cash and reverse ratio, liquidity ratio can capture the effect of financial slack more directly, we lack of such data.

2. The marginal effect of interaction terms can be calculated using the derivative, $\frac{dy}{dx} = \beta_1 + \beta_2 \times \text{managerial discretion}$, evaluated at all values of the latter, with β_1 and β_2 being the foreign ownership estimates of the constitutive and interaction terms respectively. However, most of our proxies of managerial discretion are factor variables (rather than continuous variables), therefore, the actual marginal effect of the interaction terms are less meaningful in this case.

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