Managing Business Corruption: Targeting Non-Compliant Practices in Systemically Corrupt Environments

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Introduction

As argued by Paul Heywood in this volume, the effectiveness of the principal-agent model approach to anti-corruption policy-making had been questioned in the light of accumulating evidence for the underperformance of anti-corruption interventions.[1] Recent research has revisited the theoretical underpinnings of these interventions to gain new insights, arguing for a move away from principal-agent based interventions to ones that emphasize collective action, which is more relevant for systemically corrupt environments. The collective action perspective is better equipped to embrace the fact that while corruption is widely perceived as a social bad, it is also widely practised by individuals seeking to find practical solutions to real-life problems. In other words, where outsiders characterize corruption as a 'disease', the causes, conditions and effects of which must be diagnosed, monitored and cured,[2] insiders tend to perceive it as a 'cure'

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[1] See also A. Mungiu-Pippidi, *The Quest for Good Governance: How Societies Develop Control of Corruption*, Cambridge, 2015; H. Marquette and C. Pfeiffer, *Corruption and Collective Action*, Anti-Corruption Resource Centre Research Paper 32, Bergen, 2015; A. Persson, B. Rothstein and J. Teorell, 'Why Anticorruption Reforms Fail — Systemic Corruption as a Collective Action Problem', *Governance*, 26, 2013, 3, pp. 449–71.

[2] S. H. Alatas, *Corruption: Its Nature, Causes and Function*, Aldershot and Brookfield, VT, 1990. See also <www.anticorrp.eu> for the findings of the ANTICORRP Media and

for situations where no better solutions are available. Such ambivalence in perceptions — 'if I do it — it's need, if others do it — it's greed' — has been insufficiently articulated in research.[3] Those involved in corrupt practices more often than not are conceptually silenced in the analytical frameworks employed to study them. Studies of corporate corruption are based predominantly on normative assumptions about good and bad governance; appropriate organizational behaviour and misbehaviour; bad organizations (bad barrels) and bad individuals (bad apples).[4] These dichotomies, however, limit our understanding of systemically corrupt environments, where principals are not principled, good people do bad things and property rights are not secure and the public/private distinction cannot be made. Anthropologists find that what appear to be instances of corruption from the normative perspective might in fact constitute a hybrid phenomenon, best understood on its own terms.[5] Moreover, even where non-compliant practices that conform to neither official nor social norms (or to both but in a hybrid way) are acknowledged on their own terms, they are 'chronically underestimated' and 'systematic analyses of the practical norms governing these non-compliant practices' are few.[6]

Corruption work package.

[3] For an exception, see M. Bauhr, 'Need or Greed Corruption', in *Good Government: The Relevance of Political Science*, edited by S. Holmberg and B. Rothstein, Cheltenham, 2014.

[4] Some scholars call it 'deviant behaviour': R. E. Kidwell, Jr. and C. L. Martin, 'The Prevalence (and Ambiguity) of Deviant Behaviour at Work: An Overview', in Kidwell and Martin (eds), *Managing Organizational Deviance*, Thousand Oaks, CA, 2005, pp. 1–21; S. L. Robinson and R. J. Bennett, 'A Typology of Deviant Workplace Behaviors: A Multidimensional Scaling Study', *Academy of Management Journal*, 38, 1995, pp. 555–72, or 'organizational misbehavior': S. Ackroyd and P. Thompson, 'Why Organizational Misbehavior?', in Ackroyd and Thompson (eds), *Organizational Misbehavior*, London, 1999, pp. 8–30; A. Sagie and S. Stashevsky and M. Koslowsky (eds), *Misbehavior and Dysfunctional Attitudes in Organizations*, New York, 2003; Y. Vardi and E. Weitz, *Misbehavior in Organizations: Theory, Research and Management*, Mahwah, NJ, 2003, but very often just a 'criminal act': Galt de Jong and Hans van Ees, 'Firms and Corruption', *European Management Review*, 11, 2014, 3–4, pp. 187–90.

[5] M. L. Caldwell, *Not By Bread Alone: Social Support in the New Russia*, Berkeley, CA, 2004; A. Ledeneva, *Russia's Economy of Favours: Blat, Networking and Informal Exchange*, Cambridge, 1998; A. Ledeneva, *How Russia Really Works: the Informal Practices that Shaped Post-Soviet Politics and Business*, Ithaca, NY, 2006; N. Ries, *Russian Talk: Culture and Conversation during Perestroika*, Ithaca, NY, 1997; R. Mandel, and C. Humphrey (eds), *Markets and Moralities: Ethnographies of Postsocialism*, New York and Oxford, 2002; D. Torsello and V. Betrand, 'The Anthropology of Corruption', *Journal of Management Inquiry,* 25, 2016, 1, pp. 34–54.

[6] J. P. O. de Sardan, 'For an Anthropology of Gaps, Discrepancies and Contradictions', *Antropologia*, 3, March 2016, 1, pp. 111–31 (pp. 114, 117). On informal norms and the interaction with formal systems, see Princeton University Research on innovations for successful societies (for example the Colombia Bogota case and the Philippines cases at

Analysing firm-level issues (such as retaining best qualified managers who are likely to leave the firm if their informal income opportunities are streamlined) through normative approaches and prescriptive policies on good governance and integrity in such settings is not sufficient. Focus on practical norms and non-compliant practices is not the same as the revisionist view of corruption that implies functionality of corruption in coping with overly rigid political and bureaucratic regimes.[7] We find that while the official norms prescribe intolerance and the practical norms prescribe tolerance towards corruption, business leaders solve their problems by 'managing' corruption at the firm level and invent strategies 'that work' to resolve the paradox of official and unofficial constraints.

The problem-solving approach in our study includes assembling bottom-up accounts of non-compliant practices and sustaining the meanings the actors ascribe to their actions in a context-bound way. We use the language of participants in our data collection and in the design of monitoring tools for non-compliant practices. We investigate tensions that exist between the formal compliance with anti-corruption legislation adopted at the national level and the firms' non-compliant practices essential for solving firm-level problems in systemically corrupt environments: where the 'letter' of national anti-corruption regulation is complied with, its 'spirit' is routinely violated to keep businesses competitive — corporate leaders cannot be expected to pioneer anti-corruption campaigns at the firm-level. And yet, some of them do. Thus, we seek to explain the cases of outliers — leaders experimenting with firm-level anti-corruption strategies — and consider these cases of 'individual agency' in the context of the debates on organizational behaviour:

> More recent theoretical developments in organizational research have argued that the realm in which single individuals can impact organizational performance is so limited that there is essentially no reason to worry about whether there are any behaviours or attributes that are unique to leadership. For example, resource dependence research[8] argues that most organizational action can be understood not as an exercise of individual agency but as an organizational response to the demands of external actors upon which organizations depend for resources and support.[9]

<http://successfulsocieties.princeton.edu/research/publications>).

[7] J. Girling, *Corruption, Capitalism and Democracy*, London, 1997.

[8] J. Pfeffer and G. R. Salancik, *The External Control of Organizations: A Resource Dependence Approach*, New York, 1978.

[9] N. Nohria and R. Khurana, 'Advancing Leadership in Theory and Practice', in *Handbook of Leadership Theory and Practice*, Cambridge, MA, 2013, pp. 3–26 (p. 9).

In other words, external pressures are so strong that they over-determine organizational reactions to set up a 'template of strategies […] that organization mimics because they are perceived as legitimate and appropriate'.[10] Such templates in Russia are not so different from establishing 'transparency, accountability, disclosure' elsewhere. Adopting such strategies in systemically corrupt environments, however, results in a de-facto situation of 'over-regulation and under-enforcement' that leaves it to corporate leaders to bridge the gap. Corruption remains one of the main challenges in doing business in many countries.[11] Examining the current initiatives undertaken by companies to manage the risk of corruption, PricewaterhouseCoopers found that only 22 per cent of firms are confident of the effectiveness of the anti-corruption programmes they already have.[12] Fast-developing economies like China, India, Brazil, Indonesia and Russia have all been scoring high in the 2011 Bribery index.[13]

1. Identifying and monitoring non-compliant practices

Our previous research has identified business practices ubiquitous in Russia and introduced specific tools for monitoring non-compliant practices in Russian firms.[14]

[10] Ibid.

[11] R. Fisman and J. Svensson, 'Are Corruption and Taxation Really Harmful to Growth? Firm Level Evidence', *Journal of Development Economics*, 83, 2007, 1, pp. 63–75; R. M. N. Galang, 'Victim or Victimizer: Firm Responses to Government Corruption', *Journal of Management Studies*, 49, 2012, 2, pp. 429–62; S. Knack and P. Keefer, 'Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Indicators', *Economics and Politics*, 7, 1995, 3, pp. 207–28; P. Mauro, 'Corruption and Growth', *The Quarterly Journal of Economics*, 110, 1995, 3, pp. 681–712; A. Shleifer and R. W. Vishny, 'Corruption', *The Quarterly Journal of Economics*, 108, 1993, 3, pp. 599–617; S. Globerman and D. Shapiro, 'Governance Infrastructure and US Foreign Direct Investment', *Journal of International Business Studies*, 34, 2003, 1, pp. 19–39; K. A. Getz and R. J. Volkema, 'Culture, Perceived Corruption and Economics: A Model of Predictors and Outcomes', *Business Society*, 40, 2001, 1, pp. 7–30.

[12] The PricewaterhouseCoopers Report, 'Confronting Corruption: The Business Case for an Effective Anti-Corruption Program' is available online at <http://www.pwc.com/gx/en/forensic-accounting-dispute-consulting-services/business-case-anti-corruption-programme.jhtml>. The report is based on a survey of 390 senior executives, supplemented with in-depth interviews with 36 senior executives and experts in anti-corruption efforts. The geography of the survey covers many several countries around the world including Russia: 42% Asia-Pacific, 16% Middle East and Africa, 23% Western Europe, 8% North America, 5% Latin America and 5% Central and Eastern Europe. It examines the current and possible future actions companies perform to manage the risk of corruption.

[13] <http://www.transparency.org/bpi2011>.

[14] S. Shekshnia, A. Ledeneva and E. Denisova-Schmidt, *Reflective Leadership vs. Endemic Corruption in Emerging Markets*, INSEAD Working Paper 2013/121/EFE <http://sites.insead.edu/facultyresearch/research/doc.cfm?did=53474>; S. Shekshnia, A. Ledeneva

Russia is an interesting case:[15] it is one of the largest emerging economies in the world, yet it is also labelled as one of the most corrupt countries.[16] In 2008–2011, the Russian government undertook significant anti-corruption efforts in line with OECD, WTO and World Bank policy recommendations, but the results of such efforts at the firm level have been far from conclusive. Part of the reason is political. Mungiu-Pippidi observes that many former Communist regimes have attempted to make the transition from a particularistic system to a universalistic one (i.e. from predominantly relations-based to the predominantly rules-based forms of governance), but have so far only reached a stage that she calls 'competitive particularism'. She argues that at this point most countries in the region are hybrids, combining the elements of the two 'ideal types', while the distinction between public and private remains blurred.[17] Theoretical perspectives based on a presumption of the public/private distinction may have misled the policies in the region.[18] Marquette and Pfeiffer argue that anti-corruption initiatives failed not because they are based on inadequate theories, such as principal-agent theory and/or collective action theory, but rather because they do not consider the third perspective — that corruption might be an effective tool that helps people to get things done, especially in weak institutional environments.[19] Replacing corrupt channels by innovative solutions has been an important shift in public policy (e-governance) and among non-governmental organizations (Integrity Action Fix rate).[20] In order to address corruption-related challenges in

and E. Denisova-Schmidt, *How to Mitigate Corruption in Emerging Markets: The Case of Russia*, Edmond J. Safra Working Papers No. 36, Cambridge, MA, 2014 <http://discovery.ucl.ac.uk/1451069/1/EDS_SS_AL_SSRN-id2391950.pdf>.

[15] In spite of the current political situation, many international companies still consider Russia a promising market in the mid- and long-term perspectives. See E. Denisova-Schmidt and O. Kryzhko, 'Managing Informal Business Practices in Russia: The Experience of Foreign Companies', *Mir Rossii*, 24, 2015, 4, pp. 149–74.

[16] Transparency International measures the perception of corruption in the public sector in the aggregate Corruption Perception Index (CPI). In 2015 Russia was placed at 119 out of 168 countries.

[17] See note 1 above.

[18] See articles by Heywood and Camargo-Baez/Ledeneva in this volume and Marquette and Pfeiffer (note 1).

[19] GCB2013 data shows insignificant variation in the use of contacts. In the USA, a person might arrange a job interview as a favour, but that person will not necessarily be hired. In Russia and the other BRIC countries, on the other hand, being hired would be expected. See D. J. McCarthy, S. M. Puffer, D. Dunlap-Hinkler and A. M. Jaeger, 'A Stakeholder Approach to the Ethicality of BRIC-Firm Managers' Use of Favors', *Journal of Business Ethics*, 109, 2012, 1, pp. 27–38.

[20] See <http://integrityaction.org/training-materials/56>.

corporate contexts, we developed a practical tool that allows leadership to identify specific non-compliant practices on the firm level and to devise mitigating strategies.

At the exploratory stage, we examined the existing typologies of corruption in post-Communist societies[21] and conducted a content analysis of the media in order to identify corrupt practices that correspond to these types. In a 2006 World Bank paper, which adopts the Transparency International definition of corruption as 'the misuse of entrusted power for private gain', economist Stephen Knack organizes these variations into six dimensions of corruption: by their level of the political system (central government, provincial, municipal), roughly corresponding to 'petty' and 'grand' corruption; by the purpose of the improper actions: to influence the content of laws and rules ('state capture') or to influence their implementation ('administrative corruption'); by the actors involved in the corrupt transaction: various combinations of firms, households and public officials; by the characteristics of a particular set of actors, such as the bribes that are required for large versus small firms, or for rich versus poor households; by the administrative agency or service: tax and customs, business licenses, inspections, utility connections, courts or public education and health facilities; and by the incidence or magnitude of bribes or by the uncertainty they create for businesses and households.[22] In more than thirty interviews, we asked CEOs and directors of companies operating in Russia to comment on the familiarity of each practice, as well as on its frequency. In the 2010 pilot survey, conducted face-to-face, we reserved a space for respondents to add to our list of practices — yet only two practices have been added.[23] Among the obvious reasons as to why open-choice survey questions remain unanswered, such a low number of additions to the list of informal practices could be interpreted either as a validation of sufficiency of the existing list or a statement

[21] V. Tanzi, *Corruption Around the World: Causes, Consequences, Scope, and Cures*, IMF Staff Papers, 45, IMF, Washington, D.C., 1998; R. Karklins, *The System Made Me Do It: Corruption in Post-Communist Societies*, Ithaca, NY, 2005; S. Knack, *Measuring Corruption in Eastern Europe and Central Asia: A Critique of Cross-Country Indicators*, World Bank Policy Research Working Paper 3936, Washington, D.C., 2006; A. Ledeneva, *How Russia Really Works: The Informal Practices that Shaped Post-Soviet Politics and Business*, Ithaca, NY, 2006; A. Ledeneva, 'From Russia with Blat: Can Informal Networks Help Modernize Russia?', *Social Research*, 76, 2009, 1, pp. 257–88; A. Ledeneva, *Can Russia Modernise? Sistema, Power Networks and Informal Governance*, Cambridge, 2013.

[22] Knack, *Measuring Corruption in Eastern Europe and Central Asia*.

[23] A. Ledeneva, and S. Shekshnia, 'Doing Business in Russia: Informal Practices and Anti-Corruption Strategies', *Russie.Nei.Visions*, 58, 2011, IFRI, Paris <https://www.ifri.org/sites/default/files/atoms/files/ifriledenevashekshniafracorruptionmarch2011jn.pdf>.

of the unarticulated nature of the practices for those who use them routinely (apart from intention to conceal that we did envisage but have not encountered).[24] While interpreting the pilot data, we made a decision to allow the list of questions to be long and inclusive, yet also feasible for CEOs to handle in 15–20 minutes. The final questionnaire includes twenty-seven practices and nineteen anti-corruption strategies (Tables 1 and 2).

Inspired by Kay's concept of obliquity, whereby 'goals are best achieved indirectly', we have replaced the negatively connoted 'non-compliant practices' by the more neutral 'informal ways of getting things done' — the practical norms that CEOs and top managers use to achieve results.[25] We ask the respondents to report anonymously the extent to which their firm is engaged in each practice, choosing from three possible answers: 'systematically', 'sometimes' or 'never', and similar assessments are made for strategies.[26] Anonymity has been emphasized and preserved, even where it imposed serious limitations on our analysis. Given the level of our respondents and somewhat sensitive nature of our questions, we had to make an extra effort to ensure that those completing the survey were willing to share their views. Personal assurances were given where possible.

It was not our aim to create a representative sample. Originally we identified 500 businessmen — clients of a top executive search company — and one of the authors approached them directly. At the later stage we added some respondents who attended executive development programmes and business school alumni forums (volunteering). The survey data gave us insights to explore in the in-depth interviews on the role of leadership in systemically corrupt environments, as well as opportunities to explore the potential of using the 'language of participants' recognized by the respondents.

[24] R. M. Groves, D. A. Dillman, J. L. Eltinge and R. J. A. Little, *Survey Nonresponse*, Hoboken, NJ, 2001.

[25] J. Kay, *Obliquity: Why our Goals are Best Achieved Indirectly*, London, 2011.

[26] This instrument was tested in the Ukrainian business environment. See E. Denisova-Schmidt and M. Huber, 'Regional Differences in Perceived Corruption among Ukrainian Firms', *Eurasian Geography and Economics*, 55, 2014, 1, pp. 10–36; E. Denisova-Schmidt, and Y. Prytula, 'Liike-elämän korruptio Ukrainassa' (Business Corruption in Ukraine), *Idäntutkimus: The Finnish Review of East European Studies*, 1, 2016, pp. 94–95; E. Denisova-Schmidt and Y. Prytula, 'The Shadow Economy and Entrepreneurship in Ukraine', in *The Entrepreneurship and Shadow Economy*, edited by A. Sauka, F. Schneider and C. Williams, Cheltenham and Northampton, MA, 2016, pp. 151–68; E. Denisova-Schmidt, M. Huber and Y. Prytula, 'Corruption among Ukrainian Businesses: Do Firm Size, Industry and Region Matter?', in Johannes Leitner and Hannes Meissner, *State Capture, Political Risks and International Business: Cases from the Black Sea Region*, Abingdon and New York, forthcoming 2017; E. Denisova-Schmidt and Y. Prytula, 'Corruption and Trust Among Ukrainian Firms', *Eastern European Economics*, forthcoming.

Table 1. Informal Practices vs. Corruption

Forms of corruption in the TI classification	Informal Practices as known to participants	Initiator	Beneficiary
	Extorting bribes by regional regulatory agencies: tax inspectorate, sanitation service, police, etc.	Officials	Officials
	Paying for the services of regional regulatory agencies: tax inspectorate, customs, sanitation service, police, fire inspectorate, standardization agencies, etc.	Executives	Officials
	Paying exorbitant board of directors' fees to cronies	Executives	Executives
	Extorting bribes by regional authorities	Officials	Officials
BRIBERY,	Paying police and the prosecution service to open or close criminal cases	Executives	Officials
ABUSE OF POWER	Paying for favourable court rulings by the regional courts	Executives	Officials
OR OFFICE	Paying for tax audits and other inspections in regional subdivisions with pre-agreed results	Executives	Officials
	Using 'telephone rule' — informal pressure on regional managers and verbal instructions — by representatives of federal regional authorities	Officials	Officials
	Regional authorities; pressure on the company's regional managers to provide funding for their regional programmes and projects	Officials	Officials
	Using informal tools (compromising documents and information, material from security services and *krugovaia poruka*) against competitors	Executives	Executives
	Using informal tools (comprising documents and information, material from security services and *krugovaia poruka*) to manage company staff	Executives	Executives
	Using informal tools (comprising documents and information, material from security services and *krugovaia poruka*) to exert pressure on regional authorities	Executives	Executives

Forms of corruption in the TI classification	Informal Practices as known to participants	Initiator	Beneficiary
	Using company staff to carry out personal assignments for regional managers (assistance to family members, construction and decoration of housing, organization of holidays and entertainment)	Executives	Executives
GIFTS AND HOSPITALITY	Receiving kickbacks or other informal rewards (e.g. expensive gifts) by regional managers from vendors, suppliers and buyers	Vendors	Executives
	Receiving commissions or other material benefits from job candidates by heads of regional subdivisions	Employees	Executives
FRAUD	Paying salaries and bonuses to staff of regional subdivisions in cash without paying social tax	Executives	Executives
	Using company funds by heads of regional subdivisions to buy expensive cars, telephones, to pay for travel, etc.	Executives	Executives
	Leasing of the company's production, office premises or production equipment by regional managers for personal gain	Executives	Executives
CRONYISM AND NEPOTISM	Disregarding 'conflict of interest' of regional managers, e.g. their use of companies affiliated to them, recruitment of relatives, etc.	Executives	Executives
	Selecting vendors/contractors with whom regional managers have informal relationships or arrangements	Executives/ Vendors	Executives/ Vendors
	Using informal connections and networks to obtain state orders (state procurement) and loans from state banks	Executives	Executives
	Selecting winners of open tenders at the regional level on the basis of informal relationships and arrangements	Executives/ Vendors	Executives/ Vendors

Forms of corruption in the TI classification	Informal Practices as known to participants	Initiator	Beneficiary
INFLUENCE PEDDLING	Funding of publications in regional press and broadcasts on regional TV and radio	Executives	ALL
	Paying or providing services (foreign trips, medical expenses, etc.) to regional executive authorities	Officials/ Executives	Officials/ Executives
	Paying or providing services (foreign trips, medical expenses, etc.) to regional legislative authorities	Officials/ Executives	Officials/ Executives
	Receiving subsidies and tax benefits from regional authorities	Executives	Executives
COLLUSION	Creating informal alliances with other companies in the region to exert influence on regional authorities	Executives	Executives

Table 2. Anti-Corruption Strategies

Strategy	Target category	Prevention/ Control	Transmission channels
Creation and dissemination of internal policies and procedures setting out detailed rules for working with contractors, such as holding tenders amongst suppliers and contractors	Executives, employees	Prevention	Admin
Use of high-profile campaigns	All	Prevention	Social
Use of the security department to detect and stop internal abuses and theft	Executives, employees, contractors	Prevention/ Control	Admin
Training of managers and regional staff in the internal rules of interaction with their counterparts	Executives, employees	Prevention	Admin
Creation and dissemination of Codes of Corporate Conduct	Executives, employees	Prevention	Admin
Use of internal audit service to identify internal abuses and violations	Executives, employees, contractors	Control	Admin
Pro-active communication of company's rules and standards on working with contractors, government and regulatory agencies and mass media to partners	Officials, contractors	Prevention	Admin
Pro-active proposals to regional authorities and regulatory agencies on cooperation programmes and methods	Officials	Prevention	Admin

Strategy	Target category	Prevention/ Control	Transmission channels
Engaging top management companies-counterparts in countering unscrupulous actions by their regional representatives	Society	Control	Social
'Buffer' strategy — the use of subcontractors, agents and third parties to work with regional authorities and regulatory agencies	Officials	Prevention	Social
Use of courts to counter unscrupulous actions by regional authorities or regulatory agencies	Officials	Prevention	Admin
Allocation of annual budget for developing informal relationships with representative authorities and regulatory agencies	Officials	Prevention	Admin
Exchanging information with other companies about unscrupulous businesses, regional authorities and regulatory agencies	Officials	Prevention	Social
Allocation of annual budget for developing informal relations with representatives of the regional media	Officials	Prevention	Admin
Use of informal contacts ('telephone law' and oral instructions) to put pressure on the representatives of regional authorities to counter unscrupulous actions and to ensure respect of law	Officials	Control	Social
Formal approaches to federal officials to counter unscrupulous actions by regional authorities and regulatory agencies	Officials	Control	Admin
Use of the media to counter unscrupulous actions by regional authorities or regulatory agencies	Officials	Control	Social
Creation of alliances with other companies in the region to counter unscrupulous actions by the representatives of the authorities or the regulatory agencies	Officials	Control	Social

Strategy	Target category	Prevention/ Control	Transmission channels
Engagement of representatives of religious institutions in promoting the company's interests in the regions	All	Prevention	Admin
Additionally reported anti-corruption strategies			
Telephone hot-lines available for employees and external parties to report corrupt acts of company executives	Executives	Control	Admin
Offering commissions to employees uncovering corporate fraud	Executives	Control	Admin
'Buying' an executive position in regional governmnet to protect business from corrupt officials	Officials	Prevention	Social
Gaining a seat in local legislature to protect business from corrupt officials	Officials	Prevention	Social
Video-taping of contract negotiations	Executives, Contractors	Prevention	Admin

2. Conceptualizing 'managing corruption' in systemically corrupt environments

Our data set was collected between 2010 and 2013. The total sample includes 110 questionnaires in addition to thirty in-depth interviews. Appendix 1 provides an overview of the firms' characteristics. Although the list of characteristics looks rather short, it was congruent to our primary goal of reaching out to the firms' leaders and creating a questionnaire that could be completed in 15–20 minutes. It is interesting to note that further studies based on this methodology conducted in Ukraine showed no statistically significant differences in terms of the firms' industry or size or the respondents' experiences with the firm, gender or educational levels.[27]

During our in-depth interviews, we asked executives to speak about their business environment and systemic corruption in Russia. On the basis of the management literature analysis on government corruption, Galang argues that a firm's behaviour in a corrupt environment is determined by two factors: the firm's political resources and the dependence of the industry in which it operates on government regulations. Factors such as a country's institutional development, and the corporate culture and structure of the firm also play a part.[28] Galang identifies four distinct strategic approaches to government corruption:

> *Alter* (high regulatory dependence-high level of political resource) which leads to engagement with the government, institutional change and regulatory capture; this strategy benefits both the firm and the economy.
> *Avoid* (low regulatory dependence-high level of political resource) which leads to self-restraint, non-investment and formation of business groups; this strategy benefits the firm.
> *Ally* (high regulatory dependence-low level of political resource) which leads to networking and forming joint ventures; this strategy benefits both the firm and the economy.

[27] Statistically significant differences were found only in terms of the regions (the western part of Ukraine is perceived to be less corrupt) and ownership (foreign companies are more resistant to corruption). Denisova-Schmidt, Huber and Prytula, 'Corruption among Ukrainian Businesses'. See also, E. Denisova-Schmidt and M. Huber, 'Regional Differences in Perceived Corruption among Ukrainian Firms', *Eurasian Geography and Economics*, 55, 2014, 1, pp. 10–36, and Denisova-Schmidt and Prytula, 'Corruption and Trust among Ukrainian Firms'.

[28] R. M. N. Galang, 'Victim or Victimizer: Firm Responses to Government Corruption', *Journal of Management Studies*, 49, 2012, 2, pp. 429–62.

Accede (low regulatory dependence-low level of political resource) which leads to acceptance of the rules of the game proposed by government officials and bribing; this strategy benefits both the firm and the economy.

Based on our qualitative data, we identified four dispositions that executives take up in relation to corruption that are not dissimilar from Galang's findings:

The first — *toleration* — is the most widespread among interviewees: 'Because the whole society is corrupt, and unless systemic changes occur, corruption cannot be effectively dealt with and is widely accepted. It is not up to us to promote anti-corruption changes; the government should take care of it.'
The second — *exploitation* — is expressed openly only by a small minority: 'Since Russian society is deeply corrupt, corruption should not only be accepted but also proactively used to advance business interests.' In other words, the endemic nature of corruption makes it a legitimate instrument for doing business.
The third — *avoidance* — is also articulated by a small minority: 'Even in an endemically corrupt environment, where corruption is generally accepted, it is possible to avoid it and to run a business without it playing a role. Others may suffer from corruption but we can find a way to stay away from it.'
The fourth — *management of corruption* — is shared by a select few: 'Corruption is a problem and we are working on it, even where we are unable to change the environment.' These executives recognize corruption as a major risk and develop specific strategies and mechanisms to mitigate it.

The four positions articulated above can be organized into a matrix demonstrating that the majority of executives do not prioritize a full-scale fight against corruption (percentage estimated by the interviewers) (Table 3). A number of psychological and technical factors prevent them from taking up the anti-corruption challenge.

Table 3. Executives' attitudes to corruption

Attitudes to corruption	Passive attitude	Active attitude
Acceptance of corruption as a significant risk to business	Toleration (60%)	Management (15%)
Non-acceptance of corruption as a significant risk to business	Avoidance (15%)	Exploitation (10%)

Failure to recognize corruption as a threat to business in systemically corrupt environments (often at a subconscious level) or rationalization of personal inability to tackle it prevents executives from managing corruption effectively.[29] Limited applicability of top-down 'template' of government-driven strategies, as well as the lack of knowledge of alternative firm-level methods, reduces executives' capacity to act. As shown above some corporate leaders consider corruption as a way to develop their business (the exploitation disposition). Corporations tend to blame corruption in the public sector and hide internal corruption from the public, while the most important aspect of corruption — the interaction between the state and the firm — remains unscrutinized.

Only a few corporate executives demonstrated what we call 'reflective leadership'. Reflective leaders confront external corruption proactively and deploy anti-corruption instruments to deal with the firm's internal corruption. This is a particularly daunting task in systemically corrupt environments. It boils down to tackling specific corruption risks associated with non-compliant practices where these are widespread in the company, i.e. with a concrete set of objectives in mind. One of the interviewed CEOs framed it as follows:

> We spend hundreds of millions on IT and I knew that we suffered from kickbacks received by our purchasing managers from vendors. I wanted to fight this so I have set three goals: reduction of our IT-related costs by 10 per cent next year; a review of the list of our IT vendors in order to get rid of companies affiliated with our managers in some way, and uncovering a few cases of kickbacks and making them public.

[29] V. Anand, B. E. Ashforth and M. Joshi, 'Business as Usual: The Acceptance and Perpetuation of Corruption in Organizations', *Academy of Management Executive*, 19, 2005, 4, pp. 9–23; P. Fleming and S. C. Zyglidopoulos, *Charting Corporate Corruption: Agency, Structure and Escalation*, Cheltenham and Northampton, MA, 2009.

A combination of both top-down and bottom-up approaches could make a difference at the firm level. However, we found that in the majority of cases executives either do not try or struggle to identify the shortlist of most damaging practices. We propose a simple yet comprehensive four-step approach to identify targets of anticorruption strategies at the firm level.

First, we develop a custom-made list of practices using in-depth interviews with executives and the content analysis of business publications in the national and regional media. It is essential to keep the original formulation of practices — sample of the formulations can be found in Table 1 — while verifying the list against existing classifications.[30]

Second, experts with deep company knowledge (senior executives and business unit managers) are invited to add to the list of practices, especially where these are specific for their own company. It is practical to keep the list manageable so that it can be converted into a simple-to-answer questionnaire. Any omission may lead to failure to identify some of the most widespread practices and those that are taken for granted.

Third, once the final list is determined, company employees are asked to assess whether, in their experience, these practices occur 'systematically', 'occasionally' or 'never'. Since the study takes place in systemically corrupt environments, where informal networks and cultural traditions penetrate corporate organizations, people who know about the practice may be constrained from reporting it, even if they do not directly participate in it. To overcome this limitation, we recommend: a large random sample of firms' employees at all levels, on-line survey, anonymity of respondents and a survey administrator independent of the management. The survey produces a list of the informal practices most frequently recognized and acknowledged by company employees. It will form a foundation for prioritising targets and developing specific anti-corruption measures.

Fourth, the CEO and senior corporate leaders select a limited number of specific practices they want to target, identify concrete goals they aim to achieve with regard to each of them and select monitoring instruments. The proposed instrument allows executives to identify specific corruption risks rather than 'corruption in general', to direct limited resources to most relevant targets, to communicate the anti-corruption strategy effectively and to monitor the change.

[30] See Tanzi, *Corruption Around the World*; Karklins, *The System Made Me Do It*; Transparency International typology of corruption in TI 2012 <http://www.transparency.org/cpi2012/results>.

We came across three companies that have successfully implemented a similar approach. The choice of appropriate execution strategies is discussed in the next section.

3. Firm-level strategies

Our research into corruption mitigation strategies adopted by companies operating in Russia has tested Lange's model of organizational controls. In his theoretical attempt to organize existing internal corruption mitigation mechanisms Lange identifies four types (functions) of corruption controls by organizations: 1) autonomy reduction (AR); 2) consequence systems (CS); ensuring reward and punishment; 3) environmental sanctioning, 'in which an organization interprets and transmits external pressures to the member for legal/regulatory compliance and social conformity' (ES); 4) 'intrinsically oriented controls, in which an organization fosters and facilitates the member's own inclination to reject corruption behavior' (IC).[31] In other words, the executives who subscribe to the management of corruption adopt two distinct types of strategies when dealing with it — control and prevention — and use two distinct transmitting channels for their actions — organizational hierarchies and personal networks.

In the control mode, managers deal with non-compliant practices reactively after these practices have already taken place and damaged the business. For example, the CEO of an oil company publicly fired a successful regional manager for selling gasoline at a lower price to a company affiliated with him. In the prevention mode, executives deal with risks which might hurt the business if they occur in the future and proactively look out for practices that may be indicative of those risks. For example, the CEO of a mining company issued an executive order prohibiting sales managers from sponsoring foreign trips for government officials.

Hierarchical strategies imply the use of such institutional instruments as executive orders and procedures, codes of conducts, incentive-based systems (punitive or rewarding), formal agendas, direct campaigns. Network-based channels are used for communicating informal signals, hidden agendas, personalized incentives and other methods of informal governance.[32]

Our interviewees point out that in addition to formal policies, it is crucial to communicate the degree of commitment of the leadership informally. Informal incentives and signals can be more effective in mitigating

[31] D. Lange, 'A Multidimensional Conceptualization of Organizational Corruption Control', *Academy of Management Review*, 33, 2008, 3, pp. 710–29.

[32] Ledeneva, *Can Russia Modernise?*, pp. 211–43.

corruption risks and preventing specific informal practices by personal example. One CEO set an example for his regional directors and declared a personal commitment to fight conflicts of interest among managers working with informally affiliated vendors and suppliers. He sent a strong signal about the forthcoming change through his company-wide informal network: he would no longer tolerate any divergence from the new strategy, no matter how close his relationships with a particular manager had been in the past. According to him, that informal warning had a stronger impact than all formal policies and procedures developed to tackle the issue.

The combination of two modes and two types of transmitting channels discussed above creates four ideal types of corruption management at the firm level, as presented in Table 4.

Table 4. Types of corruption management at the firm level

Types of Corruption Management	Control	Prevention
Formal channels (heirarchical, official, written, codified)	Reactive management through formal channels (1)	Proactive management through formal channels (3)
Informal channels (network-based, unofficial, unwritten, non-codified)	Reactive management through informal channels (2)	Proactive management through informal channels (4)

The four types are ideal types. Thus, in the example above, the CEO has applied proactive management through informal channels, yet he has also targeted widespread practices of conflict of interest indicating that his actions may have been reactive. Below, we illustrate the ideal types with examples that featured in our qualitative database:

1. *Reactive-formal*. An internal audit investigation of acquisition of assets in a new region results in identifying a conflict of interest on the part of the responsible manager. The CEO fires the manager for abuse of corporate office.
2. *Reactive-informal*. With the help of the founder-CEO's network, a bank employee caught stealing $200,000 from a bank client is not only sacked, but a criminal case against him is opened and a five-year

sentence handed down. Reactive in one case, the sentence is a powerful deterrent for other employees.

3. *Proactive-formal*. Rotating membership in a tender committee every two years as a matter of policy prevents long-term informal affiliations of its members, bias in decisions and inflated contracts for affiliated vendor and suppliers of large oil and gas companies.
4. *Proactive-informal*. Before introducing a new policy with regard to purchasing managers' expenses, a Russian energy company CEO attends a number of meetings with them and discusses the proposed policy off the record. These meetings allow the managers to share concerns, raise important questions and create awareness, thus giving them a chance to adjust their routines in advance of publication of the formal policy.

None of the described types of strategies is superior in delivering effective management of corruption. The choice depends on such contingencies as the nature and prioritization of specific corruption risks, the initiators, beneficiaries and cost bearers of the specific non-compliant practice, the resources available to the CEO, and the corporate culture of the firm. CEOs of companies operating in a systemically corrupt environment need to master all four types and to develop the largest possible arsenal of anti-corruption strategies.[33]

The example of one leading Russian energy company demonstrates how it can be done. In 2010, the CEO's team initiated a thorough investigation of corruption risks in the company and identified two targets: vendors' kickbacks and managers' conflicts of interest. With an aim to fully eradicate cases of undeclared and unauthorized conflict of interest in relation to vendors' contracts in excess of US $20 million and to reduce total corporate purchasing costs by 15 per cent in three years. They identified the initiators (owners and managers of suppliers related to corporate executives and corporate executives), the beneficiaries (corporate executives and related parties, owners of vendor companies) and the cost bearers (five individuals, including the CEO, who owned the company). After that the CEO and his team outlined a set of specific strategies with regard to each identified stakeholder group, as presented below in Table 5.

[33] A simulation game was developed by Stanislav Shekshnia and Alena Ledeneva as an INSEAD tool of training leaders for handling high-risk environment and uncertainty.

Table 5. Corruption mitigation strategies

	Stakeholders	
	Owners and CEOs of vendors	**Corporate executives with conflict of interest**
Control/Informal	Collecting rumours about vendors/executives' relations through informal networks.	Sending informal signals to specific executives to fix their conflict of interest or to be publicly ostracized.
Control/Formal	Breaking contracts with vendors suspected to be in affiliation with corporate executives. Instructing internal audit and internal security to conduct investigations of potential cases of conflict of interest.	Amnesty (3 months) for all reported cases of conflict of interest. Firing people with conflict of interest after 3 months. Opening criminal cases against some executives.
Prevention/ Informal	Informal CEO meetings with key suppliers to communicate the new policy and advise on disengaging corporate executives and their relatives from shareholders/ beneficiaries of their businesses.	Sending a strong signal through the company grapevine about the seriousness of the new strategy.
Prevention/Formal	Updating vendors' management rules. Communicating new procedures of vendors' management at vendors' conference. Establishing conflict commissions for vendors' complaints.	Replacing committee principle with individual general manager's responsibility in purchasing management.

After three years these anti-corruption initiatives have achieved some tangible results: the cost of purchasing decreased by 15 per cent, more than twenty companies were excluded from the suppliers' list, twenty-seven corrupt managers lost their jobs, and five received jail terms.

Conclusion

We would like to conclude by summarizing key action points for senior business leaders to effectively manage corruption in systemically corrupt environments such as Russia:

1. Make corruption management one of the CEO's top priorities. Start by recognizing corruption as a major risk for the company and its stakeholders, overcome blind spots and lack of recognition with regard to corruption risks.
2. Channel the priority status of the anti-corruption management through both the organizational hierarchy and informal networks.
3. Use a bottom-up, ethnographic approach to identify specific practices that are particularly problematic. Spend time and resources investigating which specific informal practices inflict most systematic damage on the corporation. 'Slice' the corruption 'elephant' into smaller pieces that can be more easily tackled in endemically corrupt environments.
4. Target specific non-compliant practices, not corruption in general.
5. Combine formal tools and informal influence. Effective anti-corruption strategies are based both on formal tools (such as hotlines, codes of conduct, open tender competition and standard policies and procedures) and informal influence (role modelling, peer pressure and other instruments of informal governance).
6. Provide training to employees to develop skills to identify, articulate, measure and mitigate non-compliant practices. Most CEOs seeking to mitigate the risks of business corruption in Russian companies agree that making key employees at every level of the organization active participants in the anti-corruption strategy is critical for its success. Conducting detailed surveys on informal practices and providing a platform for discussion of the elephant-in-the-room in systemically corrupt environments is an important addition to anti-corruption legal training and integrity education. A leader's will to control the risks associated with corruption, to go beyond general programmes of anti-corruption compliance and to offer specific skills to identify, articulate, measure and manage corrupt practices can and does work in endemically corrupt environments.

Appendix 1 — Descriptive Statistics

	Frequency	Per cent	Cumulative per cent
Firm size: number of employees			
no response	8	7.27	7.27
> 50,000	4	3.64	10.91
10,000 – 49,999	10	9.09	20.00
1,0000 – 9,999	21	19.09	39.09
100 – 999	33	30.00	69.09
50 – 99	14	12.73	81.82
> 50	20	18.18	100.00
Industry			
no response	5	4.55	4.55
extractive industry	3	2.73	7.27
energy, oil & gas	7	6.36	13.64
manufacturing	13	11.82	25.45
telecommunications & IT	16	14.55	40.00
financial services	12	10.91	50.91
retail	5	4.55	55.45
services	25	22.73	78.18
other	24	21.82	100.00
Firm ownership			
no response	5	4.55	4.55
foreign company	13	11.82	16.36
joint venture	9	8.18	24.55
public company	5	4.55	29.09
government-controlled public company	2	1.82	30.91
state-owned company	6	5.45	36.36
private company	70	63.64	100.00
Firm: present in number of regions			
no response	5	4.55	4.55
> 10	28	25.45	30.00
5 – 9	17	15.45	45.45
2 – 4	41	37.27	82.73
1	19	17.27	100.00

	Frequency	Per cent	Cumulative per cent
Firm: age			
no response	6	5.45	5.45
> 20	16	14.55	20.00
11 – 20	46	41.82	61.82
6 – 10	25	22.73	84.55
2 – 5	12	10.91	95.45
< 5	5	4.55	100.00
Respondent: position in firm			
no response	5	4.55	4.55
supervisory board	12	10.91	15.45
vice-president	6	5.45	20.91
CEO	40	36.36	57.27
board of directors	13	11.82	69.09
shareholder	10	9.09	78.18
other	24	21.82	100.00
Respondent: years within firm			
no response	5	4.55	4.55
11 – 20	25	22.73	27.27
6 – 10	31	28.18	55.45
2 – 5	36	32.73	88.18
< 5	13	11.82	100.00
TOTAL	**110**	**100.00**	