

U.S. Multinational Corporations in Countries with Low Corruption Perception Index

Andrew I. Nwanne

College of Business, Indiana Institute of Technology, United States
*Corresponding Author: Ainwanne@indianatech.edu

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Abstract Multinational corporations (MNCs) manage production or deliver services in many countries. These corporations are required to comply with applicable U.S. laws and those of their host countries; however, the business environments differ from country to country as well as standards, practices, laws, ethics, culture and system of government. As a result, U.S. multinationals face various dilemmas and challenges in the global business environment as they strive to increase productivity, revenues, and profitability and at the same time comply with the existing laws against bribery and corruption in both home and host countries. This study reviewed the existing literature and examined the findings of the U.S. Department of Justice on select U.S. MNCs in violation of the Foreign Corrupt Practices Act (FCPA). Bribery as instrument of business practice has adverse impact on the multinational corporation, the host country, and the home country. The Foreign Corrupt Practices Act has been instrumental in controlling the U.S. businesses in bribery conducts abroad. The stiff sanctions against the violators have been effective in compliance assurance. It is recommended that countries with low corruption perception index enact or enforce their existing laws against bribery and corruption and MNCs utilize the assurance framework to avoid corrupt practices.

Keywords Multinational Corporation, Bribery, Corruption, Foreign Corrupt Practices Act

1. Introduction

As MNCs continue to engage in global business, among the overarching problem they face in their rivalry and competition is the issue of bribery and corruption. Bribery, a form of corruption, involves offering someone money, services, or other values, in order to persuade him or her to do something in return. Corruption involves behavior on the part of officials in the public and private sector, in which they improperly and unlawfully enrich themselves and/or those close to them, or induce others to do so, by misusing the position in which they are placed. Bribery is considered a

criminal offense through national and international laws. Considering that bribery is a widespread phenomenon in international business transactions, including trade and investment; this raises serious moral and political concerns, undermines good governance and economic development, and distorts international competitive conditions. The Organization for Economic Cooperation and Development (OECD), an anti-bribery convention, established legally binding standards to criminalize bribery of foreign public officials in international business transactions and provides for a host of related measures that make this effective.

Other international conventions against Corruption include UN convention against corruption which provides preventive measures and criminalization of various corrupt acts inclusive of bribery of foreign officials. Further, the Council of Europe's Criminal Law Convention on corruption has anti-bribery provisions to discourage these business practices. Hawley (2000) stated the impact of multinationals' corrupt practices on Third World as: undermining development, disadvantage to smaller domestic firms, wealth transfer to the rich countries, decision-making distortion, increase debt, benefits the company to the detriment of the host country, and the bypass of local democratic processes. Wu (2005) noted the hidden costs of bribery to include; exposure of the firm to substantial legal and financial risks, more demands for bribe payments by corrupt officials which undermines the firms' drive in developing long-term competitive advantages. He summarized that bribery practices have several hidden costs that may dwarf any immediate gains from such practices; therefore, firms should avoid or minimize the opportunities for bribery practices in order to protect the interests of the shareholders.

The purpose of this study is to review existing literature and examine the findings of the U.S. Department of Justice on select U.S. MNCs in violation of the Foreign Corrupt Practices Act (FCPA) in their host countries with low corruption perception index (CPI). The study will also examine the impact of the FCPA on the conduct of U.S. MNCs in their host countries. The findings from this study will serve as the basis for developing effective strategies and best practices for MNCs in operating in countries with low

CPI. The corruption perception index is a ranking of countries by Transparency International according to their perceived levels of public sector corruption. Countries with low CPI have a high level of public sector corruption and those with high CPI have a low level of public sector corruption. On a scale of 1-10 (with 1 representing the lowest and 10 the highest CPI index), the 2011 ranking of 183 countries placed New Zealand #1 with the score of 9.5; Denmark, #2 (9.4); U.S.A, #24 (7.1); Poland, #41(5.5); Romania, #75(3.6); Greece, #80 (3.4); Nigeria, #143 (2.4); Kyrgyzstan, #164 (2.1) and North Korea and Somalia ranked #182 (1.0).

2. Literature Review

Wrage & Wrage (2005) noted that projects with the greatest value provide the greatest opportunities for personal enrichment of decision makers and that acquiescing in petty extortionate schemes is neither efficiency-producing nor job-creating nor income distributing in any significant and valuable way. Hakkala, Norback & Svaleryd (2008) studied the asymmetric effects of corruption on Foreign Direct Investment (FDI) and found that corruption may affect the probability that a firm chooses to invest, but not the size of affiliate activities once the firm has decided to invest and that corruption may have a differential effect depending on the type of investment as measured by different types of affiliate activities.

In examining political risk as a determinant of investment by Spanish multinational firms in Europe, Jimenez, Duran & Manuel de la Fuente (2011) observed that lower political constraints, cultural and geographical proximity, population, lower unemployment rates and previous international experience in countries all around the world play a key role as determinants of FDI location for Spanish firms. They noted that Corruption Perception Index (CPI) has negative impact because the scores of the traditional destinations of Spanish FDI (Portugal, France, Italy and Germany) are lower than those countries such as Finland and Demark with higher CPI. Further, Bahmani-Oskooee, Kholdy, & Sohrabian (2013) studied the MNC and financial markets in corrupt host countries and found that foreign investment has a positive and significant effect on financial development and the stimulus effect of FDI on financial development was stronger in countries with higher degrees of political corruption. Their explanation was based on the ease of bribing the officials to expedite the necessary transactions in corrupt countries and the pressure of foreign competition that could threaten the existence of incumbent elite. Kouznetsov and Jones (2009) explored the conditions in Russia and their effects on the entry mode decisions of multinational manufacturing enterprises and noted economic conditions to be the only determinant of entry modes for large multinational manufacturing companies investing in Russia with other country factors playing role in their choices.

Lee (2012) found that MNC subsidiaries located in countries with a lower level of corruption are more profitable

and that MNC subsidiaries with a greater focus on local sales are more profitable when the corruption level is low. Field (2006) discussed the risks and costs associated with corrupt practices. He stated that corruption adds more than 10% of the total cost of doing global business and 25% to the cost of procurement contracts in developing countries; expose the company to serious risks on reputation and exerts pressure on the company to pay another bribe. In reflecting on global business corruption, Boeckmann (2008) suggests that employees and company leaders should be engaged in the global campaign to root out bribery and global business corruption. He believes that business corruption is one of today's biggest problems as it affects the national security and the national wealth of many nations.

Meanwhile, Wu (2006) examined the impact of a distance measure of corruption between the host and the source countries on cross-border direct investment and found that corruption distance deters cross-border investment. He notes that corruption distance is not as a serious a deterrent of outward direct investment from more corrupt countries as it is from less corrupt countries. Wombolt (2011) examined China's anti-corruption measures and enforcement and found a shift from the traditional demand side of bribery to a focus on the supply side. Prominent MNCs mentioned include Toyota, McDonalds, Whirlpool, etc. He emphasized that MNCs should mitigate their legal exposure under Chinese law by taking the views of their legal counsel.

Mitchell & Campbell (2009) examined the effects of corruption on business venturing within the United States and found that venturing is caused in part by corruption. They stated that in developing countries with high levels of corruption, people are often forced into small-business venturing or survivalist entrepreneurship because larger, more efficient firms do not exist compared to developed countries with low corruption where people choose entrepreneurship as a better means of innovating.

3. Data and Research Methodology

This study relied on a review of existing literature, the record of the violations of FCPA by the selected MNCs as documented by the U.S. Department of Justice, and the business operations of these corporations. In addition, the author analyzed the data of Transparency International's Corruption Perceptions Index of 2011 and Bribe Payers 2011 Index. While the Corruption Perception Index measures the perceived levels of public sector corruption, the Bribe Payers Index ranks the likelihood of companies from 28 leading economics winning business abroad by paying bribes.

4. Foreign Corrupt Practices Act (FCPA)

An Overview

The Foreign Corrupt Practices Act of 1977, as amended was enacted for the purpose of making it unlawful for certain

classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. Specifically, the anti-bribery provisions of the FCPA prohibits the willful use of the mails or any means of instrumentality of interstate commerce corruptly in furtherance of any offer, payment, promise to pay, or authorization of the payment of money or anything of value to any person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly to a foreign official to influence the foreign official in his or her official capacity, induce the foreign official to do or omit to do an act in violation of his or her lawful duty, or to secure any improper advantage in order to assist in obtaining or retaining business.

Since 1977, the anti-bribery provisions of the FCPA have been applied to all U.S. persons and certain foreign issuers of securities. With the enactment of certain amendments in 1998, the anti-bribery provisions of the FCPA now also apply to foreign firms and persons who cause, directly or through agents, an act in furtherance of such a corrupt payment to take place within the territory of the United States. The FCPA also requires companies whose securities are listed in the United States to meet its accounting provisions. These accounting provisions, which were designed to operate in tandem with the anti-bribery provisions of the FCPA, require corporations covered by the provisions to (a) make and keep books and records that accurately and fairly reflect the transactions of the corporation and (b) devise and maintain an adequate system of internal accounting controls. Koehler (2012) observed that failure to comply with FCPA has business effects such as high cost in legal fees and downgrade of a company's rating due to prolong FCPA investigation in addition to any ultimate fine and penalty amount announced on resolution day. As illustrations, he cited that Avon Corporation spent \$225,000.00 per day for three years on its FCPA investigation and Weatherford International incurred \$123 million in legal and professional fees in complying with FCPA investigation.

Three MNCs were selected for this study based on their guilty plea bargain with U.S. Department of Justice or conviction in U.S. court for violation of FCPA provisions. The selected MNCs are Kellogg Brown & Company, Johnson & Johnson, and Alliance One International Inc.

Kellogg Brown & Root LLC (KBR)

Kellogg Brown & Root LLC, a global engineering, construction and services company pleaded guilty to the charges of violating Foreign Corrupt Practices Act for participating in a decade-long scheme to bribe Nigerian government officials to obtain engineering, procurement and construction contracts. The contracts to build liquefied natural gas facilities on Bonny Island, Nigeria were valued at more than \$6 billion. Under the terms of agreement with the Department of Justice, Kellogg Brown & Root agreed to pay a \$402 million criminal fine and to retain an independent compliance monitor for a 3-year period to review the design

and the implementation of its compliance program. Overall, total penalties and forfeiture orders resulting from this bribery scheme against KBR and its co-conspirators totaled \$1.7 billion.

Johnson & Johnson

Johnson & Johnson paid \$21.4 million in criminal penalty to resolve FCPA charges against the company. According to U.S. Department of Justice (DOJ), Johnson & Johnson admitted that its subsidiaries, employees and agents paid bribes to publicly-employed health care providers in Greece, Poland and Romania and that kickbacks were paid on behalf of Johnson & Johnson subsidiary companies to the former government of Iraq under the United Nations Oil for Food program. DePuy, Inc. (DePuy), a subsidiary of Johnson & Johnson was accused of engaging in conspiracy to secure lucrative business with hospitals in the Greek public health care system by making and promising to make corrupt payments of money and things of value to publicly-employed Greek HCPs.

Alliance One International Inc.

Alliance One International, a global tobacco leaf merchant headquartered in Morrisville, NC pleaded guilty to violation FCPA charges. Two of its foreign subsidiaries were involved in bribing foreign government officials. Alliance One International AG was charged with bribing government officials in Thailand to secure contract with Thailand Tobacco, a Thailand government agency and Alliance One International-Kyrgyzstan for conspiracy to violate anti-bribery provisions of the FCPA. The plea agreement required a total of \$9.45 million in fines (AOI-AG, \$5.25 million and AOI-Kyrgyzstan, \$4.2 million).

Bribe Payers 2011 Index

Hardoon & Heinrich (2011) highlighted the study conducted by Transparency International that surveyed 3000 business executives worldwide about their perception of the extent to which companies from 28 of the world's leading economies engage in bribery while doing business abroad. The results showed that no country among the 28 major economies inclusive of United States was perceived to be whole clean that do not engage in bribery. Figure 1 provides the ranking from the scale of 0 to 10 with 0 representing pervasive engagement of bribery by companies from a specific country in doing business with other countries and 10 indicating no engagement in bribery when doing business with other countries.

Netherlands and Switzerland were ranked number 1 with each score of 8.8 and standard deviation of 2.0 and 2.2 respectively; followed by Belgium ranked #3 with a score of 8.7 and standard deviation of 2.0 and Germany ranked #4 with a score of 8.6 and standard deviation of 2.2. United States was ranked #10 with a score of 8.3 and a standard deviation of 2.7. At the bottom of the list were China, ranked #27 with a score of 6.5 and a standard deviation of 3.5 and Russia, #28 with a score of 6.1 and a standard deviation of 3.6.

| RANK/ TERRITORY | COUNTRY | SCORE | NUMBER OF OBSERVATIONS | STANDARD DEVIATION | 90% CONFIDENCE | |
|--------------------|----------------|-------|---------------------------|-----------------------|----------------|----------------|
| | | | | | LOWER BOUND | UPPER BOUND |
| 1 | Netherlands | 8.8 | 273 | 2.0 | 8.6 | 9.0 |
| 1 | Switzerland | 8.8 | 244 | 2.2 | 8.5 | 9.0 |
| 3 | Belgium | 8.7 | 221 | 2.0 | 8.5 | 9.0 |
| 4 | Germany | 8.6 | 576 | 2.2 | 8.5 | 8.8 |
| 4 | Japan | 8.6 | 319 | 2.4 | 8.4 | 8.9 |
| 6 | Australia | 8.5 | 168 | 2.2 | 8.2 | 8.8 |
| 6 | Canada | 8.5 | 209 | 2.3 | 8.2 | 8.8 |
| 8 | Singapore | 8.3 | 256 | 2.3 | 8.1 | 8.6 |
| 8 | United Kingdom | 8.3 | 414 | 2.5 | 8.1 | 8.5 |
| 10 | United States | 8.1 | 651 | 2.7 | 7.9 | 8.3 |
| 11 | France | 8.0 | 435 | 2.6 | 7.8 | 8.2 |
| 11 | Spain | 8.0 | 326 | 2.6 | 7.7 | 8.2 |
| 13 | South Korea | 7.9 | 152 | 2.8 | 7.5 | 8.2 |
| 14 | Brazil | 7.7 | 163 | 3.0 | 7.3 | 8.1 |
| 15 | Hong Kong | 7.6 | 208 | 2.9 | 7.3 | 7.9 |
| 15 | Italy | 7.6 | 397 | 2.8 | 7.4 | 7.8 |
| 15 | Malaysia | 7.6 | 148 | 2.9 | 7.2 | 8.0 |
| 15 | South Africa | 7.6 | 191 | 2.8 | 7.2 | 7.9 |
| 19 | Taiwan | 7.5 | 193 | 3.0 | 7.2 | 7.9 |
| 19 | India | 7.5 | 168 | 3.0 | 7.1 | 7.9 |
| 19 | Turkey | 7.5 | 139 | 2.7 | 7.2 | 7.9 |
| 22 | Saudi Arabia | 7.4 | 138 | 3.0 | 7.0 | 7.8 |
| 23 | Argentina | 7.3 | 115 | 3.0 | 6.8 | 7.7 |
| 23 | UAE | 7.3 | 156 | 2.9 | 6.9 | 7.7 |
| 25 | Indonesia | 7.1 | 153 | 3.4 | 6.6 | 7.5 |
| 26 | Mexico | 7.0 | 121 | 3.2 | 6.6 | 7.5 |
| 27 | China | 6.5 | 608 | 3.5 | 6.3 | 6.7 |
| 28 | Russia | 6.1 | 172 | 3.6 | 5.7 | 6.6 |

SOURCE: Transparency International (www.transparency.org)

Figure 1. Bribe Payers Index 2011

5. Discussion

A review and the analysis of DOJ records showed the extent in which KBR utilize bribes and kickbacks in furtherance of its international business. It appeared that bribery and corruption were so embedded in its organizational culture that these misconducts continued for decades at various levels of the organization. The conviction of the former top executives and lower level employees provide evidence of the extent of corporate and employees' unethical practices of the corporation. KBR was not only involved in bribing foreign government officials in order to obtain contracts but also a recipient of kickbacks in subcontracts issued to other businesses. KBR built a sophisticated network to facilitate the bribery scheme with its co-conspirators in ways designed to avoid detection of its violation of FCPA and the applicable laws in the host

countries. Aside from its massive bribery of Nigerian Government Officials to secure \$6 billion oil service contract, KBR was sued by U.S. Government for violating False Claims Acts for knowingly including impermissible costs for private arm security in billing the Army under the Logistics Civil Augmentation Program for military operations in Iraq. Further, for paying kickbacks and illegal gratuities to KBR, Saudi Arabia-based Tamimi Global Company paid U.S. Government, a total of \$20.4 million to resolve criminal and civil allegations for violating False Claims Act and the Anti-Kickback Act.

The subsidiaries of Johnson & Johnson Corporation were engaged in various illegal activities ranging from bribery and kickbacks by DePuy, Inc. in Greece, Poland and Romania. Further, Ortho-McNeil Pharmaceutical, LLC and Ortho-McNeil-Janssen Pharmaceuticals resolved both criminal and civil liability by paying substantial fines arising

from the illegal promotion of the epilepsy drug Topamax, an anti-epileptic drug for purposes not approved. In addition to these illegal activities of Johnson & Johnson subsidiaries, the U.S. Government joined suit against Scios another of its subsidiaries for marketing the cardiac drug Natrecor for a use that the Food and Drug Administration did not approve.

Johnson & Johnson, the parent company's credo provides for first priority to the service of doctors, nurses and patients, mothers and fathers and all others who use their products and services. High quality of products and services are emphasized. The Code of Business & Ethics for the Board of Directors and Executive Officers required each person certifying the policy involving conflict of interest, conduct of business & fair dealing, gifts, compliance with laws and regulations, the use of non-public information & disclosure, and the use of company funds and information. Employees are required to abide with the company's code of business conduct. It is not clear how Johnson & Johnson maintain its credo while its subsidiaries were engaged in activities that undermine what it espouses. The most common criminal and civil violations involve marketing its drugs contrary to their approved use. Such activities were detrimental to patients and others who use their products and inconsistent with high quality of service. The overall results of such illegal activities do not create long-term values to the shareholders. The same is applicable to the use of bribery as instrument of international business conduct.

Since pleading guilty to violation of FCPA charges for bribing foreign government officials in Thailand and Kyrgyzstan by its subsidiaries, Alliance One International Inc has made significant changes in its business operations. It has strengthened its Code of Business Conduct. Its revised Code of Business Conduct dealt with bribery and corruption with toll free number available to report any violation of the code with provisions for anonymity. Employees are encouraged to report any violation to the Corporate Compliance Officer without the necessity of following the chain of command.

Doh, Rodriguez, Collins, & Eden (2003) noted that the magnitude of both direct and indirect costs of corruption is driven by two key dimensions; the pervasiveness (or level) of corruption and its arbitrariness (uncertainty). They suggested the following key strategies for coping with corruption: Avoidance, adjusting entry mode, adoption of corporate code of conduct, training, development and public education, social contribution and public donation, and laws and agreements. There have been various initiatives, activities, and conventions focused on combating bribery and corruption by various international organizations. Some of these initiatives, activities, and conventions include: OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, UN Convention Against Corruption, World Bank Anti-Corruption Strategies, Inter-American Convention Against Corruption, African Union Convention on Preventing and Combating Corruption and EU Convention Against Bribery. Despite these efforts, bribery and

corruption continue to pose significant challenge in the international business transactions.

6. Recommendation

There are best practices that are available for multinational corporations to use in order to avoid entanglement or for participating in bribery and corrupt activities. Prominent among them is having an effective code of ethics and translating the code into action. It should be embedded in the organizational culture with periodic training and orientation for all employees.

As evidence of effective ethical practices, the Ethisphere Institute in New York published the list of the 2012 world's most ethical companies. Some of the sixth straight winners include several multinational companies. Among them are General Electric Co, Johnson Controls Inc., Eaton Corporation, and Kao Corporation (Japan). These companies were recognized for promoting ethical business standards and practices internally, exceeding the minimum legal requirements and shaping the future industry standards by using the best practices.

Brook, Cote-Freeman & Wilkinson (2012) in the Assurance Framework for Corporate Anti-Bribery Programmes developed by TI provide a comprehensive approach for eliminating bribery and corruption in global business. The framework serves as guidance on the process for independent assurance of an anti-bribery program in corporations. The Assurance framework requires corporate executives to take the following actions:

1. Benchmark the corporation's control objectives against TI objectives
2. Evaluate the design of the business control procedure to ensure they are likely to achieve the control objectives

Assurance Framework Control Objectives are:

- a) The corporation implements overall culture of business ethics and integrity in its operations with policy prohibiting bribery
- b) Regular risk assessment to identify changes and risks that could affect the business ability to achieve anti-bribery goals
- c) Develop appropriate measures based on risk assessment
- d) Information communicated widely both internally and externally regarding the company's anti-bribery policy
- e) Continuous monitoring of the effectiveness of the anti-bribery policies and procedures.

7. Conclusion

Bribery is prevalent in international business. The breadth and scope varies from country to country. Some multinational corporations operating in countries with low

corruption perception index are more prone to bribe in order to achieve their business prerogatives than those operating in high corruption perception index; however, no country is immune from bribery based on the previous studies analyzed. Bribery as instrument of business practice has adverse impact on the multinational corporation, the host country, and the home country.

The Foreign Corrupt Practices Act enacted by U.S. Congress and enforced by the Department of Justice has been instrumental in controlling the conduct of businesses in bribery abroad. The stiff sanctions against the violators have been effective in compliance assurance. It is in the interest of corporations engaged in international business to maintain a high corporate ethics, comply with U.S. laws, and those of their host countries. Utilizing the strategies and best practices noted in this paper will enable MNCs to operate effectively in countries with low CPI and ensure the adherence to U.S. and the host country laws. Since most of the bribery and corruption experienced by MNCs are in countries with low corruption perception index, it becomes urgent for those countries to enact or enforce existing laws against bribery and corruption that undermines its integrity, damage its reputation and impede its advancement.

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