Combating Corruption: A Corporate Perspective

-Research Report-

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Executive Summary

Corruption is a very broad topic which dates back as far as the 4th century B.C. Corruption means different things in different contexts. A brief definition is the abuse of public power for private benefit. The destructive effects of corruption on economic growth and social stability, demands for practical strategies to reduce corruption have grown dramatically over the years. Corruption simply affects everyone. For this reason, the state, public sectors, private sectors and the civil society must work together to defeat and reduce corruption. The governments obviously do have power to fight this problem, so does the civil society, especially the international organizations.

Some of the causes of corruption include: inefficient systems, lack of transparency and accountability, complex rules and regulations, trade restrictions and the lack of agreement on the political, social, and economical effects of corruption. The consequences of corruption includes: the negative impact on both foreign and domestic investments, creates uncertainty, increases cost of business, economic growth is hindered, less innovativeness, the quality of jobs will be lowered, and talented workers will be misallocated.

Multinational companies which invest in the Visegrád Group (Poland, Czech Republic, Slovakia and Hungary) are vulnerable to the problem of corruption. These are the countries with a high corruption and bribery and a large amount of Foreign Direct Investments. Therefore they should all implement main strategies for to fight corruption: publicity speak out against corruption, good corporate governance, transnational cooperation and implement a code of conduct. When we take these strategies in account, one should aspect that companies which are investing in the Visegrád Group have an explicit opinion about corruption. As we analyzed their codes of conduct it attracted our attention that only one of the four main investing companies we investigated has anti-corruption statement. In general multinationals should only do business with other parties which are explicit against corruption. In this way a whole anti-corruption network appears, which should contribute to the solution.
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Preface

This research paper is written for the department of Business Society Management, Rotterdam School of Management – Erasmus University. Corruption was one of the topics from the list of research issues for the core course “International Business and Public-Private Partnership” supervised by Professor R. van Tilder and Professor L. Meijs.

The research team consists of three students who have decided to deepen their knowledge in the area of corruption and understand the position of corporate corruption in the societal triangle.

Katarzyna Marchlewska
Alper Özçelik
Ralph Vleugel
Introduction

“Corruption is an obstacle to progress and the antithesis of good governance. It is a stain on the integrity of a nation. It diminishes its moral fibre. Corruption hinders investment, slows growth, contributes to unemployment, leads to a reduction in living standards and reduces government revenues.”

Laisenia Quarase

Corruption is a very broad topic and has gained a great deal of attention. Even today it is spoken of as if it is a new phenomenon, but it is not. Surprisingly, corruption dates back as far as the fourth century B.C, in India (IIAS, 2003). Kautilya, a prime minister of an Indian kingdom, wrote the Arthashastra discussing the issue (Tanzi, 1998). In medieval, English legislation, from 1346, judges were denied the right to take a bribe or money, which could bring gain (IIAS, 2003). These two evidences prove that corruption is clearly not a new topic.

As mentioned, corruption goes far back as the 4th century, and will enter the 21st century as if it is a new phenomenon. It is not clear whether corruption has increased or decreased within this timeframe. One can only assume that the number of governments and corporations has increased from the 4th century onwards, and therefore corruption has increased too, but then again, this is only an assumption. What we do know are the causes and effects of corruption within a society. Numerous solutions have been proposed to prevent corruption, but the question still remains if they are effective at all.

The destructive effects of corruption on economic growth and social stability, demands for practical strategies to reduce corruption have grown dramatically over the years. Unfortunately, the problem does not seem to be limited to any particular region, and developed, developing and transition economies alike are confronting these challenges (World Bank, 2005). As the Secretary-General of the United Nations, Kofi Annan, mentions it: corruption is a serious obstacle to economic and social development (United Nations, 2005).
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Therefore governments, private sectors and civil society including NGOs are trying to counter the corruption by implementing law, regulations and increasing the society awareness.

Our research question is:

“What are the causes, consequences and possible solutions of corruption in the corporate sector and how do main investors in the new EU members deal with this problem?”

The goal of this research is to create a comprehensive view on corruption and how this affects multinationals. To have a complete framework, the causes and consequences of corruption will be explained and thereafter will go in-depth on how investors in the new EU members deal with corruption. In this research we will not look at how it is corruption is solved in the new EU member but will only use these countries as a case study.

The reflective circle (Van Tulder, 1996) has been used in order to answer the research question.

Source: Lecture sheets Van Tulder, 2005
Firstly, a problem definition will be provided with background information on corruption. Secondly, a diagnosis will be given on whose problem corruption is and what the causes and consequences are. Next, the design and implementation will be jointly dealt with and looks at strategies which will be provided to combat corruption in business. Thereafter, a brief evaluation will be presented on the possible ways for monitoring corruption. Finally, a conclusion will be given.
1. Corruption

This chapter will give background information on corruption in order to fully understand the issue. Specifically, we will look at the different definitions of corruption defined by different organizations and researchers. Furthermore, the existence of quid pro quo, and the institutional positions of payers and payees is explained.

1.1 Definition of corruption

Since corruption is a very broad subject, it has been defined from an economical, political, cultural and psychological perspective. Therefore, corruption does not have a single definition. It means different things in different contexts (Bradhan, 1997).

The United Nations Office on Drugs and Crime (UNODC) has actually looked at where the word “corruption” stems from. The word "corruption" comes from the Latin verb "corruptus" to break; literally meaning broken object. Corruption is a form of behavior, which departs from ethics, morality, tradition, law and civic virtue (www.unodc.org).

The most popular and simplest definition has been defined by the World Bank as the abuse of public power for private benefit (Tanzi, 1998). Tanzi does stress out that it should not be concluded that corruption does not exist within the private sector, it does exist in the private sector. Transparency International has defined corruption as “the abuse of entrusted power for private gain” (www.transparency.org). This definition is clearly very similar to that of the World Bank, which confirms Tanzi’s statement, that the definition of the World Bank is most popular. Although the definition of the World Bank is most popular and simple, maybe too simple, we prefer to use the definition of Bradhan who has used the principle-agent theory to define corruption as “the use of public office for private gains, where an official (the agent) entrusted with carrying out a task by the public (the principle) engages in some sort of malfeasance for private enrichment which is difficult to monitor for the principle” (Bradhan, 1997). This definition is more comprehensive from a corporate perspective.
1.2 Quid pro quo

According to Rose-Ackerman, a distinction is made between appropriate and inappropriate behavior in terms of cultural norms. Gift giving and patronage might be expected, however because of the hidden costs it is not appreciated by ordinary citizens (Rose-Ackerman, 1999). Rose-Ackerman further states that economics cannot answer cultural questions, but it can help one understand the implications of a society’s choices.

To make a clear distinction between bribes, prices, tips, and gifts, Rose-Ackerman has used two dimensions: existence of quid pro quo, and the institutional positions of payers and payees. These two dimensions create the four categories: bribes, tips, gifts, and market price as shown in table 1 below.

<table>
<thead>
<tr>
<th>Quid pro quo</th>
<th>No explicit quid pro quo</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payment to principle</td>
<td>Price</td>
</tr>
<tr>
<td>Payment to agent</td>
<td>Bribe</td>
</tr>
</tbody>
</table>


*Gifts* are altruistic transfers with no expectation of material reward and provide a psychological benefit, but tangible gains do not exist. However, if gifts create obligations, the benefit in return must be something that accords to the charity’s purpose, this is a *price*. *Bribery* indicates that society inefficiently structured the agency relationship. Quid pro quo is vague with *tips* and the service is actually delivered before the tip is paid. (Rose-Ackerman, 1999)
2. Whose problem is it?

In this chapter we start with the diagnosis part of reflective circle. To know more about corruption we analyze the environment: state, civil society and the market. Because our research is from the business perspective, we will describe the state (governments) and civil society as the external parties in this chapter. The business perspective will be dealt with in the next chapter.

2.1 Corruption in the societal triangle

Corruption is a threat to the development and internal stability of countries around the world. It has an effect on the government, the private sector as well as the civil society (see Figure 1).

Figure 1. Corruption in the societal triangle

The stakeholder perception states that besides the stockholders there are other groups, which have a stake in the actions of the corporation, to whom the corporation is responsible for (Freeman & Reed, 1983).
Stakeholder refers to “those groups without whose support the organization would cease to exist” and includes the shareholders, employees, customers, suppliers, lenders, and the society (Freeman & Reed, 1983).

To clearly understand the stakeholder theory Jonker and Foster have made a table with two axes: the components involved in any stakeholder relationship and the elements involved in each stakeholder engagement. The components include the stake, parties, processes and connections and needs to be considered separately (Jonker & Foster, 2002). The elements represent those aspects of the engagement that affect its outcome which are power, criticality, and rationality (Jonker & Foster, 2002).

Table 2. Basic structure of the stakeholder model

<table>
<thead>
<tr>
<th>COMPONENTS OF THE RELATIONSHIP</th>
<th>Stake</th>
<th>Parties</th>
<th>Process</th>
<th>Connections</th>
</tr>
</thead>
<tbody>
<tr>
<td>[What are the key issues in the relationship?]</td>
<td>[Who or what are involved?]</td>
<td>[What processes are involved in managing the relationships?]</td>
<td>[What form do the connections between the organization and the stakeholders take?]</td>
<td></td>
</tr>
<tr>
<td>Does the nature of the claim or stake have implications for the type of power involved?</td>
<td>What type of power do the parties involve use [if required] to obtain a result?</td>
<td>Do some processes result in the exercise of different types of power?</td>
<td>What effects does the form of connections have on the form of power used? Or is power exercised directly or indirectly?</td>
<td></td>
</tr>
<tr>
<td>Why is the interest or stake worth investing time and effort on?</td>
<td>What is it about the attributes, behavior, attitudes or beliefs of the parties that makes the issue critical [important enough to engage]?</td>
<td>Are the processes important on the on-going life [operations] of the parties? Is it central to the decision-making process?</td>
<td>How critical or important do each party regard the connections?</td>
<td></td>
</tr>
<tr>
<td>How is the interest or stake expressed [cognitive, social or personal]?</td>
<td>What are the epistemological and ontological perspectives of the parties and how do they influence their view of the issue or interest?</td>
<td>Do the processes and procedures affect the opportunity for the understanding based on a broad or narrow conceptualization of rationality?</td>
<td>Does the form of the connection encourage or discourage dialogue rather than egocentric claims?</td>
<td></td>
</tr>
</tbody>
</table>

2.2 External parties: governments and civil society

Referring to the reflective circle, we describe the government and civil society:

**Governments**

Corruption strives where states are too weak to control their own bureaucrats, to protect property and contract rights, and to provide the institutions that underpin an effective rule of law (Hellman, Jones, Kaufman, Schankerman, 2000).

According to the World Bank's report "Helping Countries Combat Corruption: The Role of the World Bank" the causes of corruption are rooted in a country's policies, bureaucratic traditions, political development, and social history. Furthermore, it is stated that economic rents in transition economies can be huge due to the fact that the amount of formerly state-owned property is considerable. Public institutions are vulnerable because of unreliable contract enforcement, unclear property rights, unpredictable policies, and inefficient public administration, thereby significantly reducing private investment and leading to slower growth (World Bank Report, 1997).

Corruption has destabilized development in Africa and has slowed the emergence of well functioning market economies in the former Soviet Union, the coexistence of high growth and systemic corruption in some Asian countries challenges those who believe that corruption is always economically harmful (World Bank report, 1997). Many governments, including countries from Central and Easter Europe and the Baltic’s, have made combating corruption a priority and have turned to the world bank for assistance in designing feasible anti-corruption strategies (www.worldbank.org).
Civil Society (International Organizations)

Since corruption is an international problem it requires international solutions. There are numerous international organizations which are concerned and sensitive to societal issues around the world. For this reason, these organizations feel responsible in tackling these issues and clearly have a stance against corruption and are making efforts that are directed at the criminalization of corruption.

Some of these international organizations are: the International Monetary Fund (IMF), the Organization for Economic Co-operation and Development (OECD), the World Bank, the United Nations (UN), and the European Union and will briefly examine their standpoint respectively.

The International Monetary Fund (IMF) is an organization with 184 member countries. It promotes good governance which ensures the rule of law, improve the efficiency and accountability of their public sectors, and tackle corruption. The IMF defines corruption as the abuse of public authority or trust for private benefit (www.imf.org). The Board of Governors of the IMF recommended to "promote good governance in all its aspects, including by ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption, as essential elements of a framework within which economies can prosper" (www.imf.org).

The Organization for Economic Co-operation and Development (OECD) has 30 member countries and has active relationships with another 70 countries, NGO’s and civil society sharing a commitment to democratic government and the market economy (www.oecd.org). The OECD believes that in recent years corruption has become a major political and economic issue, it is no longer business as usual and therefore finds it absolutely evident to take measures against it. Fighting corruption will strengthen development, reduce poverty and encourage confidence in markets (www.oecd.org) and therefore, encourages member states to end the tax deductibility of bribes and criminalize the bribing of foreign officials (World Bank Report, 1997).
The World Bank is an organization that provides financial aid as well as technical assistance to developing countries around the world. In the past nine years the World Bank has worked together with other international groups and civil society to significantly raise the profile of corruption as a development issue (www.worldbank.org). The World Bank has a comprehensive and integrated anti-corruption strategy, and has a clear stance that corruption is an obstacle to growth and poverty reduction (www.worldbank.org). Furthermore, the World Bank has gathered a team of investigators that uncover those engaged in fraud and corrupt practices in bank projects.

According to the UN corruption is a complex social, political and economic issue and has the most impact on the poor, those least able to absorb its costs. Corruption undercuts services, such as health, education, public transportation or local policing, that those with few resources are dependent upon (www.un.org). The UN has a Global Programme Against Corruption that targets countries with vulnerable developing or transitional economies by promoting anti-corruption measures in the public sphere, private sector and in high-level financial and political circles (www.un.org). Furthermore, the United Nations has adopted a Declaration against Corruption and Bribery in International Commercial Transactions. The declaration's wording on criminalizing foreign bribery and ending its tax deductibility signifies broad political agreement in the international community on this matter (World Bank Report, 1997).

The European Union (EU) is a family of 25 “democratic” countries that are committed to working together for peace and prosperity. The EU commission has established the European Anti-Fraud Office to protect the interests of the EU, to fight fraud and corruption, and any other misconduct within the European Institutions (www.europa.eu.int). Furthermore, the European Commission (EC) adopted a Communication to the Council and the European Parliament on a Union Policy against Corruption. This sets out the EC's comprehensive policy on corruption inside the EU as well as in its relations with non-member countries.
The communication deals with a wide range of actions, including the ratification of conventions criminalizing the corruption of EC officials and officials of member countries, eliminating the tax deductibility of bribes, reforming public procurement, accounting, and auditing systems, and so on (World Bank Report, 1997).

As World Bank researches shows Poland is a new EU member that is affected the most by the problem of corruption. Therefore in 2004 CBOS, the social research Polish institution, has conducted a research about social attitude towards this problem (Korupcja, nepotyzm, nieuczciwy lobbing, CBOS, 2004). The results show that 65% of Polish citizens claim that corruption is a huge problem in Poland. In 1991 only 33% of them stated that. It reflects how the awareness of the corruption problem has increased. Moreover the bribes and gifts giving are common among the employees of the public sector and politicians (84% of Polish citizens claim that). Civil servants very often choose particular private companies from the other offers only because they have some relation with the owners of the company. What is more, the posts in the public offices are usually taken by the relatives and colleagues.

Additionally 78% of Polish citizens claim that an unfair lobbing exists in Poland. Politicians take the decisions usually under the influence of the business groups. Corruption in Poland as well as in all post communist countries increased during the privatization process which was not controlled properly. What is more, the relations between politics and business are still very strong in this region. It results in many scandals like “Rywingate” – the case of bribery given to politician by a businessman in order to implement a bill. As a result the awareness of the society is increasing and more and more social initiatives has been established like the Program against corruption” of the Batory Foundation in Poland.
3. Causes and consequences of corruption in business

Chapter 2 we described the first part of the diagnosis about the parties involved in corruption. It this chapter we continue the diagnosis by describing the causes and consequences of corruption.

3.1 Causes of Corruption

In inefficient systems, lack of transparency in rules, laws and processes creates a fertile ground for corruption (Tanzi, 1998). In such systems, rules and regulations are frequently changing and most often are unclear and very complex thereby allowing perpetrators the opportunity to cover up their misconduct by refusing to provide information or providing the wrong information (CIPE, 2004).

Governments can also constitute sources of rents by trade restrictions and government subsidies. Import licenses become very valuable because certain imported goods have quantitative restrictions and therefore perpetrators act in their own interest to bribe officials and allow more goods to be imported. Trade restrictions can also be seen as a way to protect home industry from foreign competition, and therefore home-industries “lobby” to create and maintain tariffs and going as far as bribing politicians. Furthermore, industrial policies that allows poorly targeted subsidies to be appropriate by firms for which they are not intended. (Mauro, 1997) Subsidies may also be diverted into illegal businesses by top bureaucrats in return for payments from multinational profits (Institute for International Economics, 1997).

Low wages in the public sector force a percentage of the employees into corruption (CIPE, 2004). Employees misuse their positions to collect bribes as a way of making ends meet (Mauro, 1997). Simply raising wages of employees will not reduce corruption, as long as opportunities to abuse the systems exists and punishment is weak corruption will exist (CIPE, 2004).
Systems that lack accountability (CIPE, 2004) and where there are inadequate and inefficient punishments (Tanzi, 1998) give perpetrators an opportunity to misuse the system without severe consequences.

Another cause of corruption is the lack of treatment given to this area because of the difficulty in defining corruption, the delicacy of the research which characterizes the area, the problems of obtaining data, and the lack of agreement on the political, social, and economical effects of corruption (Waldman, 1973).

3.2 Consequences of corruption

Corruption can cause inefficiencies and unfairness thereby deepening the problems in the states relationship with the private sector. Lee Tashjian, head of communications at Fluor Corporation, and a member of the Partnering Against Corruption Initiative's Steering Committee and is a Strategic Partner of the World Economic Forum perfectly sums up how businesses are affected by corruption. He states: “The private-sector monitoring organization, Transparency International, estimates that corruption equals a full three percent of the world’s gross domestic product. Corruption is corrosive by its very nature because it keeps businesses from doing work in countries where bribery is prevalent, thereby limiting economic advancement. Likewise, it also significantly damages the reputation of companies that pay bribes, creating an environment of mistrust among the public” (www.weforum.org).

Corruption and bribery have great impact on an economy as the corrupted market becomes much less competitive and brings “an aggravation of economic development, increase of unfair concurrence, intensification of monopoly, expansion of shady economics and diminution of direct foreign investment (Alakbar Mammadov, 2000). “Corruption is problematic for the economy – the market does not work properly if contracts are granted on the basis of personal interest rather than price and quality” (Implementing the UN Global Compact, 2005).
"Bribes represent illegal user fees, taxes or access charges paid to public agents. These payments influence economic decisions ranging from the size and character of public investment to the level of compliance with business regulations" (Rose-Ackerman, 1997).

Entrepreneurs should not neglect the problem of corruption. As Alakbar Mammadovv claims that a corruption piles up expenses of companies and diminish its benefits:

- cost price of product rises;
- doesn't enable to enlarge investment due to the internal recourses;
- creates unfair competition;
- breaks the principle of equity in privatization;
- limits the direct foreign investments for companies;
- creates problems for start – up;
- abates the administration and abolishes the innovation;
- makes difficult to find new companions.

Therefore the issue of fighting corruption should not only be tied to the politics and law implementation. Tackling corruption and bribery from a corporate perspective is a significant step towards solving this problem as a whole.

There are different types of corruption that exist in the business world. The bribery, probably the most common type, are payments and gifts. Embezzlement is abusing the money by the person which is in charge of it. Extortion is achieving gains using threats and violence. The World Bank indicates a few situations in which we can face corruption. Among others there are two connected to business: when private firms and individuals seek to reduce costs imposed on them by government as well as when government transfer financial benefits to companies during the privatization process or by signing procurement contracts. Corruption usually occurs when business meets the government. In such situations corruption is a way of lowering costs or dividing monopoly rents. However offering bribes can also be a way of creating business relations among the companies. It is acting against the free market rules.
Corruption has a negative impact on both foreign and domestic investments (Sullivan and Shkolnikov, 2004), hinders aid flow through funds (Mauro, 1997), and creates a degree of uncertainty which drives investors away. Investors try to avoid doing business where corruption is present because it increases the cost of doing business and undermines the rule of law (Sullivan and Shkolnikov, 2004). Furthermore, the firm costs itself are increased by delays and unnecessary requirements as a way of inducing payoffs (Institute for International Economics, 1997).

Economic growth is hindered (Mauro, 1997) and the distribution of benefits are unequally distributed (Institute for International Economics, 1997). According to Sullivan and Shkolnikov (2004), smaller enterprises in a competitive environment where corruption is present have less power to avoid corruption and eventually will not survive in the market. Basically, only the strongest survive. This prevents the accumulation of innovativeness of new ideas and products in the market. The economy is ultimately affected by this. Economic growth can only be reached by both small and bigger enterprises operating in the same environment.

Enterprises become very stable and lack the innovativeness in business since time and resources are spent in finding ways to misuse the system instead of creating opportunities to find new ways in doing business. According to Sullivan and Shkolnikov (2004), competitiveness and efficiency is drastically reduced by corruption, eventually hurting the end customer by only providing low quality and high cost goods.

According to the United Nations, corruption causes reduced investment or even disinvestment, with many long-term effects, including social polarization, lack of respect for human rights, undemocratic practices and diversion of funds intended for development and essential services (www.un.org). Corruption makes firms stable and is less likely to grow and expand, therefore it lowers private sector employment levels. The quality of jobs are also likely to be effected by this (Sullivan and Shkolnikov, 2004) and talented workers will be misallocated (Mauro, 1997).
3.3 Effects on Foreign Direct Investments (FDIs) in the EU

Corruption has negative effects on the levels of both foreign and domestic investment. Investors will ultimately avoid environments where corruption is rampant because it increases the cost of doing business and undermines the rule of law. Corruption is also often associated with a high degree of uncertainty, something that always drives investors away (Sullivan and Shkolnikov, 2004). On the contrary, foreign direct investment (FDI) does not always import higher standards of corporate behavior into developing countries, especially those in which state capture and administrative corruption have already reached high levels (World Bank, 2005).

When ten new members joined the European Union on May 1st 2004, the EU has grown 67 percent at once. Off course there are a lot differences between the old and new members. If this wasn’t the case, there whole idea behind the formation of the EU would be pointless: to improve the international business and develop the economy of the EU members. With the entry of the new members into the EU the thought is that the international business will increase and therefore more FDIs will occur. To see if companies keep account of the value of corruption in a new member we give an overview of the amount of corruption in the new and old members (Table 3).

We compared the CPI 2004 score with the FDIs of 2003-2004 and analyze if there is a relation between these two variables. Of all new members, only Malta, Estonia and Slovenia have a relatively clean score. But most of the FDIs are made in Latvia, Czech Republic, Slovakia, Hungary and especially Poland. Which is odd, because they all have a negative corruption score with Poland the most corrupt country of all new members. This is very interesting, because Table 3 shows that corruption doesn’t stop multinationals to invest in highly corrupt countries. More interesting however is to know what multinationals do to keep account of corruption.
### Table 3. FDIs and corruption in old and new EU members

<table>
<thead>
<tr>
<th>Region</th>
<th>Old EU members</th>
<th>Country rank</th>
<th>CPI 2004 score (a)</th>
<th>FDIs (US$) 2003-2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nordic Countries</td>
<td>Finland</td>
<td>1</td>
<td>9.7</td>
<td>190.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Denmark</td>
<td>3</td>
<td>9.5</td>
<td>594.50 Mn</td>
</tr>
<tr>
<td></td>
<td>Sweden</td>
<td>6</td>
<td>9.2</td>
<td>1,105.60 Mn</td>
</tr>
<tr>
<td>Western Europe</td>
<td>Netherlands</td>
<td>10</td>
<td>8.7</td>
<td>1,370.80 Mn</td>
</tr>
<tr>
<td></td>
<td>United Kingdom</td>
<td>11</td>
<td>8.6</td>
<td>16,330.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Luxembourg</td>
<td>13</td>
<td>8.4</td>
<td>218.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Belgium</td>
<td>17</td>
<td>7.5</td>
<td>2,991.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Republic of Ireland</td>
<td>17</td>
<td>7.5</td>
<td>7,370.00 Mn</td>
</tr>
<tr>
<td></td>
<td>France</td>
<td>22</td>
<td>7.1</td>
<td>4,290.00 Mn</td>
</tr>
<tr>
<td>Central Europe</td>
<td>Austria</td>
<td>13</td>
<td>8.4</td>
<td>5,020.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>15</td>
<td>8.2</td>
<td>17,540.00 Mn</td>
</tr>
<tr>
<td>Southern Europe</td>
<td>Spain</td>
<td>22</td>
<td>7.1</td>
<td>19,490.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Portugal</td>
<td>27</td>
<td>6.3</td>
<td>6,490.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>42</td>
<td>4.8</td>
<td>5,120.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Greece</td>
<td>49</td>
<td>4.3</td>
<td>11,412.00 Mn</td>
</tr>
<tr>
<td>Mediterranean States</td>
<td>Malta</td>
<td>25</td>
<td>6.8</td>
<td>30.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Cyprus</td>
<td>36</td>
<td>5.4</td>
<td>70.00 Mn</td>
</tr>
<tr>
<td>Baltic States</td>
<td>Estonia</td>
<td>31</td>
<td>6.0</td>
<td>441.70 Mn</td>
</tr>
<tr>
<td></td>
<td>Lithuania</td>
<td>44</td>
<td>4.6</td>
<td>418.30 Mn</td>
</tr>
<tr>
<td></td>
<td>Latvia</td>
<td>57</td>
<td>4.0</td>
<td>1,397.07 Mn</td>
</tr>
<tr>
<td>Central Europe</td>
<td>Slovenia</td>
<td>31</td>
<td>6.0</td>
<td>851.30 Mn</td>
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<td></td>
<td>Hungary</td>
<td>42</td>
<td>4.8</td>
<td>5,920.00 Mn</td>
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<tr>
<td></td>
<td>Czech Republic</td>
<td>51</td>
<td>4.2</td>
<td>3,940.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Slovakia</td>
<td>57</td>
<td>4.0</td>
<td>4,910.00 Mn</td>
</tr>
<tr>
<td></td>
<td>Poland</td>
<td>67</td>
<td>3.5</td>
<td>18,070.00 Mn</td>
</tr>
</tbody>
</table>

(a) ‘CPI 2004 score’ relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

Source: Based on Corruption Perceptions Index 2004, Global Corruption Report, 2005 & Loco Monitor, 2005
4. Combating Corruption in business

“The first tenet is that you should report corruption regardless of loyalty to incumbent or party.”

Linda Tripp

As we mentioned earlier in this report, corruption remains one of the most important problems facing governments (including the public sector), businesses, and civil society around the world. One might expect for governments and civil society to be responsible for the issue. However, governments and civil society cannot defeat or reduce corruption alone. In order to achieve this, all parties: state, private sector and civil society must unify and be committed to reduce corruption for a mutual benefit. According to Center for International Private Enterprise (CIPE), experience has proven that participation of the private sector can lower corruption and allow more efficient markets and governments to arise. Thus, the participation of the private sector is a key to success (Sullivan and Shkolnikov, 2004). In this chapter we focus on the great responsibility for multinationals (MNCs) which are operating abroad. But before we do this, we focus on the relation between corruption and country governance. This is important to know where the opportunities in combating corruptions are.

4.1 Relation between corruption and country governance

In early stages of ant-corruption initiatives it is important to break the taboo about discussing corruption. While discussion of corruption is increasing in many developing countries and media coverage of it is more pervasive, there are countries where the topic is still off-limits due to its political sensitivity and social acceptance (Sullivan and Shkolnikov, 2004). Multinationals which invest in foreign countries have to analyze in which way corruption plays a significant role in that particular state, because there is a relation between corruption and the quality of governance (see Table 3).
In the combat against corruption it is important to analyze the quality of country governance and corruption. One has to know how much corruption is embedded and who is responsible for the occurrence of corruption. Because many countries face a lack of political will to combat corruption (Sullivan and Shkolnikov, 2004).

The fact that much corruption in developing countries has important industrial country participation is a commonplace. The non-governmental organization (NGO) Transparency International focuses on corruption in “international business transactions” and points out that there are First World givers of many Third World bribes (Klitgaard, 1998). In this situation there is a specific role for multinationals to focus on their responsiveness in decreasing the occurrence of corruption.

4.2 Private sector corruption as the supply side of corruption

Corruption can be described in the framework of supply and demand. The supply side of corruption is the private sector that provides bribes, gifts and kickbacks to the government officials who, in turn, are the demand side of corruption (Sullivan and Shkolnikov, 2004). To reduce the corrosive impact of corruption in a sustainable way, it is important to go beyond the symptoms to tackle the causes of corruption (World Bank, 2005).
Corruption is a symptom of underlying problems, not the problem itself (Sullivan and Shkolnikov, 2004). Our focus is on the supply side, because ‘for decades, anti-corruption measures targeted the demand-side of corruption and often ignore the role of the private sector’ (Sullivan and Shkolnikov, 2004). To reduce corruption, a widespread commitment by the private sector, regardless of size, industry, and location is essential (Sullivan and Shkolnikov, 2004).

There are a few ways of avoiding as well as fighting corruption by a private firm. First of all company should avoid entering the markets where bribery and corruption is necessary to survive. Not paying bribes would mean very high costs and financial insolvency. Such company could not compete on that kind of market. Withdrawing form the market is avoiding the choice between paying bribes and going bankrupt. Nevertheless on most markets bribery is not a necessity – it is the way to compete and overhead the other players. What is more, companies in most cases act on one market and it is impossible for them to withdraw.

The World Bank (2005) also believes that an effective anticorruption strategy for multinationals builds on creating a competitive private sector through implementation of a fair, competitive, honest and transparent private sector and thus hinders broad-based economic development. Three important issues from the company’s point of view play a key role:

- **Good Corporate Governance** – Weak institutions for corporate governance not only result in inefficiency, they encourage corruption. Poorly governed managers often use their positions to extract favors from the state which they can later expropriate, rather than reinvest into restructuring their own firms, to avoid sharing their gains with other stakeholders (World Bank, 2005).

- **Business Associations** – They are a means of engaging in collective action, providing a more powerful since unified voice and protecting the single firm from potential backlashes or competitive disadvantages while pursuing ethical business practices.
Business associations can serve as legitimate instruments to represent collective interests in the formulation of law and policy (World Bank, 2005).

- Transnational Cooperation - The international community has mobilized to develop instruments against transnational corruption. A number of international conventions that have the aim of intensifying and harmonizing the detection and punishment of transnational corruption (World Bank, 2005).

Thus, multinationals should be strong institutions and cooperate with other companies in the business for international collective action against corruption. For that reason tackling corruption may be more economically reasonable by using internal code of conducts. A definition of what codes of conduct are follows:

*The rationale for codes of conduct can be found in the business-society interface. Codes of conduct, therefore, encompass guidelines, recommendations or rules issues by entities within society (adopting body or actor) with the intent to affect the behavior of (international) business entities (target) within society in order to enhance corporate responsibility (Kolk, Van Tulder, 2003).*

Thus, the code of conduct is a document in which company states the values of the organization and the rules it should follow. Nowadays almost every international company implements its own code adjusted to the specific company’s conditions and characteristic. Codes are to express the social responsibility of the company as well as to support its performance. The rules have not only public relations aim. “With regard to the effect on other actors, one might think of new market opportunities, risk reduction, increased control over business partners or improvement of the corporate image” (Ans Kolk, Rob van Tulder, Carlijn Welters, 1999). It is obvious that clients and suppliers will trust the company more if it is social responsible.

The Global Corruption Report 2005, published by Transparency International, contains a sum-up of actions for trade and professional associations to combat corruption:
Publicity speak out against corruption;
Increase awareness amongst association’s members of corruption and it’s consequences through publicity and training;
Implement a code of conduct that commits the association’s members to a strict anti-corruption policy. The code should provide a disciplinary mechanism under which members who breach the code are sanctioned;
Support the development and implementation of industry-wide anti-corruption mechanisms.

The main thoughts behind these recommendations are to make all participants clear that corruption is not acceptable. Be transparent and report corrupt practices to the authorities who have a controlling function, and the tools to take action. This is very important because one of the problems with combating corruption is that ‘corruption itself has become widely accepted and perceived as a part of daily life’ (Sullivan and Shkolnikov, 2004).

In this way the codes of conduct have also additional value. They support the company as an organization giving employees clear rules they should obey in order to add value to the company and to make it successful. In that sense complying with the social responsibility rules is increasing company’s development.

Therefore it is also the way to tackle the internal problems especially corruption. “Individual ethical principles are usually covered by internal codes of conduct, which consist of guidelines for staff on how to behave when confronted with dilemmas such as conflict of interest, gifts, theft, insider training, pay-offs and bribery” (Kolk, Van Tulder, and Welters, 1999). In many situations employee may simply not know how to act when corruption occurs. The code of conduct should show him the way to react and as a result should be a way to avoid such situations and fight with bribery. What is more it is also a clear signal to the business partners as well as competitors, clients and civil servants that the company would never accept the offer that could be treated as a corruption.
This is also clear in the strategies given by Sullivan and Shkolnikov (2004), in which they focus on minimizing the causes and opportunities for illicit payments and activities primarily within the private sector. Their key strategies include:

- **Institute sound corporate governance systems** – Good corporate governance establishes a system where companies are unable to provide bribes covertly and are easily held accountable for wrongdoing. The core values of corporate governance are fairness, transparency, accountability and responsibility (Sullivan and Shkolnikov, 2004). Everybody within the company should act within the interest of the company.

- **Improve accounting standards** – Proper financial reporting is crucial to efforts to combat corruption because it makes the provision of illegal payments and services difficult to conceal, especially for companies that operate in different markets and have access to various confusing accounting practices (Sullivan and Shkolnikov, 2004).

- **Implement codes of conduct for intermediaries** – As MNCs are increasingly dependent on intermediaries to open up markets and make them function, those same intermediaries also increasingly abuse this dependency (Sullivan and Shkolnikov, 2004). When these intermediaries have implemented codes of conduct in which they recognize their willingness to be corruption-free and combat corruption they can create an honest international business environment.

Sullivan and Shkolnikov not only describe strategies to combat corruption from their corporate’s own perspective but also mention codes of conduct for intermediaries as a recommendation. Thus, it can be mentioned that all in all codes of conduct can be an effective element of anti-corruption policy in a company provided the principles are well implemented and controlled. However not all companies have comprehensive policies against bribery. Therefore significant business initiatives have been set up in order to increase the awareness in this field among the companies.
The Global Compact, which has already been mentioned is the one of the broadest activity. “The Global Compact is the world’s largest voluntary network for corporate citizenship (…) The Global Compact encompasses ten principles on corporate citizenship based on internationally agreed conventions and treaties on human rights, labour standards, environmental protection and anti-corruption.” (Implementing the UN Global Compact, 2005). „In an address to the World Economic Forum on 31 January 1999, United Nation Secretary-General Kofi Annan challenged business leaders to join an international initiative – the Global Compact – that would bring companies together with UN agencies, labour and civil society to support universal environmental and social principles. Today, many hundreds of companies from all regions of the world, international labour and civil society organizations are engaged in the Global Compact, working to advance ten universal principles in the areas of human rights, labour, the environment and anti-corruption.”(www.globalcompact.com). The tenth principle of The Global Compact is: “Businesses should work against all forms of corruption, including extortion and bribery”.

What is more, it is a voluntary program which „is not a regulatory instrument – it does not “police”, enforce or measure the behavior or actions of companies. Rather, the Global Compact relies on public accountability, transparency and the enlightened self-interest of companies, labour and civil society to initiate and share substantive action in pursuing the principles upon which the Global Compact is based.”

With a support of UN Global Compact has become one of the largest initiatives in a filed of business ethics. It is a great guideline for the companies which were not able to implement their own policies which could tackle a problem of corruption.

There is also an increasing awareness among business people of how harmful effects can corruption bring to the company’s performance. For that reason Partnering Against Corruption Initiative was set up in partnership with the non-profit organization, Transparency International, and the Basel Institute on Governance. Among the first signatories in 2004 were ABB, Chevron Texaco, Fluor, Hilti, Hochtief, Petronas, Skanska and Statoil.
"While governmental initiatives are vital to continue progress in the fight against corruption, the real bulwark in this fight must be the companies that operate in the global market." – claims Lee Tashjian, head of communications at Fluor Corporation, a member of the PACI.

“The four key objectives of the PACI are to:

1. Act as a neutral platform for coordinating the anti-corruption measures of the signatory companies;

2. Implement effective, concrete measures to tackle corruption;

3. Help independent experts, non-governmental organizations (NGOs) and government agencies to combine their efforts in this field;

4. Engage as many companies as possible in the fight against corruption and encourage them to sign up to the scheme” (www.weforum.org).

The companies which join PACI have to demonstrate zero tolerance against corruption and fight with it actively. To date 24 companies are the members of PACI, including leading engineering and technology companies. Joining the initiative companies are obliged to sign a following declaration: "We hereby certify that we have taken steps to ensure that no person acting for us or on our behalf will engage in bribery“.

In the next paragraph we focus on the best practices-companies that introduced the codes in a successful way.
4.3 Best practices-companies

Valuing the way of fighting bribery can examine so called best practices-companies that introduced the codes in a successful way. The instruction Booklet of the UN Global Compact shows the examples of fighting various forms of corruption within organizational structure thanks to an integrated internal principle.

Novozymes, world leader in enzymes which has 4000 employees in 30 countries “Novozymes’ values have been clarified in the form of six integrity principles that have been integrated into our global quality management system” (Implementing the UN Global Compact, 2005). Those principles forbid bribery, giving gifts above the limit, money laundering, facilitation payments, protection money, and political contributions. Additionally charity contributions are restricted. At the same time company has issued special training materials and selected train employees. Committee of Business Integrity was set up with the aim of providing employees with guidance and managing implementation of the principles.

As a result company indicates: „(…)our new integrity principles lead to better risk management and better utilization of business opportunities. Thus, the principles make it possible to systemically address legal requirements as well as demands from investors and other key stakeholders. Moreover, the principles have a positive impact on our reputation as a responsible company, and they also contribute to reducing the supply chain risk of our major customers, who also attach great importance to business integrity” (Implementing the UN Global Compact, 2005).

Shell is another company which has taken part in creating best practices in the area of fighting the corruption. “Shell has taken a clear, unequivocal position that bribery and corruption are universally unacceptable. We have stated that fact clearly and unambiguously in our Business Principles. And, even more important we treat that declaration as a commitment that governs our behavior wherever we do business.” (Adrian Loader, 2004).
Nowadays Shell is known for its high reputation and wide social responsibility awareness. It has contributed to the international success of the company despite the fact that it is acting on a very „socially responsible” oil market. Unilever can also be an example of the company that fights the corruption problem with implementing clear principles. In Unilever’s Code of Business Principles, which is required to be signed and accepted by all its managers and employees, we can find a major principle: "Unilever does not give or receive bribes in order to retain or bestow business or financial advantages. Unilever employees are directed that any demand for an offer of such bribe must be immediately rejected.” The Board of Unilever is responsible for implementing the rule and monitoring compliance along with the Internal Audit. “Unilever's Code of Business Principles provides a simple, solid foundation for Corporate Governance. These core guiding principles are published throughout the business, across countries and continents. They are regularly revisited as Managers are requested to commit to the fact that they have made their staff aware of what they are, and what they mean in their particular area of the business” (Albrecht Schneider, IACC, 2000).

Now we now the best practices-companies, we can compare these with the multinationals which are investing in the new European Union members, especially the Visegrád Group.

4.4 Corruption in the Visegrád Group (V4)

Our special interest is in the Visegrád Group (V4): Poland, Czech Republic, Slovakia and Hungary. After Slovenia, the Visegrád Group is the wealthiest post-Communist countries in Europe. All of them have relatively developed free market economies and have enjoyed moderate economic growth. They also have (together with Lithuania and Latvia) a corruption score of < 5.0 (see Table 3). To know more about the way multinationals deal with corruption, it had to be clear which companies have a lot of investments in these particular countries. Table 4 gives an overview of the top investing multinationals in the V4. There are a lot of well-known multinationals. To compare their statements about international bribery and corruption we analyze the codes of conduct of four these main players.
## Table 4. Overview of the top multinationals investing in V4

<table>
<thead>
<tr>
<th>Country</th>
<th>Top multinationals investing in V4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>IKEA, Carrefour, Parkridge CE Developments, Tesco, Valeo, Skoda Auto, Bosch Diesel, Daikin Industries, Ahold, Aisin Seiki</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Tesco, Samsung Electronics, ON Semiconductor, AAA Auto, Ahold, Aisin Seiki, Skoda Auto, Bosch Diesel, Daikin Industries</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Tesco, Samsung Electronics, ON Semiconductor, AAA Auto, Ahold, Aisin Seiki, Skoda Auto, Bosch Diesel, Daikin Industries</td>
</tr>
<tr>
<td>Hungary</td>
<td>Tesco Global Aruhazak, Obi, Plaza Centers BV, Kika, Lidl, Tesco Global Aruhazak, Obi, Plaza Centers BV, Kika, Lidl</td>
</tr>
</tbody>
</table>

Source: Based on Loco Monitor, 2005

### Royal Ahold NV – a Dutch key investor in the Czech Republic and Slovakia

“Bribing and corrupting public officials are serious crimes and punishable in many countries. They are counter to the free and fair competition to which Ahold is committed. Although Ahold is seated in the Netherlands, U.S. law regarding the corruption of public officials anywhere in the world has extraterritorial effect. It therefore applies to all Ahold companies and associates world-wide. In addition, as a result, all Ahold companies and associates world-wide must comply with United States law that prohibits the bribing of public officials. Ahold associates, either directly or indirectly, may not offer, promise, give, demand or accept bribes or other undue advantage to obtain or retain business or other improper advantage to or from anyone for any reason. Ahold associates may not make use of third parties to use subcontracts, purchase orders or consulting agreements as a means of paying bribes to public officials, business relations, or their relatives.”
**Tesco PLC – an English investor in Poland, Slovakia and Hungary**

Tesco PLC doesn’t have an explicit statement against corruption in their in their corporate responsibility review. They have ‘**put in place a programme to accelerate the development of Corporate Responsibility throughout our international businesses**’. Their new slogan is ‘**The way we operate is responsible and safe**’.

**IKEA – a Swedish main investor in Poland**

In IKEA’s codes of conduct the main issues are: care for the environment and against child labour. Ant-corruption has not been mentioned. **‘Doing things right – right from the start’** and **‘Low prices – but not at any price’** are just two general phrases of which could be concluded that they are anti-corruption.

**Samsung Electronics – a South Korean key investor in Slovakia**

Samsung also hasn’t an explicit opinion against corruption. In their codes of conduct they use **‘We compete in accordance with laws and business ethics’** which is very general. A little bit more specific they use **‘The Company will compete freely and fairly at all its business sites in the world, abiding by national laws and regulations and relevant international standards governing the conduct of business.’** But again very broad.

When we compare these four statements, we can only conclude that Ahold has an explicit opinion about corruption: corruption is unacceptable. In the other statements, Tesco, Samsung and IKEA, corruption isn’t mentioned.
Evaluation

In this chapter we will examine possible ways for monitoring corruption. Internal control is needed not only for detection but also for prevention of corruption.

The management of a corporation is responsible for maintaining the highest standard of ethical conduct, and therefore the power to fight corruption rests with the senior management. Anti-corruption efforts must be identified to halt corruption. To do this management needs to identify schemes and scenarios that could invite corruption. By establishing internal checks and balances management has more accountability, and it discourages corruption in an earlier stage. Furthermore, a separate corruption prevention policy to augment a code of ethics that is reviewed annually by every employee must be developed. Everyone in the company should be made aware that corruption is taken very seriously whether committed by management or front line employees. It must be made clear that there are no possibilities to misuse the system without severe punishments.

Audits are an effective means for the internal control structure. Strong auditing must be developed to promote accountability, efficiency, and effectiveness. Auditors must seek to encourage honest and efficient management. Audit tests and checks is instrumental in revealing areas of risk on which management of the audited entities are required to take corrective action.

Measuring corruption systematically is of great importance because it allows the nature and extent of corruption, identifies possible actions against it and helps in the setting of priorities (United Nations, 2004). In the United Nations Office on Drugs and Crime report it states that: “Measurements are needed not only of corruption itself, but of information in any subject area likely to be affected by corruption. This enables comparisons and other forms of analysis and creates redundancies which protect against inaccuracy or distortion. Figures which show that the number of corruption incidents .... are reduced can be cross-checked against other performance indicators.” (United Nations, 2004).
Conclusions

Corruption is a very broad subject and therefore it does not have a single definition. It means different things in different contexts (Bradhan, 1997). The World Bank has defined corruption as *the abuse of public power for private gain*. A more comprehensive definition is given by Bradhan who uses the principle-agent theory to explain the concept. He defines corruption as “*the use of public office for private gains, where an official (the agent) entrusted with carrying out a task by the public (the principle) engages in some sort of malfeasance for private enrichment which is difficult to monitor for the principle*” (Bradhan, 1997).

Although we might think that corruption is a new phenomenon, it is not. It dates back as far as the 4th century B.C. in India. Kautilya, a prime minister of an Indian kingdom, wrote the *Arthashastra* discussing the issue (Tanzi, 1998). It is not clear whether corruption has increased or decreased, but one can only assume that it has increased over the years and many solutions are proposed to fight it. However, the question still remains if these solutions are effective.

Corruption affects all parties in the societal triangle, governments, the civil society and the market (private sector). Numerous international organizations such as the International Monetary Fund, the Organization for Economic Co-operation and Development, the World Bank, the United Nations, and the European Union have a clear stance against corruption and are continuously trying to find solutions for preventing it.

There are several causes of corruption. Corruption can be caused by the following: lack of treatment and difficulty in definition, lack of transparency and accountability, trade restrictions and government subsidies, low wages in the public sector, weak punishment for perpetrators. As there are causes, there are also consequences of corruption.
These include: negative impact on foreign and domestic investments, cost of doing business increases, uncertainty in the economy, hinders economic growth, destroys smaller businesses and prevents accumulation of innovativeness, and prevents firms from growing leading to lower private sector employment and misallocation of talented workers.

Corruption intensely affects businesses because it causes inefficiencies and unfairness, thereby deepening the problems in the states relationship with the private sector. Furthermore, it keeps businesses from doing work in countries where bribery is common, thus limiting economic advancement. It also damages the reputation of companies that pay bribes, creating an environment of mistrust among the public. Governments and civil society alone cannot prevent or reduce corruption. To achieve this, the state, the private sector and civil society must unify and be committed to prevent and reduce corruption for a mutual benefit.

Multinational companies which invest in the countries which have recently joined European Union are vulnerable to the problem of corruption. Poland, Czech Republic, Slovakia and Hungary are the countries with a high corruption and bribery and a large amount of Foreign Direct Investments. Therefore they should all implement main strategies for to fight corruption:

- **Publicity speak out against corruption**: corruption is not acceptable;

- **Good corporate governance**: fairness, transparency, accountability and responsibility;

- **Transnational cooperation**: participate with other multinationals in the development and implementation of anti-corruption mechanisms.

- **Implement a code of conduct**: follow a strict anti-corruption policy which provides a disciplinary mechanism under which offenders are sanctioned.
Basing on a suggestions of World Economic Forum as well as on a principles of UN Global Compact more and more companies introduce principles that help to solve the problem of corruption. Codes of conduct are also improving the image of the company and its business relations.

When we take these strategies in account, one should aspect that companies which are investing in the Visegrád Group has an explicit opinion about corruption. As we analyzed their codes of conduct it attracted our attention that only one of the four main investing companies we investigated has anti-corruption statement.

In general multinationals should only do business with other parties which are explicit against corruption. In this way a whole anti-corruption network appears, which should contribute to the solution.

These recommendations are off course part of the solution. Businesses alone can’t solve the problem by their own. And a big responsibility is for governments. But with these strategies they can influence the supply-side of the corruption framework, which is one part of the solution. And according to Sullivan and Shkolnikov (2004) ‘business participation is the key to success.’
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