



LUND UNIVERSITY

School of Economics and Management

Master Programme in International Economics

with a Focus on China

***Guanxi* and Corruption Study on the Firm-Level
in a Chinese context**

Jing Dai

ji5445da-s@student.lu.se

Abstract: China experienced a growing economy with a huge market and business potential and became the second biggest country in terms of GDP. However, because of the limitation of coherent business laws and government supervision, entering the Chinese market became a severe and complicated problem for different kinds of firms. Empirical papers show that networks, called *guanxi* in China make a primary contribution to the success of the business. This paper contributes to the *guanxi* in China and discusses what kind of firms are more likely to develop *guanxi*. Using enterprise-level data on business-government relationships among 2700 firms in China, I reached the conclusion that capital city located firms, foreign-owned firms, national-market-targeted firms and large size firms have demands to build "*guanxi*" and also have the potential possibility to do the corruption.

Key words: business-government relationship, firm network, *guanxi*, firm corruption,

EKHR51

Master thesis (15 credits ECTS)

August 2017

Supervisor: Christer Gunnarsson, Martin Önnersfors

Examiner: Tobias Axelsson

Word Count: 10705

Acknowledgements

It took around eight months to finish this master thesis. During my writing time, a lot of people provided me enormous help. I met so many good friends and colleagues in Sweden. However, due to the limitation of words, I cannot list all of them. But I believe that they received my sincere thanks from my heart or WhatsApp message.

I'll start with my sincere thanking to my supervisor, Professor Christer Gunnarsson. We had several appointments during the whole thesis writing. Every time I met him with different questions and new ideas, he always shared a lot of unique and meaningful insights with me and encouraged me to solve them independently. Each meeting is a new lesson for me. In addition, I want to thank my other supervisor, Martin Önnersfors, who gave me some helpful advice for the econometric section.

I want to thank my Mum, Dad, and Grandpa who spare their efforts to give me the best education and quality life. They support me whenever I needed it. They are the harbour for me forever. I would also like to thank Moritz. He teaches me how to cook and how to love, helping me to grow up in both academic work and life, though sometimes I disagree with him due to the different cultural backgrounds. But it is him that helps me adapt to the European society. Moreover, I want to thank Mr. Thanh and Mr. Pham, two Vietnamese businessmen, who shared their busy working time with me, provided me with a lot of inspirations and materials and cared about the process of my thesis.

Overall, I want to thank all the people who helped me, more or less. Without you, I could not accomplish my thesis successfully and reach this new height of my life.

Dai Jing

Malmö Stadsbiblioteket

August 2017

Table of Contents

Acknowledgements	2
List of Figures.....	5
List of Tables	6
1. Introduction.....	7
2. A Review of <i>Guanxi</i> and Corruption Literature.....	10
2.1 The Definition of Business-Government Relation	10
2.2 <i>Guanxi</i> In China.....	11
2.3 Different <i>Guanxi</i> Type.....	11
2.3.1 Family <i>Guanxi</i>	12
2.3.2 Friendship <i>Guanxi</i>	12
2.3.3 Interest <i>Guanxi</i>	12
2.4 <i>Guanxi</i> Function/Advantages/Disadvantages	13
2.5 <i>Guanxi</i> in a Japanese Context: <i>Amakudari</i>	15
2.51 Old Boy Network And <i>Amakudari</i>	15
2.6 Interweave Between <i>Guanxi</i> and Corruption.....	16
2.61 The Role of <i>Guanxi</i> in Corruption.....	16
2.62 <i>Guanxi</i> and Gifts.....	17
2.63 Two Kinds of Corruption.....	18
3. Corruption in China	20
3.1 Corruption situation in Asia.....	20
3.2 Corruption in Vietnam	23
3.3 Corruption Discussion on Firm Level.....	25
3.3.1 Firm Location.....	26
3.3.2 Firms Ownership.....	29
3.3.3 Industry Sector	31
3.3.4 Firms Size	33
3.3.5 Gender: Female Top Manager?	34
4. Methodology	36
4.1 Dependent Variable	36
4.2 Independent Variables	38
4.3 Econometric Model.....	39
4.4 Descriptive Statistics.....	40
5. Result and Discussion	42

5.1 Regression Result of the Corruption Models.....	42
5.2 Discussion	43
5.3 Implications of Corruption.....	45
5.4 Limitation.....	46
6. Conclusion	47
Reference	49
Appendix 1.....	54

List of Figures

Figure 3.1 A correlation between corruption and development	23
Figure 3.2 China Corruption Index ¹ and Vietnam Corruption Index	24
Figure 3.3 Anti-corruption Driven by Administration Region	28
Figure 3.4 Reports of Corruption – By Region (Percent reporting paying bribes to operate)	29
Figure 3.5 Bribery Incidence (percent of firms expecting at least one bribe payment request).....	29
Figure 3.6 Bribery Incidence (percent of public transactions where a gift or informal payment was requested).....	31
Figure 3.7 Bribery Incidence (percent of firms experiencing at least one bribe payment request).....	32
Figure 3.8 Bribery Incidence (percent of firms experiencing at least one bribe payment request).....	35
Figure 5.1 Bribe Payers index of 28 leading export nations.....	45

List of Tables

Table 2.1 Type of Corruptions 1	18
Table 2.2 Type of Corruptions 2.....	19
Table 3.1 Corruption Perceptions Index 2016 In Asia Pacific Region.....	20
Table 3.3 Do you think “The court system is fair, impartial and uncorrupted”?.....	26
Table 3.4 Which Industry has the most corruption?	33
Table 4.1 Summary statistic of used variables	40
Table 4.2 Explanations of Dummy Variables.....	41
Table 5.1 Regression Result of the Corruption Models.....	42
Appendix 1 Table of Descriptive Correlations	55

Chapter 1

Introduction

Based on the source dynamism of Asian countries and by looking back about half a century development in Asia, all facts indicate that countries strategic capacities provide a significant ingredient for economic growth (Weiss, 1994, pp.85). But why some states can bring their orders as well as their purposes and their business firms can be efficient with a better performance while others cannot?

Adam Smith addressed that governments have significant roles in creating an environment to support rising productivity (Porter, 1998, pp.7, Gittell, Magnusson, & Merenda, 2012, pp.102). Hereby, the environment mainly focuses on the policies and relationships of economy and business.

This paper points out how business-government relations work in Asian countries, especially emphasizing China. The rise of China is undoubtedly one of the brilliant miracles of the 21st century (Ikenberry, 2008, pp.23). China experienced a growing economy with the huge market and business potential and became the second biggest country in terms of GDP. However, due to the limitation of coherent business laws, government supervision, and varieties of firms' ownership, entering China's market involves an enormous amount of difficulties (Nee, 1992; Xin & Pearce, 1996; Lee, Pae, & Wong, 2001, pp.51). Therefore, developing networks will be the necessary and essential method for firms to enhance their marketing effectiveness and efficiency (Sheth & Parvatiyar, 1995). The Chinese call these personal networks or the interpersonal relationships "*guanxi*" and business-government relationship belongs to interest *guanxi*. Due to the same cultural root— Confucianism, Japan will be mentioned as a comparison with China in "*guanxi*". When "*guanxi*" comes to people's eyesight, another related word "corruption" always seems to appear together.

Most published, related pieces of literature either focus on the causality between corruption and environment, including the external politics, the economy, and the society etc. Some talk how to design anti-corruption instruments, establish justice system and improve the marketization etc. In this paper, emphasis will be put into firm-level corruption and what kind of firms are more likely to build these relations. This also indicates that these companies have more possibilities to do bribery.

As far as I know, none of the published literature mentioned clearly what kind of firms' have higher corruption suspicions. Even some papers discuss one or more characteristics, most of those results are based on empirical evidence or theoretical foundation. Therefore, these results will not only be quoted in this paper but will also be tested for in the methodology part.

In the quantitative study, I used the rich firm-level dataset from the World Banks China Enterprise Survey 2012. The survey includes 2489 privately-owned and 87 foreign owned firms. It also introduces firm variables such as location, ownership, target market, size etc. My approach was to combine the existing evidences and the firm data and the results showed that foreign owned, capital city located and national market targeting large companies are more likely to build interest *guanxi*, which also has significant possibilities or risk to be involved in corruption.

The whole paper will be divided into the following sections: I introduce the business-government relation in Chapter 1. Followed by Chapter 2, in which I put my emphasis especially on “*Guanxi*” in China and discuss the *guanxi* definition, type, function and compare those with Japan. In Chapter 3 I state the corruption phenomenon in China and compared it with another third-tier transition economy --Vietnam. In addition, I explore which kinds of enterprises are more likely to establish business-government relations and have the potential to do corruption. I do this with data and graphical support in Chapter 4. Furthermore, I discuss the results and implication in Chapter 5. Last but not

the least in Chapter 6, I reach my conclusion and point out some study limitations and future research possibilities that occurred.

Chapter 2

A Review of *Guanxi* and Corruption Literature

2.1 The Definition of Business-Government Relation

In a market economy, the government and public policies establish the legal system and some specific rules which all the market businesses need to obey. To some extent, government systems and policies decide these businesses to undertake revenues, costs, and net earnings. Businesses pay taxes to use public services while the government collects tax revenues to fund and finance government operations. (Gittell, Magnusson, & Merenda, 2012, pp.102). The main aim of businesses is to make profits while it is the governments' target to ensure a stable economic and employment increase. Both of them are different but pretty much co-dependent.

Business and government relations are closely connected with each other. On the one hand, due to the strong influences from government policies, businesses generally keep in touch with the government in order to benefit from the policies or even try to make some impact on public decisions and policies (Gittell, Magnusson, & Merenda, 2012, pp.99). The terms effectiveness and efficiency are vital to the business entity, maintaining business survival and continuous profitability, which can be guaranteed by cooperation (Calder, 1995, pp.613).

On the other hand, from a business perspective on governments, they should choose the perspective that firms or industries take as a main developing target for the future. Therefore, they prefer to publish some policies which can encourage these businesses. Additionally, the government should favour and stimulate businesses performance and investments. Since businesses are the main source of jobs, innovation, and societal economic well-being, the government should generate grants, tax credits, and subsidies to support businesses in the case of another Great Recession (Gittell, Magnusson, & Merenda, 2012, pp.118). In other words, business-government relations on trade issues

are characterized as protectionist lobbying or – less often – the member of the liberalization of markets lobby (Woll, & Artigas, 2007, pp.121-138). However, with states dominating the process, both public and private agencies are increasingly involved. Some literature sees public- private cooperation as a limit to state capacity and thus a challenge to statism and corruption (Weiss, 1995).

In one word, the business-government relation is the balance of power and responsibility for determining output, consumption and the price. And the availability of government means for discussing issues and solving problems effectively contributes to their destination (Vietor, 1987, pp.1)

2.2 *Guanxi* In China

In China, *guanxi* is the central part of the business-government relation. A personalized and close relationship is called *guanxi*, which is often considered as a necessary condition to start a new business in China (Xin, & Pearce, 1996). To make the definition easier, *guanxi* means good connections (Tsang, 1998, pp. 64-73).

In general, *guanxi* does not have good or wrong influence. It only works when people need to use it. Since the government is made up by people, who are in charge of the government. They are making policies and decisions. On account that businesses are eager to have sustainable competitive advantages, *guanxi* becomes valuable and rare. For the firm level, the Chinese call it “business-government relation” and *guanxi*-based business culture has a significant and positive influence on venture's accounting and market performance (Luo, 1997. pp.51-70). For the personal network or the managers view, it is called "*guanxi*".

2.3 Different *Guanxi* Type

Guanxi is typical in the Chinese culture as a phenomenon and only exist in the Chinese society in this way. Decades ago, non-Chinese speakers had no idea of this Chinese words, but nowadays most economic students have heart about it. Similar ideas can be

found in almost every country. *Guanxi* is absolutely essential to fulfilling any tasks in virtually all spheres of social life in China (Gold, Guthrie, & Wank, 2002). I divided *guanxi* into three types. The first, I call “friendship *guanxi*”. The second type is “family *guanxi*”. The third but also the most direct one is “interest *guanxi*”. *Guanxi* is easy to build, but also it is fragile, or difficult to sustain (Tsang, 1998, pp. 64-73). No matter for governments or companies, they all consist of people, who are moveable. When they leave their positions, *guanxi* will be disrupted as well. However, this *guanxi* is not mutually exclusive as they represent a concentric circle of contacts (Hwang, 1987).

2.3.1 Family *Guanxi*

Family *guanxi* is the most permanent and stable relationships among these three relations, since it is based on blood ties. It is also called “expressive ties” by Lee, Pae, and Wong in 2001. Family *guanxi* is narrowed down within a particular scope such as parents and relatives.

2.3.2 Friendship *Guanxi*

Friendship here has a general meaning, which includes classmates, schoolmates, colleagues, neighbors, same hometown etc. They are personal and practical relationships between exchange partners (Lee, Pae, & Wong, 2001).

In general, these people are strangers while during certain circumstances, such as by doing the same business or by having similar interests, they will have closer relations. It should be pointed out that the boundaries between friendship *guanxi* and interest *guanxi* are rather fluent (Hwang, 1987). In other words, friendship *guanxi* can turn into interest *guanxi*, and vice versa (Lee, Pae, & Wong, 2001)

2.3.3 Interest *Guanxi*

Interest *guanxi* could also be called “benefit *guanxi*” or “Instrumental ties”. It is the

most unstable and temporary *guanxi* among these three. To realize the resource allocation and maximize equity, buyers and sellers are more willing to build this type of *guanxi* (Hwang, 1987, Dwyer, 1987; Macneil, 1980). Therefore, interest *guanxi* has a distinct characteristic called impersonal and utilitarian (Lee, Pae, & Wong, 2001). It can be used in politics or business situation, such as the operations of informal policy and the potentially for social networks to evolve into something resembling civil society (Gold, Guthrie, & Wank, 2002). In this paper, I will only talk about interest *guanxi*, which has the closest ties to business-government relationships in China.

2.4 Guanxi Function/Advantages/Disadvantages

Guanxi has its own merits and demerits. From the positive aspect, *guanxi* provides a better method to overcome the recourse or information limitation. Meanwhile, *guanxi* offers a preferential treatment in business cooperation and avoids external risk and competition. In China, *guanxi* is especially vital to the start-up business sector (Arias, 1998; Davies, 1995; Wong, 1998). Hall and Hall (1987) argued that developing interpersonal relationships and mutual understanding at the personal level is a prerequisite for business success both in China as well as in the Japanese society. Some economists regard this *guanxi* as “grease money” which lubricates the squeaky wheels of rigid bureaucracy and commerce (Clarke, & Xu, 2004).

For international business, developing close and personal relationships helps them to understand the mutual business model, the business culture and to get more similarities. Besides, even two firms from the entirely different cultural background, they can still make an effort to find similarity, enhance their cultural affinity, reduce alienation and making them familiar with Chinese business operations (Ford, 1980; Hallen & Johanson, 1985).

Negative views show that *guanxi* may lead to corruption, such as favoritism and nepotism. Here I mainly talk about firm-level corruption. There is no literature arguing that any agreement can be made about the effects of corruption on economic growth.

Admittedly, corruption can raise the economic efficiency if the government has inefficient regulations and corruption can help business to develop quickly and smoothly.

However, on the other side, some economists argue that *guanxi* is expanding in the market which substantially influences the rational-legal systems that define the Western market economies (Gold, Guthrie, & Wank, 2002). A lot of studies conclude that corruption slows down development (Gould & Amaro-Reyes, 1983; United Nations, 1989; Klitgaard, 1991). Corruption destroys fair marketing and hurts innovative activities (Heidenheimer, Johnston, & LeVine, 1970, pp.26-27). Government corruption is defined as the sale of government property by officers and gaining personal profit (Shleifer, & Vishny, 1993. pp.599). For example, officers sell some licenses and permissions paid by a certain value of the contract or other informal payments from private businesses. Obviously, the risk of corruption is to be caught and punished, and the probability of this consequence mainly depends on the effectiveness of the country's legal system (Treisman, 2000, pp.399-457).

The Chinese central government decentralizes its fiscal, investment, and foreign trade policies, which have granted localities and created opportunities for promoting entrepreneurship (Wu, 1997. pp.319-346). This also provides corruption chances for local governments. Local governments offer official patronage in exchange for extra incomes. In the same time, the extra money local governments earned will become revenue and move to central governments treasury (Wu, 1997. pp.319-346).

Recently the sales amount of the luxury brand Louis Vuitton decreased dramatically in the mainland, China and some people said it is because of anti-corruption policies. They say that they cannot buy bags as a gift. Although it is just a rumor or a joke to some extent, it can be seen that anti-corruption in China achieves some success. Although this gloomy effect can be eliminated with the help of opening the market, improved legislation, completing government controls and developing technology, it still takes a

long time for the Chinese government to realize its anti-corruption actions (Arias, 1998; Davies, 1995; Wong, 1998).

2.5 Guanxi in a Japanese Context: *Amakudari*

Guanxi is original based on a cultural root, especially out of Confucius values, which is the core of the Chinese culture, or even all East Asian cultures. Confucianism, together with Buddhism is one of the traditional links that bind the Chinese and Japanese cultures. Confucianism is a non-theistic philosophy emphasizing wisdom gained from education, love in human relations, and the pleasure of effort expended in doing good. It conceives society from a humanistic rather than a spiritual point of view, as group-structured. It fixes role responsibilities in relationships of the social structure, placing a high value upon self-esteem, reciprocity, harmony, and loyalty to the nation and one's work group (Bartels, 1982. pp.4-12). Bartels (1982) also concludes some key words about the Japanese business culture, such as Close-knit social structure, family or group-orientation, fixed relationships, obligations, scaled loyalty obligations, mutuality of obligations etc. Some key words also exist in the Chinese business culture.

As Hofstede and Bond (1988) assumed culture values are one of the main factors to affect the economy and business growth. Japanese business is the epitome of Confucianism culture, which is homogeneous to Chinas. However, de factor Japan ranks among the least corrupt countries in the world. Companies face very low risks of corruption in Japan, dissimilar with complicated Chinese situation. In China it is called *guanxi* while it is offered as "*Amakudari*" in Japan.

2.51 Old Boy Network And *Amakudari*

When talking about Japanese business-government relations, it is impossible to ignore a standard network called "old boy", which is one of the striking features in Japan. Old boy phenomenon is mentioned almost in every comprehensive study to indicate tight government-business relations, for example by Schaede (1995), Clyde (1988),

Ramseyer and Rosenbluth (1993) etc. These retired old boys are so called “*amakudari*”. One reason of the existence of Old Boy phenomenon is due to the aging society.

Old boy (OB) phenomenon means that after government officials retire from long life in civil service, they will be hired as a board in private companies. They apply with their expertise and personal networks to begin their second career life and hence increase lifetime income. Johnson (1982) indicated that the OBs constitute part of the underlying mechanism of the "bureaucrat-led economic growth" of post-war Japan. Meanwhile, the OB phenomenon is also the primary and basic method for Japanese bureaucracy. In contrast, Calder (1989) suggests that only firms that need government help will hire old boys. Apart from that, some smaller firms or non-Tokyo firms will also hire OB in order to increase their firm's position and power and be closer to capital (Schaede, 1995, pp.293-317). Additionally, OB can help small firms to be access to core information from governments and receive some form of protection.

There are several ways to let OB continue in their career and function. First of all, OBs use their personal connections and seniority hierarchies which are exactly the same as normal people's network. Secondly, there is a mechanism called "vintage meetings" for OB. Each class of bureaucrats in a certain ministry holds regular meetings, typically a monthly lunch. Because of the step-by-step retirement, these retired officials still have members or networks at the ministry or department. The third mechanism is "OB meetings" which is organized by the ministry itself and held quarterly in order to make sure information flows in and out smoothly. During this lunch meeting, an incumbent bureaucrat delivers a speech to his retired seniors concerning regulatory or policy issues currently discussed within the ministry. Then they will talk about what they are doing now and share news instead of talking about business directly.

2.6 Interweave Between *Guanxi* and Corruption

2.6.1 The Role of *Guanxi* in Corruption

As I mentioned above, *guanxi* has enormous advantages, but also it has a negative aspect which is regarded to as corruption. Generally, it is difficult to define whether *guanxi* is good or not because *guanxi* and corruption become increasingly intertwined as China is moving towards a demoralized society (Luo, 2008). It is necessary to point out here that the debate between the relationship of *guanxi* and corruption has continued for a long time among scholars and economists. Fewer pieces of literature argue that the significance of corruption and the salience of *guanxi* are separated with each other in China. Certain numbers of scholars believe that *guanxi* is the part of the root of corruption culture while others insist that *guanxi* is distinguished from corruption because corruption is where two parties establish a short-term and benefit-based relationship while *guanxi* has the foundation of long-term trust and personal relationship (Li, 2011). Nowadays *guanxi* and corruption are used by all kinds of people for various purposes, actively or passively, such as rent-seeking businesses, worried parents looking for child education opportunities, college students seeking for jobs and nervous salesmen intending to secure some large block orders etc. (Luo, 2008).

2.62 *Guanxi* and Gifts

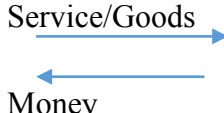
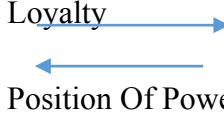
Somehow it is vexing to define corruption (Bardhan,1997) because *guanxi* and corruption are always interwoven. Take Japans old boy network as an example. The government organized a seasonal meeting for current officers and old boys who have retired from the government and work for a company. During this session, it is de jure acceptable and rational when they only drink tea or coffee. But de facto if they spent more than a certain amount of money, it is a suspicious for them of receiving gifts, which is contradictory. Gifts are the most common tool in *guanxi* to establish or bring equilibrium to the relationship. If one is feeling too indebted or stressed to another, that person may bring a gift to bring the relationship back into balance. Therefore, it is hard to say whether it is a normal *guanxi* development or abnormal corruption. It can even develop as the misuse of entrusted power in exchange for private benefits. Overall,

empirical evidences demonstrate that fighting corruption in many countries has proved so difficult.

2.63 Two Kinds of Corruption

Bardhan (1997) put forward a definition of corruption which has been accepted by academia as *'the use of public office for private gain'*. Mathieu Deflem (1995) pointed out that there are two main kinds of corruption which can be applied all over the world (Table 2.1). One is monetary corruption, which is based on money. This *guanxi* is carried out with an effective money transfer between consumers and producers in order to get service or products, such as companies and officials, which is also the main discussion topic in this thesis. The other type is called bureaucratic corruption which uses "power" or "right" as a tie to connect dominant position and loyal behavior. Old boy systems in Japan are similar to this type.

Table 2.1 Type of Corruptions 1

Type of Corruption 1	Corrupted	Medium Exchange	Of Corruptor
Monetary Corruption	Consumer	Service/Goods  Money	Producer
Bureaucratic Corruption	Client	Loyalty  Position Of Power	Administrator

Source: Mathieu. 1995.

Schramm and Taube (2003) offered another distinction between spot-market corruption and relational corruption (Table 2.2). Spot-market corruption means that in order to avoid isolated or short-terms, even immediate punishment or privilege, all transactions will be carried out. These transactions will be ended after the termination of property

right or without the participation of economy activities (Schramm, & Taube, 2003). As an illustration, a driver gives money to the traffic police in order to avoid payings for higher bills or to cross the road and save time. Instead of isolated or short-term spot-market corruption, relational corruption is more frequent in Asian countries. It begins with the attainment of a system-immanent advantage or resource by influencing the political decision-making process on various levels (Schramm, & Taube, 2003). Therefore, it is a long-term and multi-lateral transactional relation.

Table 2.2 Type of Corruptions 2

Type of Corruption 2	Characteristics	Situation
Spot-Market Corruption	Short-Term	Avoid Problems Or Violence
	Isolated	
Relational Corruption	Long-Term	Gain License/Resource/Contacts Etc.
	Multilateral	Most Common In Asia

Source: Schramm, M. and Taube, M. (2003)

Chapter 3

Corruption in China

3.1 Corruption situation in Asia

Corruption and fighting against corruption have a long history in China. It is widely held that corruption in China has increased to an epidemic or even entered an endemic period since the advent of reforms in the late 1970s. (Johnston & Hao, 1993, pp. 80–94; Root, 1996, pp. 741–757; Pei, 1999, pp. 94–110). Yet a conventional opinion demonstrates incompletely that the early reform period was characterized as a quantitative increase and the later reform period witnessed and transmitted into "intensification" of corruption (Wederman, 2004). This situation continued for 35 years. I, as one of the young generation who lived and studied under Chinese traditional education system, heard about "anti-corruption" and "anti-graft" on the 18th National Congress which was held in November 2012. Since then corruption in China has been subject to significant media attention and reached impressive achievements. According to People Daily and a Global Times report on March 3th, 2017, fighting against corruption has ranked first out of ten hottest topics in China's 2017 two sessions.

Based on CPI official website, China ranked 79th out of 176 countries in CPI¹(Corruption Perception Index) of Transparency International in 2016. Compared with 100th in 2014. China did something impressive on anti-graft project, which put China comparable to Malaysia and India. Chinas neighbors such as Myanmar, Vietnam, Laos, North Korea etc. are more corrupted than mainland, China. But China is more corrupt than Singapore, Japan etc. (More detailed ranking is shown in Table 3.1). Hereby, the definition of corruption by CPI includes graft, bribery, embezzlement, backdoor deals, nepotism, patronage, and statistical falsification.

Table 3.1 Corruption Perceptions Index 2016 In Asia Pacific Region

¹ the CPI scores and ranks countries/territories based on how corrupt a country's public sector is awarded of. It is a composite index which is collected by a variety of reputable institutions and combined surveys and assessments of corruption. <https://towardstransparency.vn/corruption-perception-index-2>

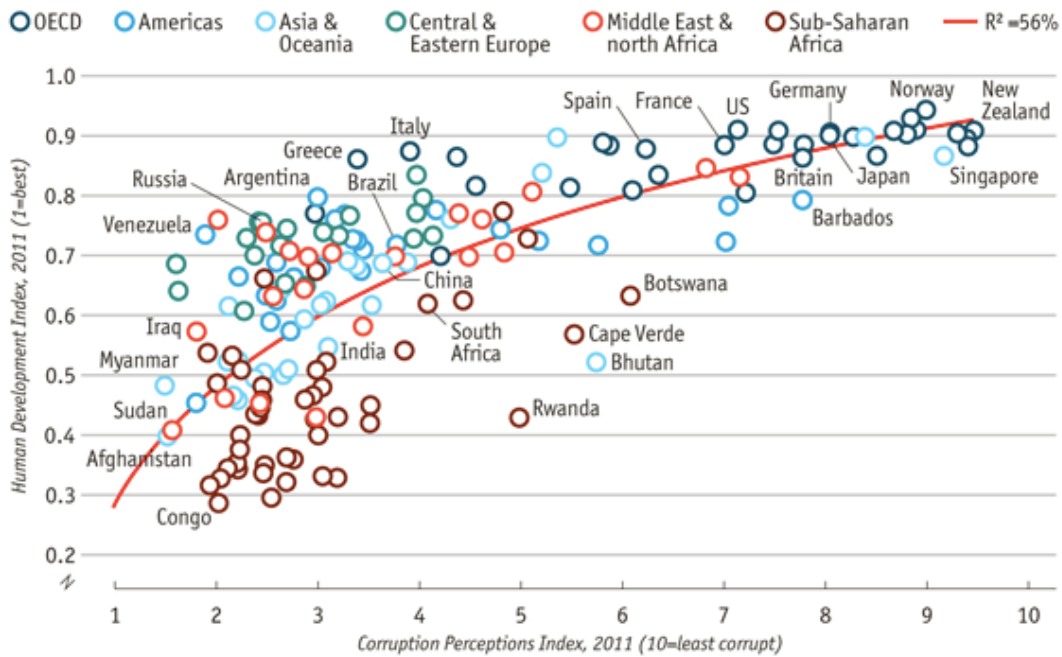
World	Country	2016	2015	2014	2013	2012
1	New Zealand	90	88	91	91	90
7	Singapore	84	85	84	86	87
13	Australia	79	79	80	81	85
15	Hong Kong	77	75	74	75	77
20	Japan	72	75	76	74	74
27	Bhutan	65	65	65	63	63
31	Taiwan	61	62	61	61	61
41	Brunei	58	N/A	N/A	60	55
52	Korea (South)	53	56	55	55	56
55	Malaysia	49	50	52	50	49
72	Solomon Islands	42	N/A	N/A	N/A	N/A
79	China	40	37	36	40	39
79	India	40	38	38	36	36
87	Mongolia	38	39	39	38	36
90	Indonesia	37	36	34	32	32
95	Maldives	36	N/A	N/A	N/A	N/A
95	Sri Lanka	36	37	38	37	40
101	Philippines	35	35	38	36	34
101	Thailand	35	38	38	35	37
101	Timor-Leste	35	28	28	30	33
113	Vietnam	33	31	31	31	31
116	Pakistan	32	30	29	28	27
123	Laos	30	25	25	26	21

131	Nepal	29	27	29	31	27
136	Myanmar	28	22	21	21	15
136	Papua New guinea	28	25	25	25	25
145	Bangladesh	26	25	25	27	26
156	Cambodia	21	21	21	20	22
169	Afghanistan	15	11	12	8	8
174	Korea (North)	12	8	8	8	8

Source: www.transparency.org/cpi for more information

In order to discuss the Asian corruption in the world range, I quote Transparency International's annual CPI result (2011) which aggregated independent surveys from across the globe. The middle-bottom line is formed mainly of Asian countries such as India, China, Vietnam while developed and good welfare countries such as Singapore and Japan stand out among other Asian countries. It is interesting to see that Asian countries gather when the corruption index is between 0.4-0.7 and it is also the strong connection area. Outliers include small but well-run poorer Asia countries such as Bhutan. Overall, I find that informal payments are much more widespread in countries where infrastructure and human rights are less developed or undeveloped. In other words, governments negative rent-seeking behaviour such as corruption is more common in less socially beneficial systems than in completed welfare countries.

Figure 3.1 A correlation between corruption and development



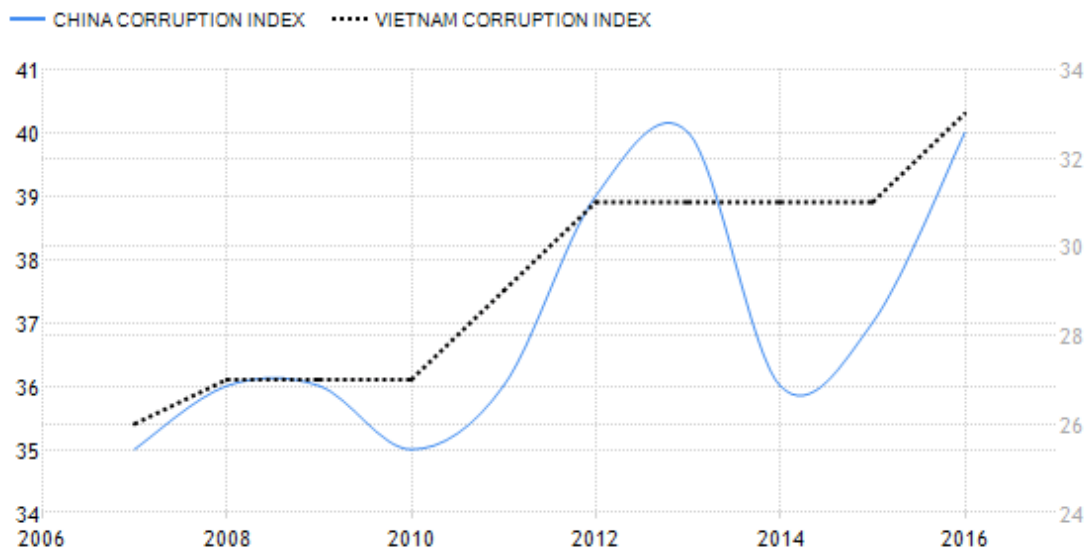
Source: Transparency International, UN Human Development Report, 2011

3.2 Corruption in Vietnam

China and Vietnam are both belonging to the third-tier transition economies. Although both are experiencing an industrial boom, disorder and confusion still obstruct the economy and business development to some extent. Corruption issues are considered as a serious one both by the Vietnamese government and international institutions such as UNDP (Tsuboi, 2005). Although the focus of this thesis is to China, the assertion is that whether I am discussing Vietnam or China, the phenomenon of big corruption cases is essentially the same and can be understood in the same way (Gainsborough, 2003).

China and Vietnam have similar corruption index levels, similar beginnings and current situation but a different track. Vietnam keeps facing increasing corruption index levels, which means that it has been improving anti-corruption and eliminating unfair market situation. However, China's road has lots of twists and turns. China experienced the worst bribery year in 2010, which happened again after four years in 2014.

Figure 3.2 China Corruption Index²¹ and Vietnam Corruption Index



Source: Trading Economics

Corruption in Vietnam has two definitions provided by international institutions and local government. International organizations believe that any acts of demanding money outside of fixed charge or taking commissions for favors on the part of the civil servants are regarded as corruption (Tsuboi, 2005). While local governments conventionally insist that because the basic salaries are not high enough to cover the living cost. Therefore, getting a commission for the service they provide cannot be considered as corruption and it is relatively fair for them to get it. For example, Vietnamese civil servants can get 200 USD at the beginning of their career life, and when retiring, their salary is around 600 USD. Only if the person takes other parts or the whole department's commission fee, it can be called "corruption" (Tsuboi, 2005).

In order to see the firm-level corruption, I found the findings of Rand, J. and Tarp, F., (2012). 30 per cent of firms are asked to pay extra to get easier access to public services. Around 21 per cent give informal payments to deal with taxes and tax collectors; whereas 16 per cent pays in order to get favourable conditions in a bid for a government

²¹ A country or region's Corruption Index score means the perceived level of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean).

contract. Additionally, bribes paid to gain government contracts are on average the largest as measured relative to firm revenues. I had an interview with a Vietnamese manager who helped foreign firms entering the Vietnamese market. He suggested that in order to save time to get stamps, documents and licenses, paying extra money in the back room would make business to go more smoothly and efficiently. In other words, public officers will not ask for payment and firms should do it actively. Either transfer money to their relatives' international bank account or bring them a bag of cash.

There is a well-known example to describe how terrible the corruption is in Vietnam, which has been exposed by some videos. When Chinese tourists visit Vietnam, Chinese need to pay 35 USD as entry visa fee at the Customer. In general, it takes several minutes to give a stamp and ask some questions. However, if Chinese accept to give "tips" then it only takes seconds; otherwise, travelers can be called upon to wait more than one hour. Tips are between 1 to 15 euros, depending on the visitor's outlook and appearance.

3.3 Corruption Discussion on Firm Level

The harassment theory, suggested by Clarke and Xu (2004) that the more profitable firms are, the more likely they make informal payments. Or in other words, profitability is somehow correlated with bribe payments. It is a consistent phenomenon that these firms pay higher bribes than less profitable enterprises. Throughout this paper, especially in the quantitative study, 'bribery' is used as being synonymous with 'corruption'. Craig Charney and Shehzad Qazi (2015) post an accurate number to show the corruption situation in China from firms' perspective. 35% of companies in China say they have to pay bribes or give gifts to officials to operate. This picture is also shown by the World Bank indicating that around 34.26% of the companies tend to disagree that "the court system is fair, impartial and uncorrupted" in China and 4.37% are strongly opposed (Table 3.3). For example, many business people said directly or indirectly that firms are always required to pay informal bills to public officials or

departments to deal with clients, taxes, licenses, permissions, regulations, services, etc. Therefore, it is necessary to figure out the common characters among these one-third companies.

Table 3.3 Do you think “The court system is fair, impartial and uncorrupted”?

	Freq.	Percent	Cum.
Don't know	33	1.22	1.22
Refuse to answer	4	0.15	1.37
Strongly disagree	118	4.37	5.74
Tend to disagree	925	34.26	40.00
Tend to agree	1,430	52.96	92.96
Strongly agree	190	7.04	100.00
Total	2,700	100.00	

Source: World Bank 2012

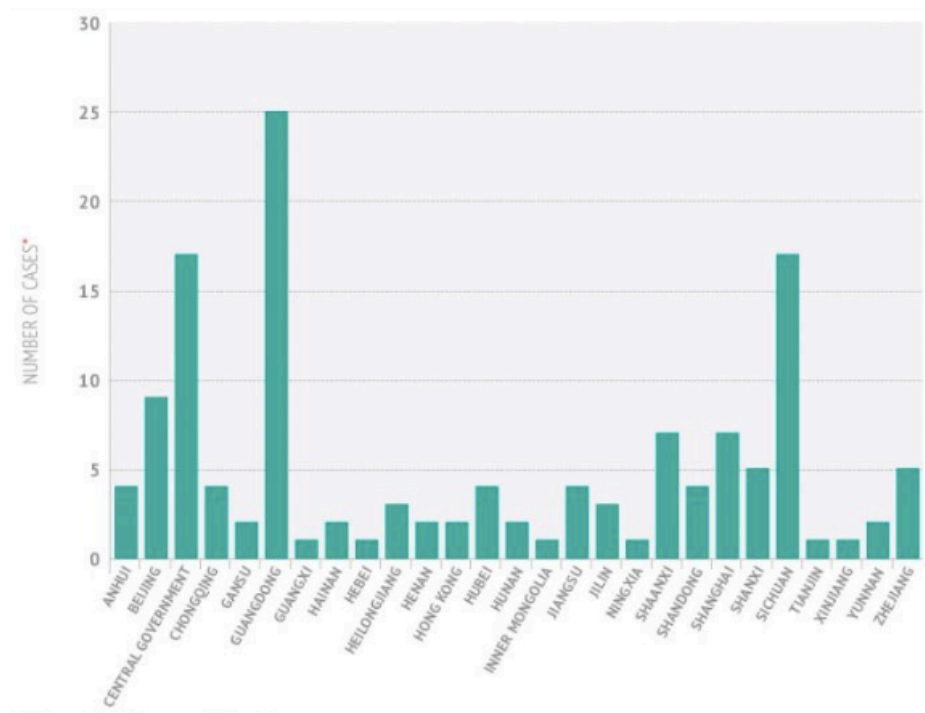
If we say that corruption is a big problem which is definitely difficult to solve and occurs in all countries more or less in different forms, then we should see how widespread the problem is and where it is occurring in the worst form. Based on the World Bank China Enterprise Survey (2012) and White Paper from Charney Research (2015), there are five key findings that might affect the bribes that enterprises have to pay to the government and utility officers. Namely: firms’ locations, ownerships, industry, size and manager gender. Therefore, these factors will be employed in the data and method part.

3.3.1 Firm Location

The corruption is affected by various city characteristics and can be reduced by the law and policy enforcement. For example, Singapore and Hong Kong focus on the anti-corruption strategies which are adopted by both city-states with emphasis on the legislative and institutional measures (Quah, 1994). The result of discussing these corrupt practices in one small city can be applied in many cities (Gardiner, 1970). Therefore, I can get a basic conclusion that the more law-obeyed city, the less corruption it will have.

However, Charney Research (2015) gave an entirely opposite answer. Officials have their hands out for gifts occurring most often around Beijing, the capital, and in the richer regions (Craig & Shehzad, 2015). Figure 3.31 is based on a sample of 136 relatively prominent cases of officials who have been investigated or prosecuted by China's various disciplinary organs since late 2012. This sample is a fraction of the total 36,907 recorded officials (Startfor, 2014). This bar figure demonstrates that this anti-corruption campaign is more heavily targeted the south and southwest such as Guangdong and Sichuan. Among all the province-level cities, Beijing and the central government has attracted more scrutiny (Startfor, 2014). The most pick place is exactly the political center of the whole nation.

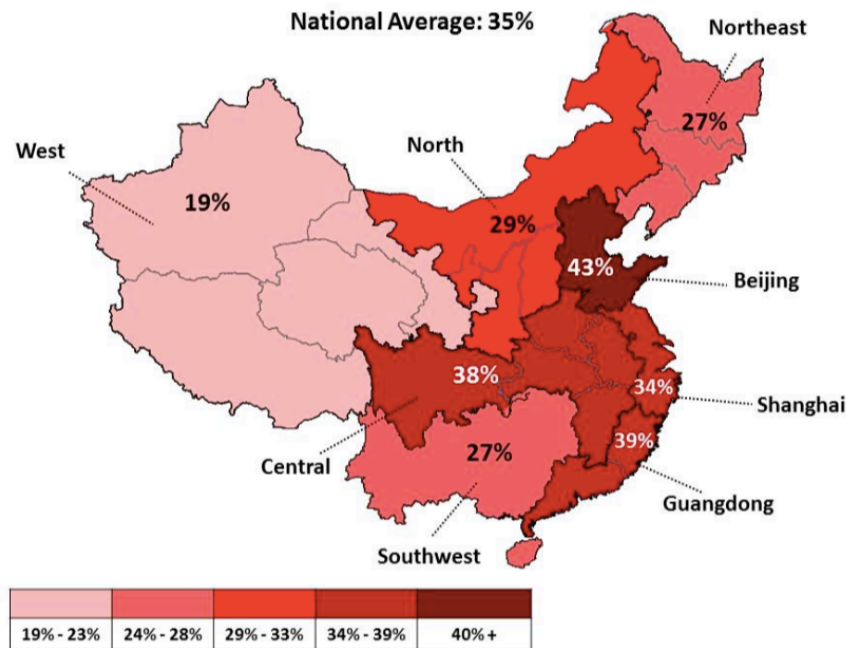
Figure3.3 Anti-corruption Driven by Administration Region



Source: South China Morning Post, 2014

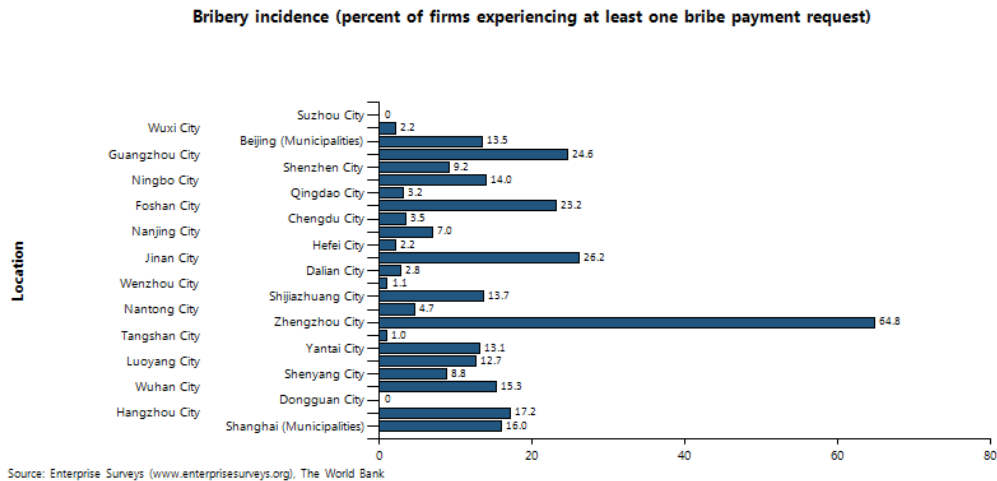
Look at Figure 3.4, Beijing, Shanghai, and Guangzhou are the most corrupted cities in China, reaching 43%, 34% and 39% separately. While for the rural part or non-developed part such as northeast, southwest and west relatively low corruption rate levels can be observed. Meanwhile, the World Bank also gives a bar graph to show the bribery index (Figure 3.5). Zhengzhou, Henan province is the most corrupted city among the 25 investigated cities. It is necessary to mention that Zhengzhou is not a traditional business city, but it is for sure a capital city.

Figure 3.4 Reports of Corruption – By Region (Percent reporting paying bribes to operate)



Source: White Paper NO.1 by Charney Research

Figure 3.5 Bribery Incidence (percent of firms expecting at least one bribe payment request)



Source: Enterprises Survey, the World Bank

3.3.2 Firms Ownership

An underdeveloped legal system makes private-company executives more dependent on *guanxi* than in state-owned or collective-hybrid companies. Compared to SOEs, private-company executives considered business connections more relevant, depending

more on protection connections, requiring more government connections, sent more unreciprocated gifts, and trusted their connections more. (Xin, & Pearce, 1996, pp.1641-1658.)

However, Clarke and Xu (2004) pointed out that privately owned utilities have less common and lower bribes. One reason for this finding is that private firms might have a greater incentive than public officers to impose penalties upon employees being corrupted.

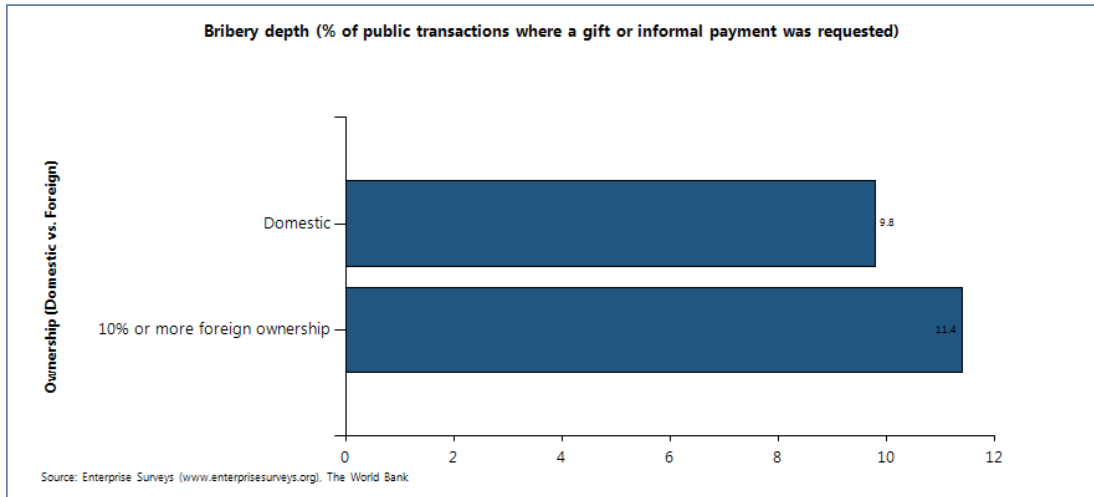
Because of the decision-making uncertainty, international market participants often face high-risk levels about target markets. Foreign companies often don not get adequate information and have a risk in predicting consequences of decisions. (Lee, Pae, & Wong, 2001, pp.51-69). As a consequence, they lack confidence in making strategic decisions (Achrol and Stern, 1988). The other problem would be language and culture, which bring foreign owned firms obstacles in mutual understanding of each other (Lee, Pae, & Wong, 2001, pp.51-69). This problem can be reduced or even solved by mutual understanding and mature conversation.

Due to the uncertainty from government parts, companies' owners have thousands of problems such as whether there is an adequate amount of information. Whether the outcomes of a certain decision are predictable and how confident the decision makers are with the decision outcomes. Alternative ways in advance are to recognize the political nature of international business and regard the role of the government as a factor of protection when firms must manage in their *guanxi* or network in China. (Boddewyn, & Brewer, 1994. pp.119-143).

The important aspect of Chinese management may be made more understandable to Westerners, and its use by western managers enhanced and encouraged (Tsang, 1998, pp. 64-73). Therefore, foreign funded companies are essential to build and protect *guanxi* towards the government. This conclusion can be illustrated by Figure 3.6. In addition, Business Insider (2015) pointed out that Hong Kong-owned firms were also

more likely to pay bribes at 44 percent, compared to foreign enterprises at 37 percent, while mainland Chinese firms have the lowest around 32 percent.

Figure 3.6 Bribery Incidence (percent of public transactions where a gift or informal payment was requested)



Source: Enterprises Survey, the World Bank

In the regression section, I will only discuss POEs and FOEs regardless SOEs. Firstly, SOEs have with no doubt more connections with the government even when there are only 10% shares held by SOEs. In addition, it is difficult to measure endogenous within SOEs because a random dinner, or gift can be both regarded as corruptions or covered in the clothes called personal *guanxi*. At last, employers in SOEs have “iron bowls” which means that their salaries are less connected with their performance. It is therefore less likely for their employers to bribe in exchange for outstanding performance.

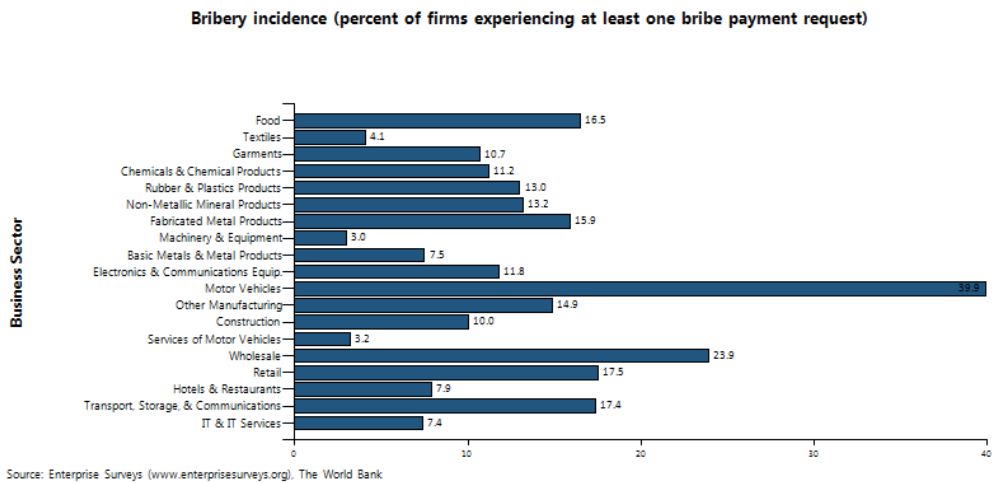
3.3.3 Industry Sector

Every industry has a possibility to do corruption. For some companies, in order to enter restrict competition such as airlines, military equipment or become monopolies, they will spend plenty of money attempting to convince the tax offices or related departments (Mauro, 1997). This expense can be used to get licenses or expand *guanxi*. For economists, this cost is called "rent", for something which is useful and

the supplier is limited (Mauro, 1997). However, Shleifer and Vishny (1993) have pointed out that corruption may be far more damaging than taxation to the economic growth. Due to the black shadow and uncertainty of higher transaction, unlike the tax, bribe payment and corrupted contracts are not enforceable in courts (Shleifer & Vishny, 1993).

From a governmental point of view, they are seeking the prospective industry for the given region or whole nation developing, which makes motor vehicles the leading section (Figure 3.7). Generally, the government is more tended to protect local industry or home industry (Mauro, 1997). Therefore, trade restrictions lead to some non-government-pet companies to do corruption in order to get government support or favour, such as subsidies or licenses etc.

Figure 3.7 Bribery Incidence (percent of firms experiencing at least one bribe payment request)



Source: Enterprises Survey, the World Bank

Among all the industries, industry-wise, real estate, and manufacturing tend to corruption (Table 3.4). To be specific, metals, residential reality, transportation construction and commercials construction are the most suspicious in the scrutiny zone.

Table 3.4 Which Industry has the most corruption?

Real Estate And Construction	Residential Realty	Transportation Construction	Commercial Construction	Commercial Reality	Residential Construction		
41%	44%	42%	40%	39%	39%		
Manufacturing	Metals	Capital Goods	Food	It	Automotive	Chemicals	Textiles
36%	46%	39%	36%	34%	33%	33%	32%
Services	Media	Chain Restaurants	Telecom/It Firms	Business Service	Private Healthcare		
35%	38%	38%	38%	35%	25%		
Retail	Luxury Goods	Apparel	Food	Furniture And Appliances	Automotive		
34%	38%	37%	34%	32%	28%		
Transportation	Shipping	Travel Agency					
32%	37%	28%					

Source: Charney Research (2015)

3.3.4 Firms Size

As a company, growth, and profit are the main things to care about. In order to get success, it is a must, to figure out which factors affect growth. The development of finance and institutions weaken the constraining effects of financial, legislation and corruption limitation. Therefore, it is again the smaller firms that benefit the most (Beck, Demirgüç-Kunt, & Maksimovic, 2005). Hence, the smallest firms are most constrained consistently. It is difficult to prove the relationship between the court of firm's country and the firm's growth, but it is believable that financial constraints from banks limited firms' growth (Beck, Demirgüç-Kunt, & Maksimovic, 2005). In other words, the

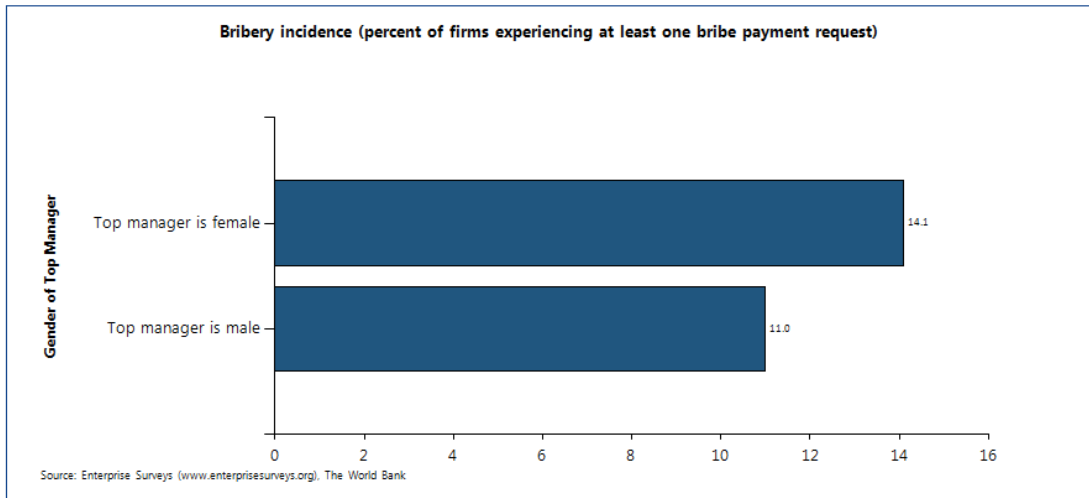
corruption of bank official affect firm growth. For example, some small size companies have to seek financial support from a folk bank instead of a state owned bank. One for the Chinese policies is that it takes small private banks a long time to get a loan from SOE banks. The other effect is that it is easier to get a loan if small banks can give some commission fee to the private bank. This commission fee helps the whole process to be dealt with faster. This problem is relatively smaller in large and mature companies. But it is also rational that in the case that the larger sized company does corruption, the percentage is relatively less but the amount would be way larger than the one of the small sized company.

3.3.5 Gender: Female Top Manager?

Is it meaningful to discuss the relationship between gender and corruption? The first impression for most people is that human beings do corruption regardless of gender. But what if we think about this question seriously? Then the majority may believe that female does less corruption than males. True! Numerous behave studies have found women to be more trustworthy and rule-obeying than men. It is grounded in essentialist notions that women have higher moral nature and assumes they will bring this propensity to the public life (Goetz, 2007). Dollar, Fisman, and Gatti (2001) found that women should be particularly effective in promoting honest government. They also state that the more representation women are in the parliament, the less corruption occurs in these countries, and these result is based on a broad cross-section of countries.

However, look at Figure 3.8 from the World Bank, it clearly shows that top female managers are slightly more corrupt than males. Although it is absolutely different from the common public knowledge, it is interesting to test for in my paper.

Figure 3.8 Bribery Incidence (percent of firms experiencing at least one bribe payment request)



Source: Enterprises Survey, the World Bank

Therefore, according to the literature above, I state my hypothesis as followed.

Hypothesis: Foreign owned, capital city located and national market targeted large company are more likely to build business-government relations, which also has the significant possibility or risk to do corruption.

Chapter 4

Methodology

In order to answer my hypotheses, I use the Manufacturing module of the World Banks China Enterprise Survey 2012, which was obtained between December 2011 and February 2013. The purpose of this survey was to obtain feedback from enterprises on the state of the private sector in China. Meanwhile, this survey helps to build a panel data of enterprise in order to track changes in the business environment over time and impact assessments of reforms (Implementation Report, 2013). I have obviously asked and got the authority from the World Bank to use these data for my master thesis.

The survey included 2489 privately-owned and 87 foreign owned firms and was conducted in order to build up a panel data set of enterprises. In this survey, the World Bank left its usual focus on private firms only, due to the importance of State owned companies within the Chinese economy. Information was gained from low-middle level managers in different organizational firms, located in the following twenty-five metro areas: Beijing (municipalities), Chengdu City, Dalian City, Dongguan City, Foshan City, Guangzhou City, Hangzhou City, Hefei City, Jinan City, Luoyang City, Nanjing City, Nantong City, Ningbo City, Qingdao City, Shanghai (municipalities), Shenyang City, Shenzhen City, Shijiazhuang City, Suzhou City, Tangshan City, Wenzhou City, Wuhan City, Wuxi City, Yantai City, Zhengzhou City. Further relevant information is that the study is only about non-agricultural companies with at least five employees and also excludes the financial sector, real estate, renting activities and all public and utility sectors.

4.1 Dependent Variable

The court system is relatively complicated in China and corruption is a sensitive topic, which decides that it is impossible to get direct data. Therefore, I choose four different

variables which can be indicating the necessity of building business-government relations and the possibility of corruption. The four variables are 1. *whether the company is asked to give gifts or informal payment*, 2. *has the company secured or attempted to secure a government contract*, 3. *how much percentage of the contract that government asked as informal payment* and 4. *whether the company is visited or inspected by tax offices*. When studying the relationship between bribes and the firms type, it is necessary to somehow scale the level of bribe payments. These four dependent variables can imply the corruption level among these firms (Fisman, & Svensson, 2007).

In order to understand the first dependent variable "gift", I would like to give a precise definition. In China, there is an old saying about private and personal behavior from government and tax office, which is called "*Chi Na Ka Yao*". Each word means an illegal action. *Chi* means inviting or being forced to invite officers to have a luxury dinner together. *Na* is about taking some stuff from the company such as shares, profits etc. *Ka* is the Chinese meaning of card in English; obviously, it means gift card, gas card etc. and *Yao* indicates officers ask some benefit or coupons directly such as good wine, cash etc. It is also necessary to mention about informal payment (the third dependent variable). In general, informal payments are used in three functions. First to get connected to public services. Second, to deal with tax and tax collectors and the third is to deal with customs (Rand, J. and Tarp, F., 2012). Visiting or inspecting by tax office (the fourth dependent variable) is direct evidence to show the interaction between public officials and firms.

About the second dependent variable (*has the company secured or attempted to secure a government contract*), does government contract mean corruption? To be honest, there is no casual cause between government contract and bribery. In some developed countries and regions such as Japan and Hong Kong, government contracts are as normal as companies' contract. While in China and Vietnam, it indicated large benefit and support from the government. For the society sight, these firms who get government

contracts have strong *guanxi* with the government, either in the form of personal- or interest *guanxi*.

4.2 Independent Variables

In order to get reliable and comparable results, I need to check for several factors that have a potential influence on my regression results. Firstly, I also controlled for the ownership since Chinese law and the national situation decide for different methods while developing business. Because SOEs have an obvious strong tie with the government, there is no meaning to compare it to private firms. So as a result of this, I only choose local private companies and foreign owned companies. Empirical work shows that in general, *guanxi* has a positive impact on market performance for domestic and foreign firms. (Sheng, Zhou, and Li, 2011). Additionally, I will control my models for the competition level, based on some competitors, since competition influences the future of the company. According to economic theory, location and sector factors of the structure of corruption, can also be assumed as potential factors (Kimuyu, 2007). Therefore, I use the control variables “capital city” and “industry sector”.

There is empirical evidence confirming that the size of a firm has indeed a positive influence on its *guanxi* or bribe payment, which also has a profound and positive impact on the firms’ efficiency and growth (Luo, & Chen, 1997). Furthermore, I will control for the size of the firms because larger organizations are more visible to bureaucrats (Fisman, & Svensson, 2007), due to some advantages such as more networks and contracts in the market. Also, the firm's age might play a role as mentioned in the introduction based on Utterback (1994). Many firm-level studies have stated that firms age may be correlated with bribes because longer established firms have better access to both financial support and government contacts (Fisman, & Svensson, 2007). So I include the log of the firm's age.

Corruption is undoubtedly a human being action, which is also connected to the gender. Generally, female owners are associated with a lower incidence of bribery and report

smaller levels of bribery (Breen, Gillanders, McNulty, & Suzuki, 2016), but it is still interesting to see if the results hold in a Chinese context.

4.3 Econometric Model

Based on these dependent and independent variables as well as on the theory mentioned above, I constructed four models.

$$\gamma_1 = \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \beta_8X_8 + e$$

$$\gamma_2 = \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \beta_8X_8 + e$$

$$\gamma_3 = \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \beta_8X_8 + e$$

$$\gamma_4 = \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \beta_6X_6 + \beta_7X_7 + \beta_8X_8 + e$$

γ_1 =whether the company is asked to give gift or informal payment

γ_2 =has the company secured or attempted to secure a government contract

γ_3 =how much percentage of the contract that government asked as informal payment

γ_4 =whether the company is visited or inspected by tax office

β_1 =firm age

β_2 =whether the company is in the capital city

β_3 =private owned firms

β_4 =foreign owned firms

β_5 =female manager

β_6 =numbers of competitors

β_7 =firm size

β_8 =main market

Based on the previous variable description I carefully choose my model. The dependent

variables for a gift, contract and visits are dummy variables. Therefore, probit models (Model 1,2 and 4) were an adequate choice given the fact that the data could be censored. While for the No.3 model, I choose the OLS method to run the following regression with robust standard errors. According to and based on theory of the previous sections, I choose these 8 independent variables.

4.4 Descriptive Statistics

The summary statistics for all variables are listed in the table below (Table 4.1). In order to see the correlation between the dependent variables and control variables, I did the Pearson's Correlation test and a correlation matrix is demonstrated in Appendix 1.

Table 4.1 Summary statistic of used variables

Variable	Obs	Mean	Std. Dev.	Min	Max
Gift requested	1,585	.0902208	.2865883	0	1
Government Contract	2,659	.148176	.3553412	0	1
Visited by tax office	2,660	.6778195	.4673995	0	1
Informal payment (%)	1,886	.1861082	1.455198	0	30
Firm age(log)	2,626	2.411082	.50759	0	4.823
Capital city	2,696	.4881306	.5021734	0	1
Private firms	2,700	.9218519	.2684543	0	1
Foreign firms	2,700	.0322222	.1766225	0	1
Female manager	2,696	.1101632	.3131512	0	1
Number of competitors	1,326	15.45872	40.57479	0	500
Firms size	2,700	1.914074	.8006262	1	3
National market	1,692	1.911348	.5196904	1	3

Among all variables, gift requested, government contract, visited by tax office, capital city, female manager, private firms and foreign firms are dummy variables.

Table 4.2 Explanations of Dummy Variables

Dummy Variables		Meaning
Gift Requested	0	The company is not requested to giving gifts
	1	The company is requested to giving gifts
Government Contract	0	Company didn't attempt to secure a government contract
	1	Company attempted to secure a government contract
Visited By Tax Office	0	The company is not visited or inspected by tax office
	1	The company is visited or inspected by tax office
Capital City	0	The company is not located in capital city
	1	The company is located in capital city
Female Manager	0	The top manager is not a female
	1	The top manager is a female
Privates Firms	0	Less than 51% owned by private
	1	Equal or more than 51% owned by private
Foreign Firms	0	Less than 51% owned by foreigner
	1	Equal or more than 51% owned by foreigner

Chapter 5

Result and Discussion

5.1 Regression Result of the Corruption Models

The results of the regressions are presented as followed in Table 5.1. Standard errors in parentheses.

Table 5.1 Regression Result of the Corruption Models

VARIABLES	(1) Gift Requested (Probit)	(2) Government Contract (Probit)	(3) Informal Payment (%) (OLS)	(4) Visited By Tax Office (Probit)
Age(log)	-0.00498 (0.00860)	-0.00160 (0.00634)	0.000280 (0.00878)	-0.000254 (0.00492)
Capital City	0.512*** (0.127)	0.259*** (0.0961)	-0.233 (0.152)	0.0888 (0.0768)
Private Owned Firms	-0.287 (0.421)	0.674** (0.323)	-0.418* (0.252)	1.401*** (0.175)
Foreign Owned Firms	-0.726 (0.622)	0.770* (0.406)	-0.0638 (0.432)	1.406*** (0.267)
Female Manager	0.0943 (0.235)	0.185 (0.163)	-0.344 (0.320)	-0.0343 (0.138)
Number Of Competitors	0.00158 (0.00214)	0.00141 (0.00248)	0.00108 (0.00312)	0.00713* (0.00399)
Middle Size Company	-0.110 (0.162)	0.228* (0.126)	-0.236 (0.173)	0.215** (0.0912)
Large Size Company	-0.264 (0.177)	0.483*** (0.131)	-0.161 (0.191)	0.612*** (0.104)
National Market	-0.0120 (0.166)	0.132 (0.125)	-0.303* (0.170)	0.204** (0.0928)

Constant	-1.082**	-2.091***	-0.813**	-1.298***
	(0.466)	(0.360)	(0.328)	(0.212)
R-squared	0.0459	0.0921	0.0141	0.0736
Observations	760	1,268	926	1,278

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

The Variance Inflating Factor (VIF) shows that there is no multicollinearity in my models.

5.2 Discussion

From the result above, it can clearly be seen that the firm's location, ownership, competitors, size and the main market have significant results towards the corruption situation.

First of all, capital cities have a positive probability of corruption, especially in giving gifts and getting a contract from the government. As I mentioned before that a capital city is the political center and the richer place in a province, so based on the "advantages". It is easier to build *guanxi* and to do corruption as well. Yet very little is known for sure about what causes corruption to be higher in one place than another.

Furthermore, ownership is also one of the most important points I focused on. Both POEs (private owned enterprises) and FOEs (foreign owned enterprises) have significantly higher possibilities in securing government contracts and visits by the tax office. Additionally, FOEs has slightly positive correlations in these two criteria. The main reason would most likely be that either FOEs are more eager to get local government support or government always spend more time management on FOEs, which is strongly correlated with the number of compliance inspections (Rand, & Tarp, 2012). It is surprising to see the negative sign shown on the gift and informal payment. Private owned firms are 41.8% less corrupted. I think this might be due to the case that a corrupter will be put into prison if he gets reported by someone with conclusive

evidences. However, getting something from the contract can be regarded as the convention, which is called brokerage or commission fee in general. Both behaviors are illegal but "commission fee" sounds relatively better and has also more space for possible explanations compared with the direct gift.

Furthermore, the literature indicates completely that small size firms are more prone to do the corruption, while my result shows that big business have a higher probability to be involved into corruption. There are three reasons I concern to be explainable. First of all, large size companies have more *guanxi* in the society and government, which helps them to secure the government contracts. Second, large companies are the pillar in the certain industry or local city. Hence, the government needs to focus on it and visits it more frequently. Last but not the least, if large companies have competitors, then these companies need more resources and support to compete. Therefore, good *guanxi* with government is an easier way to win these competitions.

The number of competitors also has significantly positive correlation with business-government relationships. The more competitors a company has, the more they are willing to be connected with the government. Increasing competitions will increase the total supply of service and products. With fewer competitors' companies, or for instance monopolists, the companies have the intensive to restrict output. However, due to multiple service providers, the government can switch providers as easy as they want and bribery can help companies to keep the cooperation with government or substitute others and expand its market share.

Last but not the least, national market business is 33% less corrupted in informal payment, but more likely to be visited by the tax office. One explanation can be that there is no big benefit to build and keep *guanxi* with its own local government. For the national-market-targeted company, either they are big sized companies which have been discussed above or they are an online business such as Taobao shop seller, who does not need to keep in touch with the local government. Because of collinearity

in the regression result, the international market target firms cannot be analyzed.

From Figure 5.1, China and Russia have extreme and the worst performance. These two countries companies always pay bribes if they are export-led firms. Firms may be more vulnerable for rent extraction or bribe payment if they are involved in either exporting trade or importing trade (Fisman & Svensson, J., 2007).

Figure 5.1 Bribe Payers index of 28 leading export nations



Source: Transparency International, 2011

Due to the complication of *guanxi* and corruption, it is impossible to control all the related variables. In the social science field, there are hundreds of factors which may impact the bribery result. This might be an explanation for the relatively low R-Square.

After my methodology and tests, my hypothesis is failed to reject, so that one can expect that capital city located firms, foreign-owned firms, and large size firms are more eager to build "*guanxi*" and also have the higher potential probability of bribery.

5.3 Implications of Corruption

There is no doubt that firms' corruption is just like a bug in the stability of the society, that destroy the relationship between government and firms, government and people, firms and people. First of all, it deeply damages the economic benefits and social welfare of the country, employees, citizens etc. Moreover, the establishment and

completion of the market system is ruined by corruption. The economy cannot be developed without a fair and clean market, especially in China. The supervision of one "invisible hand" marketing and one "visible hand" macro-control or government will be out of order under bribery. At last, corruption will decrease the country's reputation, influence the foreign direct investment and cultivate corrupted economy environment. In a nut shell, avoiding firms' corruption is one of the priority jobs that government should highlight on the memorandum and this paper provides several reasons for it.

5.4 Limitation

The biggest limitation and also a possible explanation of my results is the data limitation. The dataset in this paper is from World Bank Survey (2012), which is 5 years ago. As I mentioned above, 18th National Congress (2012 November) witnessed the anti-corruption fight within the whole nation. The situation nowadays is quite different from 2012. In addition, because of the lacking panel data, I can only do the cross-section test which makes the result monotonous. Longitudinal studies would allow me to understand the *guanxi* more thoroughly and provide more conclusive findings on the direction of causality between company type and *guanxi*. Panel data would also correct for the case that 2012 was an outlier year.

Chapter 6

Conclusion

Unlike most published literature which focuses on the causality between corruption and environment or how to design anti-corruption instruments, my emphasis will be put into firm-level corruption and see what kind of firms are more likely to build these relations. This also indicates that these companies have more possibilities to do bribery in this paper.

I started out in this paper with introducing the definition of a business-government relation. Then to be specific, I focused on China, where it is called "*guanxi*". There are three different type of "*guanxi*", family, friendships and interest *guanxi* separately. "*Guanxi*" has its advantages and disadvantages. For a good way, it helps to overcome the recourse or information limitations, offers a preferential treatment in business cooperation, avoids external risk and competition, enhance their cultural affinity and reduces alienation.

However, the negative of "*guanxi*" cannot be ignored because extreme "*guanxi*" will lead to corruption. Hereby, I mainly discuss governments and firms' corruption and compare China's situation with Japan's and Vietnam's. Japan has less corruption so that China can learn from it. Vietnam has similar corruption models like China, but in an extremer way.

As I know, there is so far no published literature pointing out clearly what kind of firms' have corruption suspicions. The majority of the results are based on empiricism and theoretical reasoning. Therefore, I make full advantage of a unique dataset that contains information on the estimated bribe payments of Chinese firms and figure out what kind of firms would be prone to develop "*guanxi*" or even do corruption. The result states that capital city located firms, foreign-owned firms, and large size firms have demanded to build "*guanxi*" and also have the higher potential possibility to do the corruption.

Admittedly, there are some limitations in my paper and some future research possibilities that occurred. Due to the specialty of Chinese society, it is almost impossible to conduct a direct corruption data set. Since I do not have a panel data set yet, I am not able to answer the inter-dependency between business-government relations and firms' development. However, the data set was announced to be the beginning of a panel data set, so that a repeating study can be conducted in several years, answering some of the remaining questions. This would also help to overcome the threat that 2012 would have been for instance an outlier year.

Reference

Bartels, R., 1982. National Culture: Business Relations: The United States and Japan Contrasted. *Management International Review*, pp.4-12.

Boddeyn, J.J., and Brewer, T.L., 1994. International-business political behavior: New theoretical directions. *Academy of management review*, 19(1), pp.119-143.

Breen, M., Gillanders, R., McNulty, G., and Suzuki, A., 2016. Gender and corruption in business. *The Journal of Development Studies*, pp.1-16.

Calder, K.E., 1995. *Strategic capitalism: private business and public purpose in Japanese industrial finance*. Princeton University Press.

Clarke, G.R., and Xu, L.C., 2004. Privatization, competition, and corruption: how characteristics of bribe takers and payers affect bribes to utilities. *Journal of Public Economics*, 88(9), pp.2067-2097.

Chalmers Johnson,1974. The Reemployment of Retired Government Bureaucrats in Japanese Big Business. *Asian Survey*, 14(11), pp. 953-65;

Chalmers Johnson,1982. MITI, and the Japanese Miracle: The Growth of Industrial Policy. *Stanford University Press*, pp.1925-1975

China Enterprise Surveys 2012, World Bank. Retrieved from (6, May, 2017)
<https://www.enterprisesurveys.org/portal/index.aspx#/library?dataset=Enterprise%20Survey>

Craig Charney and Shehzad Qazi, 2015, *Charney Research*. Retrieved from (7, July, 2017) <http://www.charneyresearch.com/wp-content/uploads/2015/01/White-Paper-Corruption-in-China-FINAL-v10.pdf>

CPI. What is the corruption perceptions index? Retrieved from (23, July, 2017)
<https://www.transparency.org/research/cpi/overview>

Dollar, D., Fishman, R., and Gatti, R., 2001. Are women really the “fairer” sex? Corruption and women in government. *Journal of Economic Behavior & Organization*, 46(4), pp.423-429.

Fishman, R. and Svensson, J., 2007. Are corruption and taxation really harmful to growth? Firm level evidence. *Journal of Development Economics*, 83(1), pp.63-75.

Ford, D., 1980. The development of buyer-seller relationships in industrial markets. *European journal of marketing*, 14(5/6), pp.339-353.

Gardiner, J.A., 1970. *The politics of corruption: Organized crime in an American city*. Russell Sage Foundation.

Gittell, R., Magnusson, M., and Merenda, M., 2012. *The sustainable business case book*. The Saylor Foundation.

Gold, T., Guthrie, D., and Wank, D. eds., 2002. *Social Connections in China: Institutions, culture, and the changing nature of guanxi* (Vol. 21). Cambridge University Press.

Goetz, A.M., 2007. Political cleaners: Women as the new anti-corruption force?. *Development and Change*, 38(1), pp.87-105.

Gainsborough, M., 2003. Corruption and the politics of economic decentralization in Vietnam. *Journal of Contemporary Asia*, 33(1), pp.69-84.

Hall, E.T., and Hall, M.R., 1987. The sounds of silence. *Anthropology Connecticut: The Dushkin Publishing Group*, pp.79-84.

Hallén, L. and Johanson, J., 1985. Industrial marketing strategies and different national environments. *Journal of Business Research*, 13(6), pp.495-509.

Hofstede, G. and Bond, M.H., 1988. The Confucius connection: From cultural roots to economic growth. *Organizational Dynamics*, 16(4), pp.5-21. the relationship of Confucian teachings with economic development in Asia

Heidenheimer, A.J., Johnston, M. and LeVine, V.T., 1970. Political corruption. *New York: Holt, Rinehart & Winston*, 24, pp.26-27.

Hilton Root, "Corruption in China: has it become systemic?" *Asian Survey*, Vol. 36, No. 8 (August 1996), pp. 741–757;

Hillman, A. and Keim, G., 1995. International variation in the business-government interface: Institutional and organizational considerations. *Academy of management review*, 20(1), pp.193-214.

Ikenberry, G.J., 2008. The rise of China and the future of the West: can the liberal system survive?. *Foreign affairs*, pp.23-37.

Implementation Report, 2013, World Bank. Retrieved from (6, May, 2017)

Kent Calder, 1989. Elites in an Equalizing Role: Ex Bureaucrats as Coordinators and Intermediaries in the Japanese Government-Business Relationship. *Comparative Politics*, 21(7), pp. 379-403.

Kimuyu, P., 2007. Corruption, firm growth and export propensity in Kenya. *International Journal of Social Economics*, 34(3), pp.197-217.

Lee, D.J., Pae, J.H., and Wong, Y.H., 2001. A model of close business relationships in China (*guanxi*). *European Journal of Marketing*, 35(1/2), pp.51-69.

Li, L., 2011. Performing Bribery in China: *guanxi*-practice, corruption with a human face. *Journal of Contemporary China*, 20(68), pp.1-20.

Luo, Y., 1997. *Guanxi* and performance of foreign-invested enterprises in China: An empirical inquiry. *MIR: Management International Review*, pp.51-70.

Luo, Y. and Chen, M., 1997. Does *guanxi* influence firm performance?. *Asia Pacific Journal of Management*, 14(1), pp.1-16.

Mauro, P., 1997. *Why worry about corruption?* (Vol. 6). International Monetary Fund.

Luo, Y., 2008. The changing Chinese culture and business behavior: The perspective of intertwinement between *guanxi* and corruption. *International Business Review*, 17(2), pp.188-193.

Mathieu. 1995. "Corruption, Law and Justice: A Conceptual Clarification." *Journal of Criminal Justice* 23(3):243-258.

Michael Johnston and Yufan Hao, "China's surge of corruption," *Journal of Democracy*, Vol. 6, No. 4 (October 1993), pp. 80–94;

Minxin Pei, "Will China become another Indonesia?" *Foreign Policy*, Issue 116 (Fall 1999), pp. 94–110.

Nee, V., 1992. Organizational dynamics of market transition: Hybrid forms, property rights, and mixed economy in China. *Administrative science quarterly*, pp.1-27.

Porter, M.E., 1998. The Adam Smith Address: Location, clusters, and the "new" micro economics of competition. *Business Economics*, 33(1), p.7.

- Quah, J.S., 1994. Controlling corruption in city-states: A comparative study of Hong Kong and Singapore. *Crime, Law and Social Change*, 22(4), pp.391-414.
- Rand, J. and Tarp, F., 2012. Firm-level corruption in Vietnam. *Economic Development and Cultural Change*, 60(3), pp.571-595.
- Schaede, U., 1995. The "Old Boy" network and government-business relationships in Japan. *Journal of Japanese Studies*, 21(2), pp.293-317.
- Sheng, S., Zhou, K.Z. and Li, J.J., 2011. The effects of business and political ties on firm performance: Evidence from China. *Journal of Marketing*, 75(1), pp.1-15.
- Shleifer, A. and Vishny, R.W., 1993. Corruption. *The quarterly journal of economics*, 108(3), pp.599-617.
- Shleifer, A., Vishny, R.W., 1993. Corruption. *Quarterly Journal of Economics* 108, 599–617.
- Schramm, M. and Taube, M., 2003. The institutional economics of legal institutions, *guanxi*, and corruption in the PR China. *Fighting corruption in Asia: Causes, effects, and remedies*, pp.271-96.
- Tsang, E.W., 1998. Can *guanxi* be a source of sustained competitive advantage for doing business in China?. *The Academy of Management Executive*, 12(2), pp.64-73.
- Tsuboi, Y., 2005. *Corruption in Vietnam*. Center of Excellence, Contemporary Asian Studies, Waseda University.
- Treisman, D., 2000. The causes of corruption: a cross-national study. *Journal of public economics*, 76(3), pp.399-457.
- Vietor, R.H., 1987. *Energy policy in America since 1945: a study of business-government relations*. Cambridge University Press.
- Wederman, A., 2004. The intensification of corruption in China. *The China Quarterly*, 180, pp.895-921.
- Weiss, L., 1995. Governed interdependence: Rethinking the government-business relationship in East Asia. *The Pacific Review*, 8(4), pp.589-616.
- Weiss, L., 1994. Government-business relations in East Asia: the changing basis of state capacity. *Asian Perspective*, pp.85-118.

Woll, C. and Artigas, A., 2007. When trade liberalization turns into regulatory reform: The impact on business–government relations in international trade politics. *Regulation & Governance*, 1(2), pp.121-138.

Wu, J.M., 1997. Strange bedfellows: Dynamics of government-business relations between Chinese local authorities and Taiwanese investors. *Journal of Contemporary China*, 6(15), pp.319-346.

Xin, K.K. and Pearce, J.L., 1996. *Guanxi*: Connections as substitutes for formal institutional support. *Academy of management journal*, 39(6), pp.1641-1658.

Appendix 1

Appendix 1 Table of Descriptive Correlations (obs=558)

	informal				capital				female	compet		
	payment	contract	visit	gift	age	city	private	foreign	manager	itors	size	marke
informal												
payment	1.000											
contract	0.031	1.000										
visit	0.013	0.026	1.000									
gift	0.286	0.176	0.021	1.000								
			-	-								
age	-0.015	0.009	0.051	0.031	1.000							
			-									
capital city	-0.012	-0.027	0.083	0.082	0.024	1.000						
					-							
private	0.022	0.047	0.226	0.028	0.048	-0.008	1.000					
				-	-							
foreign	-0.015	-0.020	0.012	0.046	0.063	0.019	-0.757	1.000				
					-							
fmanager	-0.046	-0.007	0.023	0.055	0.061	0.024	-0.030	0.073	1.000			
					-							
competitors	-0.019	0.019	0.013	0.003	0.004	0.058	-0.017	-0.020	0.006	1.000		
			-	-								
size	-0.114	0.089	0.088	0.075	0.151	0.033	-0.042	0.009	-0.016	-0.032	1.000	
			-	-								
market	-0.083	0.062	0.037	0.024	0.111	-0.064	-0.017	-0.006	-0.023	0.016	0.241	1.000