GENERALISED TRUST AND RELATION CENTRISM FOR CORRUPTION AS PERCEIVED BY FIRMS: EVIDENCE FROM LOW- AND MIDDLE-INCOME COUNTRIES

TOLU OLAREWAJU
Keele Business School
Keele University
ST5 5BG, United Kingdom

JAGANNADHA PAWAN TAMVADA
University of Southampton, United Kingdom

SHARIN MCDOWALL-EMEFIELE
University of Birmingham, United Kingdom

ABSTRACT

We investigate the role of generalised trust and relation centrism for corruption as perceived by 16,785 firms in 20 lower- and middle-income countries. This quantitative empirical research demonstrates that higher levels of family centrism and generalised trust are linked with more corruption as perceived by firms. The results however show significant regional disparities suggesting that firms will need to be aware of these differences, as they are likely to determine their optimal strategic choices when entering or expanding their operations into new territories.

INTRODUCTION

Corruption undermines development by distorting the rule of law and weakening the institutional foundations of economic growth (Olarewaju, Rufai, & Gallage, 2021; Rose-Ackerman, 1998). Corruption reveals itself to firms in many ways; from "big-time corruption" involving large sums, big corporations, senior-level public sector workers and substantial kickbacks, sometimes crossing national borders, to "petty corruption" involving smaller sums, lower-level workers and localised practices. Several studies suggest that in societies with more generalised trust, where people are more willing to deal with those outside their narrow social network, governments tend to be more efficient leading to more economic development and less corruption (Uslaner, 2004; Zak and Knack, 2001). However, there are also reasons why corruption may be greater in societies that have more generalised trust (Harris, 2007). This is because the social network may encourage corruption through wide-ranging social pressures that influence the decisions of agents. Thus, there is no consensus on the role of generalised trust for corruption in the extant literature. Furthermore, little is known about how relation centrism, a construct we introduce to reflect the extent of importance accorded to family and friends has a role for corruption.

This paper makes novel contributions by examining firm-level corruption perception through the lenses of national-level generalised trust and relation centrism. The empirical results based on a large-scale firm-level cross-country database from lower- and middle-income countries suggest that there are regional disparities in the relationship that corruption has with generalised trust and family and friend centrism in society; consequently, for strategic decision-

making and internationalisation, firms should be aware of the regional relationships that exist in the contexts where they plan to enter and operate.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Generalised Trust and Corruption

Corruption and bribery are more rampant in many less developed and emerging economies (Luo and Han, 2009). The underdeveloped political conditions typical in such countries encourage a climate of corruption, where firms may benefit from connections and rent-seeking. Putnam (1993) theorised that trust, reciprocity and civic engagement are indispensable to collective existence and argued that communities become prosperous because they have a vital civic life. A multi-level characterization and complexity of trust has also been recognized in management studies (Rousseau, Sitkin, Burt, & Camerer, 1998). In this regard, trust is usually construed as institutional trust and generalized trust with both being mutually connected positively. Institutional trust is the dynamic relationship between individuals, firms, and institutions while generalised trust refers to trust in other members of society.

Institutional Theory (North, 1991; Peng, 2003) proposes the notion that a firm's operating environment consists of two dimensions – formal corruption environment (FCE) and informal corruption environment (ICE) (Kouznetsov et al., 2019). The ICE includes such subcategories of corruption as the Individuals-to-business (I2B) and Individuals-to-Government (I2G), which together reflect the general public's views of corruption in their everyday lives. The perception of the multi-faceted corruption, as suggested by these subcategories, may affect a foreign firm's overall proclivity to unethical practices in a foreign location. Generalised trust should thrive in societies with effective, impartial, and fair bureaucracies, as these institutions should reign in corruption (Rothstein and Stolle, 2008). Generalised trust is impersonal and not related to specific social exchange relationships between people. It is an abstract attitude towards people in general, encompassing those beyond immediate familiarity, including strangers (people one randomly meets in the street, fellow citizens, and foreigners, amongst others). For these reasons, we propose:

> *Hypothesis 1: Higher levels of generalised trust in society are associated with higher levels of corruption.*

Relation Centrism and Corruption

We introduce a new construct "relation centrism", defined as the importance that people give to family and friends in society. While generalized trust refers to trust in other members of society, relation centrism builds on the concept of group centrism to refer to trust in family members or friends (Kruglanski, Pierro, Mannetti, & De Grada, 2006). Ethnic and non-ethnic ties affect firm activity and the literature has defined particularised trust as trust found in close social proximity and extended toward people the individual knows from everyday interactions (e.g., family members, friends, neighbours and co-workers) (Freitag and Traunmüller, 2009). Particularized trust has been reported to facilitate corruption (Uslaner, 2004), with the following logic: to form a bribery–corruption relationship (the transaction type corruption), some minimal trust must exist, because of the time lag and geographic separation between the bribe payment by

the briber to the bribe receiver, and delivery of the good to the briber. The literature has however not examined the role of relation centrism in family and friends for corruption. When investigating the spheres of trust and the role of relationships in the community and workplace, the deepest bonds are usually for the family, followed by friendship bonds, and then by generalised trust in other members of society (Freitag and Traunmüller, 2009).

Family and friend ties are usually stronger than the weak ties implied by generalised trust and could be "affect-based", reflecting trustworthy behaviour that is encouraged by love and kinship. In a similar vein, firms in societies with more family or friend centric values could perceive that corruption is higher in their society because the stronger affect-based or interest-based ties associated with family and friends may create better avenues for corruption with family and friends compared to the weak ties associated with generalised trust. These lead us to propose:

Hypothesis 2: Higher levels of family and friend centrism in society are associated with higher levels of corruption.

These relationships may vary across different regions and countries. Regional cultures vary in the degrees to which people – individually and within their organizations – trust and interact with one another. For example, generalised trust has been found to have a relationship with ethnic nepotism in Africa (Olarewaju and Olarewaju, 2021; Zerfu, Zikhali, & Kabenga, 2009), and political participation in Asia (Kim, 2014).

DATA AND METHODOLOGY

Firm-level data on corruption perception, firm characteristics, and their views on institutional quality and the business environment is from the 2013-2016 Enterprise Survey (ES) database of the World Bank Group. The sample is restricted to firms from 20 lower- and middle-income countries where data was collected using the global methodology from 2013 to 2016 to ensure data uniformity. The sample consists of 16,785 firms from the manufacturing, services, transportation and construction sectors. Public utilities, government services, health care, and financial services sectors are not included in the sample. In addition to the ES database, we make use of the World Value Survey (WVS) for the corresponding years to capture generalised trust and family and friend centrism at the national level.

The dependent variable "Corruption" is proxied using the question: "How much of an obstacle is corruption to the current operations of this establishment?" from the ES database of the World Bank Group to measure corruption as an obstacle to operations as perceived by firms. Answers to this question range upwards from 1 indicating "no obstacle" to 5 indicating "severe obstacle". Measures of social network ties were drawn from the WVS. We use three variables from the WVS. They are: (1) Most people can be trusted; (2) family is important and; (3) friends are important. The first variable serves as a measure for generalised trust in most members of society, the second variable serves as a measure for family centrism, and the third variable serves as a measure for friend centrism. Values for each of the variables range upwards from 0 indicating "no importance" to 4 indicating "very high importance". Therefore, higher values of these variables imply higher generalised trust in the corresponding social networks.

An effective legal system is a key institution for tackling corruption (Sarmidi, Law, & Jafari, 2014). Corruption typically flourishes where there are institutional voids with

consequences for the business environment (Khanna and Palepu, 2013; Mickiewicz and Olarewaju, 2020), so we control for legal institutional quality at the national level. Furthermore, we control for social media participation at the national level because trust in online environments is a different type of trust that needs to be measured differently (Enli and Rosenberg, 2018).

Twelve indices are also of particular interest in the ES database because they capture characteristics of the firm's business environment and perceptions about institutions at the national level. They are indices that ask firms "how much of an obstacle to business are" (1) transport infrastructure, (2) crime, theft and disorder, (3) customs and trade regulations, (4) electricity, (5) telecommunications, (6) access to land, (7) tax rates, (8) business and licencing permits, (9) political instability, (10) access to finance, (11) labour regulations, (12) and an inadequately educated workforce. They measure how obstructive each of these variables is to the business performance and responses range from 1 indicating "no obstacle" to 5 indicating "severe obstacle". As a final measure of internal consistency, we construct a Cronbach's alpha index from these twelve indices to operationalise a consistent indicator that measures the business environment as perceived by the firms. Other control variables at firm and national levels are also included as shown in the Ordered Probit Model (1), which is estimated because the dependent variable, Corruption, has ordered values ranging upwards from 1 to 5.

$$(\text{Corruption}) = \hat{\wedge}(\beta_0 + \beta_1 \text{GenTrustMostPeople}_c + \beta_2 \text{FamilyCentrism}_c + \beta_3 \text{FriendCentrism}_c + \beta_4 \text{LegalInstitutionalQuality}_f + \beta_5 \text{SocialMediaParticipation}_c + \beta_6 \text{BusinessEnvironment}_f + \beta_7 \text{Size}_f + \beta_8 \text{CapitalCity}_f + \beta_9 \text{MainBusinessCity}_f + \beta_{10} \text{PossesionofCredit}_f + \beta_{11} \text{FixedAssets}_f + \beta_{12} \text{AnnualSales}_f + \beta_{13} \text{LabourCosts}_f + \beta_{14} \text{IncomeLevel}_c + \beta_{15} \text{GeoLocation}_c + \beta_{16} \text{Landlocked}_c) \tag{1}$$

In Estimation (1), $\hat{\wedge}$ is the link Ordered Probit function. $\text{GenTrustMostPeople}_c$ denotes generalised trust in most people at the national level. FamilyCentrism_c denotes family centrism at the national level. FriendCentrism_c denotes friend centrism at the national level. $\text{LegalInstitutionalQuality}_f$ denotes legal institutional quality as perceived at firm level. $\text{SocialMediaParticipation}_c$ denotes social media participation at the national level and is a composite index of Facebook and Twitter participation at the national level. $\text{BusinessEnvironment}_f$ denotes the Cronbach's alpha index that measures the business environment perceived by firms. Controls are included for firm size (Size_f), location in a capital city (CapitalCity_f), location in the main business city ($\text{MainBusinessCity}_f$), possession of a line of credit ($\text{PossesionofCredit}_f$), fixed assets ($\text{FixedAssets}_f$), annual sales ($\text{AnnualSales}_f$), total labour costs ($\text{LabourCosts}_f$), income level of country as given by the World Bank (IncomeLevel_c), country geographic region (GeoLocation_c), and a dummy to indicate if the firm is not located in a landlocked country (Landlocked_c).

RESULTS

The results reveal that an increase in generalised trust is associated with an increase in corruption as predicted by *Hypothesis 1*. The results however reveal that an increase in family centrism is associated with an increase in corruption while an increase in friend centrism is associated with a decrease in corruption showing mixed results for *Hypothesis 2*. The results also reveal that corruption decreases with improved legal institutions, more national level social

media participation and better business environments. There are regional disparities in the nature of the relationships between generalised trust, and relation centrism for corruption. In South-Central Asia, generalised trust and family centrism have a significant positive effect on corruption perception. This is also found to a stronger degree in the Middle East and North Africa region with the addition of a significant positive effect of friend centrism on corruption perception. In contrast to the previous two regions, in Sub-Saharan Africa, friend centrism has a negative significant effect while for the Association of South-East Asian Nations, both generalised trust and friend centrism have a negative significant effect on corruption perception.

These findings have direct implications for firms because the perceptions of corruption in different regions due to differing FCEs and ICEs are likely to influence firm strategic choices to cope with corruption. For instance, in regions where increased friend centrism is associated with reduced corruption perception as a business obstacle, firms can use weak ties strategically to operate with the associated lower perceptions of corruption but would need to be more careful in regions where increased friend centrism is associated with increased corruption. In addition, the different coefficients indicate that there are different levels of relationships. These results are crucial for firms based in lower- and middle-income countries where ethnic and non-ethnic ties affect firm activity because often, familial relationship over societal trust is strong, and may have consequences for regional corruption and the strategies used to overcome them. Overall, firms need to consider the level of generalised trust and relation centrism in their host countries as these are indicative of informal social networks that influence corruption perception that could have a bearing on the strategic choices that firms need to make to manage intricate human relationships that exist in host countries.

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