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Research Report

Corruption and FDI: The role of social brokers

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Corruption and FDI: The role of social brokers

by

Jose Godinez and Mahmoud Khalik*

A growing number of policymakers, non-governmental organizations and academics are recognizing the importance of intermediaries utilized by firms when investing in highly corrupt host countries. Such intermediaries can be experienced professionals in host countries' socio-economic environment who help avoid or minimize MNEs' exposure to corruption. To reduce MNEs' engagement in corruption, these firms should be held accountable for the behavior of their intermediaries through strict auditing and reporting obligations.¹

Little attention has been placed on the intermediaries that arrange the initial meetings between MNEs and potential local partners, the so-called "social brokers." Social brokers are mainly local intermediaries, including public relations agents, local consultants, law firms, and accounting firms, among others. Social brokers include, to a lesser extent, private individuals who have international commerce expertise and established relations with local firms and institutions. The role of these brokers is basically to help MNEs find appropriate local partners ready to engage in corruption on their behalf, where this is required or would facilitate establishing MNEs' businesses in host countries. Social brokers make it unnecessary for MNEs to approach local firms directly and engage in corruption.

Social brokers rely on their social capital to arrange meetings with potential local partners. In countries like Egypt and Guatemala, foreign MNEs seldom approach unknown local businesses to collaborate in operations, especially if such businesses are [expected](#) to operate in a corrupt environment. Before early meetings take place, social brokers gather information from MNEs to see what kind of services they require and find a match with local companies, to which they communicate the MNEs' expectations. Fees for this service can reach up to 15% of the value of a

single business deal, i.e., helping MNEs to circumvent their own anti-corruption policies when establishing local businesses.

To decrease engagement in corruption by firms investing overseas with the aid of local intermediaries, some countries have enacted legislation, such as the US Foreign Corrupt Practices Act (US FCPA) or adhered to international conventions like the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention). These instruments generally create liability for foreign firms in instances where the corrupt act is carried out by a third party. Specifically, the US FCPA requires MNEs to create and maintain internal controls to ensure that there is no participation in corruption abroad, including through consultants and partners. Likewise, the OECD requires that representatives of all the ratifying countries be represented in the Working Group of Bribery in International Business Transactions. The OECD controls the implementation of anti-bribery provisions through a peer-review mechanism to ensure that all member countries comply with the OECD Convention.

Concurrently, some host countries have also enacted local laws prohibiting corrupt acts, although proper enforcement is sometimes neglected. For instance, in Guatemala, where we have conducted extensive research, while bribing public officials is illegal, public officers have been accused of protecting political allies to gain political favors. Both at the international and domestic levels, however, it is not always clear whether legal instruments and their enforcement effectively target social brokers. For instance, while the OECD Convention addresses the responsibility of foreign firms for bribery through intermediaries, in practice, its implementation focuses more on local firms with which MNEs collaborate, rather than social brokers arranging the MNE-local business collaboration. Furthermore, since there is a shift in the world economy in which emerging regions, such as Asia and the Middle East, are gaining more prominence in the world economy, existing international legislation may not apply to them.

For this reason, home and host countries should include in their anti-corruption legislation specific requirements for MNEs to disclose their partnerships with local firms and to disclose the steps taken to generate the first contact with those firms. This would help clarify the nature of the deals being agreed on by MNEs and intermediaries. Specifically, these kinds of disclosures should become part of the MNEs' compliance obligations when the need for social brokers arises and also include background investigations and information on those brokers. Important factors to be considered are the reputation of social brokers, the MNEs' connections with them and their connections with local firms, the reputation of local firms, and any compensation requested by social brokers from local organizations.

Action along these lines would make it more difficult for foreign firms to gain unfair advantages when entering foreign markets. Governments should implement more transparency policies that require foreign firms to document their practices regarding social brokers. This transparency

should help improve the compliance of anti-corruption regulations of foreign firms' foreign operations. Stricter policies would also reinforce developing countries' credibility and legitimacy when attracting more and/or higher-quality FDI.

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¹ See John Graf Lambsdorff, "Corrupt intermediaries in international business transactions: Between make, buy and reform," *European Journal of Law and Economics*, vol. 35 (2013), pp. 349-366.

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