Combining perspectives from institutional economics, transaction cost economics and agency theory literature, this paper develops a theoretical framework for properly aligning monitoring and incentive structures within institutional environments of varying levels of corruption. In addition to requiring organizational structures that take into account the agency problems that develop across borders, multinational firms require increased monitoring and performance-based incentive structures in more corrupt countries. The relationship is not entirely straightforward, however, and failure by a multinational firm to appropriately account for corruption differences will impact employee performance.

INTRODUCTION

Economic theories have long acknowledged a relationship between organizational issues of governance structures, motivation and human moral character (Williamson, 1979). In this paper, institutional economics, transaction cost economics and agency theory are combined to consider how these central issues affect employee performance in foreign subsidiary operations in different countries. Each separate economic perspective has addressed how employee performance varies in response to the alignment between organizational structures and the institutional environment. Institutional economics has explained the importance of the quality (measured by the level of corruption) of the institutional environment within which firms operate (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 1997). Transaction cost economics focuses on the significance of selecting organizational structures that properly align with the environment and minimize opportunistic behaviors of employees (Williamson, 1991).
Agency theory addresses the need for monitoring and incentive structures that encourage information availability and goal alignment between the principal and the agents (Jensen and Meckling, 1976).

Answering Eisenhardt’s 1989 challenge for management scholars to explore the agency theory model in a context-rich environment, this study focuses on agency theory constructs within the complex context of the multinational corporation (MNC). In the international arena, firms face environments with different institutional characters, reflected as variations in, among other things, corruption activities. In transaction costs economics, the level of corruption in a particular environment is evidence of the degree of potential opportunism and contracting difficulties. From the agency theory viewpoint, these environmental differences prescribe different structural and contractual approaches to curb opportunism. Failure by a firm to select an accurate monitoring and incentive structure in a particular environment will provoke employee behavior that is more self-interested than is desirable. The result, as reflected in a less favorable employee performance rating, is an employee who is performing in a manner more consistent with personal rather than firm interests.

**LITERATURE REVIEW**

As Krasner explained, the nature of an actor can only be understood as part of the institutional environment within which the actor operates (1988: 72). The impact on individuals of local norms, routines and other institutional features is a widely accepted concept (Carr and Brower, 2000; Swindler, 1986) and, a number of researchers have identified national patterns between values and resulting norms and institutionalized features (Bigoness and Blakely, 1996; England, 1967; Elsayed-Elkhouly and Buda, 1997: 105-107). The values embedded in a national culture have also been found to have a profound and enduring effect on the behavior of managers (Geletkanycz, 1997: 630). Erez (1986) commented that firm performance depends on the firm’s ability to account for and find congruence between societal values and managerial practices.

One central aspect of the institutional environment that has been correlated with the values of a society, drives many market differences between countries, and impacts economic concerns for the firm, is the level of corruption in a country (La Porta, et al., 1997; Licht, 1999; Salbu, 1999). Corruption is a culturally bound concept both with respect to its identification as such and with the degree to which it is condemned within a particular society (Salbu, 1999). While definitions vary in detail, most describe corruption as the behavior of a government official that leads to personal gain. In essence, the government official puts personal interests above institutional responsibilities and may collect special payments, bribes, or other unauthorized rents in connection with performing regular governmental duties (Collier, 2002; Ehrlich and Lui, 1999; Shleifer and Vishny, 1993).

Specifically, Shleifer and Vishny (1993) presented corruption as the sale of government property by government officials for personal gain. Ehrlich and Lui (1999) described corrupt behavior as when the government exercises the opportunity to obtain
rents in the form of side payments and bribes. Collier gave a very succinct definition, stating: “Corruption is the abuse of public office for private gain.” (2002: 1). Corruption, thus, is a measure of the nature and quality of a country’s central governmental institutions (Wei, 1998).

The level of corruption in a country also provides some insight into value differences across countries. Schwartz and Bilsky (1987) along with Armstrong and Sweeney (1994) both found that ethical considerations and perspectives vary across cultures. Variations in corruption reflect societal levels of opportunistic behavior and indicate the enforceability of contractual relations in the country.

Transaction cost economics has attempted to explain the overall impact of corruption on international business. According to Coase (1937), variation of this environmental dimension manifests itself in the different costs associated with pricing mechanisms of countries and with the hierarchies operating in and across such countries. Empirical tests have supported these concerns of increased costs with findings of reduced foreign investment to more corrupt countries (La Porta et al., 1997; Diersen, 1999; Salbu, 1999: 55; Hines, 1995). Unfortunately though, transaction cost economics does not provide guidance for a foreign subsidiary already operating in a more corrupt country. Empirical work has yet to explore how to maintain firm efficiencies in circumstances of high corruption (Moschandreas, 1997).

Indeed, transaction cost economics considers the issue of the human element from a somewhat external, contractual perspective. Within any particular environment, transaction cost economics explains why firms take certain forms and have certain contractual arrangements (Carr and Brower, 2000: 132; citing Hesterly, Liebeskind and Zenger, 1990). The organization’s strategic goal when making decisions about such issues is to mitigate the opportunism of organizational actors (Carr and Brower, 2000: 132). Opportunism must be contained and controlled for a firm to realize abnormal rents (Williamson, 1979). Transaction cost economics presumes that, in an efficient firm, internal firm governance structures and mechanisms are appropriate for the nature of the opportunism in the environment (Griesinger, 1990). However, transaction cost economics neither fully explains the employee’s response to such efforts nor assesses the impact on the employee’s performance when structures and mechanisms are not appropriate for a firm’s environment.

In contrast, agency theory focuses on the problem of an organization’s agents (Carlos, 1992) and provides a method of assessing the results of the attempted alignment of relevant firm issues to the environment. The focal point of agency theory is the contractual relationship between the principal and the agent. The inherent problems of these relationships stem from information asymmetry and goal misalignment that leave principals uncertain of the level of effort and true capabilities of agents (Jensen and Meckling, 1976). To reduce information asymmetry, principals promote structures and processes to monitor the agent’s actions while incentive structures are designed in an attempt to motivate agents to align their self-interests with the interests of the firm (Jensen and Meckling, 1976). Through appropriate monitoring and incentives, agency theory holds that the principal can provoke employee
Agency theory is particularly relevant in environments where contracting problems are more prevalent and where opportunism makes the assessment of agents most costly (Barney, 1990; Eisenhardt, 1989; Kosnik and Bettenhausen, 1992). Clearly, this is the situation within a more corrupt environment. While corruption is a covert activity, it does not occur in a vacuum and to exist must have some level of societal tolerance and, therefore, acceptance. Furthermore, higher levels of corruption arguably evidence a higher tolerance of information asymmetry within a society. While the corrupt behavior is, by implication allowed, it is neither acknowledged nor monitored. A quasi “don’t ask, don’t tell” acceptance may exist in some countries with higher corruption. From an agency perspective, therefore, increased corruption suggests an increase in both goal divergence and information asymmetry between principal and agent.

Because of these expected increased agency problems, firms would need to increase supervision and monitoring to prevent losses due to a lack of organizational effort by employees. In addition, agent and principal goal alignment would be more difficult, thus increasing the importance of the incentive program employed. Transaction cost economics assumes that the firm will respond appropriately to differences in corruption across environments. Agency theory clarifies the situation more fully, by explaining how failure to respond properly to such differences causes increased information asymmetry and goal misalignment that results in organizationally deviant behavior by employees. Ultimately, employee performance ratings, reflecting the level at which the expectations of the principal are met, will drop.

Agency theory is highly appropriate for application to the problems of MNCs seeking to properly match monitoring and incentive structures to the differing environments of their subsidiaries. Agency theory has been applied to the international context only to a limited degree. Some agency work has ventured into the international arena where the principal-agent relationship spans national boundaries (Gong, 2003 [use of expatriates]; Karunaratna, Johnson and Rao, 2001 [exporter-importer agent relationships]; Kim, Prescott and Kim, 2005 [headquarters-subsidiary relationship]; Roth and O’Donnell, 1996 [headquarters-subsidiary relationship]). Yet lacking is work focusing on agency issues at levels below the top management of the foreign subsidiary or explaining appropriate firm structures in differing environments. The model developed herein is based upon the importance of firm structural decisions pertaining to monitoring capabilities and incentives in influencing agent’s behavior and resulting performance assessments. Following the logic of Eisenhardt (1989), the model incorporates the effects of corruption as a key contextual concern influencing the effects of agency issues on MNCs.

Another environmental factor of concern is the level of economic risk. Agency theory has long noted the importance of considering the degree of uncertainty within situations (Eisenhardt, 1989). Proper management of the agency relationship requires considering the level of outcome uncertainty which affects the relationship between agent performance and firm benefit. Higher economic risk would increase outcome
uncertainty generally related to all transactions, making evaluation of agency issues and determination of appropriate agency solutions more difficult.

The remainder of this paper focuses on structural responses to the nature of the institutional environment. MNCs must select different structures in response to different levels of corruption and economic risk across countries in which they have subsidiaries. In addition, this paper considers the resulting impact of structural responses to environmental differences on the principal/agent relationship as reflected by the agent’s performance.

**PROPOSITIONS**

Figure 1 depicts the relationships anticipated between the indicators of the nature of the institutional environment and firm structural decisions, and the impact of these interactions on employee performance. Corruption and economic risk (as a measure of outcome uncertainty) are identified as key environmental factors affecting the incentive structure decisions.

**FIRM MONITORING ALIGNMENT EFFORTS**

Transaction cost economics presumes that firms seek to align their hierarchical structure with their environment (Williamson, 1991). These alignment efforts affect transaction costs and thus the performance of the firm. As a result, given any particular environment, there is an optimal alignment of hierarchical structure. Industrial economics research has found a positive association between the existence of certain types of dominate hierarchies in a country and corruption, with more levels of hierarchy associated with greater corruption (Husted, 1999; La Porta, et al., 1997). However, the nature of the casual relationship and the direction of the interaction are subject to some disagreement (Husted, 1999; Lambsdorff, 1999). One would expect that firms would
select a corresponding alignment of managerial intensity to match the cultural norms. In a more corrupt environment, while the alignment effort could be reflected in the number of organizational levels, it would almost certainly be equally evident in the ratio of managers to total employees. Greater managerial intensity would increase the degree of supervision and hierarchy in response to a more corrupt institutional environment. Thus, the governance concerns described by transaction cost economics generate an increase in supervision to combat the increased level of opportunism and contracting difficulties in a more corrupt environment (Williamson, 1999).

Agency theory would support a structure having a greater number of employees in supervisory roles due to a need for increased monitoring to ensure increased information flow and to reduce the degree of information asymmetry that might otherwise be generated in a particular environment (Jensen and Meckling, 1976; Eisenhardt, 1989). Agency theory holds that information systems are used to curb opportunism (Eisenhardt, 1989: 60). The information system should be such that it not only informs the principal of what the agent is doing, but also, by its very presence, dissuades the agent from attempting to deceive the principal (Eisenhardt, 1989: 60). The MNC, in a more corrupt location, would need to have more people responsible for forwarding information to principals in the home country to ensure the accuracy of information and to adequately monitor employees.

**Proposition 1:** In a country with a high level of corruption, a firm will have a greater number of managers to total employees than the firm will have in operations in a country with a low level of corruption.

**Firm Incentive Alignment Efforts**

Williamson (1999) noted the significance of incentive structures in achieving goal alignment between employees and the firm. Opportunism is considered a form of extrinsic motivation which may be relevant when individuals are less constrained by rules in one environment versus another (Osterloh and Frey, 2000: 539). In a more corrupt society, the motivational focus is more extrinsic and monetary rewards are expected to have a more significant impact on employee performance than in less corrupt societies where intrinsic motivation would be more relevant. While most motivational research has been conducted in environments that are typically considered less corrupt, motives have long been thought to be situationally determined (Mannheim, 1949: 249). Accordingly, approaches to manage motivational factors vary by situation and require consideration of the environment. Firms in an environment where greater emphasis is placed on external rewards should give more attention to pay issues. In a thoroughly corrupt environment, the ideal incentive system would arguably be one that was strictly a pay-for-performance system (Osterloh and Frey, 2000: 539). The increased involvement of bribes in more corrupt environments reflects a shift from a focus on firm-provided rewards to external rewards that are linked directly to specific behaviors.

Agency theory strongly supports the argument that compensation can be altered to realign the interests of the agent to better match those of the principal (Jensen and Meckling, 1976). When incentives are outcome-based, the agent is more likely to behave
consistent with the interests of the principal (Eisenhardt, 1989: 60). In a more corrupt environment, values research suggests that attitudes toward more self-interested behavior will differ from attitudes in less corrupt environments, with “corrupt” activity being more generally acceptable in the former location (Tsalikis and Nwachukwu, 1991). All else being equal, agency theory would hold that greater emphasis should be put on the use of performance-based incentives to curb opportunism in more corrupt countries.

**Proposition 2:** In a country with a high level of corruption, a firm will have a higher ratio of bonus payments to salary payments than the firm will have in operations in a country with a low level of corruption.

Notwithstanding the theory supporting this second general proposition concerning appropriate incentive structures, in circumstances where better information systems exist or where there is greater outcome uncertainty the use of outcome-based contracts would be reduced (Eisenhardt, 1989: 61). Thus, an extension to this general second proposition and alternative propositions are suggested. From her review of prior empirical work, Eisenhardt found support for propositions that an improved information system and higher level of outcome uncertainty will both be negatively related to the use of outcome-based pay for agents. If the MNC improves its information system by increasing the number of managers in its foreign locations, it may not have as great a need to rely on an outcome-based contract (1989: 61). Interestingly, these modifications might help explain the seemingly contradictory findings in motivational research where the overwhelming empirical evidence holds there is no significant relationship between pay and performance (Osterloh and Frey, 2000: 544). To an extent, a substitution effect is suggested, where increased managerial intensity compensates for an improper incentive structure in a more corrupt environment.

**Proposition 2a:** In a firm with a high number of managers to total employees, the ratio of bonus payments to salary payments will be lower than in firms with a low number of managers to total employees.

As mentioned, Eisenhardt (1989) also found support for the proposition that the greater the degree of outcome uncertainty, the less likely it was that a firm would use an outcome-based contract with its agents. A firm could not adequately assess the performance of employees by looking solely at outcome in such situations. Eisenhardt provided a list of factors that might affect the certainty of the outcome of an employee’s work, including government policies and economic climate (1989: 61). While both of these environmental factors are directly related to corruption variation, the nature of the economic environment is expected to be more directly linked to the degree of outcome uncertainty. In a country with greater economic risk, there is likely to be greater outcome uncertainty pertaining to transactions. Employee behavior will be less directly linked to firm performance and, therefore, outcome-based pay systems will not be able to accurately assess employee performance and will be ineffective as motivation devices.
Proposition 2b: In a country with a high level of economic risk, a firm will have a lower ratio of bonus payments to salary payments than the firm will have in operations in a country with a low level of economic risk.

THE IMPACT OF MONITORING ALIGNMENT ON EMPLOYEE PERFORMANCE

A critical factor in the success of the internationalization process of a firm is its governance structure (Aharoni, 1992: 17-18). As noted previously, transaction cost economics presumes that the efficient firm responds to environmental conditions with the appropriate structures and mechanisms. However, if the firm fails to align its structure properly with the environment, then its transaction costs will be higher. Agency theory explains the higher transaction costs as a failure to adequately manage the agent problem. If the proper hierarchical structure is not implemented, then monitoring efforts are inefficient. In situations of higher corruption, firms with too little managerial intensity will experience information asymmetry problems between the principal and the agent resulting in the failure of the agent to meet the performance expectations of the principal. Environments of increased opportunism and contracting difficulty promote a greater incidence of self-interested shirking behavior that cannot be sufficiently curtailed through monitoring (Eisenhardt, 1989; Jensen and Meckling, 1976). Failure of a firm to adjust its operations to account for increased risks in such an environment would result in employee performance that is less acceptable. This in turn would cause a reduction of the performance rating of the agent in such situations.

Proposition 3a: In a country with a high level of corruption, employee performance ratings will be lower in a firm with a lower number of managers to total employees than in a firm with a higher number of managers to total employees.

In environments characterized by lower levels of corruption, shirking behavior would be less of an issue in general. Thus, monitoring and the degree of supervision would not be as significant a factor in determining appropriate employee behavior. Indeed, as argued by Moschandreas, the efficiency of the hierarchy may be threatened and employee behavior may be adversely affected when systems applied in non-opportunistic settings are designed and implemented on an incorrect assumption of opportunism (1997: 53). Differences in the number of supervising employees, within a reasonable range, may not have a significant impact on either employee performance or employee performance ratings. However, if the supervision level is well above the appropriate percentage for the environment, a reduction in employee performance and employee performance ratings would be anticipated. When monitoring structures have a greater managerial intensity than is appropriate for an environment, the structure signals a lack of trust of the agents. La Porta, et al. (1997) have previously found a relationship between corruption and trust that suggests firm structures that reduce or discourage trust may promote corrupt activities (McCauley and Kuhnert, 1992). A hierarchy that is too highly monitored and restrictive will be a disincentive to agents, reducing their motivation to perform to expectation (Moschandreas, 1997) and performance ratings will suffer.
Proposition 3b: In a country with a low level of corruption, employee performance ratings will be negatively impacted to an increasing degree corresponding with the number of managers to total employees.

Table 1 provides a depiction of the relationship between the corruption level and the degree of managerial intensity as it affects employee performance. As reflected in Table 1, the optimal monitoring structures are in the high/high and low/low situations. All else being equal, in an environment with high corruption, the monitoring structure should have a higher degree of managerial intensity. Correspondingly, when the environment is one with low corruption, the level of managerial intensity should be lower. Misalignment either allows for more self-interested behavior on the part of the employee and higher information asymmetry or provokes discontent by signaling a high level of distrust. With either type of inappropriate structure, employee performance will ultimately suffer.

Table 1.
Managerial Intensity and Corruption Levels

<table>
<thead>
<tr>
<th>Corruption Level</th>
<th>Managerial Intensity (Managers: Total Employees)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>High</td>
<td>Appropriate Structure</td>
<td>Inappropriate Structure</td>
</tr>
<tr>
<td></td>
<td>Enhanced Employee Performance</td>
<td>Shirking Encouraged</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Reduced Employee Performance</td>
</tr>
<tr>
<td>Low</td>
<td>Inappropriate Structure</td>
<td>Appropriate Structure</td>
</tr>
<tr>
<td></td>
<td>Signal of Reduced Trust</td>
<td>Enhanced Employee Performance</td>
</tr>
<tr>
<td></td>
<td>Reduced Employee Performance</td>
<td></td>
</tr>
</tbody>
</table>

THE IMPACT OF INCENTIVE ALIGNMENT ON EMPLOYEE PERFORMANCE

Kosnik and Bettenhausen (1992) concluded that the impact of compensation on performance is complicated. In environments where there is more corruption, the incidence of, and focus on, monetary payments such as bribes would be expected to shift the importance of motivational factors toward such external rewards. Failure to link performance and pay, in the appropriate manner and degree in a more corrupt society, is a failure of the firm to provide sufficient goal alignment motivation to employees. Employees would be expected to act opportunistically (shirking or partaking in corrupt activities) in their own self-interest, not aligned with the interests of the firm (Eisenhardt, 1989). Controlling for managerial intensity, employee performance ratings would suffer.
Proposition 4a: In a country with a high level of corruption, employee performance ratings will be lower in a firm with a lower ratio of bonus payments to salary payments than in a firm with a higher ratio of bonus payments to salary payments.

In a less corrupt environment, a misalignment and overuse of pay-for-performance incentives would be expected to diminish the level of intrinsic motivation that would overshadow any positive benefit of the increase in extrinsic motivation, negatively impacting employee performance. Correspondingly, the more an incentive structure is based on pay for performance, the more trust between the principal and the agent is discouraged. Once again, in a less corrupt environment, the misalignment of incentive structures can provoke a negative reaction by discouraging trust and provoking more opportunistic behavior (La Porta, et al., 1997; McCauley and Kuhnert, 1992). This literature suggests that there is a balance for every environment, and especially in a less corrupt environment, that balance must be maintained concerning incentive structures. Depending on the level of corruption, the consequences of misalignment would differ in each environment. Controlling again for managerial intensity, in an environment with low corruption, an incentive misalignment that has a higher ratio of bonus payments to salary payments than is optimal could be expected to provoke a degradation of employee performance.

Proposition 4b: In a country with a low level of corruption, employee performance ratings will be lower in a firm with a higher ratio of bonus payments to salary payments than in a firm with a lower ratio of bonus payments to salary payments.

Table 2 depicts the relationship between the corruption level and the incentive structure as it affects employee performance. As with the alignment issues reflected in Table 1 regarding monitoring structures, Table 2 shows that the most appropriate incentive structures fall into the high/high and low/low categories. When corruption in the country is high, the ratio of bonus payments to salary should be higher – paying employees a more acceptable type of “bribe” for good work. However, when corruption levels are low, then the bonus to salary ratio should be lower reinforcing the nature of the relationship based more on intrinsic rewards than extrinsic rewards. In the inappropriate structure scenarios, the misalignment between the dominant nature of the motivating element (intrinsic versus extrinsic), the firm’s structures, and the environment, either encourages opportunism or promotes distrust, again ultimately leading to reduced employee performance.

CONCLUSIONS AND IMPLICATIONS

Much has been written about the importance and management or mitigation of information asymmetry and goal misalignment using agency-prescribed monitoring and incentive structures (Choo, 2005; Gibbons, 2005; Joseph and Thevaranjan, 1999; Raghu, Sen and Rao, 2003; Schotter and Weigelt, 1992). This paper is the first to consider the agency problem as it manifests between the foreign firm and its host country employees. This analysis combines findings and implications from institutional economics, transaction cost economics and agency theory to provide guidance to
MNCs seeking greater efficiency through more appropriate alignment with environmental elements. A central limitation of this study is its reliance on corruption and economic risk indicators that, themselves, are highly complex constructs still under intense scrutiny by scholars. However, research on corruption has resulted in fairly high correlations of differing measurement approaches (Lambsdorff, 1999; Mauro, 1998: 11) and there appears to be consensus concerning the definition and the importance of corruption in the international business context (Husted, 1999). Still, the theoretical development in this paper would be strengthened by a thorough integration of corruption research and an explanation of the institutional process that provokes variations in corruption. At present, the development of this broader, inclusive model is outside the scope of this paper.

A second limitation of this work pertains to likely variations related to firm or industry specifics. As reflected in the work of Jennings and Zandbergen (1995), the nature of the environment has a different impact on different institutional fields. Thus, there is an industry or firm component to this analysis that is not addressed herein. Similarly, while variations related to home country differences of foreign firms is not at issue, they may impact the accuracy of the propositions presented. Ultimately, the issue may not be the absolute level of corruption but the relative level of corruption as compared to the home country of the foreign firm.

Table 2.
Incentive Structure and Corruption Levels

<table>
<thead>
<tr>
<th>Corruption Level</th>
<th>Incentive Structure (Bonus: Salary)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>High</strong></td>
</tr>
<tr>
<td><strong>High</strong></td>
<td><strong>Appropriate Structure</strong> (Focus on Extrinsic Motivation)</td>
</tr>
<tr>
<td></td>
<td>Enhanced Goal Alignment And Employee Performance</td>
</tr>
<tr>
<td><strong>Low</strong></td>
<td><strong>Inappropriate Structure</strong> (Focus on Intrinsic Motivation)</td>
</tr>
<tr>
<td></td>
<td>Trust Discouraged/Reduced Reduced Employee Performance</td>
</tr>
</tbody>
</table>
A final limitation concerns the ability to rely upon employee performance ratings. It is difficult for a firm’s management to assess an agent’s total contribution to the firm. As explained by Gibbons (1997), an employee’s actions may affect other workers and may be more important in terms of their long-term effect than short-term result. Notwithstanding the problems in the measure of employee ratings, it is a significant component of firm assessment and decision-making. Theorists have also directly linked employee performance to firm performance (Hansen and Wernerfelt, 1989).

By considering the operations of a MNC in different country environments, this paper evaluates firm-environment alignment issues that are likely to impact employee performance. As a result, a central contribution of this paper is to suggest reasons why existing empirical work when conducted in one country is not generalizable across all employees in different environmental settings. In particular, work on issues of employee motivation and performance must be reconsidered for applicability in different environmental settings, and firm performance studies across borders should consider structural matching to divergent environments.

While this work does not directly address the issue of liability of foreignness, this concept of central import to international business literature arguably is implicated. Liability of foreignness addresses the additional costs incurred by multinational firms that relate solely to their foreign status (Hennart, 1991; Hymer, 1960/1976). Liability of foreignness has two dimensions. First, the firm suffers from a lack of complete understanding of the culture and business practices in the host country. Second, is the level of host country stakeholders’ bias against foreign firms (either all foreign firms or firms from the subject’s home country). Liability of foreignness is manifested through the foreign firm’s relationships with host country individuals, including host country employees (Calhoun, 2002). This analysis focused on how foreign firms must balance their monitoring and incentive systems with the level of corruption. Corruption is a culturally-bound concept that has been linked to the liability of foreignness. Thus, by assisting firms in understanding how agency issues differ across countries and the import of altering firm structures in response, this paper demonstrates how foreign firms may mitigate the negative impact resulting from this aspect of liability of foreignness.

Other contributions of this paper arise from extending existing work into new areas. The growing body of work on corruption is presented as having implications for more wide-ranging organizational issues faced by MNCs (La Porta et al., 1997). Traditional economic theory is applied to propose how firm structural alignment may, somewhat predictably, vary as the result of the level of corruption in a particular environment. Transaction cost economics and agency theory are employed as foundations for describing how firms respond to atmospheres of increased opportunism with greater monitoring and supervision. This paper provides an initial explanation for how proper and improper structural alignment of firms might affect employee behavior differently across separate institutional locations.

Transaction cost economics has traditionally had difficulty analyzing and controlling for intrinsic motivation (Osterloh and Frey, 2000: 539; Williamson, 1985: 12).
Motivation scholars have found intrinsic motivation to be exceedingly more relevant and have failed to find any meaningful relationship between the use of external rewards and improved performance (Osterloh and Frey, 2000). The propositions developed in this paper suggest that in more corrupt societies, the economic approach and view of the importance of external rewards may have greater support. As markets have developed norms and rules to curb opportunist behavior, the focus may have shifted from external to internal rewards and motivation. Research conducted in less corrupt environments such as in the US would reflect the diminished importance of extrinsic rewards even while the importance of monetary incentives remains strong in more corrupt, less studied environments. This paper presents a method of dissecting motivational factors, and considers the implications of societal variance in levels of corruption on the proper balance between extrinsic and intrinsic motivators. There are implications for future research on this topic from the perspectives of economics and strategic decision theory as well as organizational behavior and cross-cultural research. The testing of managerial intensity as a substitute for pay-for-performance incentives and the identification of the appropriate levels of managerial intensity and performance-based pay provide a wide platform for future consideration.

REFERENCES


Wei, S.J. (1998) ‘Corruption in economic development: Beneficial grease, minor annoyance, or major obstacle?’ *Presented at the Workshop on Integrity in Governance in Asia*.


