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# INTRODUCTION

Common wisdom and ample evidence demonstrate the negative impact that corruption has on public welfare and economies. The World Bank and International Monetary Fund (IMF) estimate that the global cost of corruption exceeds \$2 trillion annually (IMF 2016; Kaufmann 2005). For governments, studies suggest that corruption leads to lower levels of business investment and economic growth, increased levels of inequality, and substantial losses in tax revenue—equating to 4% of the gross domestic product (GDP)—compared with similar societies with low levels of corruption (Mauro 1995).

Understanding the costs of corruption alone may not provide sufficient motivation to alter the behavior of companies or individuals. This literature review covers published work on the cost of unethical conduct in tandem with scholarly insights on gains from adopting ethical practices at the firm level, providing a compelling foundation for action that has thus far not been available. Guided by consultation with experts in the field of business ethics and drawing from published research from academia and multilateral organizations, this collection of literature demonstrates that enterprises worldwide, especially small to medium enterprises (SMEs), stand not only to avoid harm but also to tangibly benefit from embracing ethical practices.

*This literature review proceeds as follows:*

- The first section assesses the impact of corruption and unethical conduct on businesses, namely SMEs, including business performance, access to financing, and reputation;
- The second section presents evidence at the individual firm level on the positive impacts of embracing ethical businesses practices; and
- The third section highlights several avenues of inquiry by which researchers may further advance our understanding of the positive impact of ethical business conduct in the future, particularly for SMEs.



## Section One: The Cost of Unethical Conduct for Firms

This section provides several examples from academic literature of ways firms may undermine their own prospects for success by perpetuating corrupt and unethical practices. It also offers evidence of ways firms may enhance their prospects, by actively pursuing ethical environments, which are in turn associated with a variety of tangible benefits.

### Impact on Business Performance

Multiple studies have examined the relationship between corruption and business performance. Fisman and Svensson (2007) find that bribery is negatively correlated with firm growth. In some cases, a one percentage point increase in the bribery rate is associated with a reduction in firm growth of three percentage points, an effect that is about three times greater than that of taxation. Similarly, Vu et al. (2018) find that the intensity of bribery is negatively correlated with SME firms' financial performance. In a survey more than 300 SMEs in Burkina Faso, Akouwerabou and Parfait (2014) identify a negative relationship between corruption and firm productivity.

Cialdini et al. (2004) find that businesses that deploy dishonest tactics often do so to increase their short-term profits (Yves, 2005) and thus might experience short-term business success. The misconduct may result in earnings in the short term; however, in the long term, Cialdini et al. argue it will negatively affect SMEs to a greater extent than the initial advantages obtained. This outcome occurs because dishonest business practices can lead to increased costs resulting from employee dissatisfaction and the spread of unethical behaviors within the firm.

Despite the negative impacts of corruption on businesses, there is also a field of research exploring how in highly corrupt or highly inefficient systems, corruption may serve to "grease the wheels" by accelerating processes that would otherwise lag (Svensson 2005). Studies including Beck and Maher (1986), Mendoza et al. (2015), and Williams et al. (2016) find bribery to be associated with enhanced firm performance. However, Williams finds that while corruption could yield firm-level benefits for some enterprises, economies with marked corruption are associated with lower average levels of overall firm performance. Such findings support the argument that even in instances where bribery can benefit firms, its overall impact on economies may impede growth and development and therefore hinder the market for all firms.

### Difficulties Accessing Financing

Another consequential and empirically identified impact of firm-level corruption concerns access to credit. Ullah (2020) studied the impact of corruption on the business environment in 28 Eastern European and Central Asian economies, finding that firm-level corruption hinders SMEs' access to financing and hampers growth. Wellalage et al. (2019) confirms this point with a study of the effect of corruption in South Asia on credit access for SMEs, finding that corruption has a detrimental effect on credit access. Specifically, corruption is found to increase the probability of SMEs experiencing credit constraints by 7.63%. Other work emphasizes how ethical challenges limit the ability of SMEs to secure trade credit, a major source of external debt finance (Fatoki 2012).

### Risk to Business Reputation

Unethical conduct can harm a business's reputation and relationships, which in turn may damage firm value. McMurrian and Matulich (2016) argue that unethical practices diminish trust among stakeholders (such as customers, employees, and partners). Moberg and Speh (2003), similarly, find that low to moderate levels of questionable business practices are associated with lower reported levels of trust and commitment between trading partners. Nguyen et al. (2016) find that corruption has harmful effects on a firm's strategic capability by eroding the integrity culture, demotivating innovation, and risking the firm's reputation. One survey found that 35% of respondent companies had been deterred from an otherwise attractive foreign investment because of the host economy's reputation for corruption (Bray 2007).



## Section Two: The Benefits of Embracing Ethical Conduct for Firms

In comparison with the number of studies assessing the costs of corruption, there are far fewer studies shedding light on the positive gains for businesses, especially SMEs, that embrace ethical business conduct. This section provides an overview of scholarly work on precisely that approach, linking desirable business outcomes with adherence to ethical practices.

### Reputational and Performance Benefits

Donker et al. (2008) constructed a corporate value index to quantify the ethical performance of Canadian businesses. They find that an increase in the corporate value index is associated with improved firm performance (as indicated by an increase in market-to-book value). Wu (2002) similarly observes that “high levels of organizational performance were found to be directly attributable to high levels of applied corporate and individual ethics” and that there is a demonstrable tendency for high-performing SMEs to reject ethically unsound practices. Ferrell et al. (2019) surveyed the attitudes of 400 US customers and find that brand attitudes were enhanced by ethical business practices, with customer responses to companies’ business ethics behavior accounting for 70% of their attitudes toward the brand.

Other studies focus on benefits of ethical conduct beyond monetary gain. A study by Vyakarnam et al. (1997) suggests that organizations increasingly understand that ethics and profits are not in conflict. Rather, moral directives can become key components of a firm’s culture. Ethical behavior, action and communication can serve in both an organization’s and the public’s best interests, making a vital contribution to the success of long-term planning and contributing to financial results. Furthermore, the benefits of an ethical stance can have a competitive advantage as a company distinguishes itself from its competitors.

In research regarding ethics in the informal business sector in South Africa, Gaxamba (2012) finds that all interviewed informal business owners feel that the benefits of ethical conduct are important. These benefits include protection of reputation, public acceptance, marketplace advantage and employee retention. Similarly, Amisano (2017) finds that small business leaders are concerned about ethical leadership because they understand that how the local community and other leaders perceive them has an impact on their business.

### Positive Work Culture and Employee Satisfaction

Beyond impact on business performance, some studies have suggested that companies with a strong, values-based corporate cultures showed improved employee engagement and significantly reduced employee turnover. One study, based on a survey of employees at a healthcare organization, found that group creativity is positively correlated with corporate ethical values and that both variables are associated with increased job satisfaction and reduced employee turnover intention (Valentine et al. 2011). Schminke et al. (2005) determine that congruence between the “moral development” of leaders and employees is positively associated with job satisfaction and organizational commitment. Amisano (2017) further finds that ethical leadership in supervisors leads to highly rated employee performance.

Some insights in this field refer to the “ethical climate,” a concept initially introduced by Victor and Cullen (1988) to describe “shared perceptions of what ethically correct behavior is and how ethical issues should be handled” (i.e., how certain conventions, norms and institutions within an organization influence internal perception of the organization’s ethical orientation.) Elçi and Alpan (2009) advanced this line of study empirically by conducting survey research on staff and managers across 62 different telecommunications firms in Turkey and categorizing the firms into nine different ethical climate types. The researchers find that firms falling into ethical climate types





## Section Three: Areas for Further Study

As demonstrated in Section One, the costs of corruption and unethical business conduct are well understood. In addition, a smaller but notable body of research has demonstrated the benefits of ethical business behavior, for large firms as well as SMEs. There remain rich opportunities to increase understanding in this area. The following avenues of inquiry would further strengthen our understanding of this field:

### **Focus on Business Conduct, Not Just Government Actions**

The study of corruption has thus far largely focused on government officials and institutions. Such research underpins policy recommendations to reform government practices to improve the overall business environment. Further study of business ethics, however, might consider how measures to mitigate corruption or unethical conduct undertaken by the business community, rather than by the government, may affect the business climate and firm performance.

### **Clarify Terms and Definitions**

When studying the impact of corruption, researchers may find it useful to further consolidate terms and definitions. Much of the research focuses primarily on the impact of bribery, although distinctions between corruption, anticorruption, business ethics, corporate culture, corporate social responsibility, and other concepts are necessary. Understanding the precise impact of corruption on business requires clarity regarding the practices and concepts being considered.

### **Recognize Sector-Based Nuances**

Many challenges or benefits demonstrated in research are thus far found to be largely consistent irrespective of an enterprise's particular industry sector. However, sectoral distinctiveness is found to be more pronounced in SMEs given their lower levels of structure as compared with large firms. This simplified structure makes SMEs highly susceptible to unique ethical considerations or dilemmas. There also appears to be a need for more research in health-related sectors, as no research on this topic specifically looking at SMEs in health-related industries has been identified.

### **Develop Fit-for-Purpose Methods to Study the Ethical Practices of SMEs and the Impact of Ethics on Business**

Typical processes for the evaluation of ethical business conduct are best suited for large enterprises. A fair characterization of SME performance may be difficult to achieve with such methods, however, given that SMEs often have limited resources to dedicate to measures such as formal reporting and retaining legal or human resources experts. SMEs also operate within smaller organizational structures, with many relying on relationships rather than formal reporting or compliance regimes (Spence 2019). These factors warrant consideration in order to produce precise work measuring the effect of ethical business practices on SMEs.

### **Study the Best Strategies and Methods for Implementing Ethical Conduct**

Some research has been undertaken to better understand methods of implementation of anticorruption measures, as well as their relative effectiveness. This work, however, has in many cases been theoretical or case study based, yielding only a limited amount of empirical evidence to quantify the effect of such measures. Kaptein and Schwartz (2008) write that the paucity of insights is due to varying definitions of key terms, deficiencies in the empirical data and methodologies used, and a lack of theory. Some studies offer evidence that ethics training sessions may lead to improved ethical organizational culture (Warren et al. 2014), but further work is needed, including research that helps to evaluate the effect of specific strategies such as business codes of ethics or business founder or leader statements on ethics commitments. And as mentioned above, tailoring this research to business specificities of sector and size would prove useful.



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