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IMPACT OF ANTI-CORRUPTION LEGISLATION ON CORPORATE ENTERTAINMENT EXPENSE AND PERFORMANCE

Abstract. *The impact of institutional change on organizations is inherently contingent upon firm- and institutional-level heterogeneities. We examine this by suggesting a game-theoretic model to analyze how firms in different conditions manage regulative pressures and how this impacts their performance. Based on Korean listed firms during 2015–2017, we discovered that firms responded to new anti-corruption legislation by reducing entertainment expenses; this trend is more prominent among larger firms and firms in regulated industries. We also note the financial consequence of this responsive nonmarket strategy, involving the function of firms' industry-level positions. This study provides important managerial implications and research directions.*

Keywords*: Anti-corruption legislation, nonmarket strategy, entertainment expenses, institutional theory, Korea.*

JEL Classification: D72, D73, D81, E02, K42

1. Introduction

According to institutional theory, the external environment exerts isomorphic pressures for organizations to obtain legitimacy (Powell & DiMaggio, 1991). Institutional theory also argues that organizations depend on social systems that explain what they should look like, how they should behave (Powell &DiMaggio, 1991), and their actions in response to normative, coercive, and mimetic environmental pressures (Chen, Fuller, & Zheng, 2018). However, a complex issue among these isomorphic pressures involves how the abrupt *coercive pressure* generated by government regulations shapes organizations' nonmarket activities. Further, the concrete mechanisms through which nationwide institutional change affects corporate strategies and shapes organizations' performance structure must be clarified.

We present a two-step approach to fill this important research gap. First, we apply a sub-game, perfect Nash equilibrium (SPNE) model (Corneli& Tarantino,

DOI: 10.24818/18423264/55.2.21.09

2016) to study anti-corruption legislation's heterogeneous impact on firm behavior. Based on SPNE, we also explore the consequence of this institutional change on firm performance. Second, we propose corresponding hypotheses based on these deductive economic models and inductively test them.

Our empirical setting is also unique; anti-corruption legislation has been adopted in many developed and developing countries (Karhunen&Ledyaeva, 2012; Andrei et al., 2009) in the past five decades. These laws prohibit local businessmen from becoming involved in semi- or explicitly corrupt activities, whether in their own country or abroad. For instance, the United States has opposed corruption in international business transactions. Since 1977, the Foreign Corrupt Practices Act has specified that U.S. companies and other firms accessing U.S. capital markets are not allowed to bribe public officials to win business abroad. In 1999, the Organization for Economic Co-Operation and Development's Anti-Bribery Convention established legally binding standards to criminalize the bribery of foreign public officials in international business transactions. More recently, Xi Jinping's landmark anti-corruption campaign has substantially affected business-government relationships in China.

Some evidence also exists that anti-corruption laws in international and domestic transactions can deter firms' involvement in illegal nonmarket strategies (Cuervo-Cazurra, 2008). However, empirical studies on how anti-corruption legislation impacts firm-level strategies in emerging countries are still rare, for the following reasons: First, firm-level corruption activities or business-government relationships largely occur in an underground market, and thus, firm-level data is difficult to obtain. Second, a concrete empirical setting is required to conduct a quasi-experiment and examine anti-corruption legislation's impacts on firm behaviors. However, it is highly difficult to control all possible explanatory and exogenous variables in this type of research. Finally, nationwide and abrupt anti-corruption legislation is uncommon; therefore, it limits the feasibility of such research. This study incorporates novel, reliable financial data to investigate how anti-corruption legislation influences firms' investment decisions regarding entertainment expenses (*ex ante*) and how such a nonmarket strategy affects firm performance (*ex post*).

Theoretically, this paper focuses on the channels of the dynamic interplay between firm characteristics and the institutional environment to analyze how institutional change exacerbates the cost of corporate political strategies. In other words, the degrees of conformity under coercive institutional pressure vary according to the firm's size and degree of conformance to current regulations, which we empirically examined from an interactional perspective. Second, this research extends the conventional knowledge of how governments implement anti-corruption policies. We primarily illustrate an incentive-based model for corporate entrainment expenses, which may generate predictions of how and why a firm is involved in political activities. Further, we integrate these with the empirical model by demonstrating that a firm's reaction to institutional change is interdependent on

DOI: 10.24818/18423264/55.2.21.09

firm- and industry-level characteristics to shape firms' choices of specific political activities. Our holistic framework may help policymakers disproportionally control possibly corrupt organizations according to their heterogeneous conditions. Institutional theory suggests that firms experience a process of conforming to a coercive institutional system and becoming homogenous, but not all firms respond similarly to the same institutional environments. Previous research has failed to indicate a generalized, theoretical framework to answer the question of how firms acclimate to coercive pressure after abrupt, nationwide institutional changes. In this sense, our study offers both theoretical and empirical contributions to nonmarket strategic research.

The remainder of this paper is organized as follows: Section 2 discusses the context of anti-corruption legislation and entertainment expenses as corporate political activities. Section 3 introduces our unique economic models and propositions. Section 4 describes our empirical setting and testable hypotheses, and this is followed by our results in Section 5. Section 6 discusses our findings and concludes.

2. Background Context

Firms—particularly those in less-developed institutional environments—employ corporate political activities to build business-government relationships. This non-market strategy may include a spectrum of actions, from legal strategies, such as providing legitimate information; to illegal strategies, such as bribing government officials. Firms may use one type of strategy or the other, and/or may combine the two. As legal systems develop, firms have shunned illegal strategies—such as bribery and lobbying to the government, the latter of which is both illegitimate and illegal in most Asian countries—or practiced them covertly (Harstad&Svensson, 2011). Subsequently, firms are more likely to depend on legitimate nonmarket strategies.

Entertainment expenses (Sun, 2016)are a common, legal nonmarket strategy in east Asia, defined as a cost disbursed for the purpose of receiving, entertaining, consoling, and gifting to clients, media members, politicians, and government officials (Morck& Nakamura, 1999). This cost is public and kept on the firm's financial statements. The reported entertainment expenses are recognized as a loss; consequently, the corporate tax standard decreases, which can benefit corporate tax reduction (Morck& Nakamura, 1999). Entertainment expenses in Asian countries are commonly used to alleviate the hazards of expropriation by the state and private parties. For instance, the typical Japanese business negotiation may involve a series of informal interactions and ceremonial gift-giving (*kosai-hi* in Japanese) (Graham & Sano, 1986). Japanese entertainment expenses surpassed even Japan's defense budget by nearly 25% (Morck& Nakamura, 1999). Entertainment expenses in Korea have been mandatorily documented since 2004 to reduce the moral hazards caused by corporate executives' personal consumption or a boom in the entertainment industry.

DOI: 10.24818/18423264/55.2.21.09

While entertainment expenses are both public and legitimate, the entertaining culture still negatively effects the economy. For example, many Korean companies expect their executives to entertain clients or government officials several nights a week at fine restaurants or hostess bars. To deter these negative business practices, the Korean government enacted strict nationwide anti-corruption regulations, or Kim Young-Ran's Law (named as the chief proponent), in September 2016. Unlike previous anti-corruption legislation, this law is a radical anti-corruption policy that regulates activities even among civilians such as journalists, educators, civil servants, and politicians. This legislation stipulates that formerly accepted corporate entertaining behaviors are illegal if the recipient of the entertainment is in the public, media, or education sectors (Choi, &Storr, 2019).

However, empirical studies indicate that introducing such anti-corruption regulation did not necessarily curb societal corruption as a whole (Doig& Riley, 1998). Many foreign cases demonstrate that total corruption does not diminish even after anti-corruption policies are introduced (Goel, Budak, &Rajh, 2015); rather, it is possible to hide corruption in a more adroit manner, thus increasing the side effects when the corruption ultimately arises. Therefore, it is necessary to follow the newly enacted anti-corruption system scientifically and examine the regulations' effectiveness. This study explores how and whether anti-corruption legislation can reduce negative business practices, such as entertainment expenses. Recent findings on corporate nonmarket strategies (Yim, Lu, & Choi, 2017) suggest that political strategies in the regulated area still positively influence firm performance. Hence, we also introduce a robust research model on how corporate performance was influenced after this anti-corruption legislation.

2. Economic models

Our game theoretic approach as well as its empirical results can provide a few insights in the related research area. Based on an SPNE model (Corneli& Tarantino, 2016), this study suggests that the anti-corruption system does not have uniform impacts; rather, they are context specific. Our economic modeling helps better interpret the contingent nature of institutional change, or how corporate political strategies are embedded in the firm's multilevel conditions as well as its characteristics. Although some previous research (e.g., Karhunen&Ledyaeva, 2012) have empirically explored the effectiveness of anti-corruption legislation on firm behavior, less is known about the concrete theoretical mechanisms to describe how firm-level effects depend on the institutional context. Thus, we first provide a deductive approach with economic models, followed by an inductive approach with empirical analyses.

2.1. Anti-corruption legislation, *ex ante*

The budget planning for firm i's entertainment expense is defined as $E = E(g, e)$, where g and e represent graft and non-graft expenses, respectively. Without any regulation on g, i uses a mixed strategy of α through a linear

DOI: 10.24818/18423264/55.2.21.09

combination of $E = \alpha g + (1-\alpha)e$, where $0 < \alpha < 1$, $g \geq 0$, and $e \geq 0$. Further, e denotes i's non-graft promotion activity incurring pe.

In the context of eastern religious heritage, Ramirez (2014) emphasizes that corruption in China is the subsequent output following a life cycle of economic growth. Wang and Lin (2014) also provide a noteworthy discovery, in that Christianity has contributed the most to China's economic development compared to traditional religions. In particular, Kim and Whitaker (2013) note that social networks based on geography, family, and education are sources of corruption in South Korea, in that social networking relying on Confucianism directly transforms to business networking. In the model, g must be understood as an inter-firm personal networking vehicle in Korea, and it creates an outside option of pg to i; otherwise, i would not pay for g. The net cost of the graft strategy is $-g + pg$. For instance, hidden networking combined with a mutual graft strategy can result in future business opportunities by reinforcing personal networking. Moreover, g can be used as a business shortcut to bribery.

The graft-based networking business habit clearly distorts the free market competition structure and deteriorates the industry-level input-output efficiency scale. Therefore, the Korean government is inclined to abolish the abuse of g while encouraging the investment behavior of x. Accordingly, it becomes a political objective to tolerate g within a socially agreeable threshold. Regarding firms' long-term survival and sustainability, the non-graft expense is surely also more desirable to firm operation than the graft expense. In fact, this is a fundamental reason firm i would be inclined to use a mixed strategy. Without losing its generosity, it can be noted that the larger firm i's size, the more actively g is used, because the opportunity cost to choose a lower α would expand proportionately. Therefore, large firms' g should be tightened under any regulation on Korean firms' entertainment expenses.

Before the anti-corruption legislation was implemented, firms had to rely on a social threshold to determine the abuse of g, as g was accepted as a Korean societal business custom. The model sets a minimum social threshold on α, or $\frac{(1-\alpha)e}{\alpha g+(1-\alpha)e} \geq \frac{\alpha g}{\alpha g+(1-\alpha)e}$, because at a minimum the proportion of the graft expense should not be greater than that of the non-graft expense, which results in $\alpha^* = \frac{e}{g+e}$.

To earn a payoff of $z(x, E)$, i invests x along with the budget planning of E. In a competitive business environment, the payoff earned through x is a pivot of i's sustainable growth, while x can be interpreted as an internal resource investment for innovation and production efficiency. In Korean Confucianism-based business relationships, it is reasonable that a marginal payoff of the graft expense g outweighs that of the non-graft expense. Hence, it is assumed as $z_g \geq z_e$, and subsequently, investing x rather than relying on E is socially more desirable, as x can enhance firm-level input-output efficiency to support firm i's long-term performance under free competition. Firm i then solves its value maximization

DOI: 10.24818/18423264/55.2.21.09

problem given Equation (1) below, where $z(x, E)$ is strictly concave and increasing in x and E:

$$z(x, E) - p(x + e) - g + pg \quad (1)$$

By definition, budget planning for E should satisfy $(1 - \alpha)e \geq pe$, and so it is $1 - \alpha - p \geq 0$, as i never abandons the graft expense of g, and it is always $\alpha > 0$, which defines $0 < p < 1$. Additionally, $\alpha g \geq -\mathrm{g} + pg$ should be satisfied under $pg \geq \alpha g$. The F.O.C.s (first order conditions) are given as

$$z_x - p = 0 \quad (2)$$
$$\alpha z_g - 1 + p = 0 \quad (3)$$
$$(1 - \alpha)z_e - p = 0 \quad (4)$$

Lemma 1 demonstrates that i is generically motivated to increase α as z_g increases in α. Simply, the higher the α, the higher the z_g, which drives i to set a mixed strategy as high as i can choose. Acknowledging the fact that i's value strictly increases in α, i might prefer to only choose α while forgiving e. However, the previously mentioned social influence is involved here, which influences i to choose the prior α^* mixed strategy.

Lemma 1. *The marginal propensity of the graft strategy regarding i's payoff increases in* α.

Proof. One can use Equations (2) to (4) to rewrite $z_g = \frac{1-(1-\alpha^*)z_e}{\alpha^*}$, which produces $\frac{\partial z_g}{\partial \alpha} = \frac{z_e(1-\alpha^*)}{\alpha^{*2}} > 0$.

Lemma 2 reveals an important firm behavior, in that firms with a higher propensity to invest in x have a higher propensity toward the non-graft expense, and vice versa. In other words, from an operational efficiency perspective those inefficient firms are strongly motivated to exploit the graft strategy.

Lemma 2. *The higher the* z_x, *the more likely it becomes* $z_e > z_g$, *and vice versa.*

Proof. As $z_g - z_e = \frac{1-\alpha-p}{\alpha(1-\alpha)}$, this satisfies $z_g > z_e$ as $z_x \to 0$, while $z_e > z_g$ as $z_x \to 1$.

DOI: 10.24818/18423264/55.2.21.09

2.2. Anti-corruption legislation, *ex post*

Proposition 1 reveals a paradoxical outcome, in that the focal point of the mutual networking vehicle of g positively affects α^*; thus, Korean firms should widely use α^* combined with Lemma 2. Fortunately, *ex ante* anti-corruption legislation α^* can be managed within a socially tolerable threshold. Nonetheless, the generic problem involves α^*, which increases as the demand on e increases, as Proposition 2 suggests. Thus, setting an upper bound for g is the most effective way to force i to deviate from the prior equilibrium of α^*, and this should eventually decrease M.

Proposition 1. *Generally, i will further emphasize the graft strategy the higher the demand for non-graft expenses; however, i's behavior as such is self-controllable by lowering α even when g increases.*

Proof. $\frac{\partial \alpha^*}{\partial e} > 0$ and $\frac{\partial \alpha^*}{\partial g} < 0$.

Proposition 2. *Ex ante, the anti-corruption legislation in a perfect equilibrium compels firm i to set* $g^* = \frac{(1-\alpha)}{(p-\alpha)} e$.

Proof. The linear combination for E should be smaller than the sum of graft and non-graft expenditures, or$\alpha g + (1-\alpha)e \leq pe + g$, with the lower interval determined as $g \geq \frac{e}{1-\alpha}(1-\alpha-p)$. Regardless of whether the graft strategy is effective, i cannot earn more than the outside option of pg, and thus, it should be satisfied by $\alpha g + (1-\alpha)e \geq pg$, which determines the upper bound. A simple calculation derives $\frac{(1-\alpha-p)}{(1-\alpha)} e \leq g \leq \frac{(1-\alpha)}{(p-\alpha)} e$. As Equation (1) is strictly increasing in g, i sets $g^* = \frac{(1-\alpha)}{(p-\alpha)} e$. As g^*>0, then $p > \alpha$.

Korea's anti-corruption legislation fundamentally aims to decreaseg^A to the level of $g^A \leq \underline{g}$, where $\underline{g}$ is the maximum available graft expense regulated by the law and unanimously applied to all industries. Regarding an exchange of the regulated expense cut on g, i is allowed to increase its non-graft expense up to $e + \Delta^e$, where $\Delta^e > 0$. As i's value strictly increases in g,i would set $g^A = \underline{g}$ under the law, where the superscript *A* represents *ex post* anti-law regulation. Therefore, the *ex post* anti-corruption legislation entertainment expense in firm i is redefined as Equation (5):

$$\underline{g} + e + \Delta^e \qquad (5)$$

The equilibrium *ex ante* anti-corruption legislation entertainment expense is denoted as M^*, and the anti-corruption legislation is designed to create a posterior

DOI: 10.24818/18423264/55.2.21.09

$M^* \geq M^{A*}$. By this intervention, one can expect that the firm-level input-output efficiency can be enhanced by increasing x, which is crucial to secure i's sustainable growth. Proposition 3 demonstrates that the anti-corruption legislation can achieve its goal when the opportunity cost of x is not too high, or$\alpha^* < p < 2\alpha^*$.

Proposition 3. *The anti-corruption legislation decreases the entertainment expense of firm i if $\alpha^* < p < 2\alpha^*$.*

Proof. The anti-corruption legislation is designed to be satisfied with $\alpha^* g + (1-\alpha^*)e - \underline{g} - e - \Delta^e \geq 0$. Inserting $\alpha^* = \frac{e}{g+e}$ rearranges this to $\frac{e}{g+e} g - \underline{g} - \frac{e}{g+e} e - \Delta^e \geq 0$, which results in $\underline{g} \geq \frac{g-e}{g+e} e - \Delta^e$. As i's value increases in g, this becomes $\underline{g}^* = \frac{g-e}{g+e} e - \Delta^e$. Inserting $\underline{g}^*$ results in $M^{A*} = \frac{2g}{g+e}$ and $M^* = \frac{e}{g+e}\left[\frac{ge}{(g+e)(p-\alpha)} + g\right]$. By a simple calculation, $M^* - M^{A*} = \frac{ge}{g+e}\left[\frac{\alpha^*}{(p-\alpha^*)} - 1\right] > 0$ if $p < 2\alpha^*$.

Proposition 4 demonstrates that the anti-corruption legislation has enabled large Korean corporations to lower M^{A*} comparatively more than small and medium-sized firms can, which can be understood as a "wag-the-dog" effect from the anti-corruption legislation; specifically, the larger the firm, the greater the "wag-the-dog" effect. Additionally, as long as this effect persists, i's entertainment expense will decrease more in highly regulated industries, as a smaller decrease in $\underline{g}$ becomes a higher cut in entertainment expense as a whole.

Proposition 4. *The larger the firm size, the larger the entertainment expense cut under the anti-corruption legislation.*

Proof. $M^* - M^{A*}$ increases positively as $\frac{\alpha^*}{(p-\alpha^*)} - 1$ increases, while $\frac{\alpha^*}{(p-\alpha^*)} - 1$ is rewritten as $\frac{e}{p(g+e)-e} - 1$, which means that as g decreases, the scale of $M^* - M^{A*}$ increases. Large firms' graft expenses outweigh that of small and medium-sized firm; thus, by the anti-corruption legislation, $(g_L - \underline{g}) > (g_s - \underline{g})$ always holds, where the subscripts *L* and *S* represent large firms and small and medium-sized firms, respectively. Hence, the entertainment expense of *L* will decrease more than that of S.

As $z_e > z_x$, i might prefer to circumvent the law by increasing e, even when the anti-corruption legislation strictly enforces $\underline{g}$. In practice, the anti-corruption legislation has been introduced not only for regulating Korean society's deeply rooted graft habit, but also to minimize indirect promotion-related expenses, which are recognized as such diversified briberies as business consulting fees, transporting services, golfing and other recreational service packages, or

DOI: 10.24818/18423264/55.2.21.09

professional speech fees, among others. When the anti-corruption legislation successfully limits the graft expense to $\underline{g}$, i must increase x to ensure sustainable firm performance. Proposition 5 suggests that if the opportunity cost to invest x^{A*} is well-managed—or, alternatively, if the gains from g are not sufficiently large—then $z_{x^{A*}}$ can dominate z_{x^*}. Therefore, i can indicate better social performance *ex ante* given the anti-corruption legislation through x^{A*}.

Proposition 5. *The anti-corruption legislation allows i to earn a higher payoff.*

Proof. Firm i's total *ex post* anti-corruption legislation expenditure is $x^{A*} + M^{A*}$, and its total *ex ante* anti-corruption legislation expenditure is $x^* + M^*$. According to Proposition 4, $M^{A*} < M^*$ if $p < 2\alpha^*$. Under the anti-corruption legislation, firm i's performance must compensate for the loss of g by investing x^{A*}, which results in $x^{A*} > x^*$. The larger the x, the higher the expected payoff for i. As $z_x > 0$, it is satisfied that $z_{x^{A*}} > z_{x^*}$.

Proposition 6 contains an important policy implication, in that firms in highly regulated industries seem to be naturally decreasing their reliance on M. However, this phenomenon should not be incorrectly interpreted as these firms' policy compliance; rather, their weakening firm performance due to the *ex post* anti-corruption legislation fundamentally forces them to decrease M. Therefore, Hypothesis 2-1 is established. Unless these firms increase x, they are likely to exhibit poorer performance, which suggests a testable Hypothesis 2-2.

Proposition 6. *If firm i's ex post anti-corruption legislation performance occurs in a highly regulated industry, the firm will be worse off if it increases its total graft expenditures.*

Proof. Given the anti-corruption legislation, $\underline{g}$ is accepted as an exogenous variable. To compensate for $g^* - \underline{g}$, in the model's context, i in a high highly regulated industry will increase α when it wants to increase its total graft expenditures. Equation (3) demonstrates $z_g = \frac{1-p}{\alpha}$: the higher the α, the lower the marginal payoff of g. Equation (4) results in $z_e = \frac{p}{(1-\alpha)}$: the higher the α, the higher the marginal payoff of e. Thus, it is evident that under *ex post* anti-corruption legislation, i is better off as e increases. However, $z_g > z_e$ always holds, which reveals that after the anti-corruption legislation was implemented, i's marginal payoff loss occurred through $\alpha\underline{g}$, when i increases α to outweigh its marginal gain from increasing $(1-\alpha)e$. By this mechanism, i's performance deteriorates; if this occurs, i could afford a larger scale of $g^* - \underline{g}$ compared to those firms in less regulated industries.

DOI: 10.24818/18423264/55.2.21.09

3. Empirical Implementation

3.1. Testable Hypotheses

This section details our empirical procedure. First, we empirically test our economic model using financial data for the firms listed on the Korea Stock Exchange from 2015 to 2017. We selected our samples through the following reasoning: First, anti-corruption legislation was enacted in September 2016, and thus, our data ranging from 2015 to 2017 can illustrate both *ex ante* and *ex post* impacts of this legislation. Second, we focus on a year-over-year comparison to investigate the determinants and consequences of the anti-corruption legislation. This year-over-year reporting compares metrics from one quarter of one year to those of the same quarter in the previous year. For instance, we compare how entertainment expenses changed between Q2 2016 and Q2 2017 to test whether entertainment expenses increased after the anti-corruption legislation was implemented in September 2016. Subsequently, we can control for possible fluctuations due to seasonal or cyclical trends. Finally, 777 firms with non-missing values were selected as analytical samples according to these criteria.

Next, based on the propositions developed in the previous modeling section, we propose the following testable hypotheses. The first hypotheses—or Hypotheses H1, H1-1, and H1-2—are designed to test the anti-corruption legislation's impact on corporate entertainment expenses as established in Propositions 4 through 6. The second group of hypotheses—or Hypotheses H2, H2-1, and H2-2—are suggested to not only test the moderating effects of the *ex post* firm's strategic behaviors after anti-corruption legislation, but also scrutinize their impact on firm performance, which relies on Propositions 1 through 3.

Hypothesis 1. *Anti-corruption legislation negatively impacts corporate entertainment expenses.*

> ***Hypothesis 1-1***. *Anti-corruption legislation has a more salient impact on corporate entertainment expenses in larger firms.*
>
> ***Hypothesis 1-2***. *Anti-corruption legislation has a more salient impact on corporate entertainment expenses for firms in regulated industries.*

Hypothesis 2. *Anti-corruption legislation positively impacts firm performance.*

> ***Hypothesis 2-1***. *The anti-corruption legislation's impact on firm performance is negatively moderated by an increase in entertainment expenses.*
>
> ***Hypothesis 2-2***. *The anti-corruption legislation's impact on firm performance is negatively moderated by an increase in entertainment expenses among firms in regulated industries.*

3.2. Empirical Framework

Our empirical model also consists of two parts. The first part tests a panel-logistic model to determine whether the anti-corruption legislation reduced entertainment expenses; if this is the case, the model notes which firm type is more

DOI: 10.24818/18423264/55.2.21.09

saliently affected by this institutional change. The second part tests whether firm sales are affected by its entertainment expense behavior after the anti-corruption legislation was implemented; if this is the case, the model notes whether the firm's operating in a regulated industry has amplified this trend. The following panel regression is suggested to analyze the first part of our model:

(1) $$EE\_INC_{i,t} = \gamma_0 + \gamma_1 \text{ANTICORRUPT}_{i,t} + \gamma_2 \text{BIG}_{i,t} + \gamma_3 \text{REG}_{i,t} + \gamma_4 \text{BIG}_{i,t} * \text{ANTICORRUPT}_{i,t} + \gamma_5 \text{REG}_{i,t} * \text{ANTICORRUPT}_{i,t} + \gamma_6 \text{DEBT}_{i,t} + \gamma_7 \text{TA}_{i,t} + \text{YR} + \text{IND} + \varepsilon_{i,t}$$

We examine the second part of our model by suggesting the following regression; the model's coefficients were estimated using this panel analysis:

(2) $$\text{GROWTH} = \gamma_0 + \gamma_1 \text{ANTICORRUPT}_{i,t} + \gamma_2 \text{EE} + \gamma_3 \text{BIG}_{i,t} + \gamma_4 \text{REG}_{i,t} + \gamma_5 \text{EE}_{i,t} * \text{ANTICORRUPT}_{i,t} + \gamma_6 \text{REG}_{i,t} * \text{ANTICORRUPT}_{i,t} + \gamma_7 \text{EE}_{i,t} * \text{REG}_{i,t} + \gamma_8 \text{EE}_{i,t} * \text{REG}_{i,t} * \text{ANTICORRUPT}_{i,t} + \gamma_9 \text{DEBT}_{i,t} + \gamma_{10} \text{TA}_{i,t} + \text{YR} + \text{IND} + \varepsilon_{i,t}$$

where

- *EE_INC*: Increase in entertainment expenses, coded as one for increased corporate entertainment expenses compared with the same quarter in the prior year, and zero otherwise;
- *EE:* Entertainment expenses (logarithms);
- *GROWTH*: The sales growth rate compared to the previous quarter (logarithms);
- *ANTICORRUPT*: An anti-corruption legislation dummy coded as one after Q4 2016, and zero otherwise;
- *DEBT*: The total debt divided by total assets;
- *OFFE*: The increase in the general administrative expenses for sale (logarithms);
- *TA*: Total assets;
- *BIG*: A dummy variable for a firm classified as a large conglomerate or *chaebol*, regulated by a cap on the firm's total equity investment system;
- *REG*: A dummy variable coded as one for a firm belonging to a highly regulated industry, such as the financial, insurance, sports, and entertainment services industries, and zero otherwise;
- *YR*: A year dummy variable; and
- *IND*: An industry dummy variable.

4. Empirical Results

Model 3 in Table 1 demonstrates that *ANTICORRUPTION* had a significant, negative impact on *EE_INC* ($p < 0.01$); therefore, Hypothesis 1 is supported. Hypotheses 2-1 and 2-2 suggest anti-corruption legislation negatively impacted firms' entertainment expenses, and this result is more salient for large Korean conglomerates known as *chaebols* and for firms in highly regulated industries. The

DOI: 10.24818/18423264/55.2.21.09

moderating effects of *BIG* and *REG* on *EE_INC* are statistically significant and negative ($p < 0.01$), thus supporting Hypotheses 1-1 and 1-2. We test Hypotheses 2, 2-1, and 2-2, by using sales growth as the dependent variable (*GROWTH*) and an indicator of firm performance. Hypothesis 2 suggests that firm performance was generally enhanced after the anti-corruption legislation was implemented, and this is statistically confirmed in Models 3 through 4 in Table 2 ($p < 0.01$). Hypothesis 2-1 suggests that firms that paid more entertainment expenses after anti-corruption legislation experienced reduced performance. Hypothesis 2-2 argues that firms that paid more entertainment expenses in regulated industries after the anti-corruption legislation was implemented also experienced reduced performance. As the coefficients of (*EE * ANTICORRUPT*) and (*EE * REG * ANTICORRUPT*) are significant and negative, respectively, Hypotheses 2-1 and 2-2 are both supported.

Table 1. **Determinants of Increase in entertainment expenses**

	Model 1	Model 2	Model 3
ANTICORRUPT		-0.918***	-0.811***
		(0.000)	(0.000)
*ANTICORRUPT * BIG*			-0.407***
			(0.008)
*ANTICORRUPT * REG*			-0.673***
			(0.000)
DEBT	0.061	0.053	0.060
	(0.720)	(0.759)	(0.728)
TA	0.029	0.032	0.032
	(0.320)	(0.275)	(0.268)
BIG	-0.085	-0.092	0.074
	(0.460)	(0.426)	(0.579)
OFFE	0.739***	0.774***	0.771***
	(0.000)	(0.000)	(0.000)
REG	-0.093	-0.102	0.173
	(0.623)	(0.596)	(0.405)
Year& Industry dummy	Yes	Yes	Yes
Constant	-0.191	-0.228	-0.284
	(0.621)	(0.560)	(0.470)
chi^2	163.1128	235.6117	256.1592
N	7,344	7,344	7,344

* $p < 0.1$, ** $p < 0.05$, and *** $p < 0.01$; p-values are reported in parentheses

Table 2. **Determinants of Sales Growth**

	Model 1	Model 2	Model 3
ANTICORRUPT	0.031***	0.027**	0.027**
	(0.009)	(0.025)	(0.026)
EE	0.050***	0.062***	0.059***
	(0.000)	(0.000)	(0.000)
REG	0.003	-0.007	-0.011
	(0.921)	(0.820)	(0.712)

DOI: 10.24818/18423264/55.2.21.09

*ANTICORRUPT * EE*		-0.026***	-0.022***
		0.000	(0.002)
*ANTICORRUPT * REG*		0.032	0.034
		(0.131)	(0.114)
*REG * EE*		0.110***	0.158***
		(0.000)	(0.000)
*ANTICORRUPT * EE * REG*			-0.072**
			(0.017)
DEBT	0.082***	0.079***	0.078***
	(0.001)	(0.002)	(0.002)
TA	0	-0.001	-0.001
	(0.973)	(0.896)	(0.854)
BIG	0.021	0.021	0.022
	(0.243)	(0.236)	(0.220)
OFFE	0.134***	0.131***	0.131***
	(0.000)	(0.000)	(0.000)
Year and Industry Dummy	Yes	Yes	Yes
Constant	-0.038	-0.032	-0.029
	(0.529)	(0.592)	(0.633)
chi^2	800.8236	879.5881	887.8058
N	7,344	7,344	7,344

* p < 0.1, ** p < 0.05, and *** p < 0.01; p-values are reported in parentheses

5. Conclusion and Discussion

We extend institutional theories to examine how organizations conform to nationwide institutional change. Our economic models based on empirical findings highlight two key insights. First, coercive isomorphism is contingent on a myriad of firm and industry characteristics, and thus, external institutions *disproportionally* shape a firm's incentives to undertake nonmarket activities. Specifically, we discover that conglomerates—and *chaebols* in particular—are more pliable to anti-corruption legislation. This finding is consistent with those of extant studies on organizations' visibility (Bowen, 2002). Previous research demonstrates that larger firms tend to be more visible to consumers, media, and the government, and thus, more vulnerable to damage from a poor reputation (Bowen, 2002; Choi, Park, & Choi, 2018). Therefore, the visible—and thus, larger—firms are more sensitive to institutional pressures and consequently pay more attention to social and legal issues.

Korea's anti-corruption legislation has built new legitimacy for firms, and acts as a guide on how they can behave ethically. In our context, as consumers and the media and government expect *chaebols* to serve as an exemplary business model, stakeholders more negatively evaluate their illegitimate behavior, such as not conforming to the philosophy of anti-corruption legislation (Choi et al., 2018). Our findings on the heterogeneous impact of institutional change for firms in regulated industries is also explained by the visibility perspective. Firms in a wide range of sectors are regulated by government agencies that establish, monitor, and

DOI: 10.24818/18423264/55.2.21.09

enforce administrative rules regarding an array of policy dimensions (Buchholz, 1990). These regulatory agencies do not operate completely independently from politicians or legislative and judicial institutions, as political institutions can nominate regulators, and these regulators' decisions are also subject to legislators' supervision. These politicians or legislators are also likely to be stricter toward firms in visible industries such as utilities, telecommunications, and pharmaceuticals, as these industries are monopolized and often criticized for illegal and unfair practices. Hence, firms in regulated industries may explicitly exhibit more malleable behaviors to reduce institutional and social pressures.

Second, our findings theoretically and empirically indicate that the consequence of both anti-corruption legislation and firms' non-conformity is not homogeneous across firms, but rather a function of the firm's market position. We find that firm performance increases entertainment expenses, even after legislative effects decrease. The institutional theory argues that firms' behaviors must comply with the institutional norms under which the firms conduct their business (DiMaggio & Powell, 1983); otherwise, the noncompliant organization will be easily punished, whether financially or non-financially (Benner &Ranganathan, 2012). Korea's nationwide anti-corruption legislation established new criteria for codes of conduct that influence firms' strategic choices. As noncompliant firms will become targets of government sanctions, noncompliant corporate strategies would be detrimental to their performance or survival. We also find that this detrimental consequence is contingent on industry characteristics, as firms in regulated industries depend more on the government because government policies highly influence the course of their business. The firm's noncompliance with the government's anti-corruption legislation is more visible through its regulatory authorities, and this reinforces the government's negative interference. The media or consumers can also easily observe any noncompliance among firms in regulated industries, and these unethical behaviors can be effectively punished by the private sector as well as the government.

Our findings provide useful managerial implications, as managers need to more comprehensively assess the institutional changes their firms face for proper decision-making in nonmarket activities. In doing so, they must not only understand that multiple factors should influence these decisions—including institutional pressures and firm- and institutional- specific characteristics—but also note that these factors may interact and reinforce their influence on firm risks. This awareness of the multiplicity of these factors helps managers understand abrupt institutional change, such as anti-corruption legislation, to make strategically correct decisions. Our findings suggest that larger, more highly regulated firms must be more sensitive to external change, and act more accordingly to address anti-corruption legislation.

Although our results are encouraging, this study also has limitations that suggest directions for future research. First, our economic model's research context is primarily based on Korean-listed firms, and such a single-country context may

DOI: 10.24818/18423264/55.2.21.09

restrict our conclusions' generalizability. Future work can address this concern through a multinational context to further investigate firms' strategies for abrupt institutional change as well as the impact of such changes on firm performance. Second, our study only measured firms' nonmarket strategies involving entertainment expenses due to data availability. For instance, bribery or lobbying could also be used as a proxy for corporate nonmarket strategies. Subsequently, researchers could explore more complicated firm behaviors under coercive government pressure.

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