

## Article

# Corruption's Crossroads: Exploring Firm Performance and Auditors' Role in Emerging Markets

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**Abstract:** This study examines the relationship between country-level corruption (proxied by the Corruption Perception Index, CPI) and firm performance (measured by Return on Assets, ROA) across 18,286 firms in the East Asia, South Asia, and Southeast Asia regions. Additionally, the moderating effects of audit quality (proxied by auditors' reputation) on the relationship are examined. The findings of the study indicate a positive association between corruption and ROA in high-income nations, thus providing evidence in favor of the "greasing the wheel" theory. On the other hand, a negative association is documented in the upper middle- and low-income nations, which is consistent with the "sanding the wheel" notion. Notably, audit quality has a positive moderating influence on the relationship between corruption and ROA, especially in nations with low corruption levels, reaffirming the pivotal role of reputable auditors in enhancing firm performance within these economic contexts. The results of this study have important ramifications for forming policy suggestions and enhancing governance. The findings highlight the opportunity to improve governance practices and regulations to reduce corruption and increase transparency. Policymakers can develop ways to strengthen institutional frameworks by recognizing the complex link between corruption, corporate profitability, and the function of respected auditors.

**Keywords:** corruption; firm performance; auditors reputation; high-income countries; upper middle-income countries; low-income countries



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## 1. Introduction

Over the past few decades, the relationship between corruption and firm performance has been a subject of debate. The presence and pervasiveness of corruption that the economy encounters in the majority of economic sectors (Wolf et al. 2010; Quah 2009) is a crucial component of the global business environment, and these limit economic activity in these markets (Muhammad et al. 2023; Al Qudah et al. 2020; Hakimi and Hamdi 2017). The pioneering work of Leff (1964), Leys (1965), and Huntington (1968) introduced the argument that corruption may be beneficial to an economy—the so-called “greasing the wheels” hypothesis. These authors posited that corruption may be beneficial in a “second best world” due to bureaucratic inefficiency or institutional voids that act as a barrier to economic activities and advancement. Over the years, this hypothesis has found profound empirical support and elaboration (Yan and Li 2023; Kopas et al. 2021; Walheiser et al. 2021; Williams and Kedir 2016; Ayaydn and Hayaloglu 2014; Kaufmann and Wei 1999; Huntington 1968; Leff 1964). Contrary to the “greasing the wheels” hypothesis, the “sanding the wheels” hypothesis views corruption as a barrier to economic development and growth (Mauro 1995). Mauro (1995)'s findings echoed earlier findings by Klitgaard (1991), and were subsequently supported by Hines (1995), Ades and Di Tella (1997), Kaufmann (1997), Tanzi and Zee (1997), Wei (1997a), Brunetti and Weder (1998), Gaviria (2002), De Rosa et al.

(2010), Faruq et al. (2013), Hoinaru et al. (2020), and Ünlü and Ulusoy (2021), to mention a few. Corruption has also been implicated in imposing huge costs on firms operating in these markets (L. Martins et al. 2020; Sharma and Mitra 2015; Doh et al. 2003; Jain 2001; Svensson 2005).

In this paper, we propose that the direction of the relationship between corruption and firm performance is contingent on the institutional context in which the firm operates. The institutional framework has a significant impact on how corruption impacts firms (Khelil et al. 2022). The impact of corruption is expected to vary depending on the current laws, regulatory institutions, and cultural norms. In some institutional settings, corruption might produce benefits or opportunities that momentarily improve performance, but in other settings, it might have negative effects like diminished competitiveness, increased legal risk, and reputational harm, which would hurt an organization's profitability and competitiveness. This study attempts to provide a broader perspective of the complex relationship between corruption and corporate performance by recognizing contextual variations providing significant insights for policymakers and companies navigating varied global settings. In doing so, the study endeavors to develop a more nuanced explanation of the effects of corrupt environments on firm performance and contribute to resolving the "greasing" versus "sanding" debate. Weak legal systems and informal political systems (Papageorgiadis et al. 2020; Bayat 2012; Venard and Hanafi 2008) create a self-reinforcing cycle where corruption affects income distribution in societies (Whitmire 2024; Stephenson 2020; Jain 2001) and further weakens government structures and key societal institution such as courts and regulatory bodies.

In the context of such institutional frameworks in innumerable circumstances, a crucial question is the function of the "auditors' role" in discovering and correctly documenting transactions involving corruption. A competent and reputable auditing firm may improve financial reporting transparency and credibility, thus reducing the detrimental impact of perceived corruption. When auditors preserve their independence and integrity, they are able to uncover errors caused by corruption, resulting in better financial reporting quality. As a result, the adverse effects of corruption on investor confidence are reduced because stakeholders and investors are more inclined to place confidence in financial disclosures. This research intends to determine how such acts affect the firm's accounting performance. Thus, we examine the relationship between corruption (proxied by the Corruption Perception Index from Transparency International) and firm performance in selected countries in the East Asia, South Asia, and Southeast Asia regions and the moderating effects of auditors' reputation on the relationship between corruption and firm performance in these countries.

To summarize, the present research differentiates itself in a couple of aspects. Firstly, it investigates the association involving corruption levels and firm performance in fourteen East Asia, South Asia, and Southeast Asia nations. These locations were selected because of their exceptional diversity in institutional frameworks and diverse economic situations, which provide a perfect empirical environment for the research. By embracing a vast range of nations, the study intends to identify the subtle influence of corruption on company performance across this heterogeneous socioeconomic backdrop. Second, the research further investigates the complexities of this relationship by considering the efficacy of institutional gaps in various nations. Institutions are the backbone of a country's economic and social systems, and differences in their quality may have a substantial influence on corporate behavior. The study further examines how institutional quality affects the association between corruption and company performance in order to understand how different institutional settings might affect this dynamic. Finally, the study broadens the scope to include audit firms, examining how auditors' reputations may impact this association. Auditors serve a critical role in ensuring financial transparency and responsibility. Understanding how their reputation capital impacts the corruption–firm profitability dynamic could shed light on the efficacy of auditors' reputations in various settings. In summary, this study intends to establish an adequate basis for a comprehensive knowledge of the complex relationship

between corruption, institutional frameworks, and auditors' reputation/quality, hence improving the understanding of the financial dynamics in these different East Asia, South Asia, and Southeast Asia regions.

## 2. Hypotheses Development

### 2.1. Corruption and Firm Performance

Corruption has been defined typically as the abuse of public power for private benefits that exist within private sector activities (Yusubboevich 2022; Sartor and Beamish 2019; Pozsgai-Alvarez 2020; Tanzi 1998; Uslaner 2004; Akcay 2006). For instance, Transparency International (TI), whose assessment of corruption (Corruption Perceptions Index (CPI)) is widely used, defines corruption as “the abuse of entrusted power for private gain” (<https://www.transparency.org/en/what-we-do>, accessed on 30 December 2023). Corruption is both persistent and significant around the world (Ortiz-Ospina and Roser 2024; Khelil et al. 2024; Papageorgiadis et al. 2020; Wolf et al. 2010; Shleifer and Vishny 1993) and is found in varying degrees in both developing (Schomaker 2020; Mauro 1998) and developed countries (Zahoor et al. 2023; Yusubboevich 2022; Wei 1997b). According to the Corruption Perceptions Index (CPI) announced by Transparency International, while there is significant variation, none of the 180 countries ranked a perfect score (very clean) on the CPI index. Bribery, extortion, and embezzlement are some of the ways corruption manifests itself with the purpose of creating private benefits (Yusubboevich 2022; Pozsgai-Alvarez 2020; Myint 2000).

At the national level, corruption has been implicated in lower gross domestic product (GDP) per capita, foreign direct investment, and economic growth of a country (Belloumi and Alshehry 2021; Offiong et al. 2020; Anoruo and Braha 2005; Jong-Sung and Khagram 2005; Rock and Bonnett 2004). It has also been suggested that corruption adversely affects trade in cross-border investment by multinational firms (Thede and Karpaty 2023; Li and Reuer 2021; Shleifer and Vishny 1993; Wu 2006; Mahagaonkar 2008; Lalountas et al. 2011; Ulman 2014), perverts the discipline of the market and ultimately contribute adversely to firm performance (Shaikh 2022; Guluma 2021; Gaviria 2002). Economies with lesser degrees of corruption tend to develop faster and better than those with higher degrees (L. Martins et al. 2020; Feruni et al. 2020), and corruption is also argued to negatively affect the level of competitiveness of that economy (Akimova et al. 2020; Hoinaru et al. 2020; Ulman 2014; Mahagaonkar 2008; Blackburn and Forgues-Puccio 2009).

However, at a more micro, firm level, a more nuanced understanding of the effect of corruption on firm performance has gained currency over the years. There are two schools of thought in terms of the relationship between corruption and firm performance: “greasing the wheels” and “sanding the wheels”. Proponents of “greasing the wheels” (Yan and Li 2023; Kopas et al. 2021; Heo et al. 2021; Walheiser et al. 2021; Huntington 1968; Leff 1964; Kaufmann and Wei 1999; Ayaydin and Hayaloglu 2014; Vial and Hanoteau 2010; Williams and Kedir 2016; Blagojevic and Damijan 2012) believe that corruption significantly enhances rather than harms firm performance, national employment, and overall productivity growth rates. The fundamental concept known as the “grease the wheels” hypothesis, initially proposed by Leff (1964), Leys (1965), and Huntington (1968), suggests that corruption might offset the detrimental impact on a nation's growth and productivity caused by an ineffective bureaucracy and, in broader terms, malfunctioning institutions. Leff (1964) and Bailey (1966) argue that corruption can insulate the firm from the effects of bad public policies (e.g., curbing the private pursuit of profitable opportunities, i.e., entrepreneurship) and improve the quality of investments since entities initiating the corruption would use the benefits they receive to pursue economically profitable opportunities. For proponents of this view, corruption compensates for the consequences of an ineffective institutional framework and/or the weak rule of law. In particular, “greasing the wheels” proponents propose that an inefficient bureaucracy is a major obstacle to productive economic actions, and corruption acts as a grease to overcome bureaucratic friction and enable the consummation of economic transactions by entrepreneurial actors. It has been argued that

bribes incentivize bureaucrats to speed up slow-moving administration (Leys 1965) and reduce waiting time (Lui 1985). As a second-order effect of corruption, Leys (1965), and Bailey (1966) also found that it overcomes issues related to the quality of civil servants and may work as an incentive to attract better quality staff, thus contributing to economic efficiency ultimately.

On the other hand, proponents of “Sanding the wheels” (Ünlü and Ulusoy 2021; Hoinaru et al. 2020; Faruq et al. 2013; Mauro 1995; De Rosa et al. 2010; Gaviria 2002; Lavallée and Roubaud 2011; McArthur and Teal 2002) believe that the higher the level of corruption in countries, the lower is the level of economic development and growth. Corruption has also been argued to negatively affect the level of competitiveness of that economy (Spyromitros and Panagiotidis 2022; Akimova et al. 2020; L. Martins et al. 2020; Ulman 2014; Mahagaonkar 2008; Blackburn and Forgues-Puccio 2009). Pioneering the “sanding the wheels” hypothesis, Myrdal (1968) points out that corrupt civil servants may not necessarily speed up transactions but may deliberately delay and slow them down for the ultimate purpose of receiving bribes, thus contributing to creating a rent-seeking economy (Krueger 1974). Additionally, Kurer (1993) contends that corrupt practices are self-reinforcing—they induce other distortions in economic transactions with the intention of preserving the source of illegal income. Mauro (1998) and Langseth et al. (1997) further argued that increased corruption and bribes lead to socially inefficient economic resource allocation, retard government expenditure on basic services such as schools, welfare services, infrastructure, and education, and ultimately contribute to low national economic performance. Supporting their arguments, corruption has been implicated in lower gross domestic product (GDP) per capita (Spyromitros and Panagiotidis 2022; Schöll and Schermuly 2018) and foreign direct investment and economic growth of a country (Spyromitros and Panagiotidis 2022; Bayar et al. 2020; Anoruo and Braha 2005; Jong-Sung and Khagram 2005; Rock and Bonnett 2004). Weak legal systems and informal political systems (Papageorgiadis et al. 2020; Venard and Hanafi 2008) may create a self-reinforcing cycle where corruption may affect income distribution in societies (Hartwell and Urban 2020; Urbina 2020; Jain 2001) and further weaken government structures and key national institutions such as courts and regulatory bodies. Corruption also has an impact on the sustainability initiatives of firms (Troisi et al. 2023). A positive association is documented for sustainability related to industrialization and production processes, but a negative effect on sustainability issues related to employment and labor processes suggests the prevalence of both greasing and sanding effects.

In the context of international business and looking at firm-level effects, it has been suggested that corruption adversely affects trade in cross-border investment by multinational firms (Thede and Karpaty 2023; Li and Reuer 2021; Escresa and Picci 2019; Shleifer and Vishny 1993; Wu 2006; Mahagaonkar 2008; Lalountas et al. 2011; Ulman 2014), perverts the discipline of the market, and, by imposing costs on the firms, ultimately contributes adversely to firm performance (Gaviria 2002; Doh et al. 2003; Jain 2001; Svensson 2005). Several other studies have also shown support for the “sanding the wheels” hypothesis (Feruni et al. 2020; L. Martins et al. 2020; McArthur and Teal 2002; Gaviria 2002; De Rosa et al. 2010; Lavallée and Roubaud 2011; Faruq et al. 2013).

Despite the harmful effects of corruption on the larger national economic indicators, in general, we anticipate a positive relationship between corruption and the performance of individual firms at a microeconomic level, thus, in line with the “greasing the wheels” hypothesis. The “greasing the wheels” hypothesis posits that corruption can facilitate business activities in environments with inefficient bureaucracies. By expediting bureaucratic processes through bribes, firms can navigate red tape more efficiently, reducing delays and uncertainty. Corruption can also align the incentives of private firms and public officials, enabling businesses to secure government contracts and access scarce resources that might otherwise be inaccessible. Theoretical and empirical studies, such as those by Leff (1964) and Bailey (1966), argue that corruption can mitigate the adverse effects of bad public

policies, particularly in countries where bureaucratic inefficiencies are significant obstacles to business operations.

Corruption can enhance firm profitability by reducing operational delays, facilitating market entry, and allowing firms to respond flexibly to changing market conditions. Empirical evidence from Méon and Weill (2010) supports the idea that corruption can positively affect economic efficiency in countries with highly ineffective governments. Firms that engage in corrupt practices can expedite transactions, ensuring steady revenue flows and capitalizing on various entrepreneurial opportunities. This approach allows businesses to overcome biases and barriers, thus fostering a more dynamic and responsive business environment in countries where official channels are often sluggish and unreliable.

Thus, we propose the following hypothesis for the relationship between country-level corruption and firm profitability in that country, *ceteris paribus*.

**H1.** *There is a significantly positive relationship between corruption and firm performance in the respective countries. (Note: inverse relationship between CPI and corruption levels; low CPI indicates high corruption levels, and vice versa).*

## 2.2. Corruption and Firm Performance in Countries with Diverse Economic Classifications

Prior research emphasizes that economic behavior is strongly influenced by the institutional context of a country (Aloulou 2021; Urbano et al. 2019; North 1990; Furubotn and Richter 2010), with distinct institutional environments affecting the relationship between corruption and firms' financial performance. In the context of embracing corporate governance practices, the formal and informal institutional frameworks at the country level have been identified as exerting substantial path-dependency on business practices. These structures either resist the adoption or nullify the effect of internationally accepted corporate governance practices (Filatotchev and Boyd 2009; Kumar and Zattoni 2013; Yoshikawa and Rasheed 2009; Alon and Hageman 2017). Several cross-national studies have found corruption to be less prevalent in countries with higher institutional quality characterized by greater respect and adherence to the rule of law (Montes and Luna 2020; Guerrero and Castañeda 2021; Li et al. 2008). Sound institutional structures provide guidelines of what to expect in a particular situation (Guerrero and Castañeda 2021; Escresa and Picci 2019; Alon 2013; Greenwood et al. 2011) and decrease the dominance of unofficial payments in business transactions (Aguilera and Vadera 2008; Cleveland et al. 2009).

In high-income countries, corruption can sometimes act as a "greasing the wheels" mechanism, facilitating economic activities by circumventing bureaucratic inefficiencies or institutional gaps. Even with well-developed institutions, bureaucratic processes can still be cumbersome and slow. Corruption can expedite these processes by providing incentives for officials to speed up approvals, permits, or other necessary documentation, which is particularly beneficial in time-sensitive industries like construction and technology. Furthermore, corruption aligns the incentives of different parties involved in a transaction. For instance, firms might use bribes to secure government contracts or ensure favorable regulatory decisions, helping them navigate complex regulatory environments more effectively. Corruption can also serve as a workaround for institutional gaps, enabling firms to operate smoothly despite potential inefficiencies in the regulatory framework. This is especially relevant when certain regulations are outdated or overly restrictive, allowing corruption to foster more dynamic business operations. Additionally, in a highly regulated environment, corruption can provide a level of predictability, ensuring that business operations proceed without unexpected interruptions or delays, which is crucial for business planning and overall efficiency. The institutionalization of corruption can lead to lower transaction costs, creating a more predictable and efficient environment for business transactions. Empirical evidence supports the "greasing the wheels" hypothesis. For example, Méon and Weill (2010) found that in countries with highly ineffective governments, corruption can positively affect economic efficiency by enabling firms to overcome bureaucratic hurdles. Similarly, Vial and Hanoteau (2010) observed that in Indonesia, corruption helped

firms navigate regulatory constraints, resulting in improved firm performance. While these potential benefits exist, it is important to recognize the broader negative impacts on economic fairness, equity, and long-term institutional integrity. Nonetheless, in specific contexts, corruption can facilitate business operations by reducing delays, aligning incentives, overcoming institutional gaps, enhancing predictability, and minimizing transaction costs.

On the other hand, emerging markets (typically, relatively low-income countries) are considered to suffer from “institutional voids”—weak or ineffective contract enforcement mechanisms, absence or poor quality of external certification agencies, absence of or inefficient markets for buyers and sellers to determine prices, etc. (Theede and Karpaty 2023; Belloumi and Alshehry 2021; Dhanaraj and Khanna 2011; Khanna and Yafeh 2007). These institutional voids create significant challenges for businesses operating in these environments, requiring innovative and context-specific solutions that differ from those used in high-income, developed markets (Dhanaraj and Khanna 2011; Khanna and Palepu 1997; Khanna and Rivkin 2001). In these markets, corruption can act as a “sanding the wheels” mechanism, impeding rather than facilitating economic activities. Institutional corruption in these economies is often not well established, leading to high transaction costs and significant uncertainty regarding the efficacy of corrupt transactions. This uncertainty can deter firms from engaging in corruption or result in wasted resources when they do. Consequently, firms may avoid riskier but potentially profitable opportunities, operating below their profit potential due to the opaque and unreliable nature of corrupt dealings (Benson 2019). Transactions may be uneconomically divided among too many dispersed parties with misaligned interests, creating further inefficiencies. This inefficiency in the “institutions of corruption” represents a context of “sanding the wheels”, where firms waste resources without concluding business deals or pass up on entrepreneurial opportunities due to uncertain payoffs (Dünhaupt et al. 2022; Krueger 1974; Brooks and Heijdra 1988; Tullock 1988). In these environments, individuals in power may extort monopolistic rents, exploiting their positions without the technical capacity to execute promised transactions. For example, in Eastern European countries, formal verification intended to minimize corruption actually led to more corruption, as officers used inspections to extract additional bribes (Alon and Hageman 2017). In Russia, weak market-oriented regulatory institutions forced individuals to rely on trust-based informal networks, leading to pervasive unofficial payments and increased risks of wasted payments due to violations of trust (Alon and Dwyer 2012; Puffer and McCarthy 2007, 2011; Li 2009; Luo 2005). Ultimately, in countries with significant institutional voids, the financial performance of firms suffers due to the high costs, inefficiencies, and uncertainties associated with corruption (Abdul-Baki et al. 2023). Firms may focus only on safer business opportunities, forgoing more entrepreneurial ventures, thus limiting their growth and profitability in such challenging environments.

**H1a.** *There is a significant positive relationship between corruption and performance among firms operating in high-income countries.*

**H1b.** *There is a significant negative relationship between corruption and performance among firms operating in upper middle-income and low-income countries.*

### *2.3. Moderating Roles of Auditors’ Reputation (Audit Quality) on Country-Level Corruption and Firm Performance*

The auditing function is crucial in identifying instances of corruption as well as assisting in mitigating these actions (Farooq and Shehata 2018; Kimbro 2002; Cuervo-Cazurra 2008; Ball 2001; Guedhami and Pittman 2006). Auditors can spot abnormalities indicative of corrupt practices in a company by thoroughly examining financial records, transactional activity, and organizational procedures. This early detection not only helps stop dishonest behavior but also promotes an environment of accountability and integrity in the organization. Strategic initiatives and policy reforms targeted at bolstering anti-

corruption measures inside the organization and the larger society environment might be guided by the information gained from these audits.

Nevertheless, auditors differ in their technical and organizational competence as well as experience, which leads to differences in the quality of audits (O'Keefe and Westort 1992). Reputed auditors have the capacity to enhance their reputation through the conduct of high-quality audits. Research indicates that they exhibit heightened proficiency in identifying significant misstatements within financial statements and demonstrate enhanced transparency in their reporting practices (DeAngelo 1981). These auditors also engage in a greater degree of specialization and invest heavily in professional development, human capital, and information technology, thus representing better technical training in accounting and audit principles and may provide better oversight of the firm's financial operations. Most importantly, in the context of this study, audits by reputed auditors may overcome the weaknesses of institutions and assure the investors about the overall quality of a firm's financial statement and internal controls.

Since reputation is an economic asset, reputed auditing firms have an incentive to maintain their reputation. Beatty (1989) and Lennox (1999) also argue that reputable auditors have more incentive to issue accurate and high-quality audit work as they have a propensity for receiving additional fees than others. Clients also rely on their auditor's reputation to assure their investors and other stakeholders about the quality of their accounting systems and the accuracy of their accounting reports (Dopuch and Simunic 1980; Francis and Wilson 1988) and may be willing to pay a premium to have their audits performed by reputed auditors. Litigation risk, which could harm the reputation of both the auditors as well as their clients, also motivates these auditors to be more conservative and diligent in providing audit services (DeAngelo 1981; Thoman 1996) although it has also been posited that this may not be the case in environments with institutional voids such as some of the ASEAN countries (Khurana and Raman 2004).

To summarize, auditors differ in their quality and reputation; reputed auditors may attract better talent, be more competent in their activities, and have an incentive to protect their reputation, resulting in a more conservative approach to their overall engagement with their clients. Furthermore, the signaling effect of having a reputed auditor onboard itself may discourage management and other employees from indulging in questionable accounting practices. In low-corruption countries, the technical expertise of reputable auditors, as well as the signaling effect of their reputation, may make it easier for external stakeholders to deal with the firm and lower indulgence in questionable accounting practices in the expectation that these would be flagged and disallowed by the auditors. In high-corruption cases, the reputed auditors would use their technical competence to ensure compliance with established accounting standards. They would have an incentive to do so to protect their reputation on a global basis and avoid the spillover of harm to their reputation due to audit lapses in any one country. These dynamics imply that auditor reputation would positively moderate the relationship between corruption and firm performance, such that when reputed auditors are used, reported firm performance may improve. Therefore, we propose that auditor reputation will positively moderate the relationship between corruption and firm performance.

**H2.** *Auditors' reputation positively moderates the relationship between corruption and firm performance.*

### 3. Methodology

Data for this study were collected from the Emerging Markets Information System (EMIS) database. The main model is based on the entire sample of companies from 14 countries within the East and South East Asia regions, with a final sample size of 18,286 companies. For further tests, the dataset is divided into 3 main categories (World Bank's classifications, based on the GNI per capita): high-income, upper middle-income, and lower-income countries within the East Asia, South Asia, and Southeast Asia regions. Cambodia and Laos are deleted from the dataset because of the small number of com-

panies. The selection of countries across East Asia, South Asia, and Southeast Asia is justified by several critical factors, including diversity in governance systems (Droz et al. 2023), economic development, availability of data (Işık et al. 2024; Varvarigos 2023), and representativeness of the regions.

The chosen countries represent a wide array of governance systems, which is essential for understanding how different governance environments impact the relationship between profitability and corruption (Varvarigos 2023; Asteriou et al. 2021). For instance, East Asia includes China, a one-party socialist republic with significant state intervention; South Korea, a developed democracy with robust regulatory frameworks; Taiwan, a democratic country with strong economic regulations; and Hong Kong, a special administrative region with a free-market economy under a “one country, two systems” arrangement with China. Southeast Asia features Indonesia, a democratic republic with ongoing corruption challenges; Malaysia, a federal constitutional monarchy with active anti-corruption efforts; the Philippines, a democratic republic with persistent governance issues; Singapore, known for its stringent anti-corruption measures; Thailand, a constitutional monarchy with a history of political instability; and Vietnam, a one-party socialist republic with state-controlled economic sectors. South Asia includes Bangladesh, a parliamentary democracy with significant corruption issues; India, the world’s largest democracy with diverse regional governance structures; and Sri Lanka, a democratic socialist republic with ongoing governance challenges (Kaufmann et al. 2009).

Data availability and reliability are crucial for empirical research, and the chosen countries generally have accessible and reliable data on corporate performance and corruption indices. Countries like China, South Korea, India, and Singapore have well-established financial markets with extensive corporate data, while nations like Vietnam and Bangladesh have improved their data transparency and availability in recent years (Global Reporting Initiative 2022; United Nations Conference on Trade and Development 2023).

The exclusion of other South Asian, East Asian, and Southeast Asian countries can be attributed to several reasons, including political instability, data availability, and the need for diversity in governance systems (Rosli and Kamaluddin 2023). Countries like Myanmar and Afghanistan, for example, face significant political instability, affecting data reliability and potentially introducing noise into the analysis. Smaller or less economically developed countries may lack comprehensive corporate data and reliable corruption indices, and some countries might have governance systems too similar to those already included, adding little to the diversity needed for a robust analysis.

The selected countries also vary significantly in terms of economic development and market size, influencing the generalizability of the findings. Developed economies like South Korea, Taiwan, Hong Kong, and Singapore contrast with emerging markets such as China, Malaysia, Thailand, Vietnam, Indonesia, the Philippines, India, and Bangladesh, providing insights into various economic contexts. Developing economies like Bangladesh and Sri Lanka offer perspectives from nations with unique governance challenges, ensuring that the study captures a range of economic environments (World Bank 2023; International Monetary Fund 2023). Given the prevalent corruption challenges in the region, studying how companies navigate such environments becomes crucial for informed policy recommendations and business strategies. Research in this region holds the potential to yield insights directly applicable to policy formulation, aiding in combating corruption and fostering economic growth. Table 1 demonstrates the final dataset, categorizing the countries into high-income, middle-income, and low-income countries based on the World Bank’s classifications.

As for the variable measurements, this study measures firm performance based on firm profitability: Return on Assets (ROA). In terms of countries’ corruption level, although no single measure can fully capture a phenomenon as complex as corruption (Doig 2011; Murphy 2011), the standardized methodology of Transparency International (TI), however, allows producing internationally comparable information on corruption and is widely used in empirical studies involving country-level corruption. Thus, this study uses the



Corruption Perception Index (CPI) from Transparency International as a measure of a country's corruption level. This comprises a corruption score for a total of 180 countries ranging between a score of 0 (highly corrupted) and 100 (highly clean). Table 1 displays the corruption level of countries used in this study.

**Table 1.** Number of firms and their corruption levels for all countries/regions (World Bank's classifications, based on the GNI per capita).

High-Income Countries			Upper Middle-Income Countries			Low-Income Countries		
Country/Region	# Firms	CPI *	Country/Region	# Firms	CPI *	Country/Region	# Firms	CPI *
Singapore	740	84	Malaysia	869	52	India	4698	46
Hong Kong	2195	74	Mauritius	109	48	Philippines	227	38
Taiwan	1887	61	China	3194	36	Thailand	638	38
South Korea	1808	55				Indonesia	492	34
						Sri Lanka	294	34
						Vietnam	817	31
						Bangladesh	318	24
Total	6630			4172			7484	

\* CPI—Corruption Perception Index from Transparency International as a measure of a country/region's corruption level.

This study adopts the measure used by [Titman and Trueman \(1986\)](#) and [Beatty and Ritter \(1986\)](#) in determining audit quality. [DeAngelo \(1981\)](#) defines the quality of auditors based on the size of an accounting firm, which is in line with using Big 4 versus non-Big 4 dichotomy. The justification is that large-size auditors usually provide better quality of work to their clients as they have their reputation capital to take care of compared to small audit firms. Information on the auditors employed by the firm is obtained from the Bloomberg databases and/or the respective firms' financial reports. The Big 4 audit firms are considered reputable auditors (proxy of audit quality), while the non-Big 4 audit firms are classified as less-reputable auditors for the purpose of this research. A dummy variable is created; reputable auditors will be assigned a value of 1, while non-reputable auditors will be assigned a value of 0. A summary of the variable's measurements, its operationalization, and descriptive statistics are shown in Tables 2 and 3.

**Table 2.** Variable measurements and operationalization.

Variables	Description	Operationalization
<b>Independent variables</b>		
Corruption level of countries (CPI)	The index ranks 180 countries and territories by their perceived levels of public sector corruption according to experts and business people. <i>Source: Transparency International.</i>	Corruption Perception Index (CPI), using a scale of 0 to 100, where 0 is highly corrupt and 100 is very clean.
<b>Dependent variables</b>		
Return on Assets (ROA)	Measures the percentage of profit a company earns in relation to its overall resources employed.	Net Income/Total Assets (obtained from EMIS).
<b>Moderating variable</b>		
Audit quality (AQ)	Audit quality is proxied by auditor's reputation. It is based on whether the auditors are the Big 4 CPAs or otherwise.	A binary variable of 1 is assigned if the auditors are one of the Big 4 CPAs and a 0 if otherwise.
<b>Control variables</b>		
Firm size (FS)	Proxied by total assets.	Natural log of total assets.
Firm age (FA)	Companies' existence from time of incorporation to year of study.	Difference between year of study and the year of incorporation.

Table 3. Descriptive statistics of variables.

Bangladesh						Philippines					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	318	0.0	57.5	19.4	15.4	ROA	227	0.0	53.8	22.7	16.7
CPI	318	26.0	26.0	26.0	0.0	CPI	227	35.0	35.0	35.0	0.0
AUDIT	318	0	1	0.0	0.1	AUDIT	227	0	1	0.0	0.1
AGE	316	2.0	112.0	24.9	14.2	AGE	226	2.0	114.0	42.4	24.2
Size	315	0.0	1447.1	70.1	139.4	Size	227	0.0	7608.6	281.4	669.5
China						Singapore					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	3194	−1.1	36.7	4.6	4.3	ROA	740	0.0	59.7	32.2	15.3
CPI	3194	40.0	40.0	40.0	0.0	CPI	740	84.0	84.0	84.0	0.0
AUDIT	3194	0	1	0.0	0.2	AUDIT	740	0	1	0.6	0.5
AGE	3192	5.0	65.0	19.5	5.4	AGE	739	1.0	109.0	21.3	15.5
Size	2993	45.6	185,567.3	2353.7	6966.8	Size	740	0.0	16,012.4	376.0	955.8
Hong Kong						South Korea					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	2195	−9.9	47.9	4.4	6.3	ROA	1808	0.2	59.5	33.3	13.7
CPI	2195	77.0	77.0	77.0	0.0	CPI	1808	53.0	53.0	53.0	0.0
AUDIT	2195	0	1	0.7	0.5	AUDIT	1808	0	1	0.2	0.7
AGE	1737	1.0	114.0	21.5	15.1	AGE	1808	1.0	120.0	28.0	17.1
Size	2104	6.2	231,804.7	2366.2	12,226.8	Size	1808	0.1	15,724.5	146.2	551.1
India						Sri Lanka					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	4698	0.0	59.7	16.6	16.7	ROA	294	0.0	54.9	19.5	17.2
CPI	4698	40.0	40.0	40.0	0.0	CPI	294	36.0	36.0	36.0	0.0
AUDIT	4698	0	1	0.1	0.2	AUDIT	294	0	1	0.8	0.4
AGE	4357	1.0	148.0	34.0	18.4	AGE	294	3.0	125.0	38.3	23.5
Size	4662	0.0	29,223.0	116.5	895.0	Size	293	0.1	2052.4	91.1	206.2
Indonesia						Taiwan					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	492	0.0	59.7	29.5	16.3	ROA	1887	−1.3	41.4	4.7	5.2
CPI	492	37.0	37.0	37.0	0.0	CPI	1887	65.0	65.0	65.0	0.0
AUDIT	492	0	1	0.7	0.4	AUDIT	1887	0	1	0.9	0.3
AGE	492	3.0	106.0	31.8	14.8	AGE	1887	1.0	100.0	28.0	14.1
Size	492	0.1	3080.0	258.8	408.1	Size	1877	0.6	177,669.5	592.2	4695.5
Malaysia						Thailand					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	869	0.0	59.7	29.4	15.9	ROA	638	0.0	59.6	31.2	14.6
CPI	869	49.0	49.0	49.0	0.0	CPI	638	35.0	35.0	35.0	0.0
AUDIT	869	0	1	0.4	0.5	AUDIT	638	0	1	0.6	0.5
AGE	869	2.0	110.0	26.1	17.9	AGE	637	2.0	88.0	29.8	15.0
Size	868	0.0	5137.4	183.4	406.4	Size	638	0.1	2917.6	182.3	328.1
Mauritius						Vietnam					
	N	Min	Max	Mean	Std. Dev.		N	Min	Max	Mean	Std. Dev.
ROA	109	0.1	59.0	21.9	17.1	ROA	817	0.0	59.3	20.6	16.7
CPI	109	54.0	54.0	54.0	0.0	CPI	817	33.0	33.0	33.0	0.0
AUDIT	109	0	1	0.4	0.5	AUDIT	817	0	1	0.2	0.4
AGE	108	1.0	179.0	46.7	39.6	AGE	806	5.0	112.0	19.6	14.1
Size	108	1.2	1654.1	194.6	324.7	Size	817	0.4	2482.8	58.7	173.5

As for hypothesis testing, a Generalized Least Square (GLS) panel and pool data analysis are employed, with the cross-section being the income level, corrected for heteroscedasticity. The dependent variable is the Return on Assets (ROA), and the independent variable is the Corruption Perception Index (CPI), moderated by audit quality (AQ). The control variables are firm size (FS) and firm age (FA).

The GLS panel data regression equations are given by the following:

$$ROA_{ij} = \alpha_0 + \alpha_1 CPI_{ijc} + \alpha_2 CPI_{ijc} \cdot AQ_{ij} + \alpha_3 FS_{ijc} + \alpha_4 FA_{ijc} + \varepsilon_{ijc} \quad (1)$$

where

$i$  = high income, upper middle income, low income;

$j$  = country/region;

$c$  = company;

CPI—Corruption Perception Index;

AQ—audit quality;

FS—firm size;

FA—firm age.

#### 4. Results and Discussion

This paper uses Eviews 13 and Stata 18 (to test for endogeneity) to analyze Equation (1). This study first investigates if the endogeneity problem is presence in Equation (1), where any independent variable might be correlated with the error term, resulting in inconsistent estimators. The endogeneity issue of corruption impact on performance is a concern when using panel data (Cuervo-Cazurra 2008; Martins et al. 2020). Corruption may be positively viewed (as grease) or negatively (as sand). Further audit quality may be related to both performance and corruption levels. Because of concerns about the endogeneity of the interaction terms between corruption measure and auditor quality (CPI\*AQ), instrumental variables FS CPI FA<sup>2</sup> are used to test for the endogeneity problem. In the Wu–Hausman test below (Table 4), there is no evidence for the endogeneity issue in Equation (1).

**Table 4.** Results of the Tests of Endogeneity.

H <sub>0</sub> : Variables Are Exogenous	Stat.	p-Value
Durbin (score) chi2(1)	0.006	0.940
Wu–Hausman F(1, 17,145)	0.006	0.940

Since the null hypothesis that variables are exogenous cannot be rejected, the least square estimation, which will be used to analyze Equation (1), is favorable over the instrumental variable model.

Table 5 shows the results of the panel data analyses (country as the cross-section, with fixed effects) with ROA as the dependent variable. In this analysis, a fixed effect model is not possible due to a near singular matrix issue. Thus, random effect is used, and the Hausman test statistic provides little evidence (at 5% level) against the null hypothesis that there is no misspecification (Table 3). However, the coefficient for CPI is not significant; thus, hypothesis H<sub>1</sub> is not supported.

As for the moderation effects of audit quality on the relationship between corruption and firm performance in the selected East Asia, South Asia, and Southeast Asia countries, the results show a significantly positive relationship at a 5% significance level. Thus, H<sub>2</sub> is supported. As hypothesized, reputable auditors, i.e., the Big 4 auditing firms, are associated with higher firm performance. As part of the auditing procedures, reputable auditors may ensure effective internal control and monitoring, which contributes to high-quality financial statements with less earnings management. Reputable auditors also have the ability to help companies reduce overhead costs, create solutions to enhance efficiency, and abate exposure to possible losses from insufficiently safeguarded firm assets. Greenley and Foxall (1997) discovered that reputable auditors act as a “watchdog” on the financial performance of an organization, which rescues the organization from negligence and indiscretions and enables the organization to fully utilize all their assets in generating a high level of productivity and profitability.

As further tests, the East Asia, South Asia, and Southeast Asia countries are divided into sub-categories by income levels (based on the World Bank classification), high-income countries, upper middle-income countries, and low-income countries within the East Asia, South Asia, and Southeast Asia regions. Table 6 documents the empirical evidence for the fixed effect pooled data regression (as Eviews panel data analyses only provide common coefficients for all cross-sections, and fixed effect is used since the number of cross-sections is less than number of coefficients) with dependent variable (ROA) for the three income levels as the cross-section. The relationship between corruption levels and firm performance differs between the three income categories. The results need to be interpreted

carefully due to the inverse relationship between CPI and corruption levels; High CPI refers to low corruption (and vice versa). High-income countries seem to have a positive relationship between *corruption* and firm performance (negative relationship between *CPI* and *ROA*), supporting the “greasing the wheel” hypothesis. As stated earlier, in high-income countries, corruption can sometimes expedite economic activities by bypassing bureaucratic inefficiencies and aligning the incentives of transaction parties, thus more efficient business operations despite potential institutional gaps.

**Table 5.** Results for panel data analysis (country/region as the cross-section) for Equation (1).

Dependent Variable: ROA				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
CPI	−0.045	0.202	−0.225	0.822
AUDIT Quality*CPI	0.821	0.062	13.166	0.000
AGE	1.499	0.093	16.067	0.000
SIZE	−0.001	0.000	−4.083	0.000
C	49.853	9.994	4.988	0.000
Effects Specification				
Cross-Section Fixed (Dummy Variables)				
Weighted Statistics				
R-squared	0.043	Mean dependent var	189.421	
Adjusted R-squared	0.043	S.D. dependent var	796.742	
S.E. of regression	782.510	Sum squared resid	$1.01 \times 10^{10}$	
F-statistic	123.778	Durbin–Watson stat	1.000	
Prob(F-statistic)	0.000			
Correlated Random Effects—Hausman Test. Test Cross-Section Random Effects				
Test summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	7.415	3.000	0.060	

**Table 6.** Empirical evidence with dependent variable (ROA) for the three income levels as the cross-section.

Dependent Variable: ROA				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	−347.846	62.976	−5.523	0.000
High-Income Nation, AQ*CPI	0.141	0.076	1.845	0.065
Low-Income Nation. AQ*CPI	3.242	1.091	2.970	0.003
Middle-Income Nation. AQ*CPI	1.591	0.088	18.183	0.000
High-Income Nation. CPI	−2.384	0.236	−10.097	0.000
Low-Income Nation. CPI	22.930	4.225	5.427	0.000
Middle-Income Nation. CPI	6.282	0.349	18.020	0.000
High-Income Nation. Firm Age	0.910	0.157	5.804	0.000
Low-Income Nation. Firm Age	3.500	0.760	4.607	0.000
Middle-Income Nation. Firm Age	0.581	0.103	5.661	0.000
High-Income Nation. Firm Size	0.000	0.000	−0.574	0.566
Low-Income Nation. Firm Size	0.794	0.018	44.680	0.000
Middle-Income Nation. Firm Size	0.000	0.000	−2.328	0.020

Table 6. Cont.

Dependent Variable: ROA				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
Fixed Effects (Cross)				
HI—C	533.779			
LM—C	−540.662			
UM—C	88.190			
Effects Specification				
Cross-Section Fixed (Dummy Variables)				
Weighted Statistics				
R-squared	0.198	Mean dependent var		191.519
Adjusted R-squared	0.198	S.D. dependent var		804.163
S.E. of regression	722.684	Sum squared resid		$8.64 \times 10^9$
F-statistic	292.297	Durbin–Watson stat		0.981
Prob(F-statistic)	0.000			

As for the upper middle-income and lower-income countries, the empirical evidence indicates a negative relationship between *corruption* and firm performance (positive relationship between *CPI* and ROA), supporting the “sanding the wheels” hypothesis. The results are most significant in the lower-income countries (coefficient of 22.93). Most countries in this category (India, Philippines, Thailand, Indonesia, Sri Lanka, Vietnam, and Bangladesh) are very impoverished and have little social and political capital, low trust levels, and weak legal frameworks (Ünlü and Ulusoy 2021; Hoinaru et al. 2020). In such countries, it could be difficult to make any kind of economic transaction work as economic freedom is relatively limited (Dünhaupt et al. 2022; Alon and Hageman 2017; L. Martins et al. 2020). We re-run the data (ex-India) to ensure no data biasness, but the results are still very similar. Thus, hypotheses H1a and H1b are supported.

The moderation effects of audit quality on the relationship between corruption and firm performance for all three sub-categories are also documented. All coefficients ( $AQ \times CPI$ ) in the ROA regression are significant for the three income levels. In all the sub-categories, i.e., high-, low-, and upper middle-income countries, auditors’ reputation positively moderates the relationship between corruption and ROA. Thus, hypothesis H<sub>2</sub> is supported. Low-income countries have the largest positive moderating effects of an auditor’s reputation on the relationship between corruption and ROA, while high-income countries have the lowest. This indicates that, in countries with high corruption levels (represented by a low Corruption Perception Index), reputable auditors play a more pivotal role in the company’s performance. In such an environment, reputable auditors who are highly skilled play a more critical role in ensuring minimal earnings management or rent-seeking activities, as auditors have reputational incentives to avoid audit failures. These auditors also act in their professional capacity as advisors to the firms in terms of effective use of financial resources, thus contributing to shareholders’ wealth maximization. The results are in line with those of Farooq and Shehata (2018), Kimbro (2002), Cuervo-Cazurra (2008), Ball (2001), and Guedhami and Pittman (2006), who conjecture that auditing function, auditor quality, and reputation play a vital role in detecting instances of corruption and aiding in the prevention of such activities, especially where litigation and legal framework is weak.

## 5. Conclusions

In conclusion, this study examined the relationship between firm performance [proxied by Return on Assets (ROA)] and country-level corruption, using the Corruption Perception Index (CPI) as a proxy. Examining 18,286 corporations across East Asia, South Asia, and

Southeast Asia, the research highlights divergent outcomes based on income levels. In high-income nations, a positive association between corruption and firm performance supports the “greasing the wheel” hypothesis, suggesting that corruption may facilitate business operations in these environments. In contrast, upper middle- and low-income countries exhibit a negative correlation, consistent with the “sanding the wheel” theory, indicating that corruption hinders firm performance in these contexts. The study also underscores the moderating role of audit quality, proxied by auditors’ reputation, which positively influences the relationship between corruption and firm performance, particularly in nations with lower levels of corruption. This finding emphasizes the essential role of reputable auditors in strengthening firm performance within these economic settings. Reputable auditors are associated with higher reported financial performance of companies in all three sub-categories of countries, and this relationship is more dominant in low-income countries as compared to high-income countries, suggesting that quality audits conducted by reputable auditors play a crucial role in enhancing companies’ performance within the context of combating corruption and strengthening institutional frameworks.

It is important to note that the impact of corruption on firm performance can vary depending on the extent of corruption within a country, the specific industry, and the ability of firms to adapt to the local environment. Though some firms may navigate corrupt systems more effectively than others, in the long run, pervasive corruption could have negative effects on the performance of firms operating within such contexts, as well as the overall economic development. Thus, it is essential for policymakers and companies to understand the complex relationship between corruption and corporate performance in order to implement appropriate initiatives. This will ensure that country-level corruption is contained and improve the efficacy of business-level measures such as governance and audit function, which may create a more favorable investment climate. Promoting transparency is a potent weapon against corruption as it enables inspection, making it tougher for dishonest practices to thrive. Additionally, strengthening governance by setting strict rules, efficient enforcement techniques, and impartial judicial systems provides fair playing fields and lessens the potential for corruption. Instilling moral principles that place a premium on honesty in business and society as a whole is a crucial part of creating a culture of integrity.

Based on the findings of this study, several policy recommendations emerge to enhance corporate performance and governance in the context of varying levels of corruption. Firstly, improving audit quality through stringent regulations and promoting the reputation of auditors can ensure more reliable financial reporting and reduce corrupt practices. Secondly, implementing robust anti-corruption frameworks and enforcement mechanisms will help deter corrupt activities, especially in upper middle- and low-income countries where the negative impacts are more pronounced. Thirdly, increasing transparency in governmental and business transactions by leveraging digital technologies can reduce opportunities for corruption and build trust in institutions. Fourthly, providing targeted support and incentives for firms operating in high-corruption environments to adopt best practices in governance and compliance can enhance their performance. Lastly, fostering international cooperation to share best practices and support anti-corruption initiatives can strengthen global efforts against corruption and contribute to a more equitable business environment. These policy measures, collectively, can help mitigate the adverse effects of corruption, enhance firm profitability, and improve overall economic governance.

The main limitation of the study is data availability, as it involves a relatively large dataset. Some of the control variables could not be added due to data unavailability. Future research could further undertake a sector-specific analysis to examine how corruption impacts business performance in certain industries (such as banking, manufacturing, and services) since different industries have varying levels of susceptibility to corruption. This is important as targeted interventions need a thorough understanding of these sectoral distinctions. In-depth qualitative interviews and case studies involving businesses, auditors, and regulatory authorities might also be used in research to supplement quantitative

assessments. Additionally, future studies could also assess how anti-corruption legislation, rules, and enforcement affect the connections between corruption, business performance, and the function of auditors. Research could analyze if legal deterrents increase corporate performance and how strict anti-corruption laws affect the moderating impact of auditors. Research on technical innovations and auditor efficiency might be beneficial in the present technological era. It may be investigated how emerging technologies, such as blockchain and artificial intelligence, might help auditors be more effective at identifying and reducing risks associated with corruption. Research may also look at how improvements in technology might enable auditors to act as more effective moderators. It is also important to investigate any potential improved governance systems that can complement auditors in the fight against corruption. The outcome of this research could hold significant implications for policy recommendations and governance enhancement. Furthermore, by acknowledging the importance of auditors and broadening their roles and responsibilities, policymakers can formulate strategies to fortify governance systems and foster sustainability.

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