Foreign Direct Investments: Examining the Roles of Democracy, Corruption and Judicial Systems Across Countries

Saikat Banerjee
Indian Institute of Management Ahmedabad

The paper utilizes a novel agency theory perspective to argue that governments are opportunistic agents of citizens at the country level. Extending extant international business literature, this study theoretically integrates various antecedents of foreign direct investments examined discretely in past studies and explains how the natures of governments influence the foreign direct investment decisions. The paper proposes a moderated mediation model where control mechanism such as access to justice moderates the strength of the mediated relationship between democracy and foreign direct investments via absence of corruption, such that the mediated relationship will be stronger under high control mechanism than under low control mechanism. Based on a sample of 90 countries, the empirical results indicate that democracy positively influences the amount of foreign direct investments through absence of corruption. In addition, access to justice moderates the relationships. Theoretical and managerial implications of the findings are discussed.

Keywords: Agency theory, Corruption and FDI, Democracy

INTRODUCTION

Understanding the determinants of foreign direct investment (FDI) (Crespo, and Fontoura, 2007; Gastanaga et al, 1998; Kinda, 2010; Noorbakhsh et al, 2001) is crucial for economic development (Chakraborty, and Nunnenkamp, 2008) of countries. The recent international political developments such as immigration policy in United States of America, Brexit in European Union, South China Sea dispute in Asia, emergence of communal interests in Middle-east and South Asia emphasize the importance of the nature of national governments in influencing the business environment for foreign investors in the context of international business. Though the roles of corruption of governments in the strategic decisions of foreign investors are studied in the extant research literature (Robertson and Watson, 2004; Uhlenbruck, Rodriguez, Doh, and Eden, 2006), none of the past studies examine how the nature of national governments determine the level of corruption and subsequently influence the amount of FDI. The aims of the paper are to address this research gap, extend the theoretical understanding of the phenomena using agency theory, and test the hypotheses of a moderated mediation model.

Ethical issues based on corruption of governments determine various international strategic choices such as selection of countries (Getz and Volkema, 2001; Robertson and Watson, 2004), and business decisions (Uhlenbruck, Rodriguez, Doh, and Eden, 2006). Understanding the relationship between the nature of national governments and FDI in the context of corruption at the country level is crucial for both researchers and practitioners. What kind of governments would be suitable for FDI in the countries? How do the ethical natures of governments influence the FDI at the country level? What are the roles of other country level factors in the relationships between government and FDI? I consider these questions in the context of 90 countries during 2014-2015 and propose a moderated mediation model (Reiche, Harzing, and Pudelko, 2015).

Scholars have identified various types of mechanisms of governments at the country level. Among them, high level of democracy can be considered as the representation of citizens in the government (Barro, 1999; Ledyaeva, Karhunen, and Kosonen, 2013). Though many countries claimed to have democracy in principle, the degree of democratic power of citizens in the decision making process is different in different countries. In general, FDI helps to improve the quality of livings of citizens in any country and citizens exercise democratic rights to introduce public policies encouraging FDI. Based on these assumptions, I propose that the high level of democracy would be effective for the overall welfare of the citizens in any country and will lead to FDI in any country. There were no substantial studies carried out in the past research literature to examine the effect of democracy on FDI in the context of a large number of countries in the world.

In this paper, I also explain the relationship further and examine how democracy influences the foreign direct investment in a country. Drawing from the agency theory, I propose that the government agencies and government officials are agents and citizens are principals in the agency relationship between government and citizens. Government facilitates common public works at an aggregate level whereas the ownership of the public works lies with the citizens (Lenway and Murtha, 1994; Rodriguez, Uhlenbruck and Eden, 2005). So, control mechanisms enforced by citizens or principal in the activities of agent or government would determine the level of opportunistic behaviors of government agencies and officials. High level of democracy is an indicator of active participation of citizens in the decision making processes (Jensen, 2003; Ledyaeva, Karhunen, and Kosonen, 2013) leading to high control mechanism in the opportunistic behaviors of the government agencies and government officials. The restriction in exercising opportunistic behaviors of government officials would enhance the absence of corruption (Lindgreen, 2004) and subsequently FDI in the countries (Davis and Ruhe, 2003).

I also examine the roles of another important factor access to justice in these relationships. Justice is a mechanism which can act with democracy to reduce the opportunistic behaviors of government officials and help to promote FDI in a country (Jensen, 2003; Ledyaeva, Karhunen, and Kosonen, 2013; Ramamurti and Doh, 2004).

By combining these multiple concepts, this paper contributes the followings. First, the paper opens the black-box by empirically modeling the relationships between democracy and FDI. Second, examining the roles of democracy, absence of corruption and access to justice in shaping FDI extends the existing literature related to government-business interface. Finally, the findings have great implications for practitioners doing business in multiple countries.

In the next section, I discuss theoretical backgrounds and past literature. Then, I develop hypotheses to describe relationships among democracy, absence of corruption, access to justice, and FDI. Finally, I describe sources of data, findings and implications for both researchers and practitioners.

THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT

Agency Theory

Agency theory was widely studied in past research literature to understand the agency relationships between principals and agents. In addition to its widely recognized economics paradigm (Arrow, 1985; Berle, and Means, 1932; Jensen and Meckling, 1976; Pratt, and Zeckhauser, 1985; Ross, 1973) Shapiro (2005) argued that the concept is also founded in other research fields such as management (Eisenhardt, 1989; Wright and Mukherji, 1999), political science (Majone, 2001), law (DeMott, 1998) and sociology (Adams, 1996; Kiser and Cai, 2003). "Agency relationship is defined as a contract under which one or more persons (the principals) engage other persons (agents) to perform some services on their behalf which involve delegating some decision making authority to the agent and as the contractual parties are utility maximizer, the agents will not act in the best interest of the principals" (Jensen and Meckling, 1976).

The convenient assumption of individuals as rational and self-interested utility-maximizer for mathematical computation (Jansen and Meckling, 1976) is not suitable in the context of multiple principals and agents due to increased information asymmetry, monitoring cost, and bargaining power (Shapiro, 2005). Information asymmetry causes extreme difficulty to design an agreement in favor of principal and reduce the costs of monitoring and enforcement (Pratt and Zeckhauser, 1985). Even the incentive structure and control mechanisms are often modified by agents due to lack of position and access of principals (Arrow, 1985; Pratt, and Zeckhauser, 1985).

One of the major critiques of the agency theory of economics is its assumption about the principals and agents as 'invariably work averse, self-interested utility maximizers' (Perrow, 1986; Shapiro, 2005). Different streams of research literature were also developed by relaxing this key assumption of classical agency theory. One of the major streams of research is based on the stewardship theory which conceptualizes agents as stewards of their teams based on the theories such as cooperation and coordination (Shapiro, 2005). The research scholars of legal studies consider agency issue as the obligations of principals for the actions of agents on external parties (Shapiro, 2005).

In the context of social phenomena, the assumption of the self-interested utility maximizer individuals can be replaced by the conflicts of interests between principals and agents (Shapiro, 2005; Wiseman et al., 2012). Principals and agents can have different desires, view, and goals leading to conflicts (Wiseman et al., 2012).

Political scientists also consider agency theory to understand the delegation of power and authority (Majone, 2001; Shapiro, 2005). Delegation issues are subject of interest also in the context of management and organizations (Eisenhardt, 1985, 1989; Gomez-Mejia and Balkin, 1992).

Political institutions also inherit agency issues due to information asymmetries, conflicts of interest and self-interest of agents as utility maximizers (Shapiro, 2005). Principal agent issues could be reduced by the governance mechanisms such as incentive alignment (Wiseman et al., 2012) by the powerful ownership (Berle, and Means, 1932); or external and internal agent monitoring (Wiseman et al., 2012) by the favorable political, social, and economic conditions (Berle, and Means, 1932).

Another stream of researchers assumed government as the agent of citizens to maximize public interest (Rodriguez, Uhlenbruck and Eden, 2005). The theories emerged from management science are applied in understanding similar phenomena in public organizations only by very few researchers (Kelman, 2005). Only a small portion of researchers such as Bazerman and Watkins (2004) are connecting public administration to the mainstream organizational theory (Kelman, 2005). So, the principal-agent theory widely examined in the organizational context, can also be applied to the context of governments.

Based on the above reasoning I argue that governments act as the agents for the citizens as the principals. The relationships between governments and citizens also have agency issues due to information asymmetries, conflict of interests and self interests. These issues could be reduced by the governance mechanisms such as incentive alignment through powerful ownership in terms of participation of citizens in the decision making process in governments; and external and internal monitoring of activities of governments through the judiciary systems.

Democracy

Democracy can be defined as the "institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote'' (Barro, 1999). Democracy can enhance an environment of equal opportunity for all parties to business. In contrast, autocracy would help the supporters of the autocratic government only and create a barrier to others (Ledyaeva et al, 2013). Due to various institutional restrictions, autocracy favors only a specific portion of the firms (Ledyaeva et al, 2013; Neumayer and de Soysa, 2005). Democracy controls the opportunistic behaviors of government officials and provides the freedom to do business without minimal government intervention (Jensen, 2003; Ledyaeva et al, 2013; Ramamurti and Doh, 2004). Democratic political institutions harvest a cooperation based culture and norms between states and business entities (Jensen, 2003; Ledyaeva et al, 2013).

Corruption

A strategic analysis of the effects of corruption on the cost of operation in foreign countries considering the associate uncertainty (Poynter, 1982) is critical for the appropriation of value of internationalization (Doh et al., 2003). The cross-cultural model in the context of international study is also carried out to understand the nature of corruption (Robertson and Watson, 2004). Perceived level of corruption of the managers is a determining factor in the foreign investment decision of a firm (Voyer and Beamish, 2004). High level of corruption will reduce the legitimate means of investment in any country (Warren and Laufer, 2009). In the context of 'government corruption and entry strategies of multinational enterprises', Rodriguez, Uhlenbruck and Eden (2005) proposed that the corruption is a strategic instrument to exploit political ties and a two-dimensional framework using institutional theory is formed to 'examine how the pervasiveness and arbitrariness of corruption can affect an MNE's organizational legitimacy and strategic decision making'.

According to Robertson and Watson (2004), between-country differences in corruption can be explained by three streams of past research literature such as economics, culture and integration of these two streams and corruption is defined as 'the abuse of public roles and resources for private benefit or the misuse of office for nonofficial ends'.

Democracy, Absence of Corruption and FDI

The level of corruption would be reduced in the presence of factors such as decentralized decision making process (Lindgreen, 2004), mutual commitment (Lindgreen, 2004), communication (Halter, Arruda, and Halter, 2009), transparency (Halter, Arruda, and Halter, 2009), compliance with the code of conduct (Halter, Arruda, and Halter, 2009), press freedom (Jensen et al., 2010), low power distance, and access to information (DiRienzo et al., 2007). I argue that the democracy founded in the cooperation based culture and norms (Ledyaeva et al., 2013), could be conceptualized as the determinants of decentralized decision making process, mutual commitment, communication, transparency, compliance with code of conduct, low power distance, and access to information. Hence, the high level of democracy would influence the absence of corruption at the country level.

The effects of corruption in FDI are also examined in the past literature. In addition to the varied degree of corruption across countries, corruption is in general not favorable to the business environment (Davis and Ruhe, 2003). For example, in the context of Nigeria, the poor performance of the economy is due to corruption (Agbiboa, 2012). Corruption is negatively related to the legitimacy of the government, and rule of law (Argandona, 2007). In the countries, corruption has multiple consequences such as reduced economic efficiency and growth (Argandona, 2003), high risk rating, lower foreign trade, lower foreign investment, and lower per capita income (Davis and Ruhe, 2003), inefficient inter-firm partnerships (Jensen et al., 2010; Rodriguez et al., 2006; Uhlenbruck et al., 2006). So, low amount of corruption enhances FDI in the countries.

Based on the above reasoning, I propose the following hypothesis.

Hypothesis 1: *Absence of corruption mediates the relationships between democracy and FDI.*

Role of Access to Justice

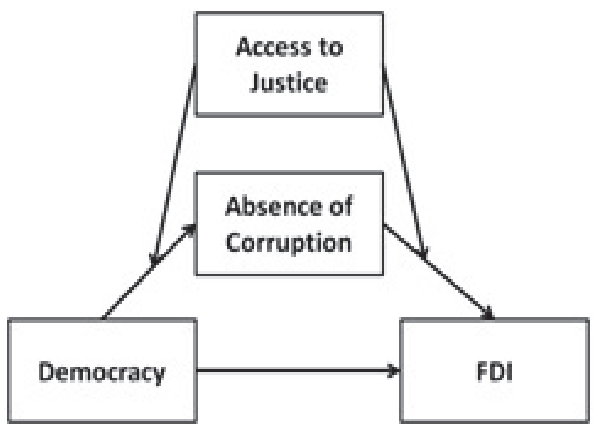
The theoretical foundation of the reduction of corruption can be approached in two ways such as organizational behavior perspectives based on reward systems, ethics, leadership behaviors; and economically oriented approaches based on controls over opportunisms and self-interests (Misangyi et al., 2008). So, corruption can be reduced only by the involvement of citizens or introduction of rules and laws (Misangyi et al., 2008). In another study, drawing from both organizational control literature and the corruption control literature, Lange (2008) identified several corruption control mechanisms such as 'bureaucratic controls, punishment, incentive alignments, legal/ regulatory sanctioning, social sanctioning, vigilance controls, self-controls, and concertive controls'. In the context of countries, the effectiveness of reward system to minimize agency issues in the citizens-government relationship can be understood by examining the level of democracy. Similarly, the effectiveness of control mechanisms can be explained by examining the effects of legal systems in the country.

External forces such as institutional superstructure based on legality, regulatory frameworks, justice and accountability; and internal forces such as norms that respect procedural justice, moral accountability to stakeholders, and economic freedom would jointly have positive influence on organizational effectiveness (Herzfeld, and Weiss, 2003; Nwabuzor, 2005; Voyer and Beamish, 2004). Establishment of anti-corruption code will reduce the corruption in a country (Cleveland et al., 2009; Lindgreen, 2004). Quality of legal framework is positively related to the quality of the business system (Venard and Hanafi, 2008) and the amount of economic returns in the business (Cumming et al., 2010). Hence, high amount of access to justice enhances the positive effect of democracy on FDI.

Based on the above reasoning, I propose the following hypothesis.

Hypothesis 2: *Access to justice will moderate the strength of the mediated relationships between democracy and FDI via absence of corruption, such that the mediated relationship will be stronger under high access to justice than under low access to justice.*

FIGURE 1
THE MODERATED MEDIATION RELATIONSHIP BETWEEN DEMOCRACY AND FDI



METHODS

Sample and Data Sources

The sample frame of our study included countries of The World Justice Project (Pratt et al., 2014). The Rule of Law Index 2014 of World Justice Project provides the measures of Absence of Corruption and Access to Justice for several countries. To avoid common method bias, the data for other variables related to these countries are collected from other sources. The data related to the level of democracy is obtained from the Democracy Index 2014 published by the Economist Intelligence Unit (Unit E I, 2015). The FDI is measured from World Development Indicators. Independent variables such as democracy, absence of corruption and access to justice are measured for the year 2014 and dependent variable FDI is measured for the year 2015 to establish causal effects. The collection of data is restricted only to recent years to analyze a large number of countries and generalize the findings. After considering for missing data, the sample contains data related to 90 countries.

Past research studies utilizing secondary data at the county level, have considered panel data analysis of cross-sectional data over time to utilize the availability of data. Alternatively, research studies involving survey based primary data have considered cross-sectional data analysis recognizing the limitations of the interpretation of results. Although our sample consists of countries included in World Justice Project, and data of World Justice Project is available over time, we cannot consider panel data analysis due to multiple reasons. According to the recommendation of World Justice Project, "scores across iterations of the Index are not strictly comparable. This is primarily due to three reasons. First, countries are scored relative to other countries in the sample. Ninety-seven (97) countries / jurisdictions were included in the 2012-2013 dataset. Ninety-nine (99) countries / jurisdictions were included in 2014. One hundred and two (102) countries / jurisdictions were included in 2015. One hundred and thirteen (113) countries / jurisdictions are included in 2016 and 2017-2018. Second, the construction of the indicators has been slightly revised with the publication of each report. Third, the underlying survey instruments have been slightly revised each year." For these reasons, the scores cannot be compared over time.

Measures

Independent Variable: Democracy

Democracy can be measured in multiple ways. One of the established indexes to measure democracy is The Economist Intelligence Unit's Democracy Index published in 2014. This is the seventh edition of democracy index showing the popularity and reliability of this index in the researchers' and practitioners' community. In this index of 2014, the score of the level of democracy for 165 independent states are calculated based on the 60 indicators grouped in 5 categories such as electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. 'Each category has a rating on a 0 to 10 scale, and the overall index of democracy is the simple average of the five category indexes. The category indexes are based on the sum of the indicator scores in the category, converted to a 0 to 10 scale'. A combination of a dichotomous 1-0 scoring system (1 for a yes and 0 for a no answer) and a three-point scoring system 1-0.5-0 capturing the 'grey areas' are used for the 60 indicators. More refined scoring systems such as 1-5 or 1-7 are not used due to their inherited issues such as difficulty to define meaningful and comparable criteria or guidelines for each score; and the associated issues with the principle of reliability defined as the degree to which a measurement procedure produces the same measurements every time, regardless of who is performing it. Two or three point systems can improve the reliability. Out of the available scores of democracy for 165 countries, the score of the 90 countries mentioned in The Rule of Law Index 2014 of World Justice Project report are considered for the analysis.

Dependent Variable: FDI

FDI is measured as the net inflow in current USD for the year of 2015 from World Development Indicators database.

Mediator: Absence of Corruption

Absence of Corruption is measured from the Rule of Law Index 2014 published by World Justice Project, an independent multidisciplinary organization. It is defined in the publication as the use of public power for private gain. The purpose of the collection of data in the Rule of Law Index is to understand the experience and perception of people in their dealing with the government, the police, and the courts; and assess the openness and accountability of the state; the extent of corruption; and the magnitude of the common crimes. The Rule of Law Index 2014 consists of nine aggregate indicators or factors such as constraints on government powers; absence of corruption; open government; fundamental rights; order and security; regulatory enforcement; civil justice; criminal justice; informal justice. These 9 factors are further categorized into 47 specific sub-factors. One of the factors measured in the Rule of Law Index 2014 is absence of corruption. It has four sub-factors measuring whether public offices are used for private gain by the government officials in the executive branch; judicial branch; police and military; and legislative branch or not. Each sub-factors measures three types of corruptions such as bribery; improper influence by public or private interests; and misappropriation of public funds or other resources. The data is collected from two sources such as a general population poll conducted by leading local polling companies using a representative sample of 1000 respondents in the three largest cities; and qualified respondents' questionnaire consisting of close-ended questions completed by in-country practitioners and academics with expertise in civil and commercial law, criminal justice, labor law, and public health. The data are processed and normalized on a 0-1 scale and aggregated to calculate a score for the absence of corruption.

Moderator: Access to Justice

Data related to access to justice across 90 countries can also be obtained the Rule of Law Index 2014 published by World Justice Project. Rule of Law Index 2014 measures three types of justice such as civil justice, criminal justice; and informal justice. Criminal justice focuses on the investigation, prosecution, adjudication, and punishment of criminal offenses successfully. Informal justice is also based on traditional, tribal, and religious courts, and community based systems in the resolution of disputes. So, Criminal justice and informal justice cannot be considered in the context of democracy and FDI. As the focus of the paper is to understand the effects of formal legal system in government, corruption, and FDI, considering access to civil justice as the operationalized measure of access to justice is suitable for the research question. Access to civil justice also measure three types of corruptions such as bribery; improper influence by public or private interests; and misappropriation of public funds or other resources. It has seven sub-factors measuring access and affordability; discrimination; corruption; improper government influence; unreasonable delay; and effective enforcement of civil justice and accessibility, impartiality and efficiency of the alternate dispute resolution mechanisms. The procedure of data collection is similar to the data collection procedure of absence of corruption factor explained in the earlier section.

Control Variables

Based on the extensive literature review, a number of control variables are identified. Natural logarithm of both population and gross domestic product (Habib, and Zurawicki, 2002) are considered as proxies for size and development level in the host country (Alesina, and Wacziarg, 1998; Holburn, and Zelner, 2010; Lu, Liu, Wright, and Filatotchev, 2014; Martin, Salomon, & Wu, 2010; Tang, and Koveos, 2008; Vaaler, and Schrage, 2009). Gross domestic product growth rate is also considered to measure economic growth in host countries (Holburn & Zelner, 2010; Lu, Liu, Wright, and Filatotchev, 2014; Martin, Salomon, & Wu, 2010; Yu, Subramaniam, and Cannella Jr, 2013).

RESULTS

Hierarchical multiple regressions are used to test Hypothesis 1 and hierarchical moderated regressions are used to test Hypotheses 2. In all analyses, population, gross domestic product, and gross domestic product growth rate are considered as controlled variable. The independent and moderator variables are centered to avoid multicollinearity issues (Aiken & West, 1991).

TABLE 1
MEANS, STANDARD DEVIATIONS, AND CORRELATIONS

Variable		Mean	SD	1	2	3	4	5	6	7
1	Democracy	5.97	1.85							
2	Absence of Corruption	.51	.19	.618**						
3	Access To Civil Justice	.52	.13	.621**	.887**					
4	Ln(FDI)	21.78	1.94	.351**	.533**	.418**				
5	Ln(Population)	16.85	1.51	-.141	-.108	-.173	.546**			
6	Ln(GDP)	28.77	3.00	-.213*	-.126	-.094	.222*	.505**		
7	GDP Growth Rate	3.47	2.63	-.364**	-.300**	-.351**	-.212*	.102	.266*	

All correlations are two-tailed. N=90. * $p < 0.05$; ** $p < 0.01$.

According to hypothesis 1, absence of corruption mediates the relationship between democracy and FDI. Four conditions are necessary to establish mediation (Baron and Kenny, 1986; Ng, Ang, and Chan, 2008): (a) the relationship between independent variable and mediator must be significant; (b) the relationship between independent and dependent variables must be significant; (c) the relationship between mediator and dependent variable must be significant; and (d) the addition of mediator will result in a nonsignificant or weak relationship between the independent variable and dependent variable. Table 2 shows the results of regression analysis of mediation.

According to the results in Table 2, democracy ($\beta = .0597$, $p < .01$) is positively related to absence of corruption and condition 1 is supported. Democracy ($\beta = .4116$, $p < .01$) is significantly related to FDI and, condition 2 is supported. Absence of corruption is positively related to FDI ($\beta = 5.3691$, $p < .01$) and condition 3 is supported. Finally, after considering absence of corruption, if the effects of democracy become nonsignificant, then it is complete mediation, and if effects of democracy become weaker, then it is partial mediation. As the effects of democracy ($\beta = .0911$, $p > .10$) become nonsignificant, the relationship suggests complete mediation.

TABLE 2
REGRESSION RESULTS FOR TESTING MEDIATION (HYPOTHESIS 1)

Factor and statistics	Absence of Corruption	ln (FDI)	
		Step 1	Step 2
ln(Population)	-.0047	.7599**	.7850**
ln(GDP)	.0027	.0279	.0133
GDP Growth Rate	-.0067	-.1041†	-.0683
Democracy	.0597**	.4116**	.0911
Absence of Corruption			5.3691**
F	13.5862**	21.3635**	33.5672**
R^2	.3900	.5013	.6664

† $p < 0.10$, * $p< .05$, ** $p< .01$.

To further assess the significance of the mediation, I use Sobel's (1982) test for indirect effects (MacKinnon et al., 2002). Results show that the intervening effect of absence of corruption in the relationship between democracy and FDI (Sobel Test Statistics = 4.5151, $p < .01$) is significant. To overcome the assumption of normality associated with Sobel test, bootstrap test is also carried out to test the significance of indirect effect (Effect=.3204, SE=.0765, BootLLCI=.1928, and BootULCI=.4980). As the interval does not contain zero, the indirect effect is significant. Taken together, Hypotheses 1 is supported.

Hypothesis 2 predicts that the indirect effect of Absence of Corruption for the Democracy–FDI relationships would be strengthened by high access to justice. To test for moderated mediation (Feng, and Wang, 2016; Muller et al., 2005; Preacher et al., 2007; Wu et al, 2015), four conditions can be tested: (a) significant effects of democracy on FDI; (b) significant interactions between democracy and access to justice; (c) significant effect of absence of corruption on FDI; and (d) different conditional indirect effect of democracy on FDI, via absence of corruption, across low and high levels of each of the access to justice. The last condition, which is the primary argument for moderated mediation, establishes whether the strength of the mediation via absence of corruption differs across the two levels of the moderator (Preacher et al., 2007). Moderated mediation is demonstrated when the conditional indirect effect of democracy on FDI, via absence of corruption, differs in strength across low and high levels of access to justice.

The results for Hypothesis 1, which demonstrated that democracy is significantly related to FDI, supported Condition 1 for moderated mediation. To test for Condition 2, I examine whether the interactions of democracy with access to justice is significant in predicting absence of corruption. Results of the moderated regressions of access to justice on absence of corruption and FDI, organized by the democracy, are presented in Table 3. Table 3 shows that the interaction terms for democracy with access to justice ($\beta = .0765$, $p < .10$) is significant in predicting absence of corruption. The interaction term for absence of corruption and access to justice ($\beta = .8680$, $p > .10$) is nonsignificant in predicting FDI. In a moderated mediation model, a moderator can moderate the mediated relationships in any of the three ways (Preacher, 2007): (a) moderator can influence the path between independent variable and mediator; (b) moderator can influence the path between mediator and dependent variable; (c) moderator can influence both the path between independent variable and mediator, and the path between mediator and dependent variable. According to the findings in Table 3, the moderator access to justice influences only the path between democracy and absence of corruption. Condition 2 is satisfied as there is significant interaction between democracy and access to justice in predicting absence of corruption.

TABLE 3
RESULTS OF REGRESSIONS FOR MODERATION EFFECT OF ACCESS TO JUSTICE (HYPOTHESIS 2)

Factor and statistic	Absence of Corruption	ln (FDI)
ln(Population)	.0089	.7667**
ln(GDP)	-.0046	.0221
GDP Growth Rate	.0034	-.0764
Democracy	.0101	.1023
Access to Justice	1.1656**	-1.7739
Democracy X Access to Justice	.0765†	
Absence of Corruption		6.2632**
Absence of Corruption X Access to Justice		.8680
F	59.4055**	23.6861**
R^2	.8111	.6691

† p < 0.10, * p< .05, ** p< .01.

According to hypothesis 1, absence of corruption is positively related to FDI, condition 3 is supported. As, the initial three conditions are satisfied, access to justice could moderate the strength of the mediated relationships between democracy and FDI via absence of corruption

To examine the moderated mediation relationships, I examine Condition 4, which tests the different conditional indirect effect of the democracy via absence of corruption for countries across high and low levels of access to justice. I use Bootstrap method for indirect effects, to compute lower limit and upper limit of confidence intervals. I test moderated mediation for democracy and moderator. Following Preacher et al.'s (2007) recommendation, I operationalize high and low levels of Access to Justice as one standard deviation above and below the mean score of the access to justice (-.1289 and .1289). Table 4 presents the estimates, standard errors, bootstrap lower limit of confidence interval, and upper limit of confidence interval value of the conditional indirect effects for democracy across low and high levels of access to justice.

Results show that, for access to justice, the conditional indirect effects of democracy are stronger and significant in the high access to justice condition (Boot LLCI = .0019, and Boot ULCI = .2910, significant) but are weaker and not significant in the low access to justice condition (Boot LLCI = -.1092, and Boot ULCI = .0815, not significant). Thus, Hypotheses 2 is supported.

TABLE 4
MODERATED MEDIATED RESULTS FOR DEMOCRACY ACROSS ACCESS TO JUSTICE

Moderator	Level	Conditional Indirect Effect	Democracy		
			Boot SE	Boot LLCI	Boot ULCI
Access to Justice	Low	.0017	.0470	-.1092	.0815
	High	.1274	.0717	.0019	.2910

DISCUSSION AND MANAGERIAL IMPLICATIONS

Discussion

Though the roles of government, corruption, and legal systems are identified discretely as antecedents of FDI in past studies, the internal relationships among them are examined in the research. The research contributes in three ways. Firstly, the conceptualization of citizens-government relationship as principals-agent relationship using agency theory advances the theoretical understanding of the varied amount of FDI across countries. Secondly, the positive relationship between democracy and FDI contributes to the understanding of the government-business interaction across countries. Finally, the moderated mediation model opens the black box and explains how democracy influences the amount of FDI across countries. The implications of these three contributions are discussed in the subsequent sections.

In the context of international business, agency theory is widely used to explain phenomena inside firms. The research recognizes the relationship between two important factors such as citizens and government in a country and explains the agency relationship between them. In a country, citizens delegate the tasks to government and generate agency issues between citizens/ principals and governments/ agents. The level of democracy in a country indicates the amount of control mechanisms, and reward systems in the reducing agency issues between government and citizens. The application of agency theory enables a powerful theoretical lens to explain the phenomena.

Secondly, past research on government-business interactions examine how the public policies of governments influence the strategic decisions of business firms. Fundamentally, the nature of public policies depends on the nature of government. The research identifies an important nature of government i.e. democracy and find positive relationship between democracy and FDI. The findings contribute to the understanding of government-business interactions and how the natures of government influence FDI across countries. Citizens as principals can utilize a reward/ punishment mechanism to control the agency issues derived from the delegation of tasks to government as agent. The amount of democracy in a country represents the strength of reward/ punishment system in the agency issues. Hence, high level of democracy indicates high amount of reward/ punishment system enforced by the principal/citizens on agent/ government to reduce agency issues and subsequently increases foreign direct investment.

The positive relationship between democracy and FDI explains the roles of citizens in shaping policy decisions through governments. Firms taking strategic decisions to invest in a foreign country can consider beyond government policies and examine the relationship between citizens and government as the amount of democracy. Hence, the explanation of positive relationship between democracy and FDI utilizing agency theory emphasizes the roles of the relationship between government and citizens beyond the only consideration of government policies and contributes to the understanding of government-business interaction.

Finally, past literatures have examined the roles of democracy, government, corruption, and legal system discretely, and attempt to integrate the concepts is still at a nascent stage. However, outcomes of government policies such as immigration policy in United States of America, Brexit in European Union, South China Sea dispute in Asia etc based of democracy and legal systems in the respective countries influence the amount of FDI in a country. For example, investment decisions of outsourcing firms in foreign countries reduce significantly due to restriction imposed on human-mobility in the recent changed immigration policies of some countries. No studies that integrate multiple concepts to explain the amount of FDI in a country are available. This study attempts to open the black-box, explains that absence of corruption mediates the relationships between democracy and FDI. Access to justice moderates this mediated relationship. The moderated mediation model theoretically links various concepts discussed separately in the past literature. The results of the statistical models show a positive relationship between democracy and FDI through absence of corruption. Results also confirm that access to justice can moderate the mediated relationship between democracy and FDI. Overall statistical results support our hypotheses.

Managerial Implications

Managers responsible for taking strategic decisions on FDI in a foreign country are always concerned about the relationship with multiple stakeholders such as government, citizens, and legal systems. They are often in dilemma about their decision to invest directly or invest jointly with a local partner in foreign country. The moderated mediation model and our findings provide a powerful framework to take strategic decisions on FDI.

Democracy is positively related to absences of corruption and absence of corruption is positively related to FDI. Managers can select countries with high level of democracy for FDI. In contrast, managers can search for local strategic alliance partners in countries with low amount of democracy.

Access to justice is a moderator in the above relationships. Even in case of countries with high amount of democracy, managers need to consider the nature of judicial system. In the presence of low amount of access to justice, the positive relationship between democracy and FDI weakens and managers need to be cautious on their decisions of FDI.

Managers can utilize the framework to think beyond government policies and examine the relationship between government and citizens including the associated agency issues and control mechanisms such as democracy and legal systems to take strategic decisions. For example, firms can decide on corporate political and social activities based on the relationship between government and citizens to gain preferential regulation.

Limitations and Future Research Directions

Although the theoretical discussions and empirical findings have several important implications, the study has some limitations that can be considered in future studies. Firstly, the aim of the study is to use data for a large number of countries. Only, recent databases have a large number of countries. Hence, the independent variables are collected only for the year 2014 and dependent variable is collected only for the year 2015 to establish causality. According to World Justice Project, data of Rule of Law are strictly not comparable due to three reasons. Countries are scored relative to other countries and number of countries changes over time. Indicators are constructed differently across the years. Even the underlying survey instruments are revised every year. For these reasons, the scores cannot be compared over time and we consider cross-sectional data analysis. With the usage of a stable instrument and consideration of same number of countries for data collection in future, future research can use panel data analysis to test the hypotheses. Secondly, the theoretical conceptualization of citizens-government relationship as principals-agent relationship is discussed in the context of FDI. Future research can utilize the same concept to explain various phenomena such as strategic alliances, joint ventures etc. Finally, only absence of corruption is studied as a mediator in the relationship between democracy and FDI. Future research can examine other mediators such as level of infrastructure, support from government etc.

Compliance with Ethical Standards

Conflict of Interest

Author declares that he has no conflict of interest.

Ethical Approval

This article does not contain any studies with human participants or animals performed by any of the authors.

REFERENCES

Adams, J. (1996). Principals and agents, colonialists and company men: The decay of colonial control in the Dutch East Indies. *American Sociological Review*, 12-28.

Agbiboa, D. E. (2012). Between corruption and development: The political economy of state robbery in Nigeria. *Journal of Business Ethics*, 108(3), 325-345.

Aiken, L. S., West, S. G., & Reno, R. R. (1991). *Multiple regression: Testing and interpreting interactions*. Sage.

Alesina, A., & Wacziarg, R. (1998). Openness, country size and government. *Journal of Public Economics*, 69(3), 305-321.

Argandoña, A. (2003). Private-to-private corruption. *Journal of Business Ethics*, 47(3), 253-267.

Argandoña, A. (2007). The United Nations convention against corruption and its impact on international companies. *Journal of Business Ethics*, 74(4), 481-496.

Arrow, K. J. (1985). Informational structure of the firm. *The American Economic Review*, 75(2), 303-307.

Baron, R. M., & Kenny, D. A. (1986). The moderator–mediator variable distinction in social psychological research: Conceptual, strategic, and statistical considerations. *Journal of Personality and Social Psychology*, 51(6), 1173.

Barro, R. J. (1999). Determinants of democracy. *Journal of Political Economy*, 107(S6), S158-S183.

Berle, A., & Means, G. (1932). *The modern corporate and private property*. McMillian, New York, NY.

Chakraborty, C., & Nunnenkamp, P. (2008). Economic reforms, FDI, and economic growth in India: a sector level analysis. *World Development*, 36(7), 1192-1212.

Cleveland, M., Favo, C. M., Frecka, T. J., & Owens, C. L. (2009). Trends in the international fight against bribery and corruption. *Journal of Business Ethics*, 90(2), 199-244.

Crespo, N., & Fontoura, M. P. (2007). Determinant factors of FDI spillovers–what do we really know? *World Development*, 35(3), 410-425.

Cumming, D., Fleming, G., Johan, S., & Takeuchi, M. (2010). Legal protection, corruption and private equity returns in Asia. *Journal of Business Ethics*, 95(2), 173-193.

Davis, J. H., & Ruhe, J. A. (2003). Perceptions of country corruption: Antecedents and outcomes. *Journal of Business Ethics*, 43(4), 275-288.

DeMott, D. A. (1998). Lawyer as Agent, The. *Fordham L. Rev.*, 67, 301.

DiRienzo, C. E., Das, J., Cort, K. T., & Burbridge, J. (2007). Corruption and the role of information. *Journal of International Business Studies*, 38(2), 320-332.

Doh, J. P., Rodriguez, P., Uhlenbruck, K., Collins, J., & Eden, L. (2003). Coping with corruption in foreign markets. *The Academy of Management Executive*, 17(3), 114-127.

Eisenhardt, K. M. (1985). Control: Organizational and economic approaches. *Management Science*, 31(2), 134-149.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *Academy of Management Review*, 14(1), 57-74.

Feng, T., & Wang, D. (2016). The influence of environmental management systems on financial performance: A moderated-mediation analysis. *Journal of Business Ethics*, 135(2), 265-278.

Gastanaga, V. M., Nugent, J. B., & Pashamova, B. (1998). Host country reforms and FDI inflows: How much difference do they make? *World Development*, 26(7), 1299-1314.

Getz, K. A., & Volkema, R. J. (2001). Culture, perceived corruption, and economics: A model of predictors and outcomes. *Business & Society*, 40(1), 7-30.

Gomez-Mejia, L. R., & Balkin, D. B. (1992). Determinants of faculty pay: An agency theory perspective. *Academy of Management Journal*, 35(5), 921-955.

Habib, M., & Zurawicki, L. (2002). Corruption and foreign direct investment. *Journal of International Business Studies*, 33(2), 291-307.

Halter, M. V., De Arruda, M. C. C., & Halter, R. B. (2009). Transparency to reduce corruption. *Journal of Business Ethics*, 84(3), 373-385.

Herzfeld, T., & Weiss, C. (2003). Corruption and legal (in) effectiveness: an empirical investigation. *European Journal of Political Economy*, 19(3), 621-632.

Holburn, G. L. F., & Zelner, B. A. 2010. Political capabilities, policy risk, and international investment strategy: Evidence from the global electric power generation industry. *Strategic Management Journal*, 31(12), 1290–1315.

Jensen, R. (2003). Dan Rather and the problem with patriotism: Steps toward the redemption of American journalism and democracy. *Global Media Journal*, 2(3).

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305-360.

Jensen, N. M., Li, Q., & Rahman, A. (2010). Understanding corruption and firm responses in cross-national firm-level surveys. *Journal of International Business Studies*, 41(9), 1481-1504.

Kelman, H. C. (2005). Building trust among enemies: The central challenge for international conflict resolution. *International Journal of Intercultural Relations*, 29(6), 639-650.

Kinda, T. (2010). Investment climate and FDI in developing countries: firm-level evidence. *World Development*, 38(4), 498-513.

Kiser, E., & Cai, Y. (2003). War and bureaucratization in Qin China: Exploring an anomalous case. *American Sociological Review*, 511-539.

Lange, D. (2008). A multidimensional conceptualization of organizational corruption control. *Academy of Management Review*, 33(3), 710-729.

Ledyaeva, S., Karhunen, P., & Kosonen, R. (2013). Birds of a feather: Evidence on commonality of corruption and democracy in the origin and location of foreign investment in Russian regions. *European Journal of Political Economy*, 32, 1-25.

Lenway, S. A., & Murtha, T. P. (1994). The state as strategist in international business research. *Journal of International Business Studies*, 25(3), 513-535.

Lindgreen, A. (2004). Corruption and unethical behavior: Report on a set of Danish guidelines. *Journal of Business Ethics*, 51(1), 31-39.

Lu, J., Liu, X., Wright, M., & Filatotchev, I. (2014). International experience and FDI location choices of Chinese firms: The moderating effects of home country government support and host country institutions. *Journal of International Business Studies*, 45(4), 428-449.

Majone, G. (2001). Two Logics of Delegation Agency and Fiduciary Relations in EU Governance. *European Union Politics*, 2(1), 103-122.

MacKinnon, D. P., Lockwood, C. M., Hoffman, J. M., West, S. G., & Sheets, V. (2002). A comparison of methods to test mediation and other intervening variable effects. *Psychological Methods*, 7(1), 83.

Martin, X., Salomon, R., & Wu, Z. (2010). The institutional determinants of agglomeration: A study in the global semiconductor industry. *Industrial and Corporate Change*, 19(6), 1769–1800.

Misangyi, V. F., Weaver, G. R., & Elms, H. (2008). Ending corruption: The interplay among institutional logics, resources, and institutional entrepreneurs. *Academy of Management Review*, 33(3), 750-770.

Muller, D., Judd, C. M., & Yzerbyt, V. Y. (2005). When moderation is mediated, and mediation is moderated. *Journal of Personality and Social Psychology*, 89(6), 852.
Neumayer, E., & De Soysa, I. (2005). Trade openness, foreign direct investment and child labor. *World Development*, 33(1), 43-63.
Ng, K. Y., Ang, S., & Chan, K. Y. (2008). Personality and leader effectiveness: a moderated mediation model of leadership self-efficacy, job demands, and job autonomy. *Journal of Applied Psychology*, 93(4), 733.
Noorbakhsh, F., Paloni, A., & Youssef, A. (2001). Human capital and FDI inflows to developing countries: New empirical evidence. *World Development*, 29(9), 1593-1610.
Nwabuzor, A. (2005). Corruption and development: new initiatives in economic openness and strengthened rule of law. *Journal of Business Ethics*, 59(1-2), 121-138.
Perrow, C. (1986). Economic theories of organization. *Theory and Society*, 15(1), 11-45.
Poynter, T. A. (1982). Government intervention in less developed countries: The experience of multinational companies. *Journal of International Business Studies*, 9-25.
Pratt, C. S., Roberts, K., Steele, J., Barral, S., Kyei, C. V. B., Gitau, B., ... & Marks, M. (2014). *The World Justice Project Rule of Law Index 2014*. World Justice Project, New York.
Pratt, J. W., & Zeckhauser, R. (1985). *Principals and agents* (pp. 2-4). Boston, MA: Harvard Business School Press.
Preacher, K. J., Rucker, D. D., & Hayes, A. F. (2007). Addressing moderated mediation hypotheses: Theory, methods, and prescriptions. *Multivariate Behavioral Research*, 42(1), 185-227.
Ramamurti, R., & Doh, J. P. (2004). Rethinking foreign infrastructure investment in developing countries. *Journal of World Business*, 39(2), 151-167.
Reiche, B. S., Harzing, A. W., & Pudelko, M. (2015). Why and how does shared language affect subsidiary knowledge inflows? A social identity perspective. *Journal of International Business Studies*, 46(5), 528-551.
Robertson, C. J., & Watson, A. (2004). Corruption and change: The impact of foreign direct investment. *Strategic Management Journal*, 25(4), 385-396.
Rodriguez, P., Siegel, D. S., Hillman, A., & Eden, L. (2006). Three lenses on the multinational enterprise: Politics, corruption, and corporate social responsibility. *Journal of International Business Studies*, 37(6), 733-746.
Rodriguez, P., Uhlenbruck, K., & Eden, L. (2005). Government corruption and the entry strategies of multinationals. *Academy of Management Review*, 30(2), 383-396.
Ross, S. A. (1973). The economic theory of agency: The principal's problem. *The American Economic Review*, 63(2), 134-139.
Shapiro, S. P. (2005). Agency theory. *Annual Review of Sociology*, 263-284.
Tang, L., & Koveos, P. E. (2008). A framework to update Hofstede's cultural value indices: economic dynamics and institutional stability. *Journal of International Business Studies*, 39(6), 1045-1063.
Unit, E. I. (2015). Democracy Index 2014: Democracy and its discontents. *Report from The Economist Intelligence Unit*, 1-55.
Uhlenbruck, K., Rodriguez, P., Doh, J., & Eden, L. (2006). The impact of corruption on entry strategy: Evidence from telecommunication projects in emerging economies. *Organization Science*, 17(3), 402-414.
Vaaler, P. M., & Schrage, B. N. (2009). Residual state ownership, policy stability and financial performance following strategic decisions by privatizing telecoms. *Journal of International Business Studies*, 40(4), 621-641.
Venard, B., & Hanafi, M. (2008). Organizational isomorphism and corruption in financial institutions: Empirical research in emerging countries. *Journal of Business Ethics*, 81(2), 481-498.
Voyer, P. A., & Beamish, P. W. (2004). The effect of corruption on Japanese foreign direct investment. *Journal of Business Ethics*, 50(3), 211-224.
Warren, D. E., & Laufer, W. S. (2009). Are corruption indices a self-fulfilling prophecy? A social labeling perspective of corruption. *Journal of Business Ethics*, 88(4), 841-849.

Wiseman, R. M., Cuevas-Rodríguez, G., & Gomez-Mejia, L. R. (2012). Towards a social theory of agency. *Journal of Management Studies*, 49(1), 202-222.

Wright, P., & Mukherji, A. (1999). Inside the firm: Socioeconomic versus agency perspectives on firm competitiveness. *The Journal of Socio-Economics*, 28(3), 295-307.

Wu, L. Z., Kwan, H. K., Yim, F. H. K., Chiu, R. K., & He, X. (2015). CEO ethical leadership and corporate social responsibility: A moderated mediation model. *Journal of Business Ethics*, 130(4), 819-831.

Yu, T., Subramaniam, M., & Cannella Jr, A. A. (2013). Competing globally, allying locally: Alliances between global rivals and host-country factors. *Journal of International Business Studies*, 44(2), 117-137.