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Confronting corruption

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Policies, controls, and culture must all work together to withstand the inevitable pressures when they arise.

Consider these real-life situations faced by executives in global corporations.

- A local political leader has demanded a payment to help settle a labor dispute that he has engineered; he implies that if you refuse, the outcome could be unpredictable and bad for business. Eventually, he mellows and agrees to accept a check payable to a school for poor children that he runs. Should you pay?

- A routine audit by the tax authorities has developed into a wider investigation. After two months, they have found no evidence of tax evasion but their demands for information are increasing and proving a distraction to the company's employees. Tax evasion is a criminal offense in this country but the inspector offers a solution: if you hire a tax accountant or consultant of their choice for $100,000, the investigation will be wound down. What should you do?

- Your company is due a substantial tax refund from the local government of one of the countries where you operate. This amount is now 11 months overdue. The global CFO is under pressure to write off the amount, but such a write-down will wipe out your annual profit; employees will have to forgo their bonuses for no fault of theirs. It is becoming clear that without a payoff, this refund will not happen in a reasonable time. The demand is quite modest considering the magnitude of the refund. Most local firms and several multinational companies have quietly paid up. What should you do?

Many of the world's most admired and well-managed firms—all of them with codes of conduct, written policies, and seemingly tight controls—have grappled with these sorts of dilemmas for years. But recent media reports highlight how the risks of succumbing to bribery and fraud are intensifying. Two factors are driving this.

The first is companies' greater exposure to growth opportunities in emerging markets with a history of corruption. The second is the rising backlash against corporate wrongdoing in many developed and developing markets. In China, for example, Xi Jinping's government seems increasingly determined to change the long-standing culture of graft and backhanders; in India, an important new law has been enacted to curb corrupt politicians, ministers, and bureaucrats. In Turkey, protesters against corruption have taken to the streets, and in Brazil senior political figures have been jailed. Concurrently, governments in countries such as the United States, Germany, and the United Kingdom are strengthening and enforcing their own anticorruption and antibribery laws more vigorously, notably the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act. These efforts make companies increasingly liable not just for the conduct of their employees but also for the actions of their intermediaries, such as consultants, agents, and joint-venture partners.

These developments potentially raise the odds of success for leaders seeking to build multinational organizations that consistently adhere to high ethical standards—and make the present a good moment to take a fresh look at the question of corruption. My perspective on this issue has been shaped over 20 years as a senior executive in South Asia at US multinationals (Cummins and Microsoft) and by experiences as a board member at a variety of companies, including Volvo and Infosys. My conclusion from this range of experiences is that the hardest issues for ethical multinationals, regardless of their country of origin, are rarely the big-ticket scandals and scams that make headlines. Rather, it's the subtler but more pervasive forms of fraud and corruption, such as pressures for payments on routine transactions, that often pose the biggest challenge. These quiet killers of ethical business practices are what really make it difficult for executives to do business profitably while doing the right thing. Although much of my experience is rooted in India, I believe the observations and lessons I learned also apply to many other markets.

To illustrate what I mean, I describe here four broad categories of corruption and fraud that executives are likely to come across—and include some tactical ideas on how to deal with them. I conclude by arguing that companies should protect themselves against the risks by going beyond policies and controls and building a culture of ethics and compliance. In this way, healthy organizations will give themselves the best chance of avoiding difficult situations in the first place rather than having to deal with them when they happen.

A taxonomy of corruption

Corruption and fraud are broad terms that span a wide variety of situations. To help people up and down the line understand the pressures they are likely to face, I have found it useful to parse corruption and fraud into four categories: bribes, speed money, extortion, and employee fraud.

Bribes

Global companies routinely get into trouble when managers make payments to, say, win a business contract, gain regulatory approval of a product, reduce their taxes, or avoid customs duties. Multinational companies are forbidden to pay bribes both by the local laws of the countries in which they operate and by laws in their "home" jurisdiction. All such laws prohibit managers from offering anything of value to a government official, political party, or party official with the intent to influence that person or to secure an improper advantage in obtaining or retaining business.

This sounds cut and dried, but in practice managers seldom make payments directly. Instead, the payments usually involve creative practices such as using agents or dealers to make payments, tapping unaccounted pools of cash, or slush funds, sponsoring foreign travel, providing extravagant gifts or entertainment, and making charitable contributions to nongovernmental organizations recommended by government officials and politicians.

Over time, a company that is uncompromising in its ethics develops a reputation that serves as the best shield against bribery. Indeed, I would contend that in the consumer (B2C) and industrial (B2B) sectors of most countries, companies can function without paying

bribes. When it does occur, it often simply reflects a leadership choice or a lapse in leadership.

Looking for plausible deniability is a short-term strategy at best. Consider, for example, the many multinational companies with channel-driven business models that route sales through distributors, dealers, and other value-added resellers. On the face of it, this business model offers a natural firewall against corruption. In my experience, though, principled foreign companies are loath to condone bribery by their channel partners, and sooner or later, the ethics of a multinational and a local partner are liable to collide.

Speed money, or 'grease payments'

A far bigger problem for companies is the demand for small payments to facilitate routine transactions and services. The distinction between bribes and speed money is simple: a bribe is a payment to a public official (or someone in authority in the private sector) for doing something he or she should not do; speed money is a payment for doing something he or she should do, faster.

Many companies encounter demands for speed money, especially from government officials but also increasingly from employees in the private sector. There are often circumstances when companies must make a facilitation payment or suffer inordinate delays—in clearing shipments, getting permits or licenses, or registering land deals, for example. As a well-known Asian businessperson puts it, "From the time a businessman thinks of starting a venture, every step is paved with red tape and demands for grease payments. The system makes it impossible for people to function legally. There is no time limit to issue a license or renew a permit. If I do not pay my way through, the authorities can make me wait indefinitely before processing my application. It's simply more efficient to pay."

Paying speed money is illegal in many countries, including India and the United Kingdom, although it is permissible in certain circumstances under the US FCPA. Almost no one will officially admit to paying speed money, but the uncomfortable reality is that there may be no alternative for a business that needs to keep operating. Although no substitute for legal review of any such payments, it can be helpful to consider whether or not the transaction involved is a routine, nondiscretionary action and if the

company is seeking an improper benefit. The agency or intermediary the company uses should be reputable and provide a value-added service. Every payment to such an agency should be approved by legal experts at global headquarters and accounted for explicitly. From the perspective of the multinational, nothing should be "under the table" and left out of its business documentation.

Extortion

Crooked politicians and bureaucrats in certain developing countries, where the rule of law is tenuous, sometimes seek to extract money by making credible threats against a business or even the lives of its executives. Inexperienced companies usually find it easier to pay up than to run the risk of being held hostage. The short case study of the local politician who threatened to escalate a labor problem unless he was paid off—as outlined at the beginning of this article—is not untypical. His reputation and past actions suggested that the threat was real. Such situations are defining moments. There are no easy or right answers since there are multiple considerations, including employee safety. While country managers need judgment and courage, they should not try to deal with the problem alone and should always discuss the matter with their global CEO and general counsel. In such situations, a powerful local network and an effective advisory board can be a help. Bear in mind too that extortionists are usually solo rogue actors without institutional backing: it is often possible to call their bluff, which, in my experience, helps a company cultivate a reputation for honesty and acts as further protection against future demands.

Employee fraud

Increasingly, the biggest corruption threat facing companies is not bribe payments or speed money but the risk that their own employees may be on the take. Several recent surveys[1] on global fraud have highlighted this problem, drawing attention to the involvement of senior executives of multinational companies in emerging markets. Causes include the rising pressures to deliver improved financial performance; the temptation is there to cook the books, stuff the channel with inventory, and make side agreements with customers and partners. Greed is also driving more

[1] *2013/2014 Global Fraud Report*, Kroll, fraud.kroll.com.

management fraud: kickbacks from vendors and advertising agencies, commissions on real-estate transactions or machinery purchases, deposits in overseas bank accounts on successful acquisitions or sales of companies. These transactions are becoming routine in some places, and they are difficult to combat without the right organizational culture.

Inoculating the organization

Many years of experience running diverse businesses in South Asia make me optimistic that companies can operate ethically in emerging or any other markets. While greedy politicians and venal public officials are convenient scapegoats, corruption is a two-way street; succumbing to it is a leadership choice. Companies must therefore build their own internal competence and develop a robust culture to withstand the inevitable pressures when they arise. Here are four principles to keep in mind.

Don't ignore the basics

Companies need to ensure that basic controls are in place on a range of issues. For example, too few foreign companies pay adequate attention to compliance, mainly because businesses usually allocate budgets for audits and compliance reviews in proportion to revenues, and individual emerging markets often still contribute relatively little to revenues. This is a mistake: India might account for 1 percent of global sales and China 5 percent—but their contribution to overall compliance risk might be much higher.

Many other basics also get overlooked. According to Ernst & Young's most recent fraud survey, only 35 percent of companies have taken action against employees, and one-fifth of respondents stated that their companies did not have policies in place or they were unaware of an existing one.[2] In another survey, conducted by Kroll, less than one-third of respondents said their foreign employees, vendors, and managers were trained to be both familiar and compliant with the UK Bribery Act and the US FCPA.[3] Cultural and geographic

[2] *Overcoming compliance fatigue: Reinforcing the commitment to ethical growth*, 13th Global Survey, Ernst & Young, 2014, ey.com.

[3] *2011/2012 Global Fraud Report,* Kroll, fraud.kroll.com.

distance can further lead to overdependence on local management to the point of abdication. Other fundamental questions are: Has the company instituted a formal code of conduct that every employee has to recertify annually? Is there mandatory training on compliance, with appropriate rules and regulations for customer-facing employees? What is the preapproval process for discounts, gifts, travel, entertainment expenditures, and charitable contributions? How is the company's code of conduct communicated to customers, dealers, and partners? Do customers know the entertainment and travel reimbursement policies of the company? How does the company deal with a problem? Is investigation swift and punishment decisive and fair?

Invest in the key functions

Many companies manage head count very tightly and underinvest in staffing compliance functions such as finance, internal audit, and legal. That's penny-wise and pound-foolish, given the relatively low cost of head count in developing countries. The finance and administration unit is usually the primary contact with bureaucracy, and it's critical to have a strong team, with managers who understand local laws and regulations, possess the skills to work with government officials, and can get things done without paying bribes. Being lax or saving costs by taking shortcuts will inevitably expose companies to exploitation by the unscrupulous. The reputational damage and distraction to a business of dodging taxes can be many times higher than the magnitude of the apparent evasion.

Leadership matters

Clear policies, procedures with approval processes and stringent controls, and regular internal audits of high-risk areas are all necessary measures—but what really matters is strong local leadership in the matter of compliance. "In hierarchical cultures, bribery and corruption depend largely on the tone from the top," declares one leading fraud expert. Global companies should therefore hold their country CEOs accountable for compliance with their policies and codes of conduct, as well as with the laws of their "host" country. There should be zero tolerance. Too many companies focus too much on hitting the numbers, with insufficient discussion of the character of leaders during the appraisal process.

It's the small things—such as segregating personal phone calls, only charging appropriate business expenses, and avoiding the personal use of company assets—that often matter. A sense of entitlement in small things is often a predictor of bigger problems. In many cases, employees are aware of suspicious conduct long before it is officially discovered, but they won't blow the whistle if they don't feel top management is serious about punishing wrongdoers. Leaders can demonstrate their seriousness in myriad ways: paying attention to simple steps such as conducting rigorous reference checks during the hiring process, for example. These may take a little extra work in unfamiliar markets but can provide invaluable insight. In retrospect, I could have avoided many mistakes by better and more personal due diligence. For instance, after we terminated a senior executive for "channel stuffing" one year after hiring him, a distributor told us that the executive had a reputation in the industry for indulging in that practice.

Be prepared to tough it out

Success is perfectly possible in emerging markets without making compromises, but there are real consequences and real costs for those who uphold ethical behavior, especially in the short term. Some business may be lost, budgets may be missed, approvals may take more time, and officials may respond angrily. Local managers can come under pressure from senior managers at headquarters willing to turn a blind eye. When fraud is discovered, they feign ignorance and respond with shock and dismay; middle managers and frontline employees are made the scapegoats. Global leaders should publicly support antibribery laws, speaking out against corrupt practices in their industry and explicitly acknowledging any loss of business that results from adherence to ethical principles. CEOs must ensure that every employee in every part of the world is utterly clear about what conduct is acceptable and what is not.

They should follow the example of the head of one Indian IT company, who said recently: "We ask our people to persist and prevail, not to take shortcuts. The message is simple: we will work alongside you. We will not hold it against you if a project gets delayed or we lose

money; we will do what is right, not what is convenient. Over time, people will know what is acceptable here and what's not. Social memory is many times more effective than a bunch of policies."

Globalization today provides companies with lucrative new opportunities in markets where they may encounter new risks relating to bribery, grease payments, extortion, and employee fraud. To combat the threat to their reputation—and ultimately to their bottom line—CEOs must make dealing with corruption a core employee and organizational competence. This requires a relentless focus on compliance, a commitment from senior leaders to ethical behavior, and a determination to tough it out when these high standards appear to carry a short-term cost. ○

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