Keeping Your Firm Incorruptible

International crackdowns mean it's time for all businesses to take a second look at themselves

By Peter Humphrey

Regulatory agencies throughout the world have recently been cracking down on multinationals and individuals resorting to bribery or other corrupt business practices outside of the US. They have even been projecting their investigations across international borders. While American companies that engage in these kinds of tactics make up only a tiny percentage of the business community, all companies need to ensure that they are beyond reproach. Even companies that have been very careful to follow the letter and spirit of the law should be aware that they are likely to be scrutinized more closely than their Chinese competitors, and thus should not leave anything to chance.

The anti-corruption drive is largely led by the US, whose Foreign Corrupt Practices Act (FCPA) bans any firm that does business in the US from bribing government officials anywhere in the world. This legislation is being enforced with new vigor by the Department of Justice (DOJ) and the US Securities and Exchange Commission (SEC). In Europe, regulators have also intensified their actions since the 1997 Organization for Cooperation and Development (OECD) Anti-Bribery Treaty.

Chinese media recently listed many specific, well-known multinationals that had been ensnared one way or another in commercial bribery scandals. According to a Chinese media report, 64 percent of the 500,000 commercial bribery cases investigated in China in the past decade involved foreign companies and businesspeople. Clearly these trends indicate a globalization of anti-bribery investigations, although many question whether the emphasis on foreign companies reflects a disparity in corporate practices, or more likely, government propensity to look at non-Chinese companies.

Regardless of whether this reflects a governmental bias or not, clearly US companies need to remain beyond question when it comes to bribery. If not, they are likely to be targeted. Recently US firm Avery Dennison was in the headlines over kickbacks in China. In so-called "developed" countries, officials are reaching out to fellow-enforcers in jurisdictions beyond their own borders—including China—to coordinate anti-graft cases. The results are very tangible. Settlements and penalties have risen from a total of about US $3.1 million in 2002 globally to more than US $150 million in 2007, and jumped to more than US $1.7 billion in 2008.

Just in the US, the DOJ and SEC are said to be working through a backlist of at least 120 cases. The penalties are expected to grow harsher. The trend shows clearly that firms should not slash costs on compliance during the recession, but should instead stay vigilant against bribery transgressions. Ensuring that your company is following the letter of the law throughout the world is now a global branding imperative.

Transparency International, the world's leading independent corruption watchdog, headquartered in Berlin, ranks China as one of the more corrupt countries in the world. Much of this reflects common practices among domestic companies, but it can spill into the foreign arena as well. A number of multinationals, including US firms, have recently made headlines after falling afoul of the FCPA. So the need for strict compliance and vigilance is ever greater.

Firms from the US and OECD countries are particularly exposed to risks in China linked with the FCPA. Graft and abuse of privilege is as old and sturdy a Chinese landmark as the Great Wall. This is partly because of a tradition that has long valued "harmonious" social arrangements over formal legal convention, but also stems from a history of monopoly and centralized authority.

I have had insight into many corporate corruption-related cases in China, ranging from the simplest backhanders passed to procurement officers in exchange for contracts to more sophisticated bribery schemes involving "slush funds" parked in shell companies for the benefit of multiple parties who all stood to partake of the spoils. Working

Tips for Best Business Practices

- Implement an across-the-board compliance program
- Due diligence must go beyond the balance sheet
- Write FCPA anti-bribery language into all your contracts and code of conduct
- Thoroughly screen of staff, vendors, distributors, resellers
- Check whether people are or were officials or have relatives in government
- Conduct periodic internal audits, fraud risk assessments, process reviews
- Check compliance with internal procedures and the law
- Closely monitor employees and agents who interact with government
- Ensure expenditures are properly documented and transparent, especially sales expenses
- Conduct regular analysis of commission/finders fee payments
- Track entertainment expenses for government employees

closely with in-house and external legal counsel, often under conditions of attorney privilege, I have seen numerous inquiries driven by FCPA concerns in China business operations, both on the side of prevention—as in merger and acquisition situations—and in troubleshooting cases, where bribery has been alleged or suspected.

The revelations come in two ways: while we are investigating allegations or potential issues in our client's operations, or while a sensible client is making FCPA issues part of its due diligence inquiries in a pre-transactional situation, such as forming a joint venture or making an acquisition. The due diligence results are often telling—but not all companies treat the red flags seriously.

One of the common areas where trouble and agony arise is in sales to state sector clients. For example, one global IT manufacturer initiated an investigation into allegations of irregularities in its public sector sales division, tasked with selling products to state entities such as ministries, the police, schools and hospitals. Inquiries revealed that the head of government sales, in collusion with leaders of regional sales teams under him, had systematically extorted kickbacks from distributors by threatening to strike them off an approved distributor list. Cowed distributors were also bullied to fake big orders from state entities supposedly requiring the provision of large amounts of under-priced IT equipment from company headquarters. These were then sold on by the crooked head of public sector sales at an enormous mark-up for private profit. The kickbacks paid to the head of sales, who was later terminated, were worth several hundred thousand dollars a month. The company had worried he might have been bribing officials. But it turned out to be plain fraud.

The examples are countless. In a due diligence scenario, a global telecom operator decided to conduct FCPA background research on an acquisition target, a large telecom equipment provider. It was discovered that the target's business success hinged on its ability to bribe government procurement departments and manipulate tender bids by "coddling" government staff into revealing insider information. Kickbacks were an unwritten rule and typically made up three to five percent of contracts worth tens of millions of dollars. The company's value should have been re-assessed and the bad business firewalled. But the company went ahead anyway and two years later ran into huge problems.

These are worrisome situations, to say the least, and are something that companies should always keep an eye out for. In the face of the toughening stance of regulators, companies should enforce serious compliance measures internally in order to avoid getting into trouble and wrecking their reputation. A failure to ensure that your company is fully in compliance with appropriate business standards can cause a lot of pain down the road.

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