The Growing Importance of Ethics

By Peter Humphrey, Managing Director, ChinaWhys Company Limited

In today's business world, ethics is becoming an imperative. The "E" word has moved to the top of the governance agenda in most advanced economies. The collapse of Enron and Anderson in 2002 pressured businesses and regulators to protect stakeholders with enhanced governance and controls. The strengthening of SEC (Securities and Exchange Commission) rules and new laws such as the Sarbanes Oxley Act, plus beefed-up international anti-bribery and anti-money-laundering laws, all have placed the onus on corporate shoulders to manage in an ethical way. If you take a chance, sooner or later you may have to pay a fine, go to jail, or both. This heightened responsibility is finding its way from the boardrooms into the China operations of leading multinationals. Hard experiences and ethics lessons from the frontlines of business in China are pushing this tendency.

Troublesome Tales

A recent case involved a Chinese scientist who was working for a big life sciences MNC in an R&D team that had developed an innovative cost-saving industrial process. The firm had patents on the technology and expected to make hundreds of millions of dollars in profits by building plants using this technology. Indeed the first contract had been signed. The scientist suddenly resigned and was later found to have copied all the related files from the IT system on to CDs and was working with companies in China to build a business around this stolen technology.

And then there was the packaged consumer goods manufacturer operating in China, where employees in almost every department colluded with a counterfeit syndicate to produce fake products and inject them back into the firm's distribution channels alongside the genuine product. People in procurement, packaging, sales and distribution, in the warehouses and in trucking, even in the R&D department were in on the act. They even had a business plan with annual production and sales targets. This explosive mix of faking, supplier-purchaser scams, distribution fraud, and technology theft forced the firm, at great cost, to restructure its China operation, terminate many agreements with suppliers, staff, and distributors and end numerous partnerships.

Then there was Anita, a senior buyer at a major supermarket chain, who pocketed the equivalent of 30 per cent of all the buying transactions that she handled. She controlled a valuable chunk of the buying operation in dry foods and alcoholic drinks. She collected kickbacks, gifts and allowances from vendors; she favoured companies that she had set up in the names of her mother and her boyfriend as her employer's suppliers, companies without any physical existence. She ran scams with rebated goods; she manipulated the electronic price system. In the end she was caught and fired because her boyfriend's wife blew the whistle on her!

In all these cases the victims had neglected basic business controls and measures to reduce the risk of such a disaster occurring, and they had been slow to react when the first signs of the problem became apparent. It is due to the tighter rules in places like the US and to such blatant governance failures that many MNCs are now stepping up their ethics management in China.

Culture Gap

The high incidence of fraud in China, roughly four times as high as the US, occurs against the background of a get-rich-quick social revolution and economic development phase that has spawned a high incidence of graft in both the public and private sectors. Not only that, due to the large language and culture gap between many multinationals and their China operations, it is often difficult to detect and respond to the challenges of white-collar crime.

The culture gap is one of the single most important factors. No foreign culture and language can surely be more remote and more difficult to grasp for western multinationals than China's. Multinational head offices and their representatives are often blind to what is happening on the ground inside their own China operations. This blindness creates opportunity and temptation for unscrupulous individuals to commit fraud, thinking, often correctly, that they will not be detected. Very few multinationals bridge this gap successfully.

Communication Breakdown

Very often head office or a senior expatriate manager fail to demonstrate a sufficiently hands-on posture. They do not show that they actually care about their operation, they are unable to reach out to all levels of employees, and they over-rely on a single point of reporting - usually a local hire with good English - to provide them with information about the operation. This person gathers power and controls the whole business: language, connections to the government, internal networks, external social networks, direct contact with suppliers, direct contact with distributors, and loyalty from other staff within the company. Conversely, junior employees wishing to express ethical complaints often have no channel to communicate with head office or with the senior expatriate managers. This creates fertile ground for deception and fraud. Companies must tackle this risk through a healthy and balanced approach towards the local versus expatriate ratio, HR management, screening, training and internal controls.

Get-Rich-Quick Mentality

Adding to these communication problems, you get the 'get-rich-quick mentality' that has seized many people in this society and the tremendous social pressure felt by many people here - especially young people. Money brings prestige, and many people are prepared to take shortcuts to own houses, cars and luxury goods. Scholars at Beijing's prestigious Tsinghua University have estimated that the equivalent of 16 per cent of China's GDP is lost to fraud and corruption each year, compared with an estimated 4 per cent fraud rate in the United States.

Faced by such challenges, more companies have recently been adopting broad-based ethics control programmes to pre-screen employees, vendors, distributors and prospective JV partners or acquisition targets. We have also seen a significant rise in compliance audits, especially those focused upon Sarbanes Oxley conformity. In short, due diligence, background vetting, robust responses to violations of internal controls or to unethical conduct, and the provision of early warning mechanisms to detect or avert fraud, are being embraced in a more integrated way.

Code of Ethics

Greater efforts are visible among many companies to introduce or strengthen a Code of Conduct or Code of Ethics by tying it into employment contracts as well as contracts with suppliers and distributors, to thus outlaw unethical behaviour, especially collusive activity between staff and business counterparts. The more advanced companies are drilling the code of ethics into their workforce and associated firms through ethical awareness and compliance training.

Whistle-blowing hotlines, traditionally established by big firms on a global basis, have been found inadequate to deal with operations in China, mainly due to cultural and language differences. A global ombudsman sitting half way around the world fails to understand the special characteristics of China. But there needs to be a reliable channel here for employees, suppliers, dealers, partners, customers and other stakeholders to report their concerns to appropriate people in the company. Some firms are now therefore setting up special hotlines to exclusively handle China complaints. All these are welcome developments.

Experts have long emphasised the consequences of ethical failures in organisations such as large legal judgements, prison sentences, anti-trust litigation, fines, lost sales, lost goodwill, etc, along with the moral need for organisations to do what is right for moral purposes alone. "There is also another important reason why ethics is crucial - organisational performance," says Simon Stokes, a consultant and expert on Organisational Behaviour based in Shanghai. "Ethics programmes can lead to positive performance changes in an organisation," he says.

"They can result in greater trust, teamwork, and group productivity and can improve the level of openness, communication and motivation," according to Stokes. They can also enhance visibility, decision making and outcomes, and can foster better reasoning and the development of strategic information. Improved processes, governance, and performance are also benefits that can arise from ethics programmes. Another spin-off is less frustration, fire-fighting and waste, and less secretive and unethical behaviour. And reduced risk!

So there are both moral and bottom-line reasons to have a corporate-wide ethics programme including well-honed ethics awareness training sessions. The Code of Conduct needs to be inculcated through regular workshops for employees, supplies, distributors and other stakeholders in your business. They have to understand that unethical conduct can cause losses, and learn that they must have a stake in the ethics of the business and not just in the money.

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