

## CHAPTER 2

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### *Integrity Management in the Private Sector*

- A. Designing Bribery and Fraud Prevention Programs in the Private Sector in Asia
- B. To Bribe or not to Bribe... Dealing with the OECD Anti-Bribery Convention from a Business Perspective

# A. Designing Bribery and Fraud Prevention Programs in the Private Sector in Asia

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This contribution addresses bribery and fraud prevention programs in the private sector in Asia. In considering issues relating to the private sector, transactions where the private meets the public sector are of particular interest. Private-to-private corruption goes on, but the most egregious forms of private sector corruption occur in the interaction with the public sector.

## Fraud vs. corruption

A discussion about corruption must start with some theory about fraud, as the phenomena are interlinked. However, they are not the same; rather they are like two circles that overlap in some areas but are separate in others. Fraud can occur, but without corruption; corruption can occur without fraud. Yet where fraud is, corruption often is too.

Protecting an organization in Asia against fraud involves addressing four issues: people, internal controls, enforcement and security.

People: who works for you? Who is being hired by your company? Who are your contractors or customers? Honest people do not commit fraud—but so often simple mistakes in hiring allow dishonest people to slip into an organization in the first place. The same can be said of relations with suppliers and customers. A common trick in Asia is for elements of a business that one believes to be third parties to be actually controlled by employees.

Internal controls: in Asia, they do not function as they do in Europe or in the United States, and again within Asia, what does work and what does not

can differ widely. In Asia, collusion is common, holidays are infrequently taken, and people are reluctant to question the chain of command. Moreover, lack of adequate training in many organizations may cause the failure of internal controls that look wonderful on paper. A major risk for multinationals operating in Asia is to rely on external audit in this region in much the same way as they do in their home jurisdictions. Major audit firms do not have consistent standards across their vast networks; even their training schemes are neither consistent nor sufficient.

**Enforcement:** a firm's position on enforcement of its policies vis-à-vis fraud is an important part of their fraud-prevention strategy. Those firms with a firmer stance against fraud will encounter fewer instances of fraud; those that ignore or treat a fraud only lightly send a message that fraud is accepted. Many organizations that have experienced major fraud (over USD5 million in losses) have previously experienced a similar, albeit much smaller, fraud by either the same person or a related person. Strong enforcement—not to be confused with zero tolerance, which will be discussed later—is a key tool of a company's fraud prevention arsenal.

**Security:** many firms' fraud prevention programs ignore even basic means of securing their assets. Company chops left on desks, movable assets not properly recorded or stored, intellectual property easily e-mailed away. Appropriate security is an important part of the overall fraud prevention program.

## **Finding fraud**

The earlier fraud intervention and prevention programs go in, the broader the intervention will be, but entailing higher costs. Positive background checks on all employees, for example, can be effective at countering a number of potential fraudulent practices for an organization; on the other hand, it would be an expensive endeavor to protect the operation of the petty cash tin, and the problem would be better addressed by simple internal controls over tin access and accountability.

Fraud prevention is therefore about choices. Choosing the appropriate point of intervention maximizes the return of any investment in fraud prevention. Sometimes it is better to let a little fraud go on, so that those involved can then be found and removed, rather than to intervene early.

## **Definition of corruption**

So, what is corruption? Is it bribery, fraud, extortion, nepotism, patronage, cronyism, embezzlement, graft, or is it all of these? Each of these notions

describes different manifestations of the same concept. Understanding the type of corruption that one is facing makes it possible to define the risk management strategy accordingly.

If, for example, a person runs a filthy fruit stall in a public market and the health inspector comes over, the person would need to bribe him to look the other way. Both individuals are happy with this arrangement: the shop owner can stay in business without the costs of cleaning up the stall, and the inspector is happy because he gets the bribe. Neither of them has any incentive to complain about the arrangement. The owner of a clean store would get very annoyed when being asked by an inspector to pay him off or else receive an infringement notice. The latter is, in fact, case of extortion, as it is likely to result in a complaint if there is a way. Although bribery and extortion both constitute corruption, the techniques to counter them differ.

## Causes of corruption

So what causes corruption? The following circumstances were found to be contributing factors in causing corruption on either a transactional or societal basis; some of them are indeed both a potential cause *and* a consequence:

- lack of transparency
- silence
- over-regulation
- lack of enforcement
- poverty
- lack of checks and balances
- greed
- illiteracy
- inequality
- lack of democracy
- unmet expectations
- weak judiciary
- weak press
- low public sector salaries
- lack of market competition
- transitional issues
- prohibition

Corruption is a function of motivation and opportunity, the likelihood of detection, the likelihood of punishment, and the degree of punishment.

Understanding these issues is an important part of designing an anti-corruption program for firms operating in Asia. For example, due to the strong anti-corruption agencies operating in Hong Kong, China and Singapore, firms doing business in those countries have less to worry about than those doing business in certain other countries of the region that have little or no enforcement capability.

## Addressing corruption

All firms, and indeed the public sector, make three choices when choosing tactics for addressing corruption:

- which tool should be used;
- what regulatory style fits the audience; and
- when the firm should intervene.

The choice of the tool depends on the type of corruption that a company is facing. The regulatory style is predetermined by issues of company culture and, more important, the nature of the jurisdiction in which the organization operates. Another factor in the choice of regulatory style will be the extent to which the firm is itself being regulated. The nature of its own regulatory environment may indeed leave little choice in what regulatory style to adopt: firms need to be very careful about conflicts between regulatory styles and cultural issues in a specific jurisdiction. The United States financial industry regulatory style, for instance, does not fit the way financial markets have typically operated in certain parts of Asia such as South Korea, Taiwan, Malaysia and Australia.

## Controlling corruption

In setting anti-corruption strategies and tactics, it is important to recognize some characteristics of corruption as a crime. First, it is normally a hidden crime. A victim or victims might not be obvious and the parties initially involved all have an interest in keeping the deal hidden.

Second, the enemy is conscious and evolves its techniques. What this means is that firms need to incorporate an intelligence function into corruption detection and eradication programs. Firms need to look for new ways in which the system may be abused. As one hole in the system is fixed, another one may appear. Too often the anti-corruption efforts do not evolve and—unfortunately—a company's anti-corruption unit sometimes has negative

incentives in uncovering more corruption, as it would mean showing that its corruption program is insufficient. The easiest way to report that no corruption issues have been uncovered—and therefore that the prevention programs are working perfectly—is to not do any investigation.

Managers need to think about the measurement systems and the incentive programs they use as well as organizational structure issues (particularly reporting lines) that may affect the operational effectiveness of integrity units.

## **Essential elements of an anti-corruption program**

An anti-corruption program has three essential elements: education, investigation and enforcement. A program that lacks one of these elements will ultimately fail.

Education needs to take place both at the moment when an employee joins the organization and as his or her employment continues.

Investigation needs to have reactive as well as proactive elements. In its simplest form, an anti-corruption unit needs to be able to respond to a complaint from a customer, supplier or business unit, as well as to conduct its own independent integrity testing of the business and those third parties considered to be risk areas.

Enforcement needs to be fairly conducted, easy to understand and firm in its application.

There is no such thing as a perfect way to deal with these issues. Each business will have a different way of approaching these three essential elements that fits with its operations and the type of risk issues that are most applicable to it. For instance, dealing with supplier kickbacks in the purchasing department requires different tactics than when faced with bribe paying to government officials.

## **Zero tolerance?**

A common theme among companies and governments, and indeed a common theme with some speakers at this conference, is the notion that zero tolerance should apply to corrupt activities.

The Knapp Commission, which some 30 years ago investigated the New York City Police Department, proved this concept wrong. Zero tolerance does not work. When a company adopts zero tolerance, it is presenting its employees with a stark choice: on one side are all those totally honest employees and on the other are all those who are dishonest; the guy in purchasing who has a few free beers with his suppliers is just as corrupt as the guy in the construction

department who is selling off safety equipment inside the buildings he is constructing.

In order to be effective in isolating those in a company who are the worst offenders, and thus those that are putting the organization most at risk from corrupt practices, a graduated approach to enforcement is needed. Zero tolerance has the effect of shifting the bell curve of corrupt behavior to the right. This is not to say that corrupt activity should not be punished, but enforcement action must be proportional to the issue.

## B. To Bribe or Not to Bribe... Dealing with the OECD Anti-Bribery Convention from a Business Perspective

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**N**ot all athletes take performance-enhancing drugs. The recent world athletics championship provided a first glimmer of hope as regards the effectiveness of the fight against doping in sport: we may now believe in healthier competition between healthier athletes.

Bribery is to international business what doping is to high-level sports competition. Even though bribery is widely acknowledged to be harmful, it has for a long time been perceived as a necessary evil and the result of an unshakeable logic in international business. Nowadays, however, bribery, like doping, entails severe punishment if brought to light. Hence, companies are required to adapt their business practices to this new legal environment. In fact, they have a strong incentive to do so: an investigation—or even a simple allegation—in relation to the newly established offense under domestic laws can have considerable repercussions for the company image.

After performing the role of Financial Public Prosecutor in Paris for twelve years and having thus been made aware of the difficulties involved for the judiciary in combating bribery, I have spent the last three years helping companies to anticipate better the acts that may expose them to criminal proceedings. My approach is therefore no longer that of an official responsible for punishing acts of bribery, but that of one helping to prevent this type of crime in the private sector.



## **Criminalization of bribery in international business transactions**

While bribery has been tolerated by law and even encouraged by tax regulations for many years, the view on bribery in international business transactions has dramatically changed over the past two decades. When regular payments of commissions by the US aircraft manufacturer Lockheed, aimed to secure contracts in foreign countries, came to light in the 1970s, the public in the United States (US) was shocked. As a direct result, the US Foreign Corrupt Practices Act (FCPA) was passed in 1977, providing for sanctions against US businesses that intentionally bribed foreign public officials in international business transactions.

Because of this law, US exporters soon felt themselves to be at a competitive disadvantage compared to non-US competitors, and lobbied against this situation. At the same time, international awareness of the harmful effects of corruption on the world economy gradually was rising. In 1997, twenty years after the FCPA's entry into force, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions was signed, becoming the first legally binding international anti-bribery instrument. This Convention requires its signatory states to penalize the payment of bribes to foreign public officials and to amend regulations in related fields. Today, such payments are subject to severe criminal sanctions in most of the major exporting countries. Similarly, the tax deductibility of bribes has been abandoned in all signatory states.

## **Foreign bribery as a risky business**

Whether or not companies are adapting their business practices to the new legal environment cannot be fully assessed due to the short period of time in which the Convention and implementing national legislation have been in force. It is certain, however, that the laws on foreign bribery entail serious risks for companies that continue to do their business "as usual". Moreover, while the risk of criminal charges for bribery increases, the perceived competitive advantages of bribery, due to the convergence of national legal environments, are fading. Hence, companies have a strong incentive to take seriously the risk of criminal prosecution for bribery in international business and to bring their business practices in line with the new legislation.

As the public is less and less tolerant toward obscure transactions violating business ethics, allegations of acts of bribery are more likely to be referred to the law enforcement agencies. In the recent past, reporting of offenses has been

increasingly encouraged and facilitated both in the public service and private companies, by expanded reporting obligations and secure channels to communicate allegations. In many countries today, civil servants and public officials are obliged to inform the public prosecutor of any offenses they become aware of in the course of their duties. In France, for example, statutory auditors are subject to such an obligation. These obligations have emerged in connection with parallel reporting duties in the surveillance of financial sector transactions addressing the problem of money laundering and terrorism. Similarly, a growing number of companies today have enacted codes of conduct for their staff that foresee the establishment of an in-house ombudsperson and provide for whistleblower protection regulations.

Finally, while clearly constituting an abuse of the anti-corruption laws and judicial systems, making allegations for bribery against a competitor appears to have become a strategic weapon that some companies employ to harass their economic rivals. The risk of being subject to such abuse increases as the signaling of allegations to relevant law enforcement authorities is increasingly permitted via an intermediary or anonymously. Even when the charges are unfounded or purely imaginary, the launching of proceedings for bribery usually attains wide media coverage that may damage the company concerned.

## Private sector measures to prevent foreign bribery

Companies adopt different strategies to deal with the risk of being prosecuted for bribery. These approaches may be qualified as the fatalistic, the cynical and the ideal.

Employing the fatalistic approach, certain companies (generally smaller ones) still believe they can curl up into a ball like a hedgehog and avoid being run over. This attitude is increasingly considered dangerous, as it makes companies vulnerable both to prosecution for actually committed foreign bribery and to unjustified allegations. Other companies, more cynical in their attitude, may still be tempted to opt for cosmetic measures when faced with profound changes in their business environment rather than conduct an in-depth analysis and look for lawful, innovative solutions. Such companies would try to continue paying commissions to foreign public officials using schemes that they believe can minimize the risk of criminal charges; such schemes usually include a financial platform, non-consolidated subsidiaries in a non-signatory country to the OECD Convention and the use of trusts, investment funds, intermediaries or bank accounts located in regulatory havens.

Bad habits die hard and controlling every single stage of, for instance, a tender process is difficult for any company. However, an ideal approach—in

the eyes of some the idealistic approach—takes all possible steps to prevent the risk of being subjected to criminal charges for bribery in international business. This is, after all, of vital interest to every internationally exposed company. In doing so, the following two issues are critical:

- Risks for a company arise from allegations of bribery, not only from actual conviction. In the eyes of the media and the public, despite presumed innocence, corporate officers who are subject to an investigation for bribery are liable long before the case has been tried in court. The very opening of a judicial inquiry for bribery can thus seriously harm the image of a company, whether or not the alleged act of bribery has indeed been committed.
- Second, risks for both the corporate officer and the company arise not only from actions but from omissions, as omissions may provoke suspicion of the intention to bribe. Best business practice thus implies an internal company system of prevention and control. This system not only protects the company against malpractice; in the event of an allegation of bribery, it also proves that all possible measures to avoid such incidents have been taken, and that the incident is singular.

Whereas the first risk can hardly be influenced, systems of prevention and control can be very efficient in avoiding charges for bribery. To be effective, such preventive systems must encompass at least the following elements:

- Written company codes of conduct must be circulated among staff and actively communicated. Such rules must apply not only to the company's employees but also to its agents, intermediaries, consultants and co-contractors, as such agents may divert a part of their commission back to the competent public officials in the buyer's country, in particular if their payment depends on success.
- The systems must further ensure a rigorous selection of the agents and intermediaries that are to be involved in the commercial process. A company should choose only agents and intermediaries that have the capacity of legal entities and perform a business activity that corresponds to the purpose of the agreement.
- Contractual obligations must be clearly defined and include not only an undertaking to comply strictly with the provisions of the applicable laws, but also persuasive mechanisms to be used against careless or dishonest business partners.

- Finally, a company must implement financial monitoring and internal control procedures, in particular to ensure that the margins generated on transactions are not abnormal, ensure the rigorous written substantiation of the provision of services that correspond to the commission paid, and require full transparency with respect to the method of payment.

Any shortcoming in a company's preventive mechanisms may be interpreted as a tacit incentive to commit acts of bribery and warrant the implication of their criminal liability.

Finally, an important parallel preventive measure for any company doing business abroad is to conduct in-depth studies of the foreign business environments in which it intends to invest. A company that wishes to reduce the risk of being faced with situations of corruption and eventually the possibility of being accused of or charged with bribery should take the level of bureaucratic transparency in the host country into consideration in its foreign investment strategy. Vice versa, a country wishing to attract foreign direct investment has a vital interest in increasing the transparency and accountability of its public service and enhancing the integrity of its local business community, so as to render its investment environment more attractive and less risky for foreign investors.

The signing, ratification and transposition into domestic law of the OECD Convention has several important consequences for the companies of signatory states doing business in foreign markets sensitive to corruption. The first one has been to increase within companies that do business abroad the awareness that acts that, in the past, could be performed more or less with impunity can now be investigated and prosecuted by their home country law enforcement authorities.

Second, the decision of leaders of industrialized countries to ban foreign bribery is increasingly leading to a change in the mentality of large corporate groups when deciding to invest abroad, giving rise to the development of internal corporate control mechanisms to prevent the giving of bribes to foreign public officials by managers, staff and intermediaries. Indeed, being subject to an investigation—or even a simple allegation—in relation to the newly established offense may have considerable repercussions for a company's image. For these companies, the vigilance of competitors ready to report any suspicious payment to the prosecution authorities, the adverse publicity, the institution of criminal proceedings and possible prosecution that might follow have a strong deterrent force.

Finally, the third—and not the least important—impact is on countries that have been “recipients” of bribes in the past. Although it is still premature to assess the impact of the OECD Convention on foreign investment and trade flows, it can be expected that some countries associated with a high risk of corruption by foreign companies from OECD countries might experience in the future a decrease in foreign direct investment, simply because companies will not want to take the risk of being investigated or prosecuted at home for giving bribes.