

Control Risks



Corruption, Compliance and Change
Responding to greater scrutiny in challenging times

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Introduction

Analysts are still debating how far the current global economic crisis is a genuine turning point that will lead to radically different financial and regulatory models. Or should it rather be seen as a short-term period of turbulence that will reinforce rather than overturn long-term historical trends?

In the anti-corruption field, Control Risks argues for the latter view:

- **More scams.** We can expect further spectacular cases of large-scale fraud and corruption as the crisis continues to unfold. First, the strains of the recession will continue to expose frauds that are sustainable only in expanding markets. Secondly, at a time of financial desperation, companies will be all the more tempted to take greater risks, for example by paying bribes to outmatch their competitors. However, dramatic though they may be, these fraud and corruption cases do not represent fundamental change.
- **Tighter regulation.** The inevitable consequence both of the scams and of the deeper policy failures that contributed to the crisis has been repeated calls for tighter regulation. However, in the anti-corruption field, these demands reinforce an existing trend rather than creating something new. All the major industrialised states now have laws against foreign bribery that are similar to the US Foreign Corrupt Practices Act (FCPA). The question that really matters is how effectively these laws are enforced.
- **Inconsistent and uneven enforcement.** The answer, even now, is that the application of anti-corruption laws will remain highly inconsistent. We can expect a continuing trend towards tighter enforcement in the US and, to varying degrees, in other Western countries as well as Japan. In this respect the world is genuinely – albeit gradually – changing. However, partly for political reasons, the pattern of enforcement will remain highly uneven, both among the industrialised countries and still more in developing and transition economies.

It is this inconsistency that presents the greatest challenge for mainstream international companies. They cannot afford to ignore tighter legal enforcement, especially if they are based in the US or are listed on US stock exchanges. Equally, they still need to compete against unscrupulous rivals, many of whom are less careful on corruption matters, including in countries with poor – or at best uneven - standards of governance.

This report is intended for well-managed companies navigating their way through this complex world of inconsistent governance. The first half of the report begins with an analysis of the moves towards stricter enforcement of laws against foreign bribery in the industrialised countries. It then assesses the uneven process of anti-corruption reforms in a selection of emerging and transition economies: China, Nigeria and the countries of Central and South-eastern Europe.

In today's climate of tighter legal enforcement, good companies may be tempted to stay away from high-risk markets. However, this may not be the best approach. The second part of the report argues that companies must do two things to compete successfully:

- First, they need to ensure that their compliance controls are effective and fully understood at every level of the company hierarchy.
- Secondly, they need to develop active engagement strategies to compete for business honestly, even in countries with high levels of corruption.

By combining these two strategies, they should be able to develop opportunities that others might miss.

Tighter enforcement of laws against foreign bribery?

In the international arena the three key anti-corruption instruments are:

- The 1977 US Foreign Corrupt Practices Act (FCPA). The FCPA empowers the US authorities to prosecute US companies and individuals for paying bribes to foreign officials.
- The 1997 Organisation for Economic Co-operation and Development (OECD) Anti-Bribery Convention. Under the terms of the Convention all 30 OECD member states and eight others now have similar legislation to the FCPA covering their own companies and citizens.
- The 2003 UN Convention Against Corruption (UNCAC). This sets an international benchmark for anti-bribery legislation and offers the best long-term hope for a truly global standard.

In the immediate future the instruments that really matter for international companies are the FCPA and the equivalent laws passed by the other OECD countries. The most important question is how far these laws are actively enforced.

The rising tide of FCPA cases

In the case of the US, there is no doubt of the answer. Since the early 2000s, there has been a sharp increase in FCPA cases.

The two US agencies responsible for enforcing the FCPA are the Department of Justice (DoJ) and the Securities Exchange Commission (SEC). They initiated 38 FCPA matters in 2007 followed by 25 in 2008, and show no sign of losing momentum. In late May 2009, Mark Mendelsohn, the deputy chief of the DoJ Fraud Section, reported that as many as 120 companies were currently under investigation on suspicion of FCPA violations, compared with 100 at the end of the previous year.

The FCPA has real 'teeth': companies charged with FCPA offences face the prospect of heavy fines, including 'disgorgement' of the profits that they make as a result of bribe payments. The wider costs include heavy legal fees, reputational damage and the possibility of lawsuits by company shareholders. Under the terms of recent FCPA settlements, companies have been required to accept the supervision of external monitors to ensure that their compliance controls are made more effective. Meanwhile, individual offenders face fines and prison terms.

The FCPA extends US jurisdiction over foreign companies that are listed on US stock exchanges, as well as companies and individuals that use the 'mails or other instrumentalities of interstate commerce'. These 'instrumentalities' could include banking transactions through correspondent accounts in US intermediary banks, as well as communications such as emails and faxes via the US.

US enforcement actions against foreign companies have become all the more effective because of a pattern of increased co-operation between US investigators and their foreign counterparts.

Landmark cases

In the last year there has been a series of significant cases that are notable for their size, complexity and international connections.

Halliburton/KBR – Nigerian natural gas

In February 2009, US oil services company Halliburton and its former subsidiary KBR agreed to pay a penalty of \$579m, made up of a \$402m fine plus \$177m disgorgement of company profits. This is the largest fine ever paid by a US company in an FCPA case – exceeded only by the Siemens fine (see below). Earlier, former KBR CEO Jack Stanley had pleaded guilty to FCPA charges and faces a seven-year prison sentence.

The Halliburton/KBR case involves a series of bribes paid to secure contracts to build a natural gas plant in Bonny Island, Nigeria. The case is notable for its multiple international connections. KBR was a member of a four-company consortium, the other members of which came from France, Italy and Japan. The bribes were paid via a British solicitor, who was arrested in March 2009, and a so-far unnamed Japanese trading company. French, British and other international investigators are known to have assisted their US counterparts, and the case may yet lead to further prosecutions.

As part of its settlement with the SEC, Halliburton will retain an independent consultant to evaluate and review its anti-bribery controls. Similarly, KBR will retain an independent corporate monitor for a term of three years.

Siemens AG – record fines

The corruption case involving German engineering conglomerate Siemens AG is the most striking recent example of an FCPA enforcement against a foreign company. Siemens has been listed on the New York Stock Exchange since March 2001, and was therefore required to comply with the provisions of the FCPA as well as German law.

The German authorities' investigation into Siemens began in late 2006. In October 2007, following its conviction in a Munich court, the company paid a fine of €201m (approximately \$285m) in connection with an initial set of 77 bribery offences concerning Libya, Russia and Nigeria. Meanwhile, the SEC and the DoJ began their own parallel investigations, as did the authorities in other countries ranging from China and Hungary to Israel, Russia, Norway and Indonesia.

The outcome of the US investigations was that in December 2008, Siemens and its subsidiaries agreed to pay criminal fines on FCPA charges totalling \$450m, as well as \$350m in disgorgement of profits made as a result of the bribes. These were by far the largest fines imposed in an FCPA case to date. On the same day, Siemens also entered into a settlement with the Office of the Prosecutor General in Munich and agreed to pay a penalty of €395m (approximately \$569m). This was in addition to the earlier fine of €201m, bringing its total penalty to around \$1.6bn.

On top of these fines, Siemens incurred massive bills from a US law firm and international accountancy companies. Investigators hired by the company are reported to have conducted more than 1,700 interviews in 34 countries. The total fees for professional services amount to approximately \$1bn, so the combined cost to Siemens of fees and fines is of the order of \$2.6bn. Siemens has been required to accept the supervision of an external monitor, in this case former German finance minister Theo Wiegler.

Bridgestone Corporation (Japan) – the long arm of the US law

Also in December 2008, a Texas court sentenced Misao Hioki, the former general manager of Bridgestone Corporation's International Engineered Products (IEP) division, to two years in jail and a fine of \$80,000 on FCPA charges. Hioki had been based in Tokyo, and the bribes were reportedly paid in Argentina, Brazil, Ecuador, Mexico and Venezuela: the case illustrates the wide international reach of the FCPA.

The charges against Hioki came as a result of an earlier enquiry into suspected breaches of anti-trust laws. In May 2007, the US DoJ, the European Commission and Japan's Fair Trade Commission initiated joint investigations into Bridgestone and five other international companies that had reportedly been involved in an international cartel to sell marine hoses at inflated prices. In the course of the investigation it emerged that Bridgestone had been paying bribes via local sales agents to win business from state-owned companies in Latin America.

Hioki was responsible for supervising the executives who set up the bribery arrangements. He came under US jurisdiction on the FCPA charges because many of his company's internal meetings to discuss the bribe payments had taken place at the offices of a Bridgestone subsidiary company in Houston, Texas. He was arrested in Houston in May 2007 following a meeting with representatives of other companies in the cartel.

So far, Bridgestone as a company has not been charged under the FCPA, but further DoJ investigations into its activities were reported to be still under way in early 2009.

Prosecutions for bribes to customs officers

Aibel Group Ltd, a British engineering company, in November 2008 pleaded guilty to an FCPA charge of paying bribes to the Nigerian Customs Services via an international freight forwarding and customs clearing agent, and agreed to pay a fine of \$4.2m.

This is one of a series of recent cases whereby both US and foreign companies have been charged for bribes paid to customs officials. The common features of these cases are first that the payments were made to secure preferential treatment, such as a reduction of duty, and not just to speed up customs clearances. Secondly, the fact that the payments were made via an intermediary – in this case a freight forwarding agent – does not exempt the client company from liability. Together, these cases demonstrate that the US authorities take a broad view in their interpretation of the FCPA: they understand it to apply not only to bribes paid to win contracts, but also to other illicit business advantages.



Enforcement by other OECD countries

In theory, the OECD Anti-Bribery Convention is supposed to establish a common standard among all the leading industrialised nations, and thus prevent bribes from being used as a form of unfair competition. To ensure that this happens, the OECD operates a system of 'peer review' through its Working Group on Bribery in International Business Transactions. The Working Group, which is made up of specialist representatives of signatory governments, has conducted a series of reviews, first to assess each country's anti-corruption legislation, and secondly to assess the effectiveness with which laws against foreign bribery are actually implemented.

So far, the results have been mixed. In some cases, there have been loopholes in the legislation. In other cases, the letter of the law may be fine, but the government has been slow to publicise it, or to follow up with investigations and prosecutions. The investigation of foreign bribes is in any case expensive and time-consuming, especially if the host government does not co-operate. Many countries have yet to devote adequate resources to this task.

The impact of the convention has therefore been gradual and cumulative rather than sudden and dramatic. Nevertheless, there is now growing evidence of tighter enforcement among several of the leading trading nations.

Germany – continuing repercussions of the Siemens scandal

After the US, Germany currently has the strongest record for enforcing its laws against foreign bribery. Naturally, the Siemens case had the greatest impact because of the company's status as one of the icons of German industry, and because of the sheer extent of the bribery network uncovered by the investigations of the German and US authorities. However, Siemens is far from being the only foreign bribery case. By 2008, there were already 43 enforcement cases, and further investigations are known to be under way. In May 2009, news emerged of a major investigation into truck company MAN, reportedly including bribes to boost sales of around €14m between 2002 and 2005. Most of the improper payments are said to have taken place outside Germany.

Whatever the outcome of the MAN investigations, there is no doubt that corruption is on the corporate agenda in Germany.

France – a tradition of judicial activism

France also performs relatively well, in part because of a long history of judicial activism whereby investigating magistrates have taken on high-profile cases, often reaching to the heart of the French establishment. By 2008, France had 19 enforcement cases concerning foreign bribery. The French authorities are understood to have collaborated with their US counterparts into the Bonny Island case, which led to the Halliburton/KBR conviction (see above), as well as bribes reportedly paid in Costa Rica by French telecommunications company Alcatel (now part of Alcatel-Lucent). In mid-2008, there were reports of international investigations into alleged bribery offences concerning French engineering company Alstom, but these have not led to any prosecutions.

Like the OECD, the Council of Europe operates a peer review system, and its March 2009 report on France expressed concerns about the country's anti-corruption legislation, noting that it had 'severely restricted its jurisdiction and its ability to prosecute cases with an international dimension'. On a similar note, the French chapter of anti-corruption watchdog Transparency International issued a progress report in May 2009 on anti-corruption initiatives during the first two years in office of President Nicolas Sarkozy. The report welcomed the Law of 13 November 2007, which – among other measures – provides legal safeguards for private-sector whistleblowers and extends the range of surveillance techniques available to corruption investigators. However, it called for further reforms to ensure prosecutors' freedom from political interference.

Despite these concerns, the tradition of French anti-corruption activism clearly continues. In mid-2009 a French magistrate launched an investigation into alleged money-laundering by the presidents of Congo (Brazzaville), Equatorial Guinea and Gabon.

UK – new enforcement measures

To date the UK's performance in the international campaign against foreign bribery has been notably weak, but this may be beginning to change.

The UK ratified the OECD convention on the understanding that its existing package of anti-corruption laws, which date back to 1889, were sufficient to meet the convention's requirements. This interpretation was challenged by legal experts, and the government in 2002 introduced a legal amendment stating explicitly that British legislation applied to bribes abroad as well as at home. However, until recently, there had been no British convictions for foreign bribery, and a series of OECD reports have criticised the UK's ineffective enforcement of the convention.

The OECD has been especially critical of the Serious Fraud Office (SFO) decision in December 2006 to halt a high-profile investigation into the activities of British defence company BAE in Saudi Arabia. At the time, then prime minister Tony Blair argued that the investigation would damage relations with Saudi Arabia, thus undermining vital national security issues. In light of this episode, and continuing deficiencies in British legislation, the OECD Working Group issued a report in October 2008 stating that it was 'disappointed and seriously concerned with the unsatisfactory implementation of the convention by the UK'. In the restrained language of international diplomacy, this phrase amounts to a serious rebuke.

Despite these concerns, there have been three significant enforcement cases in the last year, and these signal an enhanced willingness on the part of the authorities to use a variety of legal strategies to combat corruption:

- In August 2008, the Overseas Anti-Corruption Unit (OACU) of the City of London Police brought a successful case against Neils Jorgen Tobiasen, the Danish managing director of The CBRN Team, a UK-based company specialising in countering chemical threats. Tobiasen pleaded guilty to bribing Ugandan officials. This was the first successful prosecution of a UK-based company for a foreign bribery offence.
- In early October 2008, Balfour Beatty, a leading UK-based construction company, agreed to pay a penalty of £2.25m in relation to 'certain payment irregularities' in respect of a major project in

Egypt. In April 2005, Balfour Beatty had itself discovered the irregularities within a subsidiary company and reported them to the SFO, which conducted its own investigation. The payment takes the form of a Civil Recovery Order under the 2002 Proceeds of Crime Act, whereby the SFO can recover property obtained by unlawful conduct. Balfour Beatty has also undertaken to introduce compliance measures to ensure that the offence is not repeated. The settlement reflects a partial change in strategy by the SFO: by using its powers under the Proceeds of Crime Act, it avoided the expense and potential complications of a formal prosecution.

- On 9 January the UK Financial Services Authority (FSA) fined insurance company Aon £5.25m for failing to 'establish and maintain effective systems and controls for countering the risks of bribery and corruption'. Aon had reportedly made suspicious payments to third parties amounting to approximately \$2.5m and €3.4m between January 2005 and September 2007. This is the largest financial crime-related fine imposed by the FSA to date, though Aon negotiated a reduction in the penalty by co-operating with the FSA investigation.

In March 2009, the City of London Police's anti-corruption unit was reported to be investigating a further 20 suspected foreign bribery offences, and it is likely that at least some of these will in due course lead to further prosecutions.

Even more importantly, the UK has taken a significant step towards legislative reform with the publication in March 2009 of a new bribery bill. It is as yet uncertain whether the bill will be passed into law before the next national elections, which are due by 2010 at the latest. Once it does come on to the statute books, the bill will set new standards that in some respects will go further than the FCPA.

Among other measures, the bill seeks to establish corporate liability for failing to prevent bribery. Under existing UK law, prosecutors cannot prosecute a company for bribery unless they can establish that its 'directing mind' – usually a board director – authorised the bribe. The bill creates a defence for companies that have introduced 'adequate' measures to prohibit corruption. It will therefore be incumbent on businesses to adopt anti-corruption programmes to document their implementation.

Japan – the first prosecutions of foreign bribery cases

Japan's performance has also been weak, but here too there are signs of change.

Japan's laws against foreign bribery take the form of a series of amendments since 1998 to the Unfair Competition Prevention Law (UCPL). For several years after the law was first amended, there were no prosecutions and, like the UK, Japan has been rebuked in a series of OECD Working Group reports for its weak implementation of the Anti-Bribery Convention. However, in the last two years, there have been two enforcement cases:

- In March 2007, prosecutors in the southern island of Kyushu filed a summary indictment against two employees of the electrical and engineering company Kyudenko Corp on charges of bribing Philippine government officials. In 2004 they had invited two representatives of the Philippine National Bureau of Investigation to Japan, and had given them expensive sets of golf clubs in a bid to promote the sale of Kyudenko's fingerprint identification system in the Philippines. The two employees were fined a total of ¥700,000 (\$6,000). Although the offence that was prosecuted was relatively minor, it nevertheless marked the first time that the UCPL had been applied in a foreign bribery case.
- In January 2009, a Japanese court convicted three former senior executives of Tokyo-based Pacific Consultants International (PCI) on charges of bribing a senior Vietnamese official. The three were sentenced to suspended prison terms of two years, 20 months and 18 months respectively, and the company was ordered to pay a fine of ¥70m (\$774,000). A fourth PCI executive received a suspended prison sentence of two years and six months in March 2009. PCI had reportedly paid seven bribes amounting to a total of \$2.43m to Vietnamese officials in return for the award of consulting contracts for road construction projects in Hanoi.

By US standards, the sentences against the PCI executives were relatively light. Nevertheless, the PCI case was the first time that a UCPL foreign bribery offence had come to trial, and to that extent marked a significant landmark in Japanese enforcement. The Japanese authorities are sending a clear signal that the laws against foreign bribery are to be taken seriously.



Competition from emerging-market multinationals

In 2006, Control Risks and international law firm Simmons & Simmons published the International Business Attitudes to Corruption survey (available on www.control-risks.com). Respondents from 350 international companies, were asked to rate the compliance standards of companies representing a range of OECD and non-OECD countries. Companies from Canada, Germany and the Netherlands were awarded the highest ratings for compliance; their counterparts from China, India and Brazil received the lowest. A more recent survey by Transparency International, the 2008 Bribe Payers Index, had similar findings. The survey is based on interviews with 2,742 business people, and ranked 22 countries. Of these, companies from India, Mexico, China and Russia were seen as most likely to pay bribes.

'New' transnational companies based in what are currently considered to be emerging markets are playing an increasingly important role in the global economy. The two surveys reflect a widespread concern that companies from countries that lack foreign bribery laws – or do not enforce them effectively – may constitute a new source of unfair competition. The extent to which this actually happens will depend in part on the effectiveness of anti-corruption enforcement in host countries for foreign investment as well as the exporting nations, and this is the focus of the next section.

Regional and national trends

It is a commonplace of international discussions on corruption that 'it takes two to tango'. The FCPA and the OECD Anti-Bribery Convention are designed to address the 'supply side' of bribery as represented by international companies that might otherwise be tempted to bribe foreign officials. However, effective action by the host governments that employ these officials is at least equally important, not least because the 'demand side' of corruption is often manifest as a form of extortion.

Here, the overall pattern is again uneven. No government questions the need to tackle corruption. The UNCAC has played a constructive role in promoting common standards, and a number of countries can point to important legal and institutional reforms. However the implementation of those reforms is all too often impeded by conflicting political messages and lack of judicial and investigative capacity.

This section assesses recent anti-corruption trends, and the implications for foreign companies, in three contrasting international markets: China, Nigeria and the countries of Central and South-east Europe.

China: working harder to win on a far from level playing field

China exemplifies both sides of the international 'tango'. In the last two years, there have been a series of FCPA cases concerning China. At the same time, the Chinese government has been engaged in a crackdown of its own.

International cases

One of the most notable cases concerned Lucent Technologies (now part of Alcatel-Lucent), which in 2007 paid total financial penalties of \$2.5m after having paid the expenses of some 315 trips to the US by Chinese officials between 2000 and 2003. The trips were primarily for sight-seeing and leisure rather than business purposes and the US authorities regarded them as a form of bribery. The FCPA definition of 'foreign officials' includes employees of state-owned enterprises (SOEs) and hospitals as well as regulatory officials, and other recent cases involve US companies that made illicit payments variously to doctors in government offices, executives of state-owned oil companies and patent officials.

A strategic imperative for the Chinese government

Complaints about corruption – for example in fraudulent land deals – have been a leitmotif of anti-government protests, particularly in the south-east of the country. Similarly, the Sichuan earthquake in early 2008 highlighted the social impact of corruption: the buildings most vulnerable to collapse included schools where contractors had bribed officials to circumvent building regulations. The political requirement to address the problem has become all the more urgent with the current economic slowdown. If ordinary citizens' hopes of future prosperity are blighted, they will be all the more likely to turn their anger against officials and business people who are believed to have cheated the system. The need to be seen to combat bribery is therefore a strategic requirement for the Chinese government.

Historically, the ruling Chinese Communist Party (CCP) has tended to focus on corruption involving government officials and party cadres. However, since 2006 the Ministry of Supervision – the lead government agency in the campaign against corruption – has launched a series of initiatives to address the private-sector 'supply side' of bribery. By September 2008 it was able to report that a total of 54,298 commercial bribery cases had been dealt with, presumably over the previous two years. Among other areas, there had been a particular focus on corruption cases involving the procurement and sales of medical supplies. Current priority areas include construction, land transfer and the financial sector.

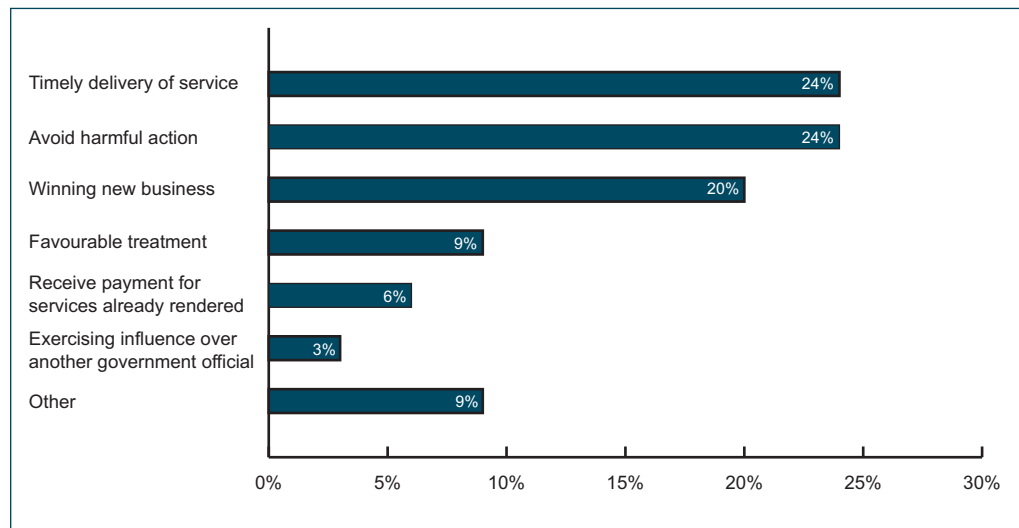
At the same time, the ministry is devoting more resources to prevention. Currently planned initiatives include a series of measures to streamline government approval processes, and to continue the process of legal reform. The laws that are currently due for review include the Anti-Unfair Competition Law, the Environmental Protection Law, and Regulations for the Supervision and Administration of Medical Devices. In a judicial interpretation released in late November 2008, the government expanded its definition of people who may be prosecuted for bribery in relation to procurement decisions to include doctors and teachers who accept money or other favours from sales people.

Risks to foreign companies

These cases highlight the risks to international companies in two important respects. First, it is more important than ever to know your business partner: it is also more difficult than ever to be confident of making the right decisions given that many leading entrepreneurs are vulnerable to accusations that they broke the rules (even if the rules were poorly defined) in the early stages of their careers. Secondly, while companies undoubtedly need expert advice to negotiate their way through the bureaucracy, they cannot afford to be associated with bribery in any form – even if the bribes are paid by intermediaries such as lawyers.

An insight into the difficulties that companies face at an operational level comes from a July 2008 report by Trace International, a US-based membership organisation working on corruption issues. A year earlier, Trace had set up its 'Bribeline' facility making it possible for companies to write anonymous online reports of cases where they have come under pressure to pay bribes. Since the reports are anonymous, they cannot be used to initiate prosecutions. However, Trace believes that they can provide a useful basis for lobbying if the same problems keep recurring in the same jurisdiction.

Nature of bribery demands in China reported by Trace International 'Bribeline', 2007-2008



Source: Trace International 'Bribeline' 2008 – sample of 148 cases.

An analysis of the first year's worth of Bribeline reports from China shows that, in 24% of the total number of cases reported, companies were asked to pay to secure the timely delivery of some service: customs clearances are an obvious example. In another 24% of cases they were asked to pay to avoid some harmful action. Trace does not give details, but a plausible example would be a threat by a fire safety inspector to close down a factory because of trivial infringements of safety rules.

Outlook

The fact that corruption cases are in the news may – in the long run – be taken as a sign of progress. In the past, Chinese business leaders and government officials might have been tempted to downplay the problem. Now it has become much harder to do so. However, for some time to come, government enforcement will remain uneven and even erratic. Moreover, despite the increased emphasis on the rule of law, political considerations will continue to influence decisions on the cases that do – or do not – come to trial.

These factors mean that in the short term the commercial environment for foreign companies is likely to become harder rather than easier. To succeed, international companies need the best products and the best services. They also need careful due diligence procedures to assess the integrity records of potential business partners, as well as thorough ethics and compliance programmes for Chinese as well as foreign employees. China has always been a difficult market: it still is.

Facing up to corruption in Nigeria

Like China, Nigeria illustrates both the national and the international aspects of current attempts to crack down on corruption. As has been seen, the Halliburton/KBR case involved bribes paid to secure contracts in a natural gas plant in Nigeria. Nigeria also figured prominently in the Siemens case. According to the SEC complaint against Siemens, the telecommunications arm of the company made approximately \$12.7m in suspicious payments in connection with Nigerian projects between 2001 and 2006: its practice of paying bribes in Nigeria was 'longstanding and systematic'. In addition there have been a series of FCPA cases involving companies in the oil and natural gas sector.

Domestic anti-corruption initiatives

Meanwhile, the Nigerian government has taken important steps towards institutional reform, notably by setting up the Independent Corrupt Practices and Other Related Offences Commission (ICPC) in 2000 and the Economic and Financial Crimes Commission (EFCC) in 2003. In 2005, during the final stages of then President Olusegun Obasanjo's term, the government introduced the so-called Due Process mechanism to bring greater transparency to the public procurement process.

These reforms have achieved mixed results. The EFCC, initially led by Nuhu Ribadu, quickly gained a reputation for political fearlessness. Between 2003 and 2007 it secured convictions in 275 out of the nearly 1,000 cases it brought to the courts. At the same time the EFCC's reputation was marred by allegations that it had been used as a political instrument to eliminate Obasanjo's political rivals. In late 2007 Ribadu was sidelined and ultimately dismissed from government service, and a political backlash appears to have contributed to his downfall.

The EFCC nevertheless continues to demonstrate a willingness to take on sensitive cases. In April 2009 it formed part of an inter-agency special committee set up to investigate the KBR case following the company's FCPA conviction. In early May 2009 it charged former Federal Capital Territory (FCT) minister Nasir el-Rufai on eight counts of criminal conspiracy and abuse of office.

Impact on business

At a minimum, despite continuing political controversies, the EFCC has begun to challenge Nigeria's former culture of impunity. Nevertheless, corruption remains a significant obstacle for companies doing business in Nigeria. For example, in the World Economic Forum's 2008-09 Global Competitiveness Report, corruption emerged as the third most problematic factor for doing business in Nigeria, after 'inadequate supply of infrastructure' and 'access to financing'.

Senior businesspeople expressed a similar view when interviewed for Control Risks' Facing up to Corruption in Nigeria report, which was released in May 2009 (see: www.control-risks.com). However, while underlining the continuing challenges, they emphasised that it was possible to do business in Nigeria without resorting to bribes. As will be seen in the final section of this report, the minimum requirement is an effective compliance programme. However, companies also need an effective engagement strategy, supported by good business intelligence, diplomatic skills and in some instances an acceptance of delays.

Crime, corruption and reform in Central and South-east Europe

Like China, the countries of Central and South-east Europe are engaged in a long-term process of transition towards a more market-oriented economic model. Particularly in the early stages, the reform process was accompanied by widespread allegations of corruption and economic crime.

In recent years, considerable progress has been made in Hungary, Poland and the Czech Republic, which joined the EU in 2004. However, the European Commission has issued a series of reports criticising Romania and – more strongly – Bulgaria, which joined the EU in 2007 but have failed to implement adequate institutional reforms to combat economic crime. In July 2008 the EU suspended €500m worth of aid to Bulgaria and, although it decided to unfreeze €115m in May 2009, this is at best a modest indication of progress. Meanwhile, questions remain about

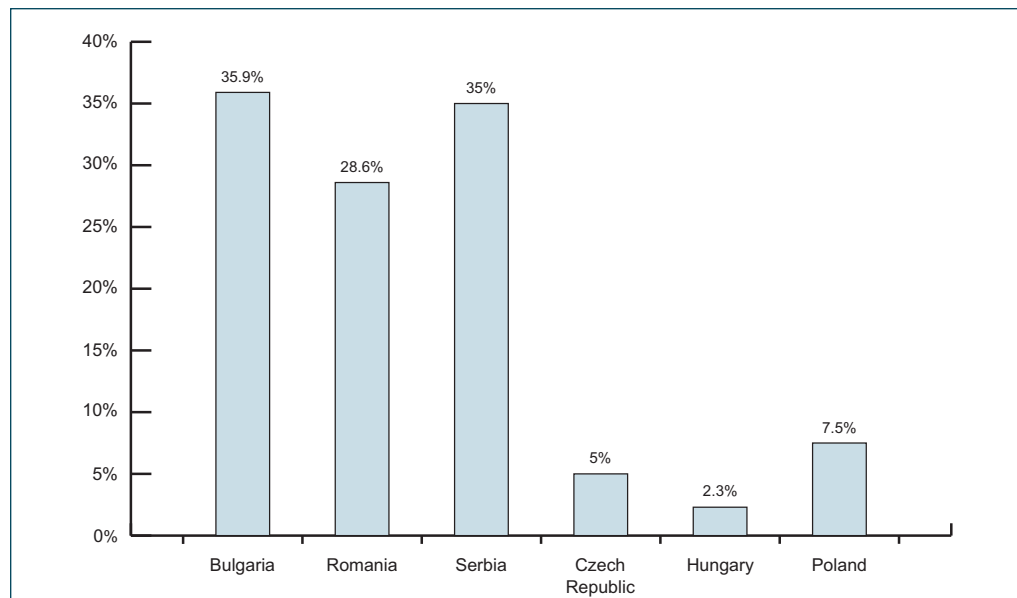
Serbia, whose new government has now formally expressed a desire to enter the EU, but which has a long-standing record of corruption and organised crime.

The regional balance sheet

The public debate on these issues raises questions about the impact on business. To find the answers, Control Risks conducted a survey of senior executives from 244 international companies operating in three countries in Central Europe (the Czech Republic, Hungary and Poland) and three in South-east Europe (Bulgaria, Romania and Serbia). The full results of the survey are published in a longer report *Business, Corruption and Economic Crime in Central and South-east Europe*, which is available on the Control Risks website (www.control-risks.com).

Overall, 18% of respondents said that corruption was 'very relevant' or 'highly relevant' to their business. However, there was a sharp disparity between the three Central European countries and their South-east European counterparts.

Respondents stating that corruption was 'very relevant' or 'highly relevant' to their business



Source: *Business, Corruption and Economic Crime in Central and South-east Europe*, Control Risks, 2009

Overall, 33.1% of respondents said that someone had tried to obtain a bribe – either in money or favours – from their company during the previous year. Some 31% believed that their company had failed to win a contract or gain new business because a competitor had paid a bribe during the past year, and 40% believed that they had failed to win a contract for this reason in the past five years. It is clear that – for a significant minority of companies – corruption remains a major obstacle to business in the region.

Overcoming this obstacle requires a detailed understanding of how and when companies are most vulnerable to demands for bribes. Respondents were asked a series of questions about the frequency of corruption in five situations. These included cases where companies were: competing for public-sector contracts; competing for private-sector contracts; applying for official permits; and wanting to speed up the work of public officials, for example during customs procedures, in which case they might receive demands for 'speed money'.

The overall results suggest that the worst problems concerned tenders for public-sector contracts and demands for 'speed money'. Just over 40% thought that corruption occurs 'often' or 'always' when companies are seeking public contracts. More than one-third thought that it occurred 'often' or 'always' when they sought to speed up the work of public officials.

Cautious optimism

Despite these concerns, the overall findings of the survey give grounds for cautious optimism. Corruption remains a significant problem. Nevertheless, an overwhelming majority of respondents either 'definitely agreed' (47%) or 'rather agreed' (38%) with the statement that 'it is possible to conduct business successfully without corruption' in their countries. A mere 3% took the hardline view that it was 'definitely not' possible to conduct business successfully, while 11% 'rather disagreed' that it was possible. Bulgaria is the country with the largest proportion of pessimists: 23% 'rather disagreed' with the view that it was possible to conduct business without corruption, and as many as 10% thought that it was 'definitely not' possible.

Control Risks agrees with the optimists: it is possible – indeed essential – to conduct business successfully in both Central and South-east Europe without resorting to graft. The minimum requirement – as in the more difficult environments of China and Nigeria – is an effective compliance programme.

Strategies for success in an unfair world

Recent national and international anti-corruption initiatives represent ground for cautious long-term optimism. However, while business leaders require a long-term vision for the future, their immediate concerns are for the present and the short-term future. In the current international environment, there are two requirements for success. The first is defensive: an effective internal compliance programme. The second is active: companies need to develop effective engagement strategies to win business without paying bribes.

Compliance and controls: get real!

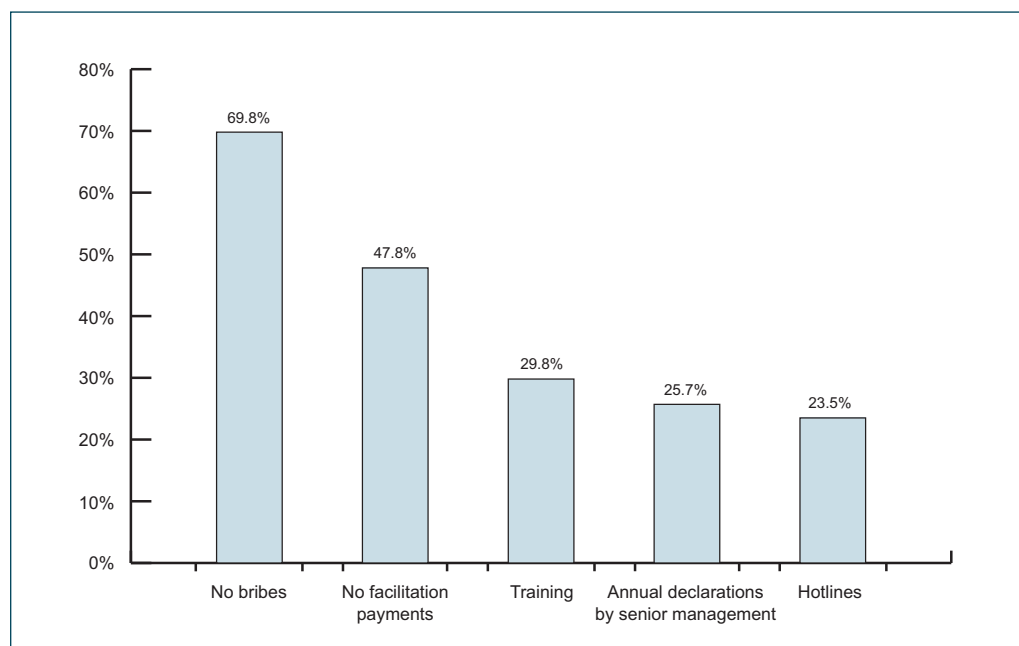
The message from recent national and international bribery cases is very clear: effective anti-corruption controls are an essential ingredient of corporate governance. Companies that have these controls are less likely to suffer from economic crime. If bribery cases do occur, they will be better placed to defend themselves by arguing that the offence was an aberration, not the inevitable result of a flawed corporate culture. However, this defence will not work unless the company can demonstrate that its controls are sincerely and consistently implemented.

'No bribes' declarations are not enough

It is now becoming standard – although still not universal – practice for companies to include a statement banning bribery in their codes of conduct. However, mere statements are useless unless they are backed up by effective compliance programmes.

Perhaps the single most important requirement is the personal commitment of the CEO and his senior management team to high standards of integrity. This must be backed up by actual commercial practice, including a willingness to support frontline management who fail to win business because of their commitment to the company code. Good two-way communication is essential. This includes training programmes, especially for executives who by the nature of their work are likely to be more exposed to corruption, as well as confidential 'hotlines' for company employees who wish to report actual or suspected ethical problems. At the policy level, it is now best practice to ban facilitation payments – so-called 'grease payments' to speed up routine governmental transactions – as well as bribes to secure business. Similarly, it is good practice for senior managers to sign annual statements confirming that their area of responsibility has been free of corruption in the past year.

Internal anti-corruption compliance measures implemented by companies in Central and South-east Europe



Source: Business, Corruption and Economic Crime in Central and South-east Europe, Control Risks, 2009

Our survey of international companies in Central and South-east Europe shows that these practices are still far from universal. The majority of our respondents came from companies with headquarters in OECD countries, and they are therefore accountable under foreign bribery laws. They are more exposed than they should be.

Siemens: failing to read the signs of the times

One of the most striking comments on the Siemens affair came from the company's CEO Peter Löscher, who took over in May 2007. Looking back at the company's recent history, he commented that:

It is completely clear that management culture failed. Managers broke the law. But this has nothing to do with a lack of rules. Siemens had and still has an outstanding set of rules. The only problem is that they were apparently being violated on an ongoing basis.

The DoJ complaint pointed out the Siemens had received a series of warning signs and 'red flags' following its listing on the New York Stock Exchange, but had failed to respond. Similarly, a Frankfurt prosecutor investigating Siemens expressed the view that the company's compliance programme existed 'only on paper'.

Siemens clearly has learnt its lesson, at immense financial cost: it has now introduced a far-reaching compliance programme that it hopes will restore its reputation, and give it a new competitive advantage. The challenge for other companies is to learn and apply the same lessons without the stimulus of a major crisis.

Engagement strategies

Nigerian-based businesspeople interviewed for Control Risks' Facing up to Corruption in Nigeria report underlined the importance of integrity programmes. Indeed, one CEO said that integrity was the 'most valuable resource', and said he wanted to write a book on 'Integrity as a Commodity'. Equally, they emphasised the need for initiative and inventiveness. Many of the qualities they emphasised are of universal application.

Business intelligence

The starting point of any engagement strategy has to be quality and competitive pricing. The second requirement is good business intelligence. Companies need to be selective in several respects:

- Choose the best people. If, as discussed above, China represents one of the toughest markets in the world, it requires the best and most experienced international executives, The same point applies equally to local recruits.
- Choose the best partners. Due diligence remains essential, both when hiring commercial agents and when planning joint ventures. The recruitment of agents is especially sensitive given that so many of the most prominent international bribery cases have been associated with corrupt intermediaries.
- Understand local geography. There are important local variations in the business environment within countries and regions. In China, Shanghai and many of the larger coastal cities have a reputation for higher standards of governance. Moreover, there are significant variations even within otherwise well-governed cities and provinces. At a minimum, companies need to be prepared for what to expect, and – if there is a choice – they may choose to operate in a region with better governance rather than another.

Companies clearly cannot choose the industries that they are in, and every sector has its particular hazards. Nevertheless they may be selective in another sense, focussing their risk management resources on the stages in the business cycle where they are likely to encounter the highest

integrity risks. In the construction sector, it is particularly important to manage the procurement process fairly and transparently. In the pharmaceutical sector, many of the greatest vulnerabilities lie in sales. It is important to deploy integrity management resources accordingly.

Cultivate diplomatic skills

The need for cultural sensitivity and 'soft skills', such as the ability to pick up implicit messages, is important in any business environment. This does not mean that international companies should compromise on their own values. It does mean that they should respect the values of others. Again, the social skills highlighted by Control Risks' Nigeria interviewees are universally applicable:

- 'Be politically savvy. Avoid comments on national issues, and respect the progress being made in the country.'
- 'The worst thing you can do is to be patronising.'
- 'It is not about shouting or fighting. The most effective way is subtle in approach, focused and determined. If you come shouting, you are screwed.'

Be prepared for setbacks

Companies need to be prepared for setbacks in several respects. Corrupt officials often put pressure on business people to pay bribes in return for faster service: it may be necessary to wait for results, even if there is a commercial cost.

Similarly, it is important to plan ahead, looking out for stages in the business cycle when the company may be more vulnerable to demands for bribes, for example when applying for planning permission or importing vital equipment. Once the risks are identified, it should be possible to develop counter-strategies.

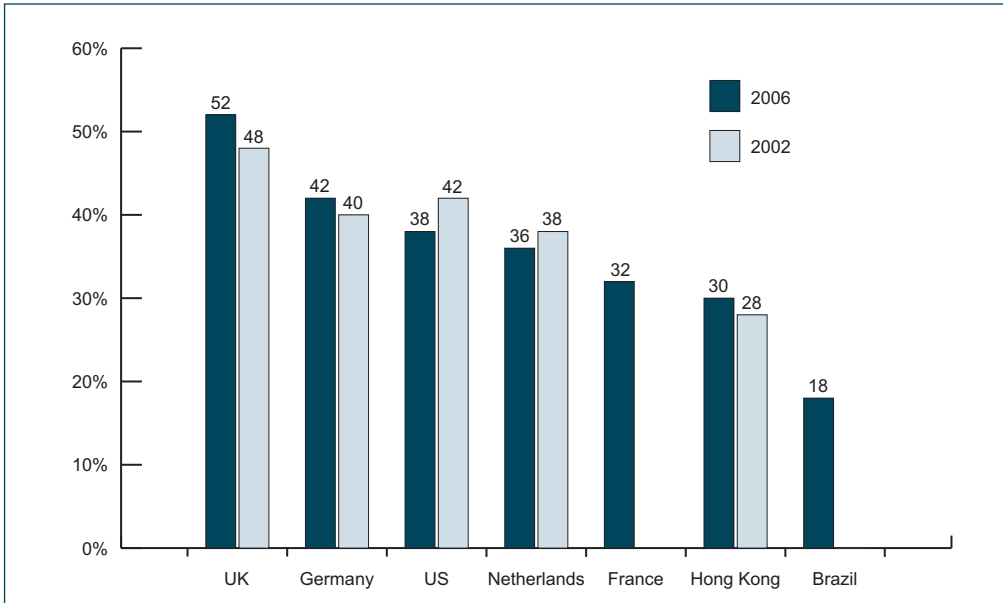
Finally, companies need to be prepared to take losses, at least initially. It clearly is impossible to win every business deal, even in the best circumstances. It may be necessary to accept some level of financial loss, particularly when the company is in the early stages of establishing its reputation as a non-payer of bribes.

Look for opportunities that others miss

In business circles it has become something of a commonplace to observe that the company ethics and compliance team should be renamed the 'business prevention department'. This pleasantry has some truth: it is indeed the task of the compliance team to prevent dishonest business deals that are against the long-term interests of the company. Nevertheless, it misses the point. The prime task of compliance specialists is to enable good companies to operate safely and ethically in high-risk environments that their more cautious competitors might shun. In that respect they should be seen as key members of their companies' business development teams.

High levels of corruption are a significant deterrent to well-managed companies. In Control Risks' 2006 International Business Attitudes to Corruption report, more than 35% of the respondents said they had been deterred from an otherwise attractive business opportunity because of a country's reputation for corruption.

Companies deterred from an otherwise attractive business opportunity on account of a country's reputation for corruption (by country).



Source: International Business Attitudes to Corruption, Control Risks and Simmons & Simmons, 2006

The highest percentages came from the UK (52% of the UK sample) followed by Germany (42%) and the US (38%). In light of the economic crisis and the trend towards tighter enforcement of foreign bribery laws, the figures in a similar survey conducted today would probably be even higher.

However, a cautious approach – simply staying away from potential problems – might not be the best response. A better answer would be to look at difficult markets, but with special care and discrimination. By modelling high standards of ethics and compliance, well-managed companies can make an invaluable contribution both to their own financial targets and to their host countries.



CONTROL RISKS' FRAUD AND ANTI-CORRUPTION PRACTICE

This report has illustrated the challenges faced by businesses in complying with regulation when operating in emerging or transition countries with poor standards of governance. So how can you build successful commercial ventures in high-risk environments, while still playing by the rules?

Control Risks' unrivalled international network offers the support that you need. We combine specialist knowledge of the US and OECD anti-corruption regimes with a deep understanding of how international markets really work. Drawing on our consultants' extensive experience, we offer a comprehensive package of services to support you from the first sales lead to the establishment of a thriving, sustainable business.

HOW CONTROL RISKS CAN HELP

- **Risk assessment and due diligence investigations.** We provide clients with the integrity information that they need before entering new markets or embarking on new business relationships. Our services range from the detailed country briefs available on our Country Risk Forecast online service to specially commissioned reports on individual companies and sectors.
- **Comprehensive third party and agent screening programmes.** Our Corporate Investigations department screens third-party vendors and commercial agents on behalf of our clients.
- **Strategic audit and review.** We help clients assess the effectiveness of their anti-corruption compliance systems. Control Risks' audits assess the effectiveness of clients' integrity policies, identify weak spots, and recommend solutions to potential problems.
- **Training.** We offer training workshops for both international companies, multilateral agencies and as a component of international conferences and seminars.
- **Problem-solving.** A well-designed ethics programme will help minimise integrity-related problems, but even the best-run companies need to be prepared for occasional setbacks. Control Risks provides the expert professional advice that companies need to withstand crises, and emerge even stronger from the experience.
- **Reports and 'white papers'.** Control Risks is an opinion-leader in the anti-corruption field. These reports distil our assessments of the latest international developments and emerging best practice. Recent and forthcoming reports include *Facing up to Corruption in Nigeria* and *Business, Corruption and Economic Crime in Central and South-east Europe*.

For further information, please see the Business Ethics and Anti-corruption page on our website at: www.control-risks.com/businessethics.

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