

OECD / ADB 4th Anti Corruption Conference

Bribery and Fraud Prevention Programs in the Private Sector

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Good afternoon.

Today I am going to address bribery and fraud prevention programs in the private sector in Asia. I am first going to provide some theory and background and then I am going to give a case study. Lastly there will be some time for questions and answers.

In considering issues relating to the private sector, my particular area of interest is transactions where the private sector meets the public sector. There is indeed private sector to private sector corruption but I would argue that the most egregious forms of private sector corruption are when there is a corrupt practice involving interaction between public and private sectors.

Fraud vs Corruption

In beginning a discussion about corruption it is important to start with some theory about fraud. This is because fraud and corruption are linked. However they are not the same, rather they are like two concentric circles that overlap in some areas but are separate in others.

You can have fraud and no corruption. You can have corruption and no fraud. But where there is fraud there is often corruption.

Protecting an organization in Asia against fraud involves addressing four issues:

- People
- Internal controls
- Enforcement
- Security

People in relation to who works for you, who are you hiring, who are your contractors, do you know your customers. It is trite to say that honest people do not commit fraud but so often we see simple mistakes made when hiring people that would never have lead to that person getting into an organization in the first place. The same can be said of vetting in relation to suppliers and customers. A common trick in Asia is for elements of the business that you believe to be third parties to be actually controlled by employees.

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The point about internal controls is that in Asia they need to be relevant. Controls that work nicely in Europe or the US may not work at all in Asia. In Asia collusion is common, holidays are infrequently taken, there is a reluctance to question up the chain of command and simply a lack of adequate training in many organizations that negates the value of internal controls that seem wonderful on paper. Within Asia what works in one country may not work at all in another.

A major risk for multinationals operating in Asia is to place the same amount of reliance on the external audit function in this region that they place on it in their home jurisdiction when it comes to the external audit being an important part of the overall control environment. The fact is that the major audit firms do not have consistent standards across their vast networks, nor do they have consistent training and they do not do enough to educate those running the head office audit about these risks.

A firm's position in relation to the enforcement of their policies vis a vis fraud is an important part of their fraud prevention strategy. Those firms with a firmer stance against fraud will find less instances of fraud. Those that ignore or only treat lightly a fraud that is discovered will find that they are sending a message that fraud is OK. Most organizations that I have seen that have experienced a major fraud (over US\$5m in losses) have had a similar fraud by either the same person or a related person prior to the major fraud for a much smaller amount. Strong enforcement (and this is not to be confused with zero tolerance that I discuss later) is a key part of your fraud prevention arsenal.

Lastly security. Big locks, big fences. So often I have seen firms ignore basic security of assets in their fraud prevention program. Company chops left on desks, movable assets not properly recorded or stored, intellectual property easily emailed away. Appropriate security is an important part of the overall fraud prevention program.

Finding Fraud

In designing fraud intervention and prevention programs you need to recognize that the earlier you go in the broader the intervention is going to be. Unfortunately the broader the intervention the higher the cost is going to be as well.

For example, deciding to do positive background checks on all employees can be effective at countering a number of potential fraudulent practices for an organization but in relation to protection of the operation of the petty cash tin it is an expensive solution for a problem better addressed by simple internal controls over tin access and accountability.

Fraud prevention is therefore about choices. Thinking about the point that you should intervene in the business is the best way to maximize the return you get from spending on fraud prevention. Sometimes its better to let a little fraud go on in order to then find and remove those involved rather than try and intervene early and believe that this will solve the problem.

Corruption - Definition

So what is corruption? Is it:

- Bribery
- Fraud
- Extortion
- Nepotism
- Patronage
- Cronyism
- Embezzlement
- Graft

Or is it all of these?

In fact the question about what is corruption and how people define it is one of the difficulties facing the anti corruption campaigner or strategist.

I will suggest to you that corruption is all of these things and in fact that each of the above descriptions are simply different manifestations of the same issue, however the key point to emphasise here is that by understanding what type of corruption it is you can then alter your risk management strategies accordingly.

For example if I own a filthy fruit stall in a public market and the health inspector comes over then I need to bribe him to look the other way. I am happy with this arrangement because it means I can stay in business without the costs of cleaning up my stall. The inspector is happy because he gets the bribe. There is no incentive in either of us complaining about the arrangement.

But if I own a clean store and the inspector tells me that unless I pay him off he will give me an infringement notice anyway, then that extortion is something that I am going to get very annoyed about. In fact if I have a way that I can complain about this treatment I probably will.

Therefore the types of techniques to adopt in relation to bribery are different to those involving extortion although both are corruption.

Corruption – Causes

So what causes corruption? The following items were found to be contributing factors in causing corruption on either a transactional or societal basis:

- Lack of transparency
- Silence
- Over regulation
- Failure to enforce / lack of enforcement
- Poverty

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- No checks and balances
- Greed
- Literacy
- Inequality
- Lack of democracy
- Expectations not met
- Weak judiciary
- Weak press
- Low public sector salaries
- Lack of market competition
- Transitional issues
- Prohibition

Many factors are both causes and consequences.

Corruption is a function of motivation and opportunity, of the likelihood of detection, of the likelihood of punishment, of 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 and Singapore there is less to worry about for firms doing business in those countries than other countries in the region that have little or no enforcement capabilities.

Addressing Corruption

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

1. Which tool to use
2. What regulatory style will fit your audience
3. When to intervene

Choosing the right tool will depend on what you understand the corruption issue to be. Regulatory style will be dictated by firm cultural issues and, most importantly, the nature of each jurisdiction you operate in. Another factor in relation to regulatory style will be the extent to which the firm is being regulated itself. The nature of your own regulatory environment may leave you little choice in what regulatory style to adopt in your anti corruption efforts. It almost goes without saying that firms need to be very careful about where a regulatory style comes directly into conflict with cultural issues in a specific jurisdiction. We often see this problem in Asia where the US financial industry regulatory style does not fit at all well with the way financial markets have typically operated in parts of Asia like South Korea, Taiwan, Malaysia and Australia.

Controlling Corruption

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In setting anti corruption strategies and tactics it is important to recognize some elements of corruption as a crime.

Firstly it is normally a hidden crime. There might not be an obvious screaming victim. The parties initially involved may all feel pretty good about keeping it hidden.

Secondly the enemy is conscious, they are evolving.

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 that the system is being abused. As one hole in the system is fixed another one may appear. Too often the anti corruption effort does not evolve and unfortunately anti corruption units within a corporation sometimes have negative incentives in uncovering more corruption. The easiest way to report to your boss that you have not uncovered any corruption issues (and therefore your prevention programs are perfect) is for you to not do any investigation or ignore new tip offs.

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

Essential Elements of an Anti Corruption Program

There are three elements to every anti corruption program:

- Education
- Investigation
- Enforcement

A program that has only one or two of these elements will ultimately fail.

Education needs to be when employees join a firm and as they continue their employment.

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

Enforcement needs to be fairly conducted, easily understood and firm in its application.

There is no such thing as a perfect way to approach all of these three issues. Each business undertaking 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. Dealing with supplier kickbacks in the

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purchasing department require different tactics than 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 there should be zero tolerance in relation to corrupt activities.

The Knapp Commission some thirty years ago into 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 that are dishonest. The guy in purchasing who has a few free beers from 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 that are the worst offenders, and thus those that are putting the organisation most at risk from corrupt practices, there needs to be a graduated approach to enforcement.

Zero tolerance has the effect of shifting the bell curve of corrupt behaviour to the right.

This is not to say that corrupt activity should not be punished, what I am advocating is an approach where the enforcement action is proportional to the issue.

That concludes the theory part of my presentation. I will now answer questions and then move to the case study.