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China's Bribery Probes: Killing the Chicken to Scare the Monkeys

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Earlier this summer, the State Administration for Industry & Commerce (SAIC) announced that it had organized its regional agencies to investigate allegations of anticompetitive market practices by food giant Tetra Pak International S.A., and New Zealand's Fonterra Co-operative Group announced that it was responding to a similar investigation in the consumer dairy space by the National Development and Reform Commission (NDRC).

In June, the NDRC also initiated a pricing probe in the infant formula market. One Chinese producer and five international producers were subsequently fined a record $110 million for pricing policies that violated China's antimonopoly law.

Nor has the pharmaceutical sector been spared, with approximately 60 companies receiving pricing surveys from the NDRC.

While these antimonopoly initiatives often result in price reductions and fines, the ramifications of China's anti-bribery initiative will be both more serious and more long lasting. As of early September, the government accused GlaxoSmithKline of paying bribes to doctors, Sanofi stated it was under investigation for similar conduct, and government investigators were reported to have visited other international pharmaceutical companies.

In addition to the immediate implications within China, the handling of bribery allegations by Chinese regulators can also create serious legal issues in home markets in the form of 10b-5 securities and shareholder derivative litigation, investigations by securities regulators, and criminal and civil charges under the U.S. Foreign Corrupt Practices Act (FCPA) and the UK Anti-Bribery Act.

The need to have in place a robust anti-bribery program that is rigorously enforced is well known to all international companies. How then could some major international companies have apparently failed so miserably? At least a significant part of the answer can be found in China. While bribery and corruption are certainly not unique to China, these problems are so very much worse and so very much more deeply entrenched in China than they are in other large economies. As GSK admitted in a statement, "certain senior executives ... appear to have acted outside of our processes and controls." If the corruption goes so far up the management chain, how can any anti-bribery program hope to catch it?

Although no program can be foolproof, there are steps one can take in China and other countries with especially significant corruption issues that can improve your chances of success.

- **Always assume you have, or will have, a problem.** The media reports on the recent investigations in China are replete with acknowledgements by unnamed company salespeople that the alleged illegal payments were "common practice" and have been for years. If this is true in a particular industry or with respect to a particular country, it is very hard to see how the senior management of a large international company could remain unaware of the problem unless they chose not to look.

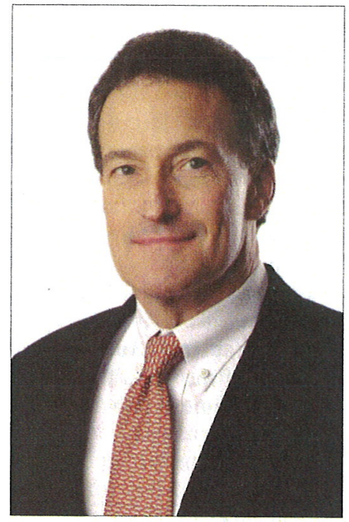
- **Learn how the corruption is executed at the local level.** Typically in China, cash flow is diverted both to generate the funds that are used for bribery and often for theft. It is obviously easier to catch a thief if you know his modus operandi.

- **Adjust your local bribery program** to your local environment; implement it rigorously; and monitor it, review it and adjust it periodically in response to what you find.
  - If you have hired intelligent creative local staff and some of them are inclined to avoid your rules, you should assume they will apply the same intelligence and creativity to circumvent the roadblocks you put in their way. Policy design and enforcement must be a fluid process in response to a changing environment.
  - De-emphasize FCPA compliance when training local employees and business partners in order to decrease tensions associated with training based on a "foreign-imposed" law. Most behavior that would be subject to sanctions under the FCPA would also be subject to sanctions under Chinese law, and some actions that would not violate the FCPA would violate Chinese law. Instead, conduct training based on local law requirements and company code of conduct requirements that are broad enough to cover all relevant jurisdictions.
  - Have your local team participate actively in training. Local buy-in is critical, as is even the appearance of local buy-in.

- **Be especially attuned to warning signs** such as:
  - High staff turnover.
  - CEOs and other senior managers who insist on being the sole point of communication with the home office.
  - Centralization of the selection of vendors, and managers who are deeply involved in the approval of all transactions.
  - Large reimbursements or reimbursements submitted with insufficient or unrelated documentation.
  - Whistleblowing by employees or tips from trusted vendors and agents.
  - Delays in the receipt of requested data from the accounting department.
  - As is alleged to have been true in the GSK case, travel agencies in China often serve as fronts to create slush funds through falsified records of travel arrangements. Investigate aggressively if one or a few agencies are always used.

- **Remembering the intelligence** and creativity of the local managers you have hired, periodically act outside your normal audit and enforcement processes.
  - Use outside professionals to vet vendors, distributors and agents.
  - Audit with internal and external auditors at the bottom layer of your local employees. Your employees at the bottom of the food chain do not share in the corruption that occurs at the management level and will typically resent their "betters" for receiving the benefits.
  - An occasional "public execution" for policy violations and even petty theft can work wonders. (Some say that the current government initiative is based on an old Chinese proverb: shā jī xià hóu ("kill the chickens to scare the monkeys"). Whether or not true in the case of the current government initiative aimed squarely, even if not exclusively, at international companies, the proverb is well-founded.)

- **Don't forget: All politics are local.**
  - Despite being often said, it remains true that business in China is based on relationships and in many competitor companies it will continue to be based on bribery. By understanding the business reality your employees face, you can develop ways for them to meet their internal goals while lawfully maintaining their relationships.
  - The pervasiveness of the government in all aspects of business in China means frequent contact with government officials is not only unavoidable but critical to conducting a successful business. Legitimate and non-excessive community and customer-wide relationship-building events can be an effective way to decrease requests for bribes.
  - If you do become the subject of an investigation, engaging the regulators early in the process is critical in China. Aggressive and antagonistic approaches to Chinese regulators are extremely counterproductive. Actively engaging them, cooperating and making it clear that the company takes the allegations seriously can help limit the scope of the inquiry and any fines or penalties that result.



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All companies and senior executives, especially those in China, should be examining the case of GSK and asking if "there but for the grace of God go I." If the answer is yes, the time to rectify the situation is past due. □