Questions of Compliance

As the Xi Jinping administration takes a closer look into corrupt practices by MNCs, foreign firms are paying increasing amounts of attention to being compliant.

By Frank Tsai

Recent high-profile cases of government investigation into corrupt and fraudulent practices at foreign multinational firms have put a spotlight on corruption risk in China. Government scrutiny of corporate corruption is not going away any time soon. While the Xi Jinping administration's anti-corruption campaign is targeting official malfeasance at high and low levels of the government (i.e. the proverbial "tigers and flies"), it has also focused on cleaning up corporate corruption seen to affect the lives of ordinary people. Thus, high-profile investigation of the healthcare industry is deliberately meant to be seen as dealing with practices that affect average consumers, who are extremely concerned about the high price of drugs, the question of whether such prices reflect genuine or counterfeit ingredients, and ultimately the sustainability of social welfare provisions such as healthcare as they enter retirement.

The logic for greater scrutiny of both official and corporate corruption is similar. The government wants to shore up support in the midst of slowing economic growth and the continuing social dislocations of more than two decades of rapid economic transformation.

This includes the full spectrum from rising inequality to break-neck urbanisation andthe sense of unfairness reflected in tens of thousands of protests and demonstrations (i.e. "mass incidents") that occur in China every year, many of which are directed at local governments. Scrutiny of local firms, in addition to foreign companies, also follows a similar logic. It may at first appear to foreigners that the targeting of MNCs is meant to shift attention away from corruption in Chinese firms, or boost relative perceptions of Chinese brands as compared to foreign competitors.

However, local firms account for the great majority of economic activity and corporate corruption in China, and the government cannot be seen as taking action on corporate corruption, and building up support among average consumers, without investigation of both local and foreign companies. Far from indicating a one-off or short-term policy of economic nationalism, efforts directed against corporate corruption should instead be seen as serious, long-term, and aimed at fundamental change.

Xi Jinping's ascension in late 2012 has resulted in changes in attitudes toward corruption and compliance among the business community in 2013. One study in particular, the American Chamber of Commerce in Shanghai's annual Business Climate Survey, conducted every year with support from Control Risks, [1]provides concrete detail into how sentiment is changing among foreign firms in China.

Among its most reported findings is that corruption was the #5 business challenge for MNCsin China in 2013. The survey also helps substantiate a number of other key trends in 2013.

Compliance as a China issue

First and foremost, compliance with anti-corruption laws and regulations has very much become a China issue for MNCs operating in China. These firms report an acceleration in greater attention paid to compliance efforts from 2012-2013 and also a doubling of greater risk of employee fraud or malfeasance in their businesses (G1). This reflects the greater seriousness with which the Chinese government and the Xi Jinping administration are cracking down on corporate corruption. MNCs also report a large jump in concern with compliance with Chinese law, as opposed to international anti-corruption law such as the Foreign Corrupt Practices Act (FCPA), which amounts to a reversal of relative concern with Chinese versus international law from 2012-2013 (G2). This clearly marks a sea change in the perceived risks of non-compliance. While MNCs continue to be concerned about the risks globally of falling afoul of international law, government investigations in China over the previous year have resulted in greater attention to China operations from corporate headquarters. Indeed, we may expect some change in those industries most concerned with corruption risk globally, i.e. consumer-focused industries such FMCG, retail, and healthcare. These are closest to the concerns of ordinary citizens whose support the government wants to consolidate, as opposed to those most exposed to FCPA risk globally.

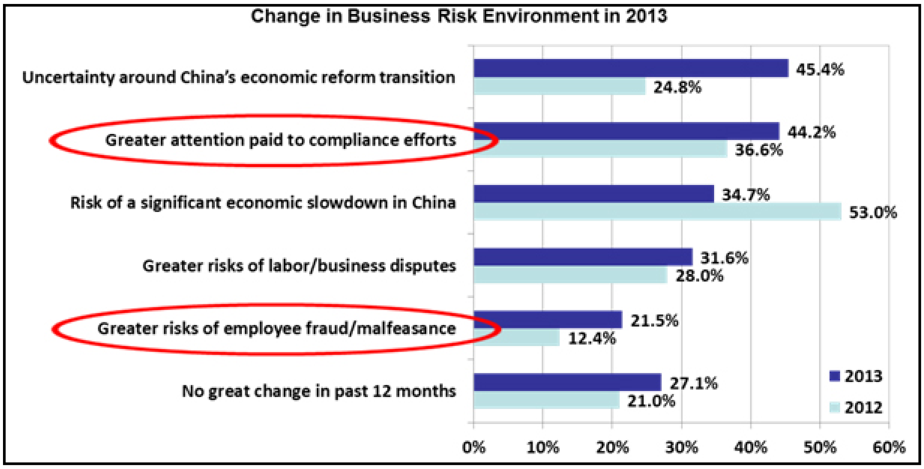
Greater incentive for enforcement

Second, senior managers at multinational firms are not only now more aware of corruption risks in China, but also have more incentive to actually enforce compliance, given the greater risks of prosecution and investigation. In other words, they may now be more willing to take action about grey and borderline practices in their operations, which they may have tolerated in the past. In the survey, one-fifth of firms report an increase in corruption risk from the Anti-Corruption Campaign between 2012 and 2013, and nearly one-half report an increase in their compliance spending, indicating a clear increase in awareness of the risks to China operations . At the same time, however, awareness does not necessarily translate into action unless also accompanied by fear, and traditionally far too many MNCs in China have been unwilling or unable to implement strict and absolute zero-tolerance policies regarding kick-backs, gift-giving, and bribery in dealings with business partners or government officials. This is now changing with greater oversight from corporate headquarters, stronger monitoring programs, and greater anxiety among senior managers about their own liability. Key to this trend is that while MNCs have always had an incentive to ignore such practices, even if aware of malfeasance, changes to the corruption risk environment are giving them both the means to discover wrongdoing and the incentive to do something about it.

Need for long-term focus

Finally, we can expect attention to corruption to continue to increase in the short-term, as it has done over the past year, but this does not necessarily mean that attention will be sustained by senior management over the long-term. In conjunction with the anti-corruption campaign over the last year has been the economic slowdown, which has given MNCs a chance to focus inwardly on their practices. We can, however, expect less focus on compliance as the economy picks up again and the costs of compliance to doing business become more apparent. The fact is that dealing with corruption risk requires money and effort, and this is not limited to an increased compliance budget, but also implies missed opportunities in the market and thepossibility of slower growth, as companies re-examine their commercial practices, existing use of distributors and third-parties, and adjust their expectations accordingly in line with stricter practices. Over-enthusiastic senior managers have often been difficult to control in fast-growing yet non-transparent developing markets such as China, as long as they deliver outsized revenue growth and profits. Any return to business-as-usual in the long-term would, however, run directly counter to the serious, long-term nature of the government's Anti-Corruption Campaign. In short, the perception of risk must remain high for senior managers to keep corruption top-of-mind, while recognising that minimising long-term risk is worth the immediate costs. SBR

Graph 1



Graph 2

<< Efforts directed against corporate corruption should be seen as serious and long-term >>

[1] *The AmCham Shanghai 2013-2014 Business Climate Survey was conducted via email in late 2013 and resulted in 399 responses from member firms. Control Risks has been AmCham Shanghai's partner on this survey since 2011. Full survey findings are available from AmCham Shanghai's website at www.amcham-shanghai.org.*

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