Control Risks

INTERNATIONAL BUSINESS ATTITUDES TO CORRUPTION

SURVEY 2015/2016

Managing Risk | Maximising Opportunity

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FOREWORD

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OVERRELIANCE ON COMPLIANCE

Our global survey of senior legal and compliance professionals shows that stronger legal enforcement and pressure from regulators with extraterritorial reach – as well as the evolution of local corruption laws – are persuading companies based around the world to improve their standards of compliance across all markets. However, in our experience, compliance programmes have failed to keep pace with the legislation. For many organisations, this produces a dangerous gap between the perceived effectiveness of a programme and the reality on the ground.

Overreliance on compliance is dangerous. Just as people drive faster when wearing a seatbelt, so compliance programmes can lead to a false sense of security. Programmes that are unfocused, incomplete or poorly implemented encourage companies to make decisions without a proper appreciation of the specific risks that they face, or the activities their operational teams on the ground are involved in. There is no point admiring the instruments on your shiny compliance dashboard if you're not watching the road ahead – and not checking your blind spots.

This is why companies with compliance programmes can still find themselves grappling with serious corruption, often uncovered in a remote office. Programmes driven from head office are overly focused on policies and training, but these alone will not be effective at mitigating corruption risks. Those procedures that have the most potential to enhance understanding of corruption risk at an operational level – due diligence, monitoring and auditing – are not being performed effectively, early enough, or at all.

COMPLIANCE AS A COMPETITIVE ADVANTAGE

Our survey shows companies continue to prefer avoiding corruption to resisting it. This is the easier option. But if ethically minded firms are deterred from markets where corrupt demands remain pervasive, they will miss out on opportunities. In our experience, these companies can successfully resist corrupt pressures if they factor integrity risks into their strategic decisions, and build a resilient culture and architecture around such decisions.

International laws and compliance programmes are deterrents and defensive measures. However, the best companies – particularly those from countries with the toughest legislation – are turning their compliance programmes into a strategic advantage. By using these programmes as strategic tools to provide intelligence to senior executives in managing risk, they are learning to navigate difficult markets more adroitly.

CHANGING CULTURE

Corruption will continue to evolve. Our survey suggests companies are ever-more aware of this and have been investing in increased compliance processes, tools and architecture. Yet gaps remain, particularly in oversight of third parties, risk assessment, and effective training and implementation. The job of legal and compliance teams has never been more important, but it is not their responsibility alone.

Resisting corruption should be the responsibility of every employee, but that requires leadership by example. Leadership that makes the effort to understand the on-the-ground risks the business and employees face. Leadership that responds with action and support, not just the threat of sanction for non-compliance. Leadership that recognises that these challenges need to be factored into forecasts and growth plans. Failure to do so will lead to distrust, non-compliance and, ultimately, breaches.

Corruption is a human risk and requires human solutions, backed by a technical and procedural compliance architecture that matches the real risks in a market – not an abstract or perceived level of "country risk". You need to really know who you are dealing with at every stage of your value chain, what motivates them, how they behave and how to forge compliant and collaborative working relationships. You need to be prepared to walk away from some deals. Then you can best calibrate all the tools at your disposal – from transaction testing to localised training to customised due diligence – to best mitigate the risk. One size does not fit all.

Even the strongest compliance culture will struggle to withstand the evolving, creative and pervasive threat of corruption – particularly when it comes to facilitation payments. That is the bad news. The good news is that if compliance is a cultural norm and is everyone's responsibility, and if compliance teams are adequately resourced, the early warning indicators can pick up problems before they become nightmares.

Our survey suggests this is still not quite happening. When early warning alarms go off, our experience is that internal investigations are one of the most crucial areas to get right, and require a combination of tact, discretion, professionalism and a clear aim. That is easily said, but much harder to do when under extreme pressure. If well-intentioned remedial action is not conducted sensitively, decisively and transparently all of the good work fostering a compliant culture will be undermined and employees will avoid tackling the very issues – the corrupt demands – that you need their support to resist.

WHAT CAN COMPANIES DO?

To entrench an anti-corruption ethos and turn this to their strategic advantage, companies should:

1. **Embed corruption risk into strategic planning**
   Too often, companies wait until after a market strategy is developed and implemented to consider the risk of corruption. However, the companies most successful at working in high corruption-risk environments are factoring corruption into their market assessments and strategic planning. For example, companies may want to segment their markets by corruption, identifying market sectors where customer bribery and kickbacks are common or where the only route-to-market is through distributors and agents who are more difficult to monitor and govern. Only when a strategy is adjusted for corruption risk can a company effectively mitigate the risks in the market.

2. **Look beyond the country level to find lower-risk deals in higher-risk markets**
   In our view, many of our respondents are still too sweeping in their approach to country risk, choosing to avoid complex environments entirely rather than find ways of engaging with them. By looking beyond country-level generalities to assess the risks involved in dealing with specific regions, sectors, companies and deals, firms can evaluate the real risks and structure deals accordingly.

3. **Scrutinise deals early on and be prepared to pass on them**
   Our survey shows external due diligence was a prime source of information for companies where corruption was the reason for pulling out of a deal, making it a critical tool in avoiding corruption. But we also know from our work with clients that it tends to come way too late in the typical merger and acquisition (M&A) process – often when the deal has unstoppable momentum.

4. **Carefully plan how to implement "zero tolerance" policy**
   When rolling out a "zero tolerance" stance to new locations, conduct a detailed risk assessment first and plan resistance strategies for how to deal with corrupt officials in advance. Remember that front-line employees are an invaluable source of information and understand the challenges of operating in their markets.

5. **Give your frontline people the support they need, train them for the environment they face and set the right incentives.**
   Take into account the environment in which employees work when creating training and use the insight they provide about the situations they face to inform the development of the programme. Take practical steps to ensure high ethical standards are fostered and rewarded through careful incentive-setting – in particular by making sure financial targets take account of costs and delays caused by resisting corruption. And back them up when they come under pressure.

Richard Fenning

SURVEY HIGHLIGHTS

Our report is based on a survey of legal and compliance specialists in more than 800 companies worldwide. It is informed by Control Risks' own experience of working with international businesses to mitigate corruption risks in complex and challenging environments. The report presents comparative data of developed economies and emerging markets, and takes a long-term view by assessing the findings from 2015 against Control Risks' research from 2002 and 2006.

Our findings reinforce many long-standing conclusions about the global anti-corruption and compliance landscape. However, they also shine a new and, perhaps, unexpected light on other issues. Notable findings include:

- There is no question that corruption remains a major cost for honest companies: in our survey, 30% of respondents said they believe they have lost deals to corrupt competitors.
- Tough extra-territorial, anti-corruption laws are seen to be a force for good. Where once they were held to be an unfair handicap to Western (particularly US) firms, hobbling their ability to compete on the international stage, now they are seen more positively. Most respondents believe such laws improve the business environment (81%), deter corrupt competitors (64%) and make it easier for good companies to operate in high-risk markets (55%).

  Strikingly, this view is held by companies based in tougher, emerging markets: good companies in more corrupt countries also welcome tough extra-territorial laws. Of the survey's Nigeria-based respondents, 97% believe the laws improve the business environment, as do 87% of Mexicans, 80% of Brazilians, 80% of Indians and 79% of Indonesians. Why? From our conversations with Nigerian, Indonesian, Indian and Brazilian organisations, it is clear that any law levelling the competitive playing field is welcomed by good companies unhappy with the haphazard enforcement of domestic legislation.
- For many international companies, compliance with anti-corruption laws has become a competitive advantage. One arresting finding is that companies from the countries with the toughest laws and the highest levels of international enforcement – the US, Germany and the UK – show a greater willingness to take risks than in previous Control Risks corruption surveys. Based on our conversations with clients, we believe that companies from these countries feel emboldened by the robust compliance programmes they have been forced to implement because of tougher laws.

  If that is the case, it comes with a major caveat: companies need to ensure that this willingness to take risks is not based on a false sense of security. The gap between the perceived protection a compliance programme brings and its actual mitigating effect is the biggest point of weakness for companies operating in high-risk markets.
- When it comes to compliance programmes themselves, third-party risk continues to be relatively unrecognised. This remains a critical vulnerability for many companies; just 58% have a procedure for integrity due diligence assessments of third parties and only 43% have third-party audit rights.
- In terms of M&As, external due diligence is the single most common source of information (27% of the time) that causes companies to pull out of deals because of corruption risk. Given how effective due diligence assessments are in identifying corruption risk, companies should consider starting them earlier in the M&A process, before letters of intent are signed and "deal momentum" becomes unstoppable.
- Although compliance programmes are crucial and the general trend is positive, reliance on a legalistic approach to compliance can be dangerous. Most respondents (51%) have conducted no internal corruption investigations in the past two years. This calls into question the effectiveness of internal audits, highlights the danger of waiting passively for a whistle to be blown, and perhaps suggests a culture of complacency in some organisations. There is certainly no "adequate procedures" defence for companies that fall foul of Chinese anti-corruption laws.
- Finally, and perhaps most importantly, companies need to set the right incentives for individuals. Respondents cited the fear of negative consequences as the penalty used most commonly to deter corrupt behaviour. On the list of eight deterrents to corruption, in lowly sixth place are company performance criteria that emphasise ethical behaviour (along with financial targets). So long as financial targets trump anti-corruption targets, shortcuts will be found. Moreover, a fancy compliance programme without leadership – or, crucially, clear support from senior managers – will fail.

HIGH COSTS FOR HONEST COMPANIES: WHO SUFFERS MOST?

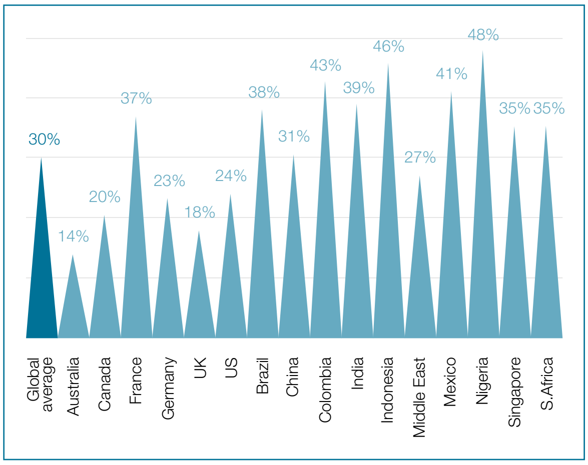
Our survey shows that corruption remains a major hazard in international business, and there are no grounds for complacency. Companies are still losing business to corrupt competitors, demands for facilitation payments are a continuing threat in emerging markets, and companies are still deterred from doing business in particular countries because of the risk of corruption.

GOOD COMPANIES ARE LOSING OUT TO CORRUPT COMPETITORS

Overall, 30% of respondents said they have failed to win contracts where there was strong circumstantial evidence of bribery by the successful competitor.[2]

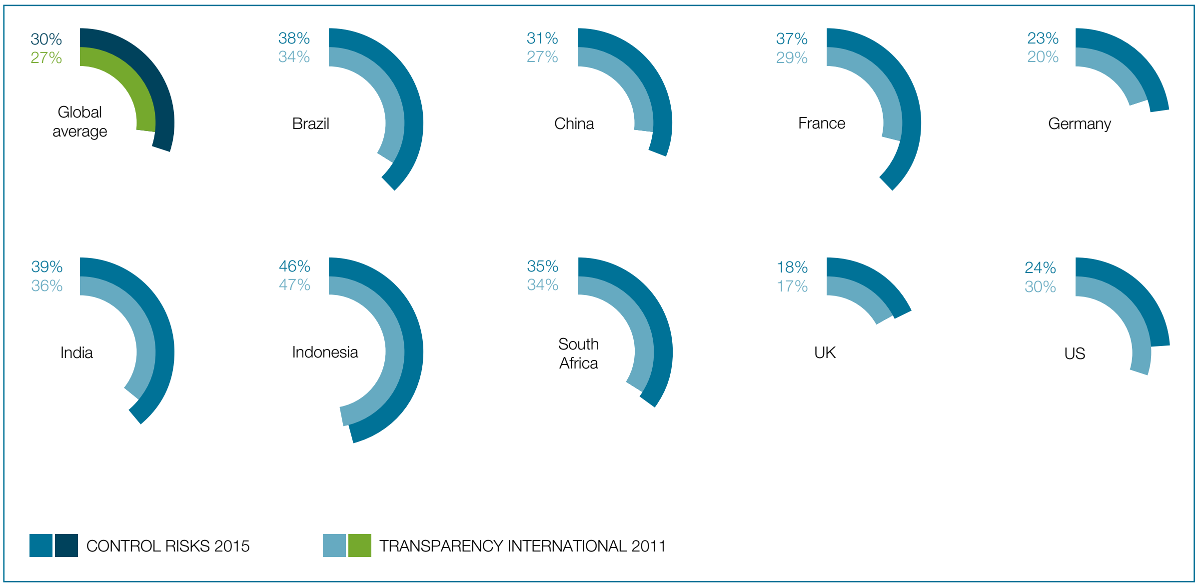
Companies based in non-Western countries are more likely to lose deals to unethical competitors: those based in Indonesia suffer most, losing 46% of such deals, followed by respondents in Colombia with 43% and Mexico with 41%. Only results for Middle Eastern respondents (mostly based in the United Arab Emirates) were less than the global average.

Among the companies with headquarters (HQ) in Western countries, France stands out, with 37% of companies reporting that they had lost out to corrupt competitors. This may in part be due to their greater international exposure: 91% of the French companies in our sample operate internationally, and more than half (54%) operate in sub-Saharan Africa.



▲ Companies that have failed to win contracts where there is strong circumstantial evidence of bribery by the successful competitor. By companies' HQ country.

In 2011 Transparency International posed a similar question about corrupt competitors to some 3,000 companies worldwide in its Putting Corruption out of Business survey.[3] Countries covered in both surveys demonstrate a striking correlation in the responses: they clearly point to the same "geography of corruption", as the chart below indicates.



▲ Companies that failed to win contracts in circumstances where the competitor may have paid a bribe. CR/TI comparisons.

[2] The survey question relates to their global businesses, not just the country where they are based.

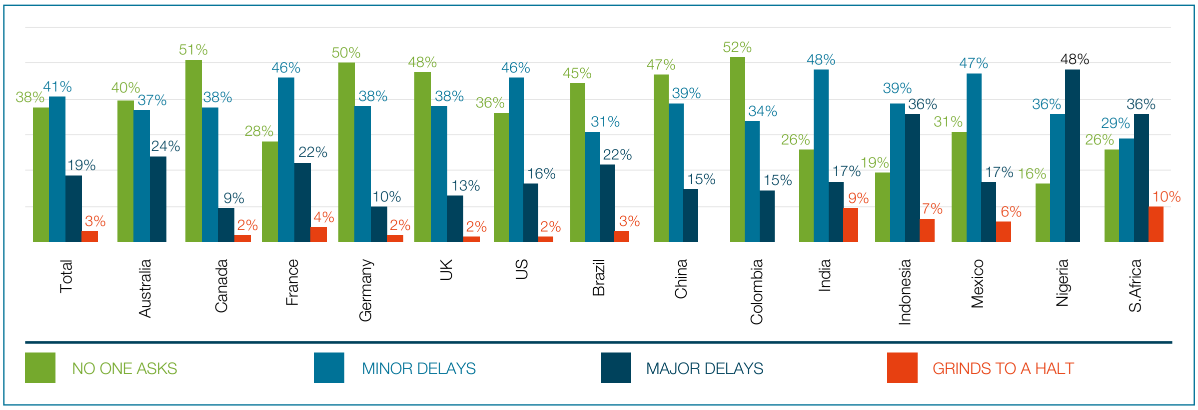
[3] Transparency International's question was, "During the last 12 months, do you think that your company has failed to win a contract or gain new business in this country because a competitor paid a bribe?"

FACILITATION PAYMENTS: THE PERCEPTION GAP

In too many emerging markets, demands for so-called "facilitation payments" – small bribes to speed routine governmental transactions – are commonplace. They are pernicious because they are typically accompanied by an implicit threat: "You need to pay or your business will suffer." So what are the consequences of refusing to pay? Is this just a trivial matter or something more damaging? For more than a fifth of our respondents, the consequences are serious: 19% believe that refusal to pay imposes "major delays and significant costs", and 3% said refusal causes their businesses to "grind to a halt".

Construction companies are particularly exposed because they operate with tight schedules and may face severe penalties for failure to meet deadlines: 25% of companies from this sector believe refusal to pay leads to significant costs, and a further 2% say refusal brings their businesses to a halt. A geographical review of responses points to some of the hotspots:

- Among South Africans, 36% say refusal to pay leads to major costs, and 10% said their businesses would grind to a halt without such payments. However, respondents may have been thinking of their international operations elsewhere in sub-Saharan Africa, not necessarily their home country.
- In Indonesia, 36% believe refusal to pay would lead to major delays, and 7% say their businesses would grind to a halt.
- Of Nigerian companies, 48% say refusal would incur major costs, though none believe it would lead to their business ceasing altogether.



▲ "Please assess the impact on your business of refusal to pay facilitation payments." (Select countries by location of respondent)

ARE FACILITATION PAYMENTS REALLY BUSINESS CRITICAL?

In our experience, the question of whether or not facilitation payments are a necessary part of business operations in certain countries provokes widely contrasting responses. Some clients say these payments are never an issue, while for others they are a business-critical threat. The people who answer "yes" frequently refer to transport and supply chains. They cite cases where officials at regional or national borders have refused to allow shipments to pass without extra payment, or when applications for vital permits were delayed indefinitely for no apparent reason. These are real problems, and some sectors – such as logistics and construction – are worse affected than others.

Yet accepting the practice of facilitation payments is problematic. They are nearly always illegal. Tolerating such payments – establishing double standards – makes it harder to establish a firm line on other forms of corruption ("bribes are wrong, but these illegal payments are OK"). In our view, "zero tolerance" is a realistic objective, but must be accompanied by an assessment of the areas where a company is most vulnerable to demands and a strategy for how to deal with them.

SUCCESSFUL RESISTANCE TO DEMANDS FOR FACILITATION PAYMENTS IN INDIA

In India we often encounter the view that it is impossible to challenge dishonest officials: "They are government officers: what can we do?" But companies are not as powerless as they think.

We recently advised a US-based retailer that was seeking to foster a zero-tolerance approach throughout its supply chain, including in India. However, the company's main Indian supplier feared his shipments to the US would be blocked if he refused to pay facilitating bribes to the Indian customs authorities.

With the US company's approval and support, the Indian supplier stopped paying the bribes, which did lead to delays. However, after several weeks, the customs officers cleared the shipments, partly because the supplier's goods were taking up much-needed space in government warehouses, prompting criticism from their superiors. Since then, the supplier has been able to clear his shipments without making illicit payments. His competitors have complained that officials have subsequently increased their demands, and they are seeking his advice on how best to respond.

A tough approach can work but it needs patient determination.

At the other end of the scale, 38% of respondents say "no one ever asks" for facilitation payments, but this is only partly reassuring. It may be true of – for example – UK respondents operating only in Western Europe, and some sectors – for example financial services – are less exposed than others. Nevertheless, this response is much less plausible for companies operating in countries such as Brazil, Indonesia or Nigeria regardless of their sector. This finding suggests that senior managers, particularly at HQ, lack a proper appreciation of the challenges their colleagues face on the ground, and so are failing to give them proper guidance.

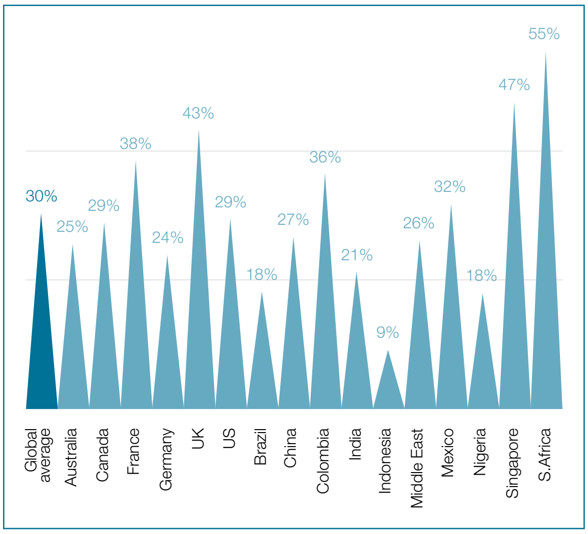
CORRUPTION RISKS CONTINUE TO DETER INVESTORS

Of survey respondents, 30% say they have decided not to conduct business in a particular country because of the perceived risk of corruption. Corruption does not deter investors completely but many good companies stay away.

The UK is the most risk averse of Western countries (43%), followed by France (38%). The US comes in at 29.3%, slightly below the global average, despite the strong record of US enforcement. This suggests that US companies are learning to live with the Foreign Corrupt Practices Act (FCPA), or even to turn it to their advantage.

Among emerging markets, companies from South Africa stand out for the high proportion that avoided particular countries. Respondents there are more exposed by virtue of their region (64% operate elsewhere in sub-Saharan Africa); this implies a greater awareness of the risks and a willingness to cut losses when the risks are unacceptable.

A similar point applies to respondents from two sectors associated with high corruption risks: 39% of companies



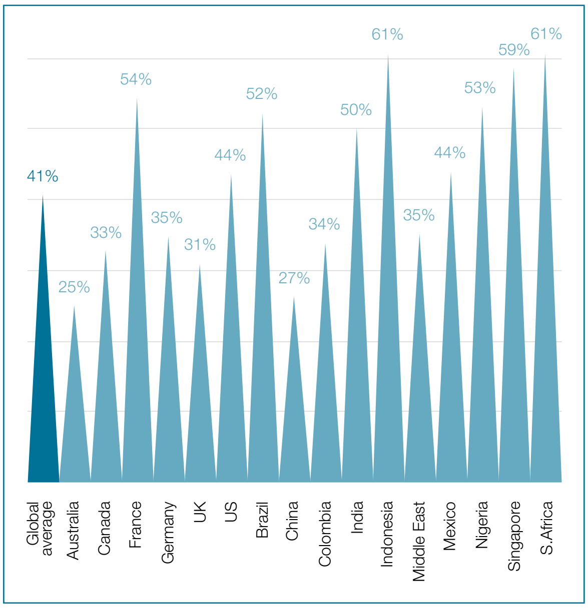
▲ Companies that decided not to conduct business in a particular country because of the perceived/actual risk of corruption. By HQ, excluding companies that do not operate internationally.

in construction/real estate and 37% of oil, gas and mining companies choose to stay away from particular countries. Greater exposure may be making them more, rather than less, risk averse.

PERSISTENT CORRUPTION KILLS DEALS

Out of our global sample, 41% of respondents reported that the risk of corruption was the primary reason they pulled out of a deal on which they had already spent time and money. Among Western countries, French companies (54%) were most likely to have gone through this experience, followed by those from the US (44%). The figures were higher in Brazil (52%), Indonesia (61%) and South Africa (61%).

These findings indicate both bad and good news. The bad news is the wasted effort and the high costs incurred because of corruption. The good news is companies' active management of the risks associated with major deals. A large part of Control Risks' problem-solving consultancy involves working with clients to sort out joint ventures that have gone wrong.



▲ "Has the risk of corruption been the primary reason for you pulling out of deal in which you have already spent time and money?" By companies' headquarter country.

SPOTLIGHT ON COLOMBIA: MAJOR OPPORTUNITIES, WEAK ENFORCEMENT

It is telling that 43% of Colombian respondents reported losing contracts where there was strong circumstantial evidence of bribery by a competitor. This is consistent with what we hear from our clients. The government has revamped the country's anti-corruption laws and signed up to the OECD Anti-Bribery Convention, but enforcement continues to lag. Law-enforcement authorities are under-resourced and prone to corruption, and the judicial system is subject to lengthy delays and integrity scandals. Drug-trafficking groups remain powerful and the steady influx of drug money has a corrosive effect on institutions.

The good news for Colombia is that our respondents feel they have mature compliance programmes in relation to other emerging markets. This is encouraging, though there is a high reliance on third-party diligence software. This can be helpful, but it is often necessary to go beyond basic software checks and conduct thorough integrity reviews of business partners – especially in corruption-sensitive regions and industries. Colombia is an exciting market for foreign investors, with an excellent track record of macroeconomic management and a growing middle class. However, it is also a market that requires robust pre-entry threat assessments, compliance training and continual monitoring of integrity risks.

TOUGH ANTI-CORRUPTION LAWS ARE WORKING, SLOWLY

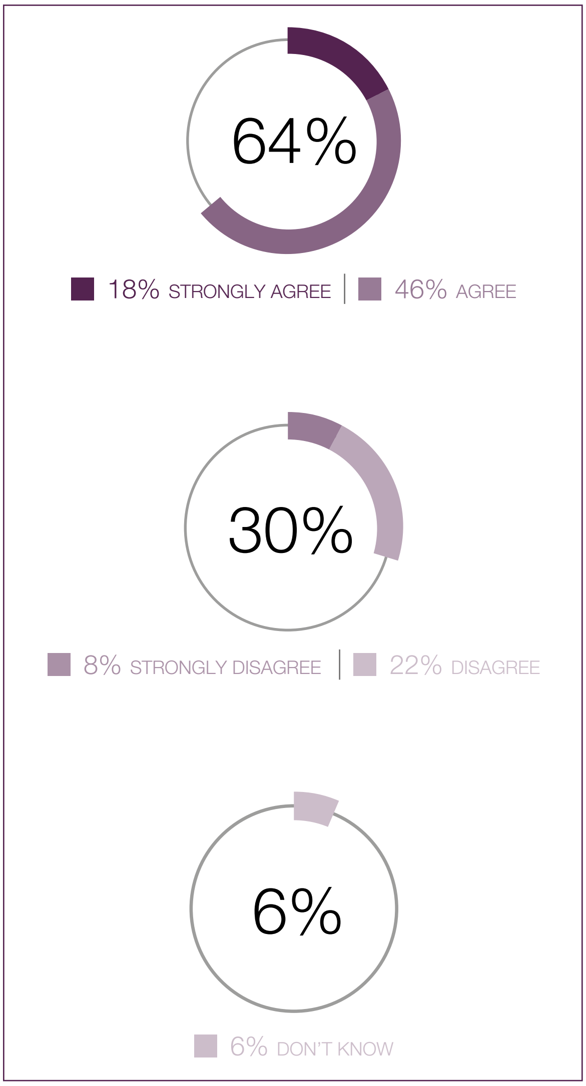
Our survey showed that a clear majority of respondents (81%) agree with the general proposition that international anti-corruption laws "improve the business environment for everyone".

There is a broad consensus in support of this view across jurisdictions, including in Nigeria, where 97% of respondents "agree" or "strongly agree", as do 87% in Mexico, 80% in Brazil, 80% in India and 79% in Indonesia, despite these countries' relatively high levels of corruption. The implication is that, at least to some degree, international legislation makes up for deficiencies of local law enforcement.

Moreover, most respondents viewed positively the impact on corrupt competitors, with 64% of the global sample strongly agreeing or agreeing that the laws served as a deterrent. Again, it is notable that 85% of Nigerian respondents share this positive opinion, despite operating in a country notorious for high levels of corruption; 78% of Brazilians and 71% of Indians also share that opinion.

Most respondents believe international anti-corruption laws make it easier for good companies to operate in high-risk markets. The arguments in support of this view include the point that the laws serve as an "alibi" for companies resisting demands: "We simply can't pay, even if we wanted to." If corrupt officials know companies can't pay, they are less likely to issue demands in the first place. Again, respondents in some of the most high-risk markets share this assessment: 79% of Mexicans agree or strongly agree, as well as 68% of Indonesians, 64% of Brazilians and 53% of Nigerians.

Opinions in established markets were more evenly divided, with 54% of US respondents supporting the view that tough laws make it easier to operate in high-risk markets, and 42% saying the opposite. In the UK the balance of opinions was reversed: 41% say the laws make it easier to operate, and 49% disagree. This may reflect the stringency of the UK Bribery Act 2010, which covers private-sector bribery, as well as bribes of officials, and has no FCPA-style exception for facilitation payments.



▲ "International anti-corruption laws serve as a deterrent for corrupt competitors." Global average.

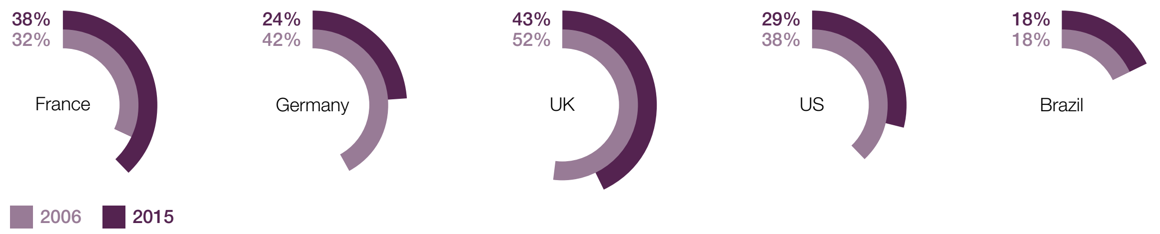
SPOTLIGHT ON THE US: NAVIGATING COMPLIANCE RISKS

US companies have nearly 40 years of experience operating under the FCPA; they have the highest compliance standards. At the same time, they have learnt to factor compliance measures into operations and investments, and so are less risk averse than many of their competitors. US companies have also become more adept at pre-transaction due diligence and managing corruption risk before and during a deal, even factoring it into pricing.

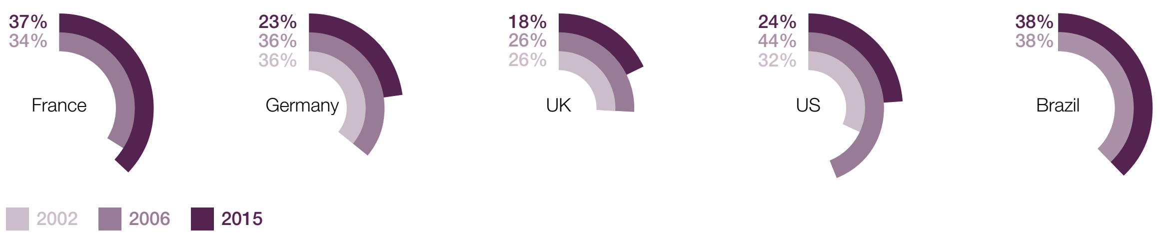
WHAT ARE COMPANIES DOING?

Despite this apparent ambivalence, a comparison with our earlier surveys in 2002 and 2006 points to positive trends in company decision-making. First, high levels of host-country corruption deter potential investors, but less so than a decade ago. Strikingly, companies from those countries with the highest levels of international enforcement show a greater willingness than before to take risks. This is particularly true of US, UK and German companies.

In Control Risks' view, this is because the more experienced companies are, by necessity, getting better at factoring corruption risks into their strategic plans. Rather than writing off entire jurisdictions, they are becoming more skilled at identifying better deals, even in difficult places. In short, it would appear that the best companies are turning their compliance programmes into a strategic advantage.



▲ Companies that decided not to operate in a country because of the risk of corruption: 2006 and 2015 comparisons. By HQ, excluding companies that do not operate internationally.



▲ Companies that failed to win contracts in circumstances where the competitor may have paid a bribe: 2002, 2006 and 2015 comparisons

SPOTLIGHT ON GERMANY

The OECD's Foreign Bribery Report, published in December 2014, ranked Germany second only to the US in the number of foreign bribery cases that had been successfully prosecuted since the OECD Anti-Bribery Convention came into force in 1999. The emerging national and international anti-corruption framework is one driver behind this trend towards tighter enforcement. Another key factor is a growing intolerance of corruption following scandals involving major corporate names such as Siemens, Daimler, MAN and, as this report went to press, Volkswagen.

In our experience, German companies tend to adopt a cautious but pragmatic approach to corruption risks. This is borne out by the 35% of German companies who, in this research, say they have pulled out of deals because of corruption risks. However, Germany continues to lag behind the UK and the US on the percentage of companies with anti-corruption training programmes (67%, compared with 78% and 82%, respectively). The recent Volkswagen emission scandal has prompted a new round of corporate soul-searching: have the compliance lessons of the past decade truly been absorbed?

SPOTLIGHT ON THE UK: THE IMPACT OF THE BRIBERY ACT

The UK Bribery Act 2010 came into force in July 2011 but is not retrospective. Many of the international corruption cases now working their way through the British enforcement system concern alleged offences that took place before that date. One example is a five-year investigation by the Serious Fraud Office (SFO) that has led to indictments of six individuals and two UK-based subsidiaries of the French engineering company Alstom. Meanwhile, in 2014 the SFO secured its first corporate convictions under the Bribery Act in the Sustainable AgroEnergy trial, which concerned a scheme in Cambodia.

Our survey shows that UK companies take a cautious approach to investment in high-risk countries, but this was already the case before the Bribery Act came into force, and they are suffering fewer losses to corrupt competitors. On most compliance measures, UK companies come second only to the US.

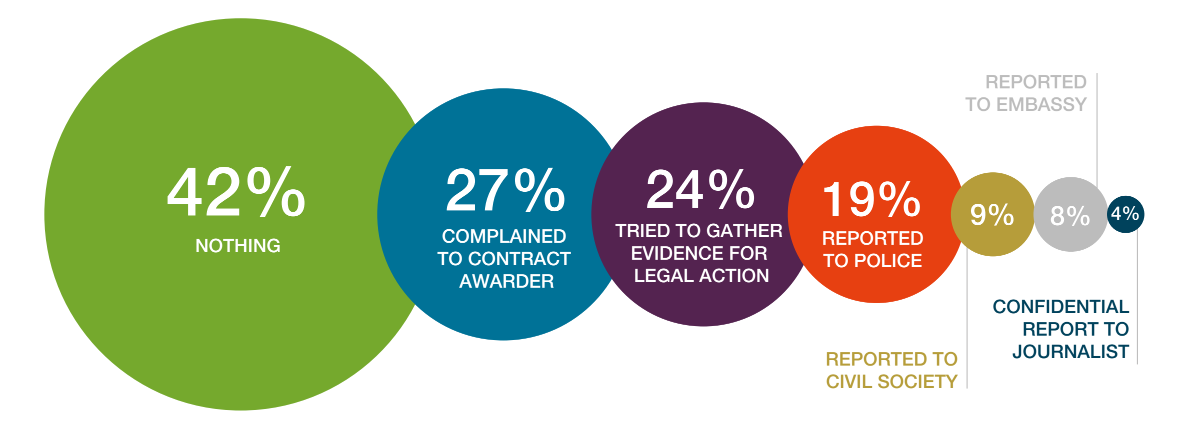
It is equally noteworthy that the companies from countries with tight enforcement are suffering fewer losses than before from corrupt competitors – sometimes dramatically fewer. In 2006, 44% of US companies in our survey said they had lost out to corrupt competitors, compared with only 24% in 2015. The figures for Germany and the UK point to a similar, if less dramatic, decline in loss of business to corruption.

Our survey suggests that companies are more willing to push back when they lose out to corrupt competitors. In our 2006 and our 2015 surveys we asked companies how they had reacted. In one respect the two surveys point to continuity. In 2015 doing "nothing" is the most popular option, favoured by 42%. Similarly, in 2006 42% of respondents said they "would avoid working again with the same customer and simply look elsewhere in future". A further 14% would "make no public complaint, hoping to be more successful next time".

But compared with 2006, the 2015 respondents showed a much greater willingness to fight back:

- In 2006, 8% of respondents said they would ask for a formal explanation from the customer, and 4% said they would lodge an appeal. In 2015 27% say they would complain to the contract awarder.
- Similarly, in 2006 only 6.5% of respondents said they would appeal to law-enforcement authorities, compared with 19% in 2015. In the 2015 sample, 24% say they would try to gather evidence for legal action.

In Control Risks' experience, it is still rare for companies to be able to gather sufficient evidence to overturn a corrupt contract award. Nevertheless, the prospect of tighter enforcement – including in many emerging markets – appears to be shifting the balance. The survey results point to a growing confidence that some kind of legal challenge can be effective.



▲ "If you failed to win business because a corrupt competitor paid a bribe, what action did you take? Please tick all that apply.

INDIA: A PARTIALLY SUCCESSFUL CHALLENGE TO A CORRUPT CONTRACT AWARD

Control Risks recently advised an Indian company that had been unsuccessful in a multi-million-dollar tender with a state government agency. We gathered evidence showing that the successful competitor had paid kickbacks to agency officials, enabling it to win the contract, despite falling short of the technical requirements of the tender.

Our client filed a complaint with the head of the agency, who had a reputation for honesty. The head ordered an internal inquiry. The results confirmed our findings, and he cancelled the competitor's contract. The competitor challenged this decision in court, but its case was dismissed and it has now been blacklisted.

The government agency has yet to reissue the tender, and this process may take several months, even years. It is therefore not certain whether our client will win the project but – especially in view of the publicity attached to the court case – the tender process is likely to be clean, and our client will have a better chance of success.

The case shows that challenging corrupt decisions is worth the effort – not just for the specific case, but also for how it can contribute to reducing integrity risks more broadly.

SPOTLIGHT ON MEXICO: ADDRESSING "CULTURAL WEAKNESSES"?

President Enrique Peña Nieto controversially quipped in 2014 that corruption was a "cultural weakness" plaguing his country. Many Mexicans took umbrage at Peña Nieto's diagnosis of the root cause, but few would argue with his broader point: corruption is a pervasive problem across the country.

There is some hope that the environment could improve. Mexico enacted anti-corruption reforms earlier this year that have the potential to help stem the tide, but only if supported by swift implementation and active enforcement. Previous attempts at anti-corruption measures have inspired little confidence, but Peña Nieto has indicated that passing secondary laws to implement these current reforms will be a top priority.

Our survey results suggest such a change would be welcome news in Mexico's business community. They were among the respondents who are reportedly most likely to lose opportunities to competitors who pay bribes. They also appear displeased with this status quo, being among the most likely to lodge a complaint against a competitor they suspect of corruption.

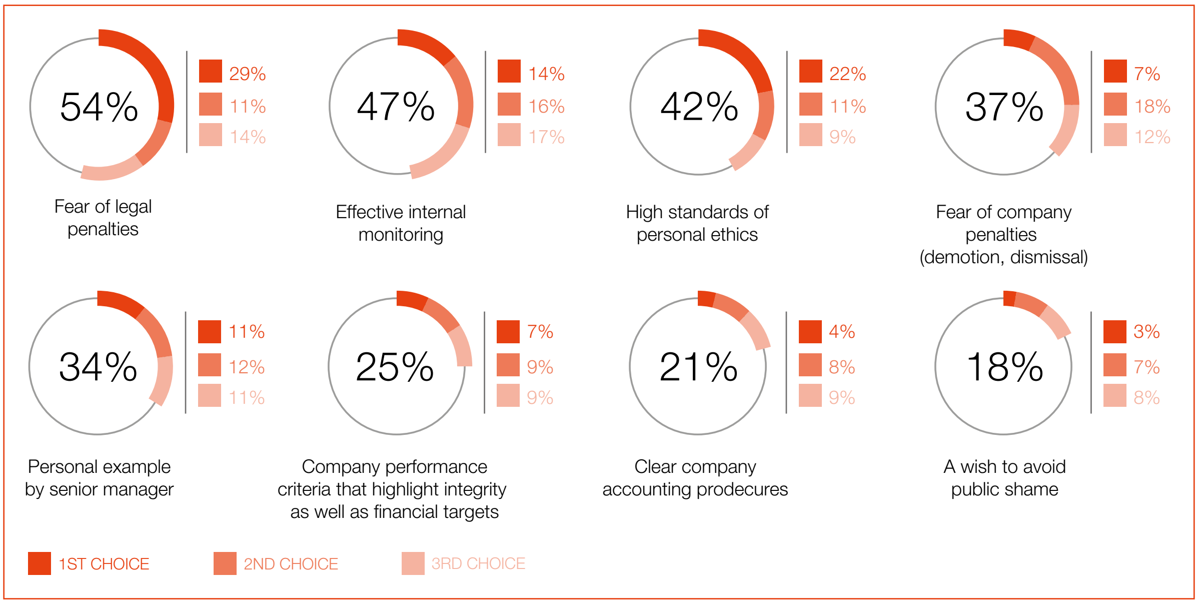
Whether any real change occurs in Mexico appears unlikely. For decades, Mexican politicians have railed against corruption and promised reform, only to give way to the country's entrenched system of patronage. This year's survey results suggest businesses may similarly struggle to break from old habits. The results showed Mexican firms are among the least likely to have conducted internal investigations into suspected corruption. At worst, this suggests a broader acceptance of corrupt practice within the business community, and at best a reluctance to tackle the problem head on.

COMPLIANCE IS WORKING TOO, BUT IT'S NOT ENOUGH

Tough anti-corruption laws are effective in the sense that they set the compliance agenda for international companies. But a legalistic approach to business integrity is not sufficient – and could even be counterproductive. Our survey shows many of the core ingredients of standard anti-corruption programmes are – to varying degrees – becoming mainstream. However, both the survey and our experience show that this is not sufficient.

COMPANIES ARE SETTING THE WRONG INCENTIVES

It is now widely understood that setting the right "tone from the top" is essential. This goes beyond well-crafted executive speeches and corporate websites. The most important questions concern incentives and motivation for individuals, such as, "What targets and behaviour patterns do you need to succeed in this company?"



▲ "The most effective ways to deter corrupt business behaviour"

In the survey we asked respondents to rank the top three deterrents to corrupt business behaviour. Three out of the four most popular choices involved an element of fear: of prosecution, of internal monitoring ("you are being watched") and of company penalties, such as demotion or dismissal.

In our view, company performance criteria where ethical behaviour is as important as financial targerts – ranked sixth out of eight options – should be much higher on the list. All too often Control Risks comes across cases where companies send mixed messages: "Your performance will be judged first, second and third by your ability to meet financial targets and, by the way, we think ethics is important as well." It is scarcely surprising that the employees who receive these messages are tempted to take unethical shortcuts. Similarly, we often see an absence of senior managers' involvement in solving compliance problems, which further contributes to confusion about the real challenges in the business, and reinforces a "them-and-us" culture.

High personal ethical standards – ranked third by our respondents – are, of course, essential, but companies need to take practical steps to ensure such standards are fostered and rewarded.

TALKING CHINA

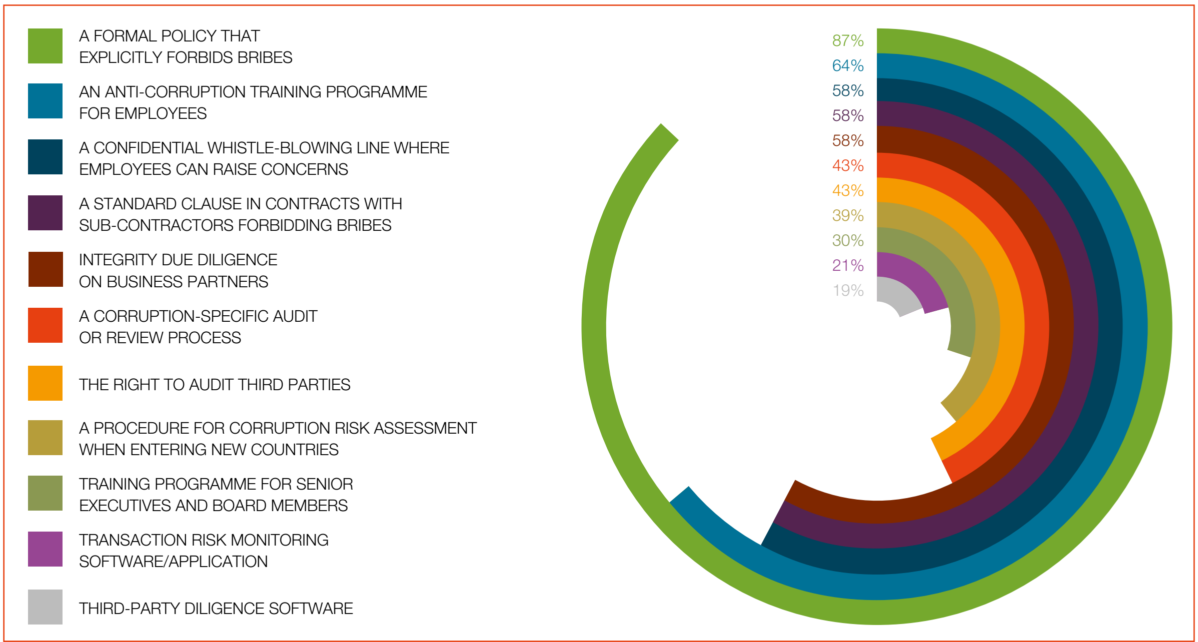
A recent conversation with a lawyer in Singapore served as a stark reminder of the disconnect that can occur between HQ and operations on the front line in emerging markets. The lawyer worked for three years in the compliance team at the HQ of a Western firm prosecuted for corruption in China. She was visibly upset about this during our conversation, and her most telling comment was: "I simply cannot understand how this could have happened. We spent three years developing the most sophisticated compliance programme and rolling it out. It just doesn't make sense."

Comments from the head of compliance for a US medical device company in China were also very pertinent. This individual was previously responsible for developing policies at HQ for China and other countries, and told us: "It was only when I moved to China three years ago that I realised I could not use the policies I had written myself, as they were completely disconnected from the reality of operating in this country."

MANY OF THE RIGHT TOOLS ARE IN PLACE

In our survey we looked at the "hierarchy" of compliance measures companies have adopted. The overall pattern is similar to the results of our earlier surveys. Nevertheless, we discerned some important trends, particularly in comparison with a decade ago. These trends point to significant improvements – and some major gaps.

The first, and most basic, are the "no bribes" policies: these are still not universal, but an overwhelming majority in all countries have them. This was not always the case. In our 2006 survey, companies in two countries stood out: 90% of US companies and 92% of UK companies indicated that they had a "no bribes" policy. Since then, Germany has closed the gap, rising from 76% of companies having "no bribes" policies in 2006 to 88% in 2015, while in France the figure has risen from 60% to 89%. Brazil has made an even greater leap, from 24% to 78%.



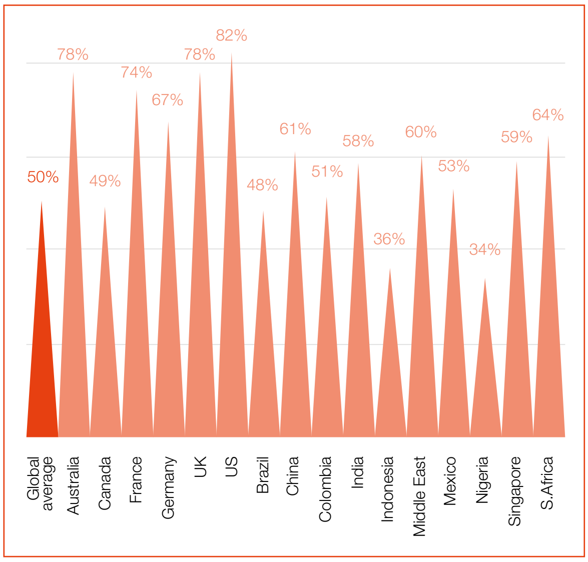
▲ Compliance measures in place.

THERE ARE STILL DISPARITIES IN TRAINING PRACTICES

Anti-corruption policies are of little value if they are not communicated. Again, in this area there have been significant changes since our 2006 survey. But, as the chart shows, there is a clear contrast between developed and emerging economies.

In 2006, 76% of US companies had compliance training programmes, compared with 82% today. The percentage of UK companies with such programmes has risen from 48% to 78%, no doubt reflecting the impact of the Bribery Act. German companies with training programmes have more than doubled, from 32% to 67%, and French have tripled, from 24% to 74%.

However, the quality of training programmes is just as important as their existence. Control Risks' observation is that training programmes too often consist of legalistic slide-show presentations that fail to engage participants or relate to the day-to-day problems they face.

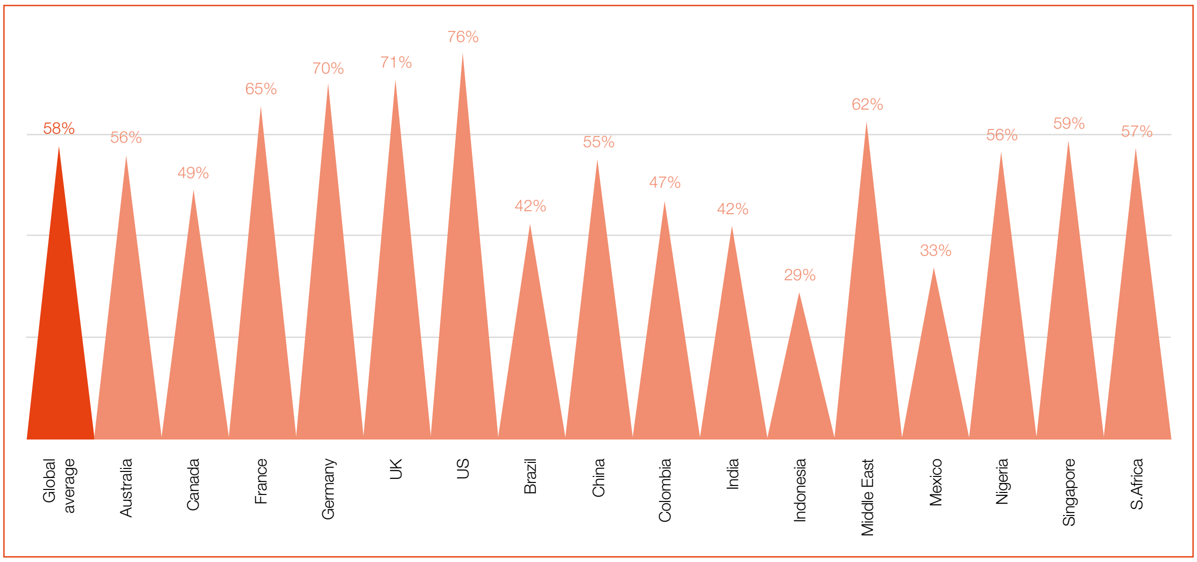


▲ An anti-corruption training programme for employees. By country HQ.

TIGHTER FOCUS ON THIRD PARTIES NEEDED

The compliance risks associated with third parties have always been important because so many international corruption cases involve bribes paid by intermediaries, such as commercial agents. In our survey, 65% of respondents say they attach "high" or "very high" priority to corruption risks associated with third parties. We think that percentage should be even higher.

There are some signs of progress. In our 2006 survey, 79% of US companies and 56% of UK companies had due diligence programmes to assess the integrity records of commercial intermediaries, as did 52% of Germans and 35% of French. In 2015 the US appears to have plateaued, with a similar percentage having due diligence programmes (76%), but other developed countries are catching up.



▲ A procedure for integrity due diligence on business partners. By country HQ.

At the same time, in the US and elsewhere, there has been a trend towards still tighter compliance measures to manage relationships with third parties. These include asserting the right to audit. For now this is another area where the US is clearly in the lead but – as with other compliance measures – the pattern in other countries is coming closer to resembling US practice.

LISTEN TO WHISTLE-BLOWERS

Compliance best practice requires companies to introduce confidential channels of communication through which employees can raise concerns or report problems. Where staff members feel uncomfortable raising such issues with their managers, there needs to be an alternative. In large companies this typically means confidential phone or internet contact.

In our 2006 survey, only 42% of respondents had such whistle-blowing lines, compared with 74% today. The most dramatic increase has been in France, from 4% to 54%. While China at 41% and Indonesia at 43% are below the global average in our survey, these are still significant numbers, given the historical background of these countries.

INTERNAL INVESTIGATIONS: YOU CAN'T AFFORD TO GET IT WRONG

Our question on internal investigations underlines the importance of whistle-blowers: 35% of companies responded by saying they had conducted an internal investigation in the previous year following a complaint from a whistle-blower. Concerned employees are a vital source of information about potential compliance infringements: it is much better to be alerted by them, and take action accordingly, than wait for a call from law enforcement or from an investigative journalist. However, the results also point to potential weaknesses in companies' compliance. At first glance it may look like good news that more than half (51%) of respondents conducted no corruption-related investigations in the previous two years.

But this figure looks too low, particularly for large companies: it may point to a false sense of complacency deriving from an overreliance on the form of effective compliance rather than the substance. Compliance teams need to be given sufficient resources and training to enable them to actively and effectively watch for potential problems, rather than waiting to be alerted to suspected infringements. Once issues are identified, investigations need to be conducted sensitively, clearly and decisively. It is advisable to seek expert advice to avoid the classic pitfalls of clumsy investigations that alert potential suspects and lead to the destruction of vital evidence.

▲ "In the last two years, has your organization conducted an internal investigation into suspected corruption triggered by any of the following? Please tick all that apply."

PROBLEM-SOLVING AFTER RECEIVING A WHISTLE-BLOWER REPORT

In many cultures – Australia is an example – concerned employees face powerful social pressures discouraging them from reporting their peers, even dishonest ones. But whistle-blowers should be celebrated, not scorned.

A recent case study underlines the importance of whistle-blowing lines as a source of information that – even if incomplete – can help identify and remediate major integrity risks. An international telecommunications company engaged Control Risks to investigate whistle-blower reports of alleged fraud, corruption and sexual harassment by one of its executives, as well as conflicts of interest on the part of a board member. After a comprehensive investigation that included information-technology forensic analysis, document analysis and interviews, Control Risks confirmed many of the allegations. We established that the client had suffered losses of approximately $2m through collusion on the part of the executive and the board member. These losses would have gone undetected if a courageous employee hadn't spoken out.

SPOTLIGHT ON AUSTRALIA: WHAT PROSPECTS FOR TIGHTER ENFORCEMENT?

Australia has long been criticised for failure to enforce its foreign bribery laws in accordance with its OECD obligations. Some Australian companies believe there is little incentive to implement proper corruption risk and compliance measures, citing a perception of weakly enforced laws and general apathy on the government's part to address corruption.

The Australian Federal Police have acknowledged that they have 14 active foreign bribery investigations, but only two are currently before the courts. They have yet to successfully prosecute any corporation for foreign bribery, despite public allegations of bribery, kickbacks and inadequate internal controls surrounding certain large Australian companies over the years. A senate committee is conducting an inquiry into measures against foreign bribery, and is due to report by 1 July 2016. With this inquiry rests the hope of increased enforcement, and reform, of Australian foreign bribery legislation.

A STRATEGIC APPROACH TO ANTI-CORRUPTION: FIVE RECOMMENDATIONS

Legal compliance is essential but – from an operational perspective – still has a bad name. All too often, it is regarded as a cost and a necessary ritual, but not a business enabler. We are told that the niceties must be observed but have little to do with real business. Such attitudes can lead to an inter-related set of hazards.

- Immature compliance programmes go some way to meet formal legal requirements but do not engage company employees or address real-life problems. If employees think compliance is no more than a formality then they are more – not less – exposed to risk.
- Conversely, well-resourced but poorly calibrated compliance programmes can lead to a false sense of security, creating the illusion that all integrity-related risks are under control. Many times, Control Risks has seen a significant disconnect between complacent head offices and entrepreneurial country managers who have adapted to local business practices the wrong way.
- Poorly considered compliance approaches can lead companies to avoid complex environments altogether, instead of managing risks and seizing opportunities.

It doesn't need to be so. Our survey suggests that companies from the US, Germany and the UK are less likely to avoid high-risk countries than they were ten years ago. They are also less likely to lose business to corrupt competitors. These positive trends have occurred not despite tighter international enforcement but because of it. Companies from these countries have learnt – or are beginning to learn – how to turn anti-corruption programmes into a strategic advantage. So how is this done?

1. INTEGRATE CORRUPTION RISK INTO STRATEGIC PLANNING

The first requirement is to integrate corruption risk assessments into strategic planning, rather than adding them on incidentally. A strategic approach includes:

- Understanding the long-term political and social trends that are transforming the enforcement environment in countries such as China.
- Focusing on the risks that are specific to individual sectors, and at every stage of the business cycle. For example, in the construction sector many of the greatest risks apply at the project execution stage. Anti-corruption compliance is not just about winning business in the right way but also sustaining it.
- Reviewing risks at every stage of the supply chain, including the part played by sub-contractors. What exactly are they doing on the company's behalf?
- Planning ahead, rather than simply responding when crises occur. Companies are more vulnerable to demands when they are under time pressure. For example, we often hear stories of officials dragging out licence applications in the hope of receiving bribes. It is easier to resist if the potential for delays is already factored into your planning.

In short, considering corruption is an integral part of enterprise risk management.

HIGH-RISK COUNTRIES: WORTH A CLOSER LOOK?

Venezuela is an example of a high-risk jurisdiction that may merit closer scrutiny. It is among the countries most frequently mentioned when we asked respondents which regions they would avoid. This wariness is certainly justified. But a willingness to take considered risks can create sizeable opportunities.

We have helped several clients do business in Venezuela on specific projects that have proved highly profitable. However, these ventures required exhaustive background checks on all business partners, as well as comprehensive compliance training for all staff to minimise integrity risks.

SPOTLIGHT ON CHINA: ANTI-CORRUPTION AND THE "NEW NORMAL"

Recent developments in China underline the importance of a strategic approach to corruption risks. Since early 2013 President Xi Jinping has been leading a harsh crackdown on corruption, including cases involving international companies. Chinese officials emphasise that the crackdown is not a temporary move – it's the "new normal".

Chinese anti-bribery and anti-monopoly laws are still quite vague and open to broad interpretation and, in some cases, politicisation. However, Chinese regulators are more and more aggressive in their enforcement. International companies are facing increasing inquiries and investigations at both the local and national levels.

To adapt to this "new normal", companies first need a deep understanding of the potential integrity risks in their value chains. Risk assessments need to be specific to particular industries, and subject to constant review.

Secondly, on the understanding that risks are often as much political as legal, companies need to map out stakeholders: Who has interests in their industry? Who can help and who can hinder in times of trouble?

And thirdly, companies need to integrate operational risk into their long-term assessments of key markets. If corruption risks are a major factor, those markets may not be as attractive as they at first seem. On the other hand, if companies can manage risks successfully, they can steal a march on their competitors.

2. SEEK OUT LOW-RISK OPPORTUNITIES IN HIGH-RISK MARKETS

Earlier in this report, we found that 30% of companies had avoided corruption risk by staying away from specific countries entirely. This indicates what is happening. It also raises a question about what should happen.

In our view, many of our respondents are still too sweeping in their approach to country risk. One particularly risk-averse respondent to our survey stated that his company avoided "any country other than the US". Others mentioned "many countries in Africa". Similarly, some referred to countries that are already excluded from an anti-money-laundering perspective because they appear on the Financial Action Task Force (FATF) blacklist, or that are low on the Transparency International Corruption Perceptions Index. Between them, respondents cited a total of 57 countries; the ones listed most frequently are Nigeria, Russia and Venezuela.

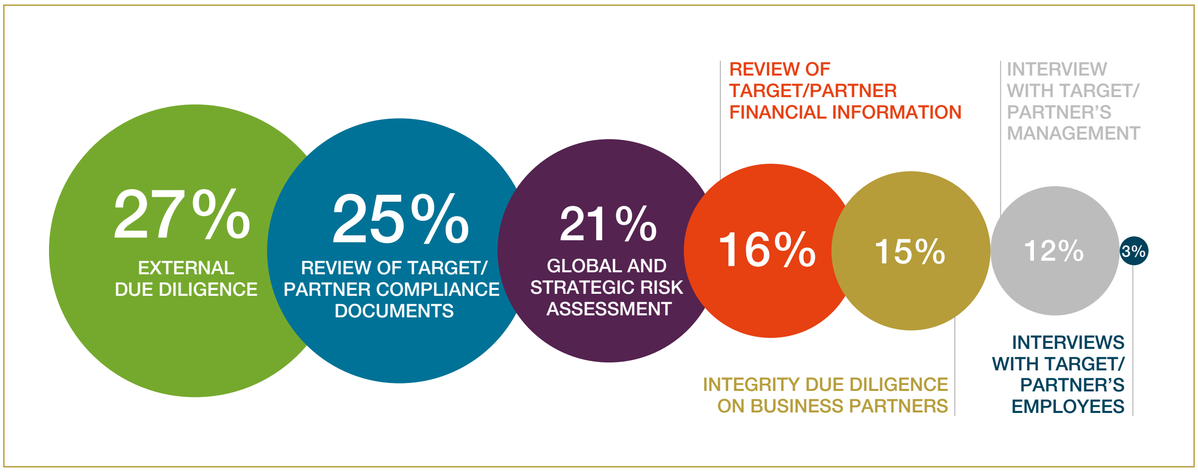
In many cases, staying away is the right answer. Effective compliance incurs high costs, including in management time, and country indices serve as useful high-level warning signs. But if the business opportunities are there, companies can look beyond generalities to specific regions, sectors and companies to understand the real risks and hence be able to mitigate them.

Well-considered risk assessment may lead to willingness to accept certain kinds of projects in high-risk countries, but not others. For example, an engineering consultancy may accept a front-end design project that involves minimal interaction with officials, while deciding not to go ahead with an actual construction project where the pressures would be much more severe.

3. SCRUTINISE DEALS EARLY ON IN THE PROCESS

It is essential to access the best possible information when making the decision whether to go ahead with a major deal. The chart shows that companies that have decided not to go ahead with a deal on which they had spent time and money had drawn on a range of internal and external resources. External due diligence provided by an objective outsider is often the most valuable.

However, our experience working with clients is that this work is often done very late in the process, sometimes when the momentum behind a deal is overwhelming.



▲ "If you pulled out of a deal because of corruption risk, what information did you use to make the decision? Please tick all that apply."

4. GIVE YOUR FRONT-LINE PEOPLE THE SUPPORT THEY NEED

A clear anti-corruption policy is an important form of support, as long as the company believes in it, because it gives employees the authority to say "no" to demands for illicit payments. But this is only the first step. Individuals' personal targets need to be realistic. For example, senior managers may need to accept a short-term reduction in sales targets following a tightening of anti-corruption policies.

Support also requires effective two-way communication. The maxim "Don't bring me problems: bring me solutions" is unlikely to be the best means of developing an anti-corruption strategy in a country where demands are commonplace. Solutions are likely to require the combined expertise of senior and middle managers, plus front-line employees.

RESTRUCTURING A PROPOSED DEAL IN BRAZIL

Adverse risk-assessment findings don't need to wreck a deal. Instead, they may lead to a restructuring designed to avoid the areas of greatest risk.

Control Risks recently advised a European company that was considering acquiring a Brazilian consultancy. The target company had live contracts with local government entities worth tens of millions of dollars. Early on, we found that some of the largest of these contracts were under investigation on suspicion of bribery, and two of the company's principals were named in the proceedings. Our client concluded that the contracts under investigation should be excluded from the portfolio, and the principals under investigation would need to be removed before the acquisition was completed.

5. TAKE A PLANNED APPROACH TO "ZERO TOLERANCE"

In Control Risks' experience, more and more leading international companies are adopting a policy of "zero tolerance" regarding facilitation payments, as well as larger bribes. They have good reasons:

- Facilitation payments may be common but they are almost always illegal in the country where they are paid.
- The US FCPA excludes facilitation payments for legitimate services from its definition of the criminal offence of foreign bribery. The UK Bribery Act does not. For now, Canada has an exception similar to that of the FCPA, but the Canadian government has put companies on notice that the exception will be removed at some point.
- It is more effective to give a clear message to company employees: "No bribes of any kind."

Control Risks supports this approach but, as discussed earlier in this report, our survey shows the scale of the challenge in countries where officials are accustomed to receiving payments. Before implementing zero tolerance, it is essential to conduct a detailed risk assessment and plan resistance strategies for how to deal with corrupt officials in advance. Front-line employees – if consulted in the right way – are among the best sources of information and ideas.

APPLYING ZERO TOLERANCE IN SOUTH-EAST ASIA

The experiences of a Western company in South-east Asia point to the hazards of introducing "zero tolerance" without careful advance planning.

On Day 1, the company introduced their global compliance programme, insisting on a complete ban on any form of corrupt payment. On Day 2, there was no gas supply and the delivery trucks failed to make it past the police checkpoint outside the gates. No work was done. On Day 3, with the support of the local Control Risks team, they initiated a thorough corruption risk assessment that gave them a fuller understanding of their vulnerabilities, including "touch points" with state officials and business-critical functions.

On this basis, they developed resistance strategies and initiated a gradual, managed programme of change, tackling facilitation payments over a period of time. Ultimately they reached their original goal of zero tolerance, but without a halt in production.

APPENDIX: SURVEY METHODOLOGY

VB Research conducted the survey on Control Risks' behalf in April and May 2015, using an internet-based questionnaire. The respondents are all legal and compliance professionals, mostly working in-house for private companies.

COUNTRY/REGIONAL BREAKDOWN INDUSTRY SECTORS

	RESPONDENTS WITH HEAD OFFICES IN REGION/COUNTRY		RESPONDENTS BASED IN REGION/COUNTRY	
	NUMBER	PERCENTAGE OF TOTAL	NUMBER	PERCENTAGE OF TOTAL
AFRICA	**68**	**8.2%**	**79**	**9.5%**
Nigeria	32	3.9%	31	3.8%
South Africa	28	3.4%	31	3.8%
Others	8	1.0%	17	2.1%
ASIA-PACIFIC	**175**	**21.2%**	**223**	**27.1%**
Australia	36	4.4%	38	4.6%
China	49	5.9%	75	9.1%
India	36	4.4%	54	6.6%
Indonesia	28	3.4%	31	3.8%
Singapore	17	2.1%	25	3.0%
Others	9	1.1%	-	-
MIDDLE EAST	**37**	**4.5%**	**46**	**5.5%**
EUROPE	**199**	**24.1%**	**163**	**19.8%**
France	46	5.6%	50	6.1%
Germany	43	5.2%	50	6.1%
UK	78	9.5%	63	7.6%
Others	32	3.9%	-	-
LATIN AMERICA	**163**	**19.8%**	**199**	**24.1%**
Brazil	50	6.1%	65	7.9%
Colombia	47	5.7%	62	7.5%
Mexico	66	8.0%	72	8.7%
NORTH AMERICA	**182**	**22.1%**	**114**	**13.8%**
Canada	49	5.9%	53	6.4%
US	133	16.1%	61	7.4%

INDUSTRY SECTORS

Respondents were invited to identify their industry sector from the following list. Some respondents chose more than one sector, so the total comes to more than 100%.

Professional services	28%
Financial services	17%
Oil, gas and mining	16%
IT and technology	13%
Manufacturing	13%
Construction, real estate	11%
Transportation	7%
Consumer goods (excluding retail)	7%
Logistics and distribution	6%
Telecoms	6%
Natural resources	6%

Healthcare services	5%
Pharmaceuticals, biotech	5%
Agriculture, agribusiness	4%
Automotive	4%
Chemicals	4%
Defence	4%
Education	4%
Media	4%
Retailing	4%
Travel, tourism	3%
Other	19%

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