10 minutes

Weathering the headwinds of bribery and corruption

India is ranked as the fourth most attractive destination for retail investment, among 30 emerging markets.[1] The sector has experienced exponential growth, with significant development taking place not just in major cities and metros, but also in Tier II and Tier III cities in India. According to data released by India's Department of Industrial Policy and Promotion (DIPP), the total FDI inflow into the country (including equity inflows, 'reinvested earnings' and 'other capital') between April 2000 and October 2013 stood at 309,012 million USD, out of which single-brand retail trading during April 2000 to June 2013 stood at 96.96 million USD.

The Indian retail market is expected to touch 1.3 trillion USD by 2020 from its current level of around 500 billion USD.

The growing online retail market in the country has become a lucrative business for international majors as well. India became only the 10th market in the world where Amazon has established a country-specific retail website.[2]

1 Source: http://www.investindia.gov.in/?q=retailing-sector

2 Source: http://www.ibef.org/pages/36323

With an increase in economic globalisation, companies are now harbouring growth prospects in emerging economies such as India. However, since they operate across numerous jurisdictions, these companies usually face the risks associated with a fast-moving and dynamic economy coupled with an often shallow understanding of local knowledge or in-country experience. This has ramifications particularly on building effective business relationships with adequate emphasis on areas such as fraud, bribery and corruption as well as other misconducts within the retail and consumer market in India.

The risk of bribery and corruption is relatively high in India. Our experience indicates that the main factors contributing to the increasing risk inbribery and corruption include the following:

- Obtaining routine administrative approvals
- Obtaining and retaining businesses
- Covering up inconsistencies in documentation, etc
- Inappropriate choice of business partners

According to UNCTAD's World Investment Prospects Survey 2012–2014, India is the third most attractive destination for foreign direct investment (FDI) in the world (after China and the US).

In the World Economic Forum's 2012 Global Compact Annual Implementation Survey, the largest survey on corporate sustainability practices with inputs from over 1,700 businesses, 39% of respondents ranked corruption as a major obstacle to sustainable development.[3]

Corruption distorts markets, undermines development and makes business unsustainable. According to the World Bank, globally, corruption increases the cost of conducting a business up to 10%.[4]

3 Source: World Economic Forum: Global Agenda Council on Anti-Corruption and Transparency 2012-2014 (http://www.weforum.org/content/global-agenda-council-anti-corruption-transparency-2012-2014)

4 Source: http://www.weforum.org/content/global-agenda-council-anti-corruption-transparency-2012-2014

Bribery and corruption: Endemic and unprecedented

The global economy is generally on the rebound, potentially reinvigorating organisations' appetite for expansion as well as risk. PwC's 17th Annual CEO Survey reveals that more than half the CEOs are concerned about the pitfalls of bribery and corruption.

As per the PwC Global Economic Crime Survey 2014, 27% of all respondents who reported economic crime, experienced corruption during the survey period of two years (the survey takes place once in two years), making it the third highest crime specified. Of all the types of fraud covered in the survey, bribery and corruption poses a great threat to global businesses since it encompasses most of the business processes within an organisation.

Of all the respondents who experienced economic crime over the survey period of two years, 49% reported it in the retail and consumer industry.[5]

PwC Global Economic Crime Survey 2014

The current business environment in India is relatively permissive to bribery and corruption, and this exerts pressure on the sales and marketing personnel, who are directed by the leadership to bring out a new product to a growing market. Sometimes, under pressure to meet sales target, staff members may resort to practices of offering a bribe or kickbacks, or otherwise rigging the sales process so as to try and secure a better price. Areas such as sales, marketing, distribution, payments, international expansion, expense reimbursement, tax compliance and facilities operations are vulnerable processes within the organisation. Business processes within the retail and consumer sector may be prone to the threats of bribery and corruption due to the following reasons:

- High level of interaction with government officials in connection with obtaining permits, licences as well as other government approvals ranging from real estate and construction to setting up and operating a business. The retail and consumer sector (due to its nature and economic factors) is exposed to a high level of interface with various regulatory authorities on business matters such as licensing, approval of new products, foreign investment, cross-border sales, imports and exports, statutory compliances, etc. Logistics and transportation of goods involve extensive interaction with state government officials as well as regulatory authorities.
- Bundling of potential illegal payments in contracts or leases may be executed in order to avoid or evade direct inappropriate contact with officials.
- Customers, suppliers as well as third-party consultants may consist of government entities or state-owned commercial enterprises. There is a lack of adequate reliable information within the public domain related to actual ownership of vendors, third-party consultants, fair or true value of capital expenditure items (especially for land and buildings) or other ongoing corruption activities.
- Use of intermediaries in order to obtain licences or dealing with government agencies or officials is prevalent in the industry. Apart from business reasons (such as local expertise and presence, costs issues, etc), there is a risk that these intermediaries or third parties may be used as conduits for inappropriate payments.
- 'Parallel economy' or 'black money' transactions involving 'cash components' in real estate deals in order to avoid or lower stamp duty fees to register, and avoid or evade taxes in the purchase of land and buildings or lease agreements
- Extensive compliance requirements due to multiple state as well as local regulations, policies and laws and their inconsistent interpretation
- High and aggressive sales targets linked to employee incentives can lead to corrupt practices between the sales and distribution teams and dealers, distributors or customers. This may include a scenario of collusion with customers or any other party for sharing rebates, promotions, discounts, etc so as to get unfair advantage and induce sales.
- Large spends on marketing or promotional events and merchandise in order to publicise and obtain business as well as 'permissions' or 'government approvals' pertaining to the same.

The Transparency International Survey on bribery and corruption ranks India high (94 out of 177 countries) on its corruption perception index.[6]

5 Source: PwC Global Economic Crime Survey 2014

6 Source: http://www.transparency.org/country#IND

In a competitive scenario, a highly-motivated team consisting of sales personnel may enter the market and set about achieving the goals of customer reach as well as connect in an organised, insightful, and energetic manner. This straightforward act of business building may nonetheless expose many of the company's business processes to broad challenges such as the following:

- **Disbursements process:** Risks may be identified by answering questions such as: are adequate records of meetings, entertainment, demonstrations as well as events been maintained? Did any government official participate? Was the value of the meals or any gifts exchanged within the bounds of corporate policy and local law?
- **Channel management and distributor appointment process**: This includes adequacy of the due diligence process so as to identify potential issues, including whether or not the company is dealing with government officials.
- **HR processes**: Are organisations conscious about screening of the local staff with good connections in the marketplace, which may include relatives working as government officials at customer agencies.
- **Logistics:** Do organisations perform adequate checks to verify if agents or employees are meeting their expectations of timely clearances, by entertaining local port or state officials on a regular basis?
- **Licencing process:** Hiring consultants, who have been recommended by the government or employed by retired agency officials to assist with the approval and licencing processes for an organisation's products, thereby challenging the due diligence process for vendor selection and payment controls.

Each of the above process has the potential to challenge the integrity of employees, thereby pressurising them as they struggle to manage the tensions of achieving financial goals while operating in compliance with the policy and regulation within a local, political and business culture characterised by a high demand for corrupt payments.

Did you know?

A convenience store will require a minimum of ***29 licences*** from nearly ***20 different authorities***.[7]

*Inadequate supply of infrastructure, **inefficient government bureaucracy as well as corruption** are ranked at the top as most problematic factors for doing business in India.*

7 Source: Insight- 'Speed money' puts the brakes on India's retail growth - http://uk.reuters.com/article/2013/05/05/uk-india-retail-insight-idUKBRE94400V20130505

8 Source: World Economic Forum-GlobalCompetitivenessReport_2013-14 Source: World Economic Forum-GlobalCompetitivenessRepo rt_2013-14

Regulations and enforcement around bribery and corruption

Bribery and corruption arise from the failure of businesses to adhere to the expected code of business conduct established by various nations across the world. Several countries, including the US and the UK, are committed to rolling out enforcement programmes, with increasingly stringent standards as well as stiff penalties.

The advent of stricter domestic as well as foreign bribery laws and their increasing enforcement, the imposition of record fines and the threat of criminal penalties for company directors as well as employees have been sending shock waves through the business community. Furthermore, pressures are mounting from responsible investment funds and indices, which are applying anti-bribery and corruption criteria into their screening procedures. As regulators and stakeholders become less tolerant of lapses, responsible companies increasingly understand that they must undertake continuous efforts in order to ensure that they identify as well as mitigate the risks of bribery and corruption effectively.

Violations can mean both civil and criminal penalties for companies as well as their executives, and the monetary costs can be huge. Beyond the price of defending itself against a government investigation, a company charged with violations will have to pay penalties and incur ongoing costs for remediation and monitoring of business activities.

The financial costs as well as the collateral damage caused by incidences of bribery and corruption, especially in the light of the penalties imposed by governments through increasingly aggressive anti-corruption enforcement laws and regulations have been significant. Various penalties have been imposed during investigations carried out by the Central Bureau of Investigation (CBI), UK Serious Fraud Office (SFO), SEC and DOJ.

In 2012, out of 324 whistleblower tips received by the US Securities Exchange Commission(SEC) and Department of Justice (DOJ), which originated overseas, 33 (10%) tips were received from India.[9]

Regulations: A global overview

	Companies Act, 2013, India	Foreign Corrupt Practices Act, US	UK Bribery Act, UK	Prevention of Corruption Act, India	Lokpal Bill, India	Prevention of Bribery of Foreign Public Officials and Officials of Public International Organisations Bill, India
Bribery and corruption procedures	Not mentioned specifically	Yes	Yes	Yes	Yes	Yes

9 *Source: http://blogs.orrick.com/securities-litigation/2012/11/15/sec-releases-first-full-year-report-on-the-dodd-frank-whistleblower-program-no-speedy-recoveries-for-whistleblowers/*

Combating bribery and corruption

Traditionally, several global retail companies have entered the Indian market through a joint venture, franchisee or wholly owned subsidiaries. As a preventive measure, the investor must ensure that a joint venture or the investee company has a code of conduct or a compliance programme in place, consistent with its own structure, and it needs to also have a plan for taking appropriate action if any instance of bribery and corruption occurs or is reasonably thought to have occurred.

Companies can mitigate bribery and corruption risks through the following options:

- Draw a comprehensive code of conduct duly aligned with regulations and business practices ensuring proper guidance to various stakeholders such as employees, vendors, third parties, etc and strict enforcement of the code with zero tolerance.
- Establish an effective and a structured internal as well as external communication so as to report instances of any violations, including bribery and corruption.
- Stakeholders such as directors, managers, employees as well as agents and where appropriate, contractors and suppliers need to receive appropriate training on their company policy in order to combat bribery and corruption.
- Retailers working through a franchisee model whereby a third-party is trusted with the use of a brand or intellectual property must keep in mind to conduct a fieldwork exercise, including review of licence agreement compliance issues as well as potential under-reporting of royalties. Companies should look at conducting regular compliance examinations on aspects such as pricing, distribution and franchise agreements.
- Companies, before investing into JV's or entering into third-party business relationships, may undertake a counter-party due diligence activity in order to identify any regulatory issues, pending litigations, company reputation, integrity of senior management and other misconducts related to bribery and corruption.
- An effective system of internal controls are to be maintained in order to counter bribery and corruption, comprising financial and organisational checks and balances over the enterprise's accounting and record keeping practices as well as other business processes.
- The enterprise needs to establish feedback mechanisms as well as other internal processes supporting the continuous improvement of the bribery and corruption programme. Senior management members of the enterprise should monitor the programme and periodically review its suitability, adequacy and effectiveness, and thereby implement improvements in order to address issues arising out of bribery and corruption.

It may be noted there is no one-size-fits-all approach in addressing the issues of bribery and corruption. Each policymaking process has to be preceded by a careful evaluation (with the help of experts and professionals) of industry risks, control deficiencies, available resources, and local jurisdictions.

As a conclusion, risk exposure on bribery and corruption can vary within different companies operating in the retail and consumer sector, but given the economic, social, business and cultural connotations as well as the nature and extent of government touch points, such risks will need to be managed.

A strong internal control environment, including a comprehensive and practical anti-bribery and corruption programme plays a crucial role in effectively managing and reducing this risk within companies as well as their dynamic business environment. Such a programme may not only strengthen the reputation of the company, build respect and raise its credibility with key stakeholders, but also weigh heavily in its favour in the event of any regulatory investigation.

The development as well as the implementation of an anti-bribery and corruption programme should be thus seen as an expression of broader ethical values and corporate responsibility, which in turn will provide companies with a better vision of the overall economic crime risks.

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