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# SUPPLY CHAIN CORRUPTION: A BUSINESS ETHICS BLIND SPOT

Jonathan Webb

Queen Mary, University of London  
Tutor: Professor Stephan Henneberg

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# Supply Chain Corruption: A Business Ethics Blind Spot

The increasingly globalised nature of supply chains is stretching companies' operations into high risk locations and exposing sourcing activities to corruption (Carter, 2000). Despite this threat, relatively little is understood about supply chain corruption and the exposure to which firms face (Arnold, *et al.*, 2012). A string of recent corruption scandals is forcing legislators and government officials to afford more attention to anti-corruption. In May 2016, world leaders recently convened in London to declare that:

“We commit to expose corruption wherever it is found, to pursue and punish those who perpetrate, facilitate or are complicit in it, to support the communities who have suffered from it, and to ensure it does not fester in our government institutions, businesses and communities.”

Global Declaration Against Corruption (12 May 2016)

During the summit, leaders attacked the practice of corruption with fresh vigour. The UK Prime Minister stated that “the evil of corruption reaches into every corner of the world,” (*Wall Street Journal*, 11 May 2016). The President Colombia noted that allowing the corrupt to operate unchecked potentially brought grave consequences: “the sisters and brothers of corruption are terrorism, drug trafficking, [and] illegal mining,” (*The Guardian*, 12 May 2016).

One of specific remedies recommended by the signatories of the Declaration believed that examining third-party and professional relationships may reduce corruption “by driving out those lawyers, real estate agents and accountants who facilitate or are complicit in corruption” (Global Declaration Against Corruption, section 1). Although the role of such professionals may enable money-laundering, the Declaration does not speak to any degree of depth towards the actions of companies overseas.

Indeed, aside from the role of inter-mediating professional firms, little business activity is addressed in the Declaration. Public sector corruption tends to attract more attention than private-to-private corruption because there is a view that corruption within business is less socially impactful, more regulated through the market mechanism and less publically visible (Argondón, 2003). Yet, a cursory glance at the business press exposes a number of high-profile corruption cases involving large multinational corporations. The most egregious offender is Siemens. In 2018, the Germany-based manufacturer received an \$800 million fine from American prosecutors for violation of the Foreign Corrupt Practices Act (Department of Justice, 2008). This was the largest fine received by a company under the FCPA, and was part of a broader penalty issued to the company exceeding \$1.6 billion. Unfortunately, charges of corruption still dog the firm. In May of this year Siemens paid \$43 million to Israeli authorities to settle a decade-long bribery dispute (Reuters, 2016). In September 2015, the company admitted to paying bribes in Argentina (*Wall Street Journal*, 2016). Other recent

investigations have uncovered similar instances of abuse. In February 2016, VimpelCom, the world's sixth-largest telecommunications firm, also paid \$835m million to American and Dutch authorities for its involvement in a massive kickback scheme to secure licences in Uzbekistan (*The Guardian*, 19 February 2016).

Although these cases are illustrative, they also manifest corruption's continued threat to the private sector. Market abuse, including bribery, can occur between rival firms or within the supply chain. Recent BBC investigations into British American Tobacco found widespread use of bribery, where BAT agents paid employees of rival firms to provide access to confidential marketing plans "within hours" of their composition (BBC, 30 November 2015). In another case, Foxconn buyers were found to have received \$5 million in bribes from suppliers, in return for special treatment (*Wall Street Journal*, 21 May 2014).

When seeking to reduce private-to-private corruption, the corporate fraud investigator first looks to the procurement department (Comer, 1998). The discretionary power of buyers to award supplier contracts and the close relationship enjoyed between procurement manager and salesman make the purchasing function high risk area for corruption (Hussain, 2014). Furthermore, the increasingly extended and globalised nature of supply chains also raises into question the ethical behaviour of suppliers (Carter, 2000). Despite this, relatively little academic work has been conducted in exploring corruption within the supply chain, indeed a recent study upon the topic finds that the academic literature is void on the matter (Arnold, *et al.*, 2012). Given the relatively light academic examination upon the topic, it is useful to clarify, as much as possible, the terminology surrounding the word 'corruption'.

### **What is (supply chain) corruption?**

Like many concepts within the social sciences, 'corruption' defies easy definition. The World Bank defines the concept as "the abuse of public office for private gain" (World Bank, 1997). An issue with this definition is that it relates only to malfeasance in government and overlooks abuses within the private sector. This has led many to treat corruption as a public sector problem and almost entirely exclude the actions of private firms from conceptual examination (c.f. Gardiner, 2002).

Until recently, the legal community has followed this vein of thought. The US hosts the world's most actively enforced law in the Foreign Corrupt Practices Act (FCPA) in large companies regularly receive multi-million dollar fines for non-compliance. As rigorously enforced as this piece of legislation is, it only applies to bribery of overseas foreign governmental officials, not to companies bribing other commercial entities. By contrast, the UK launched its own Bribery Act in 2010, which includes private-to-private corruption within its purview. This law is considered the most stringent piece of anti-corruption legislation in the world (Nicholls, *et al.*, 2011) and many are likewise expanding their conceptualisations to include private-to-private corruption. For instance, one of the most widespread definitions comes from the leading anti-corruption NGO, Transparency International, which defines corruption as:

"the abuse of entrusted power for private gain"

(Transparency International's website, 2016)

This is more useful for our current purposes as it broadens the scope of corruption to include business activity. The question that follows from this definition is: What does abuse of power involve? We can summarise the work of the legal scholar Boersma (2012) and sociologist Gambetta (2005) who describes corruption as involving bribery, extortion, embezzlement and trading in influence (see table 1).

<b>Table 1: Typology of corruption</b>	
<b>Bribery</b>	The payment of goods or services to an individual who can provide an illicit favour in return. We can understand it from two main perspectives: <ul style="list-style-type: none"> <li>• Active bribery – supplying illicit payments to another.</li> <li>• Passive bribery – receiving payments from another.</li> </ul>
<b>Extortion</b>	A version of the ‘passive bribery’ above, but a bribe is demanded where ordinarily no (or little) payment is required.
<b>Embezzlement</b>	Often known as ‘auto-corruption’, a type of white-collar crime where only one person is involved.
<b>Trading in influence</b>	An abuse of influence or personal connections to sway a favour for a third-party. The difference from bribery being that the agent engaging in this form of corruption is not directly providing the good or service, but influencing the process or individual that determines resource allocation.
<b>Abuse of functions</b>	This form of corruption is divided into two categories: <ul style="list-style-type: none"> <li>• Patronage – controlling appointments of organisational decision-makers or other key positions.</li> <li>• Nepotism – a more personalised version of patronage, where appointments are made in favour of family or kin,</li> </ul>

Adapted from Boersma, 2012 and Gambetta, 2005

Within the supply chain, corruption can take many guises and any of the above offences can be prosecuted by the supplier itself, or, indeed, the procurement manager. There are a range of permutations in which corruption can manifest: suppliers bribing procurement managers; procurement managers bribing suppliers; or perhaps suppliers engaging in governmental facilitation payments on the behalf of the buying organisation. For the purposes of simplicity (and space) we will confine this essay to cover two manifestations of supply chain corruption. Firstly, the suppliers corrupting (or exploit corrupted) buyer agents. We will call this ‘procurement corruption’. Second, suppliers acting corruptly within the supply chain, either with or without the buyer’s knowledge. We will call this ‘supplier corruption’. Another means to distinguish these is to understand these issues as ‘vendor fraud’. In the first instance, the vendor colludes with the procurement officer to defraud the buying organisation and in the latter instance, the vendor acts alone (Albrecht, *et al.*, 1995).

### **The fraud triangle**

A commonly deployed tool to understand white-collar crime such as corruption is the fraud triangle (figure 1). This was developed by the sociologist Donald Cressey (1950) who aimed to understand the circumstances that would lead hitherto decent people to commit criminal offenses. Cressey theorised that crime is brought about by three elements: first, the pressure that an individual is under. Albricht *et al.* (1995) divides pressure into three forms, either financial pressure endured by individuals, vice-related pressure, such as drug or gambling addictions, or work-related pressures, such as job dissatisfaction or grievance against the employer.

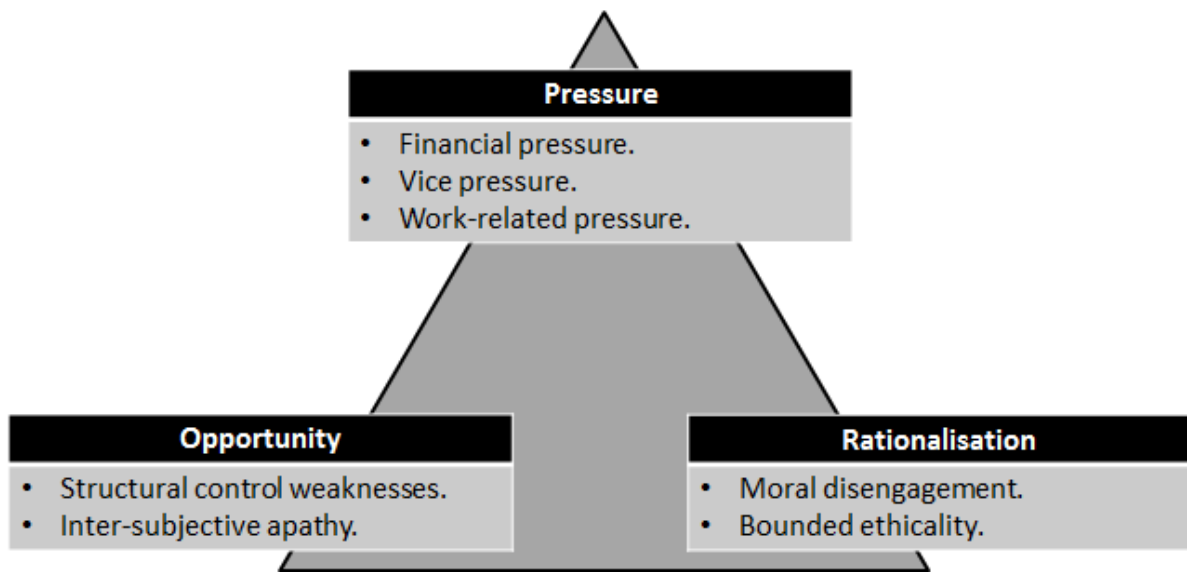
The second point of the triangle relates to opportunity. This describes the possibility that a person can successfully prosecute fraud within detection. It arises from a range of factors, both structural (lack of control, information flows, audit mechanisms, etc.) as well as intersubjective (staff are apathetic to their colleagues' potential for criminality).

The last stage relates to rationalisation. This describes an individual's ability to justify to themselves the appropriateness of their actions. This reflects moral disengagement theory, where individuals can reframe their actions to themselves by either denying a victim, distorting the results, appealing to an acceptable moral trade-off or minimising their role (Bandura, *et al.*, 1996; Moore, 2008). Another avenue is for individuals to be entirely blind to the moral content of their action, which avoids entirely the cognitive dissonance implied by moral disengagement, and individuals can automate unethical actions without consideration to morality. This is often called 'bounded ethicality' and describes certain states where it is impossible for an individual to perceive their own wrong (Kim *et al.*, 2015). Within the corruption literature, a similar phenomenon has been termed 'normalised corruption', whereby individuals are inculcated into corrupt organisational practices through the routine of day-to-day business (Ashforth and Anand, 2003).

The fraud triangle is most readily mapped onto procurement corruption, in so far as it describes the pressure to which an individual faces in the performance of her duties, the opportunities present in the control environment and any rationalisation available to her when justifying her actions. For example, we saw in the Foxconn case that the buyers were incentivised by money (\$5 million dollars) that quickly could resolve individual financial pressures, the lack of controls within the Taiwanese manufacturer enabled these bribes to be paid in the first place and, although we will never be able to fully understand the rationalisations the buyers underwent, we can speculate that the "entertainment and service fees" received may have been considered a perk of the job (*Wall Street Journal*, 21 May 2014).

Similarly, the fraud triangle can help explain the behaviour of a corporate entity when companies engage in supplier corruption. Companies may be under cashflow or balance sheet pressure and as such more amenable to behaving uncompetitively within the supply chain. Siemens, for instance, a major supplier to countless firms across the world, felt it necessary to bribe government officials to achieve goals and win contracts (Reuters, 2016; *Wall Street Journal*, 2016). There was evidence of opportunity given the weak control environment and even apathy displayed amongst colleagues: Managers did not feel obliged to report activities unless they were illegal and consequently items in an ethical grey area did not receive the adequate attention (Choudhary, 2013). Also, given the widespread use of corruption within the company, many individuals minimised their role and continued to perpetuate the use of bribery by rationalising their function as a disempowered component of the machine (Choudhary, 2013).

**Figure 1: Fraud triangle**



Adapted from Cressey, 1950

**Identifying and reducing supply chain corruption**

For the purposes of space, we focus on the opportunity aspects of the fraud triangle. Building robust a control environment is often the most practical means for companies to reduce their exposure to supply chain corruption (Hussain 2014). Within the procurement corruption context, Wane, et al. (2011) and Hussain (2014) provide a useful typology that revolves around kickbacks (buyer’s return for awarding contracts or bid-rigging (establishing an uncompetitive tender). There are controls and ‘red flags’ that companies can implement that can reduce exposure to procurement corruption (see table 2).

<b>Table 2: Typologies of supply chain corruption and identifying red flags</b>	
<b>Type</b>	<b>Red flag</b>
<b>Kickbacks</b>	<ul style="list-style-type: none"> <li>• Improper bid selection.</li> <li>• Involvement of unnecessary middleman.</li> <li>• Buyers accepting inappropriate gratuities.</li> <li>• Unexplained / conspicuous wealth of buying officers</li> <li>• Buyers rumoured for taking bribes.</li> <li>• Under-delivery / poor performance of contracts.</li> <li>• Involvement of former buyers / salesmen within a relationship.</li> <li>• Close interpersonal buyer-salesman relationships.</li> </ul>
<b>Bid-rigging</b>	<ul style="list-style-type: none"> <li>• Bid suppression: other competitor suppliers did not bid.</li> <li>• Complementary bidding: other competitor suppliers submit excessively high bids.</li> <li>• Big rotation: competitor suppliers ‘take turns’.</li> <li>• Custom or market allocation: designing a tender to map upon a single suppliers geographic or commercial footprint.</li> <li>• Low balling: post-award contract alterations.</li> <li>• Submitting apparently separate bids for the same company.</li> </ul>

Adapted from Wane *et al.* (2011) and Hussain (2014)

In reducing opportunities for supplier corruption, the emphasis moves towards company’s supply chain risk management capabilities. A key means to reduce supplier corruption is to examine the role of intermediaries (as called for by the Global Declaration Against Corruption):

“Because of their expertise, local knowledge and connections, using a local agent has become a proven way for companies to enter new markets... In corrupt transactions, the local agent is compensated for ‘capturing’ the contract for the foreign bidder by exerting influence on local public officials, including by agreeing and paying kickbacks to them”

Wane, *et al.* (2011)

The existence of such a shell companies itself, as we saw in table 2, is a red flag. Within the practices of supplier management, buyers can make use of established principles as conditions of trade if suppliers wish to transact business with the buying organisation(see table 3).

<b>Table 3: Principles for competitive supplier management</b>	
<b>Rules-based</b>	A clear regulatory framework.
<b>Competition</b>	Multiple suppliers striving to provide best value.
<b>Transparency</b>	Parties understand processes and outcome.
<b>Accountability</b>	Officers are responsible for applying rules.
<b>Economy</b>	Good value for money.
<b>Efficiency</b>	Timely process and implementation.

Adapted from Wane, *et al.*, 2011

Companies can reduce supplier opportunities for corruption by requiring that suppliers sign up to such standards, in a code of conduct or clearly stipulated terms (Hussain, 2014). Implementing such mechanisms and principles is by no means a guarantee that a company is immune to supply chain corruption, but they will reduce exposure that organisations face the negative exposures faced by Foxconn and Siemens, the legal penalties of the FCPA and UK Bribery Act, as well as the public relations penalty of consumers boycotting a corruption company. The first step to make is realising the risk of supply chain corruption and quantifying the threat. Furthermore building a stronger control environment will demonstrate commitment to the Global Declaration Against Corruption and seek to illuminate practices that have previously been a blind spot in global supply chain management.

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\*Note: All linked references active as of 30<sup>th</sup> June 2016.