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INVESTIGATION OF CORRUPTION WITHIN MULTINATIONALS

Case study

Keywords
Corruption
Multinationals

JEL Classification
M41, M42

Abstract

Nowadays companies worldwide are battling to survive and grow in what have continued to be highly adverse economic conditions. In this regard, many multinationals have intensified their efforts to detect and investigate the cases of corruption, as a special form of fraud. The purpose of this article is to analyze the cases of corruption identified within companies in the last year, the evolution of this negative phenomenon and the general perception of companies in this matter. Taking into consideration the aspects above we focus on the conceptual framework of corruption and the studies conducted in the past, later describing its main characteristics and form of manifestations. Finally, we present recent findings of corruption studies issued at the beginning of 2014.

Introduction

Over the last decades, corruption has transformed from a predominantly national or regional preoccupation to an issue of global revolutionary force. (Glynn, Kobrin, Naím, 1997) In this regard, corruption has been cited many times as the main source of suboptimal development, deteriorating national economies and political systems at macroeconomic level and being one of the main causes for firm's decline from a microeconomic perspective.

Also, the expansion of international business activities, especially of multinational companies, has lead to an increase attention of corruption, considered one of the hardest to detect among the forms of fraud. Starting from this idea, multinationals have become more careful when choosing foreign countries for their subsidiaries, being concerned that corruption can increase the costs and operational risk.

There is a vast literature on corruption linked either to firm's expansion and foreign direct investment (Eaton &Gersovitz, 1984; Bond &Samuleson, 1989; Doyle & Van Wijnbergen, 1994; Thomas and Worrall, 1994; Albuquerque, 2003), either to various conditions, causes and effects using mathematical and/or statistical modelling (Rose-Ackerman, 1975; Shleifer&Vishny, 1993).The line of research in this field covers a large area, being facilitated by several publications of worldwide corruption indices as Transparency International, the World Bank or the Economist Intelligence Unit. When using corruption indices as an independent variable, studies have shown that corruption is a leading factor to suboptimal economic growth (Barro, 1998), to poor investment related to inefficient government (Knack & Keefer, 1995; Mauro, 1997), to reduced economic competitiveness (Ades& Di Tella, 1996) or a decreased level of trust and social capital of citizens (Knack & Keefer, 1997; La Porta et al., 1998). When used as a dependent variable, researchers have found that there's a strong link between corruption and GNP per capita (Husted, 1999) and, in the short run, the more rapid the growth rate of foreign direct investment (FDI) is the higher level of corruption we identify (Robertson, Watson, 2004).

As shown in the researches and studies developed over the years, the main determinants of corruption are (Eaton, & Fernandez, 1995) : instability of financial management systems, generally, governments; incomplete nature of laws and legal procedures; imperfections of control mechanisms in finance and development; relative level of income of those working in the public domain; relatively low protection of state finances; negative impact on legal action procedures in which some special cases of corruption have been treated superficial.

1. Defining corruption

Etymologically, corruption is derived from the Latin term "Coruptio–Omnis" and means a state of deviation from morality, of honour, of duty, immorality, depravity. Corruption exists since antiquity as one of the worst behaviours and most widespread of civil servants and is rooted in the main issue between two distinct social classes: the poor and the rich (Albrecht, W.S., & Albrecht, C.O., 2003).

As a *social phenomenon*, corruption is an expression of manifestations of moral decay and spiritual degradation since it involves the diversion and use of public assets in personal purpose, occupying public office through preferential relationships, obtain material benefits for service obligations, making business and transactions evading moral and legal norms.

Corruption is a devastating phenomenon, being found in any place, in any field and in any activity. It can be considered a reflection of the degree of immorality and imbalance in society. *Constantly evolving, corruptionmakes it impossible for anyone* *to be able to define it and evaluate the actual shapes and sizes*. It may be reported to law and the share of occurrence at a time, but with a clear note of *relativity*.

In the *terms of law*, corruption is the abuse of power in order to obtain material benefits or other benefits, most often being just an ordinary illegal agreement, which acts according to Roman law principle of “do ut des” “I give that you might give” (me back) and is negotiated and carried out clandestinely and under confidentiality.

UN Convention defines corruption as “the promise, offering or giving money, gifts or other benefits to an individual for their own benefit, of a company or other person, of a civil servant in order to perform or not to perform an act related to the duties of his office” or “the public official deed, which, directly or indirectly, claims or receives money or other goods in order to perform or not to perform an act relating to the duties of his office.” (UN Convention against corruption, 2004)

The Organization for Economic Cooperation and Development (OECD) adopted the following definition of corruption: “bribery involves directly or indirectly offer or grant of any use void, pecuniary or other advantage to a foreign official for breach of statutory duty service in order to favour or obstruct a business”. (OECD, 2009)

Although these approaches are quite explicit, any definition of corruption will be equally accepted by every nation. Therefore corruption cannot receive a universal definition applied to all cases, this concept being, most of the times, elusive, ambiguous and reductionist (La Porta et al., 1998).

In general, corruption is a normative concept designating illegal and immoral violation or transgression of the rules relating to the duties of public officials, businesses or persons performing various financial and banking operations(Rose-Ackerman, S., 1999). Corruption also designates different acts or illegal acts by using fraudulent abuse of power in order to obtain personal benefits by public officials.

Corruption has several dimensions:

The *statistical* dimension offers knowledge upon the specific of different sectors, branches and institutions that have the highest frequency and extent of corruption.

The *normative (juridical)* dimension considers the main requirements and rules of law relating to irregularities and violations committed by various economic agents, public officials, institutions or individuals, and the penalties that apply in such cases and, of course, their efficiency.

The *sociological* dimension provides information about the causes and conditions that generate corruptive acts and events, as well as risk factors that exist in certain sectors and areas of activity.

The *psychological* dimension focuses on the structure and personality of individuals and groups involved in corruption acts, motives and goals pursued through corruption, public reaction to corruption.

The *foresight* dimension provides data and information on future trends of corruption to specialized organs of control that, in this way, benefit from a wide range of updates on the emergence of new forms of corruption.

The *economic* dimension focuses on the evaluation and estimation of the various economic and social costs of corruption, as well as on the qualitative assessment material and moral damage caused by this anti-social phenomenon.

From the scientific point of view, corruption takes the form of: political corruption, administrative corruption and economic corruption. Hereinafter we focus on economic corruption, forms of manifestation and its place in the fraud tree.

2. Detecting forms of corruption

Corruption schemes generally include bribery, extortion, conflict of interest and illegal increased prices. These consist in payments in exchange for certain benefits or preferential treatment. Involved in either of these schemes, companies, their owners and employees are deprived of the right to honest services being impossible for them to enjoy the same rights as the competition or to obtain profits due to normal economic conditions. When an employee or an associate wrongly appropriates some money from a transaction, the negative effect on the company activities in question is greater than he or she imagines (Albrecht, W.S., & Albrecht, C.O., 2003).

In order to position corruption among the other forms of occupational fraud we present a graphic illustration of the concept in Figure no. 1,Appendix A.

Fraud involving corruption is extremely difficult to detect because most, if not all, transactions related happen “off the books”, no evidence of their conduct being found (there is no paper to be found when someone receives a bribe in a dark alley).

Detecting *bribery* is difficult because it takes place outside the accounting system, being connected to legitimate business transactions. Consumers often connect bribery scandals to state companies but bribes are taken and given mainly in the private sector.

Phishing is a type of bribe offers in which the provider is offered a slight advantage in what is supposed to be a competitive tendering process. Supplier details are provided inside to help them win the auction or it may have already been selected in secret. The bidding process is held only for the company to ensure that the supplier “wins” the contract bid.

A similar system is the company that buys more than it needs from a supplier in an auction, its employees claiming fraudulently, that the company really needs those goods when in fact, it doesn’t. In addition, vendors are likely to understand each other in the bidding process, making illegal agreements in order to inflate bid prices.

This method can be detected by recognizing a contract with an unusually high price. Where there are few bidders, suspicion should be higher. In this situation, the investigator should consider unusual bidding patterns or obvious complicity, based on similarity of the information on offer. A provider with a record of numerous won contracts and with bids submitted in the past may indicate that there is an employee providing information about other bids submitted.

Kickbacks are received when a company pays more for goods and services and in turn a part of the amount received is paid to another person. The amount of money is usually paid extra by an employee of the purchasing company. Basically the employee in question is the one who brokered the deal, making the supplier to be selected. Instead, the employee requests a certain percentage or amount of the total transaction. Detection of such a system in a company is very difficult especially when those charged with awarding a contract or purchase products or services accumulate more connected responsibilities.

Anyone who enjoys such authorization within a company may be suspicious that such a scheme attempted. Basically the management designated an employee to find, for example, five suppliers to purchase a certain product and delegate authority to choose the best of them to the same person. This is the time when the employee in question can produce such a manoeuvre. Any employees involved in the approval of a contract, such as production, supervisors, managers, engineers, quality inspectors, are at risk for receiving or request kickbacks.

The best way to detect such a system is to analyze data using computer programs. Software can hunt any irregularity or clear differences between prices and quantities, including frequency of buying from each provider. A higher cost than normal of raw materials or unusually high volume of purchases from a single supplier may signal a problem.

In addition, the quality of raw materials or goods should be monitored closely. It is not unusual for a vendor to replace the original goods ordered with those of lower quality in order to make a bigger profit from transactions. The supplier has a lower cost of goods lower, but the price charged, simulating that provides better quality products to the customer. If in a company are found quality problems of goods we are, most likely, before a corruption scheme. Simultaneously, it's important an analysis of expenditure trends and seeking explanations period increases and / or slump. Irregularities in inventory excessive cancellations can all cover overpayments.

Contracts with providers should include the right to audit contractual clauses because their files could be an important part of an investigation into bribes or kickbacks. Under such a clause, the company would have the right to look at the provider's accounting records to determine whether there was fraud or misrepresentation.

Although not as common as other forms of corruption extortion occurs however with some regularity. If in bribes are given money to obtain certain benefits, *extortion schemes* involve someone asking for money or goods to do business together. For example, when a person within a company requires someone outside a sum of money to go into business with them, we can say that we face an obvious case of extortion.

Conflict of interest occurs when an employee, someone in management or a shareholder has a personal interest on a transaction to take place, which will adversely affect the company. Of course, the person has some influence in the transaction, resulting in a negative effect on the company from which the employee get to benefit himself, a friend, a family member or any other person involved with direct interest on the transaction.

Transactions with related parties rarely raise questions on a possible fraud because it is a common practice that businesses take place between family members, friends, affiliates, companies or other entities friends who have a special relationship with company management or owners.

As long as the related party transactions are conducted normally in the same way that the company makes with other companies with which it has no particular connection, the situation does not pose any problem. Same prices and terms of payment, same delivery specifications and contractual terms should be respected in all circumstances, regardless of the links between business partners. The problem arises when those companies reap the benefits in their business dealings with the company, especially if they have a negative impact on its financial situation by increasing costs, declining revenues or receipts and any other concessions. These types of relationships are difficult to detect, especially if the management hide a link with respective business partners. If they are covered when there are reasonable grounds, we are facing a corruption case.

Suspicion on these business relationships may occur if: some information was disclosed only to one partner at the expense of others; were sold goods or services at a price much lower or higher than the market, thus causing damage to the company, expanding the credit line of customers who would not normally met the conditions for the grant, loan money at a rate significantly lower than the market or interest free, omission declared related party relationships in the notes to the financial statements and so on.

Making transactions with related parties is not necessarily anything wrong as long as the companies involved do not favour each other or do not use existing relationships to derive benefits that would harm the partner.

3. Case studies

Even it's not the most common form of crime reported, bribery and corruption pose the greatest threat to global businesses because of the number of business processes it threatens. Sales, marketing, distribution, payments, international expansion, expense reimbursement, tax compliance, and facilities operations are all vulnerable processes affected by corruption.

In this regard many international organisations as well as multinational accounting companies are studying the evolution of this negative phenomenon based on information and surveys among companies worldwide. In 2013 corruption has been the main interest of: the Economist Intelligence Unit (EIU) which polled 901 senior executives worldwide from a broad range of industries and functions. Putting the information collected by EIU, Kroll, an international technology-enabled intelligence and information management company, has published the last global fraud report for 2013 with predictions for 2014.

Besides them, the increased interest on corruption has been shown by KPMG, which published the report *KPMG Malaysia Fraud, Bribery and Corruption Survey 2013*, by Ernst & Young, with *Building a more ethical business environment. Asia-Pacific Fraud Survey 2013*and *Growing Beyond:*
a place for integrity 0 12th Global Fraud Survey.

One of the most complete studies is *KPMG's Global Economic Crime Survey 2014* which contains information collected from companies acting in all continents, all industries, most of them being subsidiaries of multinationals or affiliated entities.

In every region analysed it has been reported a number of events related to bribery and corruption, increased since 2011 from 34% to 53% as it shown in Figure no. 2, Appendix B.

The financial costs and collateral damage caused by incidences of bribery and corruption—especially in light of the penalties imposed by governments through increasingly aggressive anticorruption enforcement—can be significant. As Figure no. 3, Appendix C illustrates, regardless of their size, companies that experienced incidences of bribery and corruption more frequently reported losses of over US$5 million.

Business globalisation imposes companies to operate in territories with a high corruption risk – 50%. As we see in Figure no. 4, Appendix D, the geographical zones with the highest risk for corruption schemes are located in Africa and Eastern Europe. The data underscores that countries within these regions are experiencing a relatively higher share of incidences of bribery and corruption (36%) vs. the global average (27%).

According to KPMG, the high reported figures of bribery and corruption can be justified by the megatrend of the shift in wealth from the developed economies of the West to the emerging high-growth economies of the South and East—many of which may have different cultural attitudes toward fraud and corruption, fewer regulations, and less-consistent enforcement of those regulations. These conditions naturally create a higher risk profile for this type of economic crime. (KPMG, 2014)

These findings are based on respondents' answers regarding the pursuing operations of the companies they represent in zones with high risk, with a reference to the 2012 Transparency International Corruption Perception Index ("CPI"). The CPI is compiled annually by Transparency International, a non-profit organisation which tracks a number of corruption indexes.

Reported to CPI, North America is considered as having less corruption than many other parts of the world. However, in this region the percentage of bribery and corruption has doubled between 2011 and 2014.

The reported bribery and corruption by industry, presented in Figure no 5, Appendix E, indicates that the sectors most affected by these acts are engineering and construction (50%), energy, utilities and mining (42%) and state owned enterprises/government (35%).

As Figure no. 6, Appendix F illustrates, there is a notably higher likelihood that an organisation operating in a high-risk market was asked to pay a bribe and/or felt they lost an opportunity to a competitor who did so, compared to those who did not operate in high-risk areas. When the competition is believed to be playing unfairly, the pressure on an organisation to follow suit can intensify.

Since bribery and corruption is often prosecuted by regulators across borders, organisations should be mindful of the significant risks involved with operating in these high-growth areas, even if local practices and customs are less rigorous. So while North America and Western Europe are actually low on the scale of regions reporting bribery and corruption, their government enforcement practices have a deep influence in this area.

4. Conclusions and future trends

Based on the findings of the corruption studies conducted in 2013 we consider bribery and corruption rising more quickly than the other categories of economic crime surveyed. Three in ten viewed theirorganisations as likely to fall victim to bribery and corruption—a significantly higher number(29% versus 23%) than in 2011. Not only is the rate of the perceived threat of bribery and corruption accelerating, it is also welldistributed across all industrial sectors, with a low of 14% in entertainment and media and a highof 42% in energy, utilities and mining.

At the regional level, future expectations generally align with actual experience, as Figure no. 7, Appendix G illustrates. However, Africa and LatinAmerica perceived more future risk (52% and 35% respectively) than what respondents reportedin the present (39% and 25%).

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Appendices

Appendix A

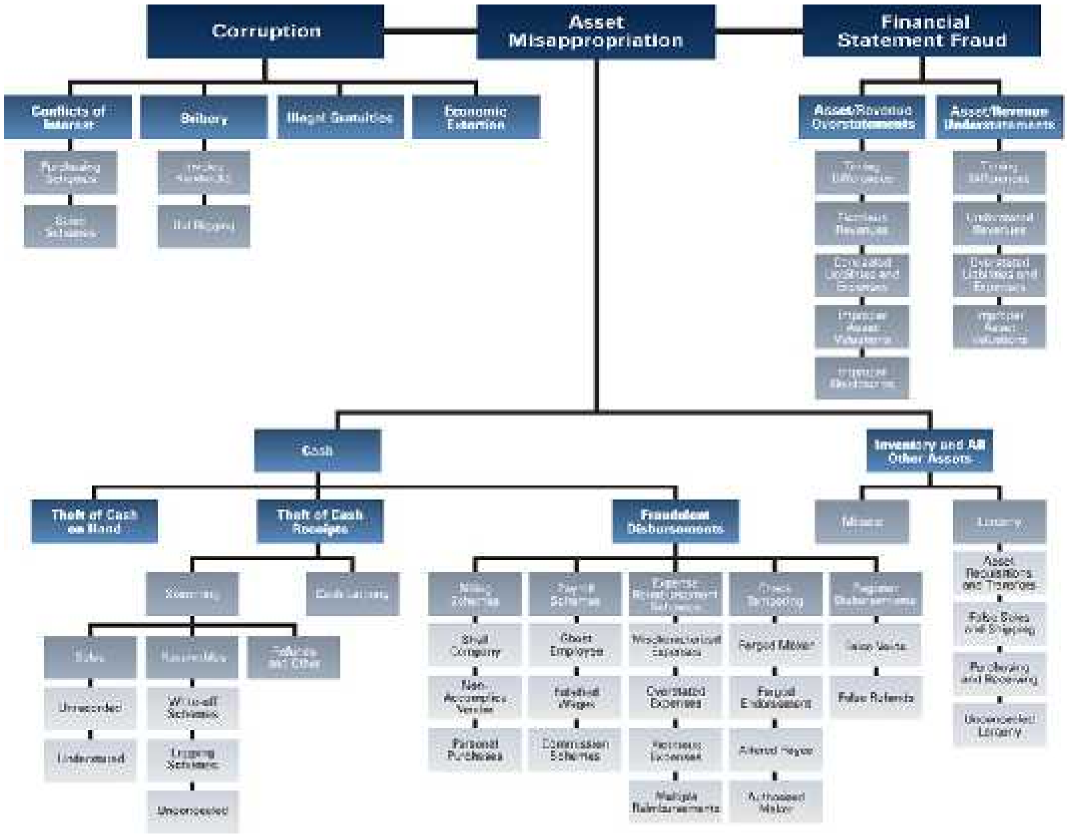

Figure no. 1.Fraud tree examination

Source: Albrecht, W.S., & Albrecht, C.O. (2003), *Fraud Examination & Prevention*, Cincinnati: South Western Educational Publishing, p. 36

Appendix B

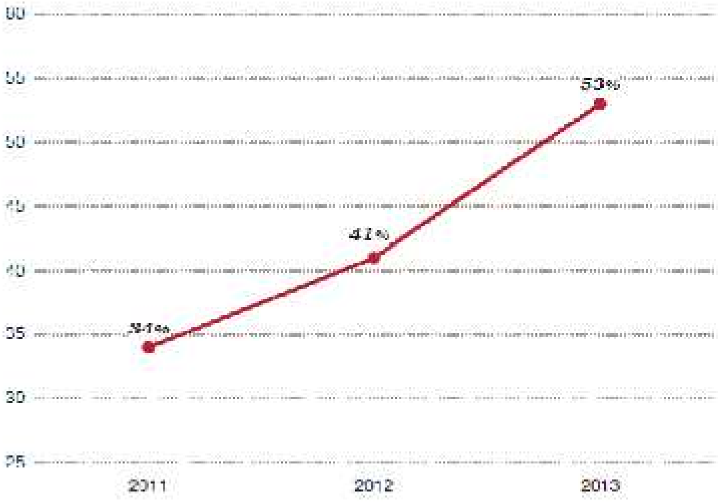

Figure no. 2. Evolution of bribery and corruption

Source: KPMG, *Global economic crime survey 2014*, p. 16

Appendix C

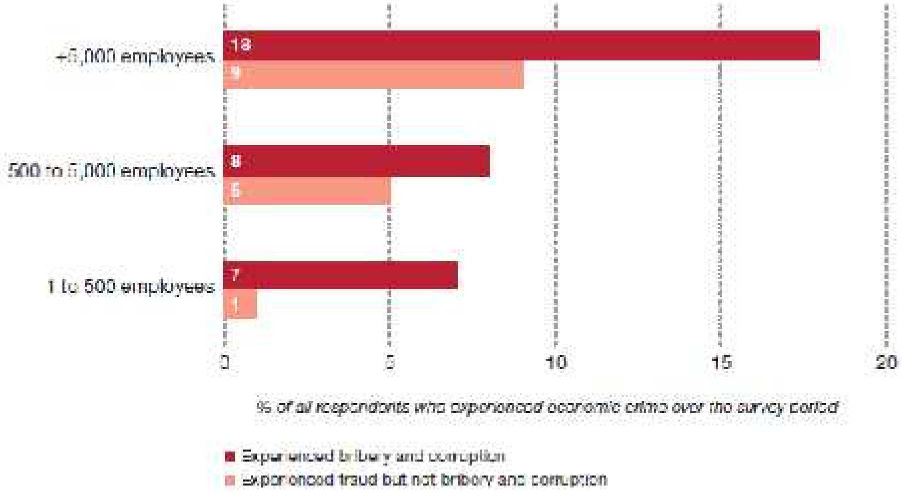

Figure no. 3. Losses over US$5M considering bribery and corruption, by company size
Source: KPMG, *Global economic crime survey 2014*, p. 18

Appendix D

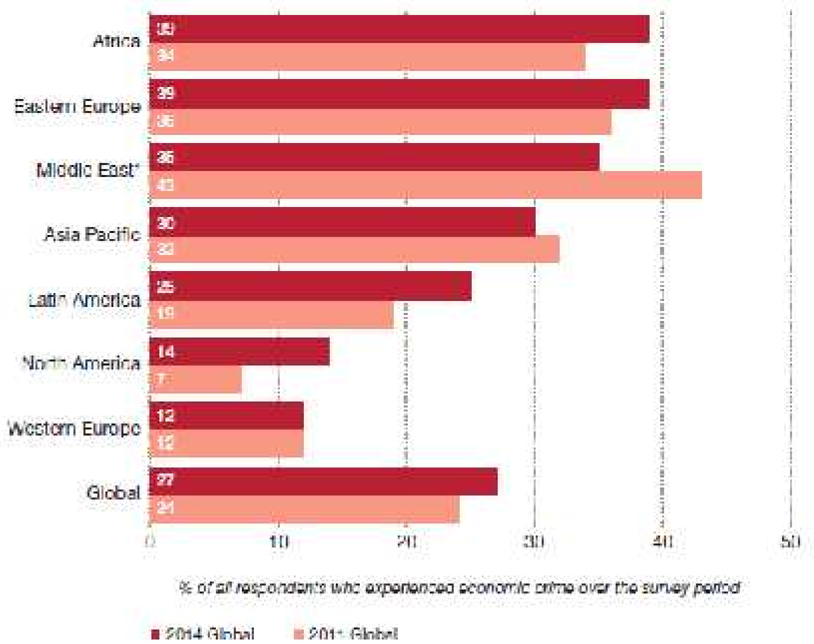

Figure no. 4. Reported bribery and corruption, by region
Source: KPMG, *Global economic crime survey 2014*, p. 19

Appendix E

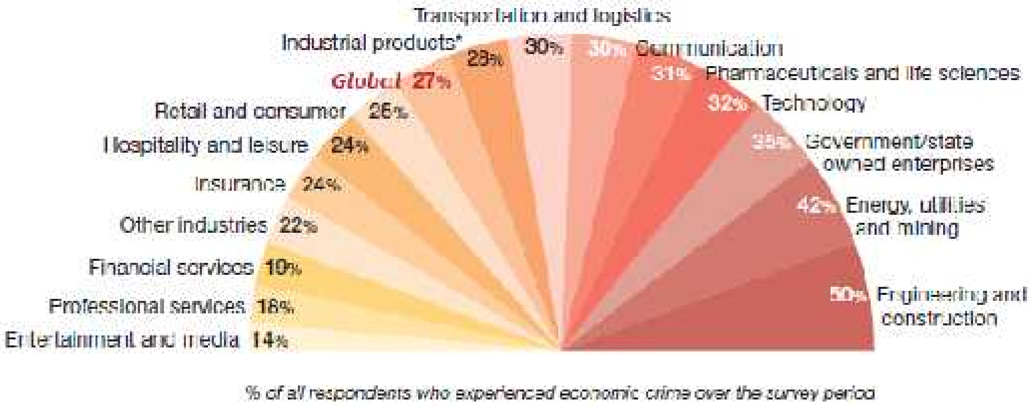

Figure no. 5. Reported bribery and corruption, by industry
Source: KPMG, *Global economic crime survey 2014*, p. 19

Appendix F

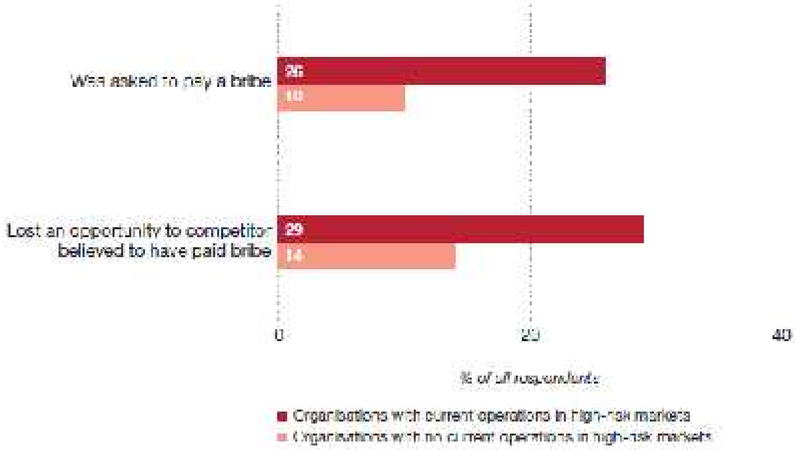

Figure no. 6. Bribery and lost opportunities
Source: KPMG, *Global economic crime survey 2014*, p. 20

Appendix G

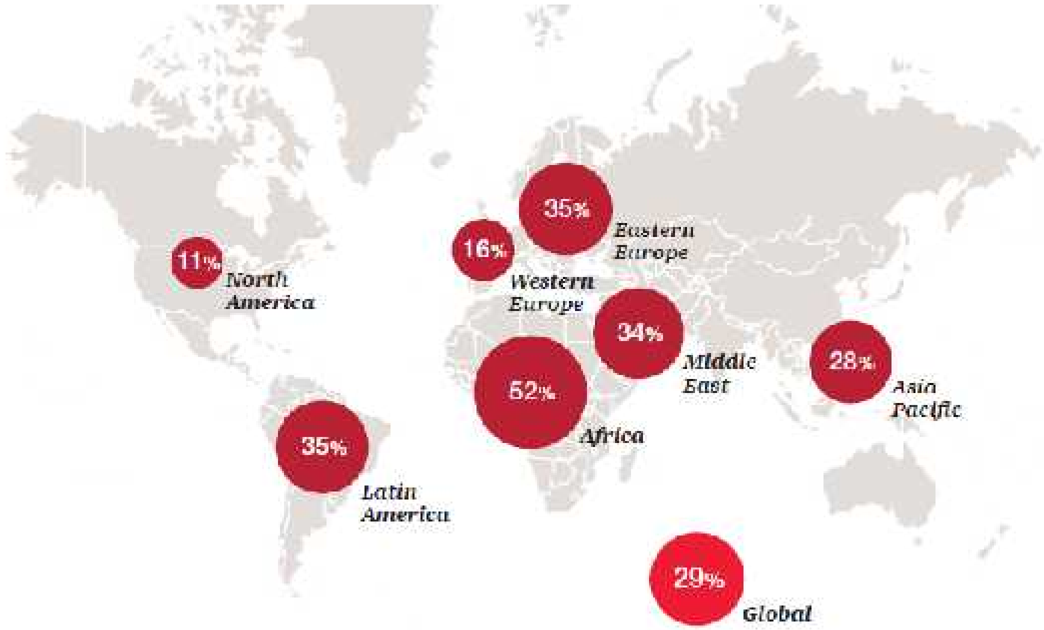

Figure no. 7. Perception on future bribery and corruption, by region
Source: KPMG, *Global economic crime survey 2014*, p. 21