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SUPPLY CHAIN SECURITY is one of the challenges *du jour* for procurement

chiefs globally, but when you look at the costs, both commercial and social, of corruption, malpractice and ethically unsound purchasing, it's clear that the future of business itself hinges on purchasers' ability to tackle the undesirable elements of conducting business.

Procurement can achieve this by establishing a governance and due-diligence framework to surround their dealings with suppliers, but also through gaining better insight into where the risks lie and how they can adapt to them.

In this whitepaper we look at the methods businesses are developing and the capabilities they have to fight corruption and remove unwanted activities from the supply chain. The opportunity is there, the question is whether business is ready to take advantage.

Steve Hall Editor

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Compliance challenge

Corrupt activity in supply chains can be overcome – it just takes the right tools and approaches, writes **Lindsay Clark**



In 2014, the US Department of Justice (DOJ) meted out fines worth a total of \$1.56bn to ten companies around the world for infringement of the Foreign Corrupt Practices Act (FCPA). Among them was Alstom SA, a subsidiary of the French engineering giant, which was subject to a \$772m fine.

The company was fined over its use of external sales consultants hired on a 'success-fee' basis to support its commercial teams. Although Alstom says it has stopped the hiring of such consultants and has made progress in the area of

compliance, the size of the fine acts as a warning to procurement chiefs to manage risk across the whole supply base, including third-party sales advisers.

"There were a number of problems in the past and we deeply regret that," said Alstom CEO Patrick Kron following the judgment. "However, this resolution with the DOJ allows Alstom to continue our efforts to ensure that business is conducted in a responsible way, consistent with the highest ethical standards."

At the time, US deputy attorney general James Cole ➡

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said: “Alstom’s corruption scheme was sustained over more than a decade and across several continents. It was astounding in its breadth, its brazenness and its worldwide consequences. This Department of Justice will be relentless in rooting out and punishing corruption to the fullest extent of the law, no matter how sweeping its scale or how daunting its prosecution.”

The volume of legislation, and the tenacity of law enforcement agencies pursuing cases, is increasing. In January 2015, it was reported that the US Federal Bureau of Investigation’s foreign corruption programme would more than triple the number of agents focused on overseas bribery from ten to over 30.

Criminal offence

At the same time, the Securities and Exchange Commission and the DOJ have prioritised enforcing the FCPA, which makes it a crime to bribe officials to win business, even if the infringement is committed by a third-party agent.

Derek Patterson, principal at Forensic Risk Alliance, a litigation support and forensic accounting firm, says: “Procurement has always been a challenge for big corporations. On top of that, now there is an increasingly bewildering array of regulations on risk that is arriving, from the FCPA and the UK’s Bribery Act through to human rights legislation and rules around conflict minerals. For companies, internal staff are not the concern. It is having to worry about external suppliers and distributors over which they have less control.”

The legislative landscape

ANTI-BRIBERY LEGISLATION: THE GLOBAL PICTURE

France

Signed the Organisation for Economic Co-operation and Development (OECD) convention in 2000, which is covered in the French penal code. It covers business-to-business transactions as well as trading with the government. Companies can be prosecuted for acts of third parties, including joint ventures and acts committed by their representatives.

Germany

The German Criminal Code is applicable to the OECD anti-corruption convention it signed up to in 1998. It covers acts committed outside Germany, regardless of the place of commission, involving the bribery of foreign public officials or members of parliament in connection with international business deals.

US

The US Foreign Corrupt Practices Act 1977 is applicable to the OECD convention, which the US signed in 1998. Its sanctions have extra territorial reach and legislation explicitly prohibits the bribery of foreign officials. Corporations can be prosecuted for acts of overseas agents, intermediaries, joint venture partners and third parties.

UK

The UK signed the OECD convention in 1999 and enacted it in the UK Bribery Act 2010 from July 2011. An individual or a corporation with a close connection with the UK can be prosecuted, irrespective of where the bribe was paid. The corporate offence of failure to prevent bribery applies to UK companies and overseas companies that carry on a business or part of a business in the UK.

means there are more laws to monitor and more practices for the supply base to report on, he says. “Most internal businesses are in the foothills of dealing with this. Most of them get what the issues are, but in the context of international business, it is very difficult,” Patterson says.

In the UK, the Bribery Act

2010 belatedly became law in 2011. Transparency International calls it one of the most thorough anti-bribery laws in the world, with several provisions that go further than the FCPA. It applies to businesses trading in the UK and creates a new offence of failing to prevent a bribe being paid by those who perform

Qatar

Qatar has not signed the OECD convention. However, Emiri decree number 17 of 2007 enshrines into Qatari law the UN Convention Against Corruption. This, together with other legislation, prohibits bribery, embezzlement, damage to the public treasury, exploitation of the office and abuse of power among other corrupt acts.

UAE

The UAE has not signed up to the OECD Convention on Combating Bribery. Its own Federal Penal Code prohibits accessory or soliciting bribes by public officers. Those subject to prosecution are those who accept, offer or facilitate a bribe. The UAE has yet to issue legislation in connection with prohibiting bribery of a foreign official.

South Africa

South Africa signed up to the OECD anti-corruption convention in 2004. Relevant legislation covers offences in respect of corrupt activities relating to public officers, foreign public officials, agents, members of legislative authority, judicial officers, members of prosecuting authorities and witnesses. There are also offences of receiving or offering of unauthorised payment by or to a party to an employment relationship.

China

China has not signed up to the OECD convention but has its own legislation governing corruption, including the People's Republic of China (PRC) Anti-Unfair Competition Law and PRC Foreign Trade Law. The PRC Foreign Trade Law expressly prohibits any commercial bribery in international business transactions.

Source: Eversheds 2013

services for, or on behalf, of the organisation.

However, in 2012 consultancy EY (until recently, known as Ernst & Young) found that 48% of British firms were failing to check suppliers for compliance with the Act and only 6% would re-tender contracts if they discovered their suppliers were not compliant.

The EY study polled 50 procurement managers and directors of firms with a turnover of £5m to £50m. It found that while mid-market firms are often less likely to have robust processes and systems in place to counter bribery risk, companies at both ends of the spectrum appeared complacent when it

came to checking their suppliers for compliance with the Act.

EY's research found that among those firms that do not currently check their suppliers, 60% reported that they were not planning to implement any anti-bribery programmes in the future.

Patterson says companies need to have a systematic approach to understanding risk from third parties on infringing bribery and corruption legislation. "The best place to start is to do some kind of risk mapping. You look at where the business operates, what kinds of suppliers it is using and what controls you have in place," he says. "You need to map out where higher risks are. Business activities in China, India, and Latin America where there is a lack of central enforcement – those are the ones to watch out for."

Complex problem

Then businesses must understand what is in the supply base. Most companies do not have a single repository for their suppliers. "There could be 900,000 suppliers across 60 procurement systems, but you have to use the data that is there to compile a list of active vendors," Patterson says.

Understanding the difference in categories also helps in finding risk. "Nuts and bolts are low risk. But a vendor that supplies introductory services to local government officials or makes sure you get your permits on land? These are the areas of risk and you have to flag them," he says.

While it's easier to introduce processes to assess new suppliers, it's more of a ➡

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challenge dealing with existing vendors. "The biggest problem is with the existing body of suppliers," he says. "What do you do? You can't just close your eyes and ignore them."

Strong compliance

Corporate consolidation has also made life more difficult in seeking out high-risk vendors, adds Patterson. "Merger and acquisitions have muddled the water. There needs to be a strong compliance programme three to six months after the acquisition. The systems need to get rolled out quickly, otherwise, if you just buy a new business and leave it, you can breach all sorts of risk. You cannot monitor or change behaviour. It can very quickly become a disaster," he says.

Increasingly, governments are expecting organisations to respond to anti-corruption and bribery legislation by having in place structured procedures for dealing with these kinds of risk,

suppliers and others that are financially important to the business," he says.

The mission to understand and manage risk is given an added sense of urgency by company

"Who are the third parties that you rely on as a business? You need to know who they are and monitor that risk."

says Mark Dunn, segment leader, due diligence and monitoring at LexisNexis, an information provider on business risk.

"Who are the third parties that you rely on as a business? You need to understand who they are and monitor that risk on an ongoing basis. That is not just sales agents, but also key

growth strategies as they want to expand in areas where there is the most risk. He says: "A prime driver for many organisations is to grow and open up opportunities in emerging and developing markets, but unfortunately Transparency International surveys show those markets indicate they have a poor

CASE STUDIES

BAE Systems**Fined £286m in UK and US**

Defence company BAE Systems, the UK's largest manufacturer, admitted being "wilfully misleading" over payments made as the firm tried to win contracts. The company said the pleas did not relate to accusations of corruption or bribery. Following the first case involving authorities in the US and UK, then BAE chairman Dick Oliver said: "We need to be a transparent, modern, clean company."



finances of \$74.2m to resolve the US Department of Justice's (DOJ) criminal case and \$29m in disgorgement. The US tech giant said it had co-operated fully with the Government's investigation and that the misconduct was limited to a small number of people who were no longer employed by the company. Regardless, the damage to reputation is impossible to put a value on.

Siemens**Fined around \$800m**

In 2008, Siemens pleaded guilty to violating the Foreign Corrupt Practices Act. It reached a \$450m settlement with the DOJ and \$350m in disgorgement of profits under its agreement with the Securities and Exchange Commission. In Germany, it paid €395m (\$569m) to settle a similar action by Munich Public Prosecutor.

**HP****Paid \$108m to settle DOJ and SEC charges**

The case involved bribery in the emerging economies of Mexico, Russia, and Poland. HP paid

reputation for corruption. You have this conflict where companies are very keen to get into those markets but they need to be clear who they are doing business with and who is representing them. This is where due diligence is important.”

Dunn believes companies need standard criteria for risk assessment in third-party relationships across the whole organisation. That might include an assessment of the country where the third party operates, the kind of business relationships they have, what products or services they provide, and the financial risk involved in doing business with them. “They have to pull together all those details then risk assess them. On the basis of that score, they can decide how much further due diligence they apply and how often to refresh and monitor that relationship. They cannot just do it once,” he says.

Reputational damage

Although regulation is bringing a focus to this area, supplier visibility and due diligence does not just manage legal risk. As well as enabling corporate expansion strategy, these processes are necessary to manage reputational risk, where suppliers or third parties may be involved in child labour, for example, which might not be illegal but is considered unethical in many countries and could damage a corporate brand by association. Standard criteria are also necessary to manage financial risk in dealing with suppliers that are unsound and could damage the supply chain operations, Dunn says. ➔



Mark Dunn

Segment leader, entity due diligence & monitoring, LexisNexis Business Insight Solutions

THIRD-PARTY DUE DILIGENCE – BOTH PREVENTION AND CURE

Few companies can operate without reliance on third-party business partners. Be they sales agents or distributors providing invaluable local insight, contacts and skills on the ground to help drive access into new markets or, alternatively, a network of suppliers delivering the essential components and raw materials necessary to keep production lines running.

Entrusted with a company's hard-earned reputation, the dependency on third parties to help execute strategic objectives, sustain a competitive edge and ultimately determine the level of return delivered to investors means it's critical to know who you are doing business with. Conducting proportionate, risk-based due diligence on third-parties and regularly updating the checks is rapidly becoming a prerequisite for government agencies and regulators tasked with enforcing extraterritorial anti-bribery, corruption and other financial crime-prevention measures across the globe.

“Comprehensive due diligence demonstrates a genuine commitment to uncovering and preventing FCPA violations,” claims a

Resource Guide to the US Foreign Corrupt Practices Act.

Next to the recognition by regulators of due diligence as essential to helping mitigate the risks of corporate misconduct, where a company may find itself a victim of corruption, having in place an effective due-diligence process is also perceived as a key component in meeting the conditions of a regulatory settlement or defence. The UK Bribery Act recognises that proportionate due diligence is crucial along with other such ‘adequate procedures’ to aid a legal defence. Similarly, within the requirements needed to satisfy the terms of an FCPA deferred prosecution agreement or plea agreement, due diligence is also a regular fixture.

The onset of heightened regulatory scrutiny across the globe, along with billion dollar settlements, debarments and executive jail sentences, mean it is critical that third-party relationships and related dependencies are managed more closely than ever. Conducting thorough due diligence and monitoring is imperative and an expectation of regulators, business peers and customers alike.

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There is a danger that, after a period of focus on supply-chain risk following the 2004 tsunami and 2011 Thailand floods, the topic has slipped down the corporate agenda, says Tim Fiore, former CPO at ThyssenKrupp, a global manufacturing firm.

"It was really a hot topic when we had the environmental crises of several years ago. There are programmes to manage risk, but I don't think it is a board-level discussion anymore," he says.

However, he welcomes the increased focus on the FCPA and similar legislation. "Those are all good things. Keeping a playing field fair is important. Although it will not happen overnight, everybody is moving in the right direction," says Fiore.

Top down approach

But to tackle risk management across the supply chain needs sponsorship from the top, says Andrew Christophers, an interim procurement manager who has worked with British retailer Boots and construction firm Balfour Beatty in the past.

"Compliance, in terms of how suppliers are managed, can become a bit comfortable, with all the right intentions. It needs opening up to scrutiny. You need a programme to put all suppliers on a similar footing with terms and conditions, health and safety and along with that anti-bribery and compliance. The key to it all working properly is that it comes from top down. It has to have senior support. It cannot be done piecemeal – the whole mindset has to change."

Christophers says procurement needs systems and processes in

place so that if an internal or external enforcement agency challenges a decision to work with a particular supplier, the

how the supplier was evaluated. Once that is in place, then you are watertight in terms of being seen to be [managing risk]," he says.

"Compliance, in terms of how suppliers are managed, can become comfortable – it needs scrutiny."

department can see clearly why the decision was made. "You need an auditable process. You need to see who was involved and

Success in this risk mitigation strategy can be measured by speed of response to any warning signs about a supplier, and how





GLOBAL CONVENTIONS PREVENTING FRAUD AND CORRUPTION

Two global conventions ensure abiding nations have enacted anti-bribery legislation. The Organisation for Economic Co-operation and Development (OECD) Anti-Bribery Convention was signed in December 1997 and came into force in February 1999. It can be adopted by any OECD member state or a nation that has become a full participant in the OECD Working Group on Bribery in International Business Transactions. As of May 2013, 41 countries had ratified or acceded to the convention. In doing so they have agreed to put in place legislation that criminalises bribing a foreign public official. The OECD has no authority to implement the convention, but monitors implementation by participating countries.

Meanwhile, the United Nations Convention against

Corruption (UNCAC) was negotiated by all members of the UN and adopted in 2003. It has been signed by 140 countries and is yet to be ratified by 22 states.

UNCAC covers five main areas: necessary preventive measures, criminalisation and law enforcement, international cooperation, asset recovery, and technical assistance and information exchange.

It includes both mandatory and non-mandatory provisions.

Other regional conventions against corruption of particular note include the Inter-American Convention Against Corruption that encompasses the nations of North and South America, the Council of Europe Civil and Criminal Law Conventions and the African Union Convention on Preventing and Combating Corruption.

long it would take to get alternative supply arrangements in place, says Christophers.

Research by Accenture found 76% of supply chain managers said risk was an important, or very important, part of supply chain strategy.

Leading trend

Of those firms Accenture judged to be 'leaders' in supply chain management, 60% were raising their spending on managing supply-chain risk by more than a fifth. About half of all firms

planned to increase risk spending by 20% or less, according to the survey based on responses from 1,014 senior executives.

Rob Woodstock, Accenture managing director for operational strategy UK and Ireland, says the management of risk in third-party agents is a new area to procurement, although existing techniques should help.

"In terms of risk management, data gathering can be incredibly powerful in terms of organisations and particular geographies that lead to issues. Being aware of

that centrally and acting on it is really important," he says.

"Procurement's traditional focus has been on vendors providing goods and services into the business. Sometimes third-party sales agents can be a blurred area of responsibility. CPOs have existing processes and technology which could be refocused and extended to include these third parties."

The Accenture research also showed that 43% of firms that doubled their return on investment on supply chain ➔

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risk in the past two years were also more likely to have centralised risk management with a chief risk officer or VP-level executive overseeing the risk-management function, compared with 32% for all firms.

“What I’ve seen is procurement working as part of wider effort in organisations to address this third-party risk and doing that using a common set of processes and a platform that generates a risk profile to engage other people in the business,” Woodstock says.

A team effort

Procurement might reach out to other experts or stakeholders in a dispersed team using a technology platform, or be part of a single, multi-disciplinary team. “That team will include procurement people but the majority will bring in other domains of expertise,” he adds.

Despite the legal risks that working with third-party agents is adding to the supply chain, they will remain necessary as firms expand globally, Woodstock says.

“Third parties have the geographic knowledge and are able to provide a channel to



market that is difficult to replicate in a new market. Doing it internally would be very costly. The trick is understanding risk, making sure they understand standards and getting visibility of them,” he says.

Public authorities around the world are increasing pressure on multinational companies to have visibility and some control of practices in all parts of their

supply chain, including third-party agents in order to eliminate bribery and corrupt practices. Meanwhile, strategic demands to reach into new markets will ensure that these third-party relationships become more extensive and also more complex.

Companies must have the structures, processes and data to ensure they thrive in the face of these challenges. ■

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