TRACE Anti-Bribery Compliance Solutions

The High Cost of Small Bribes

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INTRODUCTION

No one knows better than companies operating internationally that bribery is bad for business. These companies report that corruption introduces uncertainty into commercial transactions, fosters a permissive atmosphere for other business crimes, undermines employee confidence in management and puts a company's value and reputation at risk.

Most multinational companies have made progress toward eliminating traditional bribes from their business practices. They have done this by implementing comprehensive compliance programs, by training local and foreign employees and business intermediaries and by rigorous internal enforcement.

Now many of these companies are taking steps to eliminate "facilitation payments" from their business practices as well. These small bribes, also called "grease payments," permitted under the laws of some countries, are made to government officials to encourage them to perform or expedite routine governmental tasks. The definition of such tasks, however, is often unclear and stretched to the breaking point.

The purpose of this guidebook is to educate business people and compliance officers on the high cost of small bribes and to provide guidance on how to eliminate these payments from business practices. In preparing this guidebook, TRACE interviewed almost 100 companies engaged in international business to learn how they have stopped paying small bribes to government officials. Many of the companies interviewed have found that it is possible – occasionally even easy – to refuse to participate in bribery schemes. There are certain techniques that work and certain practices to avoid. The most significant fact discovered from the interviews is that none of the companies that approached the issue carefully and comprehensively reported significant or prolonged disruption in their business activities.

I. THE HIGH COST OF SMALL BRIBES

THE PROBLEM

In many companies a distinction has long been drawn between major bribes and mere "facilitation payments." The distinction has been confusing. Bribes and "facilitation payments" are both payments or gifts to, or favors for, government officials in exchange for preferential treatment. If companies pay these small bribes willingly, they are nevertheless bribes. If companies pay these bribes because they believe they have no choice, they are extortionate.

DOUBLE STANDARD

Of the countries that permit these small bribes overseas, none permits them at home. A Canadian or Australian who makes a "grease payment" to a foreign customs official would face criminal penalties for making the same payment to an official at home.

Permitting the citizens of one country to violate the laws of another on the grounds that it is "how they do business there," corrodes international legal standards that otherwise benefit multinational corporations.

A CONFUSING MESSAGE

It is difficult to convey to employees that the payment of large bribes to foreign government officials is likely to cost the employee his job and possibly his freedom, but that the payment of small bribes is acceptable.

A SLIPPERY SLOPE

The mixed message of permissible small bribes versus impermissible large bribes creates a dangerous arena for business activities. Many companies interviewed complained that small bribes involving routine governmental tasks are both difficult to define and impossible to control. They found that some employees, responding to pressure to ensure timely contract performance, paid bribes for distinctly non-routine services.

Small bribes are inherently illegal, create significant accounting dilemmas, damage companies' reputations and are simply bad for business.

LOSS OF LOCAL COMMUNITY'S CONFIDENCE

It is difficult to maintain a good reputation within a local business community when your company is believed to buy its way past the administrative obstacles that local citizens and companies must endure. When a bureaucratic delay is legitimate – rather than created by the bribe-taker – purchasing preferential treatment for your company bumps others further down the waiting list.

LEGAL RISK

One obvious problem with facilitation payments is that they are illegal under the laws of the countries in which they are made. These payments encourage corruption in those countries by government officials and, if permitted by international companies, encourage company employees to participate in that corruption.

Allowing facilitation payments confuses the message of absolute compliance with the laws of all nations and sets up a system of double standards in which employees are allowed to engage in illicit conduct in some places, but not others. Additionally, it may well be the case that nothing will stop the demand for such payments but ending the supply.

Billy Jacobson, Partner, Orrick and Former VP and Chief Compliance Officer, Weatherford International

INHERENT ILLEGALITY

Every bribe of a government official – regardless of size – breaks the law of at least one country. There is no country anywhere with a written law permitting the bribery of its officials. A lack of resources, political will or interest has meant violations are rarely prosecuted, but that is changing. Some countries, eager to be seen to be combating corruption, are prosecuting the payment of small bribes with increased frequency. In addition to these domestic prosecutions, anti-corruption laws in various jurisdictions increasingly are making facilitation payments illegal. Small bribes may further run afoul of books and records provisions, especially where bribes are systemic and repeated. As a result, there is widespread concern amongst the companies interviewed for this guidebook that small bribes could lead to costly legal complications.

ACCOUNTING DILEMMA

The laws of countries that permit the payment of these bribes abroad also require companies to maintain detailed and accurate records of each transaction. Many businesspeople interviewed expressed reluctance to record on company books a "payment to government official for routine task" – creating a record of a violation of local law. Yet failure to keep accurate records of the expense constitutes a violation of law even in countries where the underlying payment does not. Consequently, companies making these payments must choose between falsifying their records in violation of their own laws or recording the payment accurately and documenting a violation of local law.

FOREIGN SUBSIDIARIES

With the implementation in many countries of new laws criminalizing the payment of small bribes to foreign governments, there is also an increasing risk that a multinational company with foreign subsidiaries will violate the laws of the country where the subsidiary is based. Companies with offices in more than one country expressed concern that if they do not abolish the use of small bribes altogether, they must undertake different compliance programs based not only upon the location of each office, but the citizenship of the people working there.

INTERNATIONAL SECURITY

In addition to these more obvious legal issues, there is a growing concern regarding national security. One U.S. company reported that the increased threat of terrorism put a new face on the practice of paying small bribes. That company had routinely paid foreign officials for processing work permits and visas, but is now very uncomfortable promoting corruption in this area. If visas can be bought, borders won't be safe. The practice of bribing immigration officials can lead to serious entanglements with the enhanced security laws of the company's home country.

BAD FOR BUSINESS

Paying small bribes is poor legal practice, but more to the point, we were told, it is bad business practice. Widespread small bribes set a permissive tone, which invites more and greater demands.

Every company we interviewed expressed dissatisfaction with these small bribes. They told us that they amount to a hidden tax on business, they tend to proliferate, they buy an uncertain, unenforceable advantage and – the most common complaint – they are simply irritating. Well- run businesses seek clear, dependable terms and enforceable contracts. Small bribes introduce uncertainty, risk and delay.

REPUTATION AS A "SOFT TOUCH"

The standard argument in defense of bribery is that it is impossible to conduct business successfully overseas without paying bribes to ease the bureaucratic and regulatory burden. If true, business should be more efficient for companies paying bribes, yet this argument is not supported by research or anecdote.

Two World Bank researchers studied the premise that small bribes reduce red tape and found that "contrary to the 'efficient grease' theory, ... firms that pay more bribes are also likely to spend more, not less, management time with bureaucrats negotiating regulations and face higher, not lower, cost of capital."[1]

The study showed that entrepreneurial bribe-takers learn to focus their demands on companies that have paid bribes before. For those companies, the level of harassment for small bribes actually increased with the rate at which they were paid. Entrepreneurial bribe-takers must erect more or greater obstacles in order to increase their income. Small bribe-takers thrive on inefficiency and bureaucratic obstacles.

We heard the same message again and again: it is smarter, safer and makes better business sense to end the practice of paying small bribes.

1 "Does 'Grease Money' Speed Up the Wheels of Commerce?" Daniel Kaufmann, World Bank Institute and Shang-Jin Wei, Development Research Group, Public Economics, World Bank.

II. HOW TO BEGIN

> The process of changing our policy to prohibit facilitating payments was surprisingly easy. Our Board of Directors was very receptive to the arguments presented in "The High Cost of Small Bribes." We surveyed our global employees on potential impact and learned that many regions had already implemented a policy against facilitating payments. Our regional managers predicted that the policy change would have minimal impact on our business...and they were right. We changed the policy three years ago without disrupting our business.
>
> **Rebecca (Riv) Goldman**, Vice President, Commercial Law, Rockwell Automation

DECIDE AND COMMIT

Several companies reported that the most difficult part of eliminating the practice of paying small bribes was actually focusing attention on the issue and committing to stop. Once a company decides that it wants to eliminate the practice, it must commit itself to spending the time and money needed to carry out its goal through:

- a clear written policy
- an internal audit
- training employees and intermediaries
- enforcement

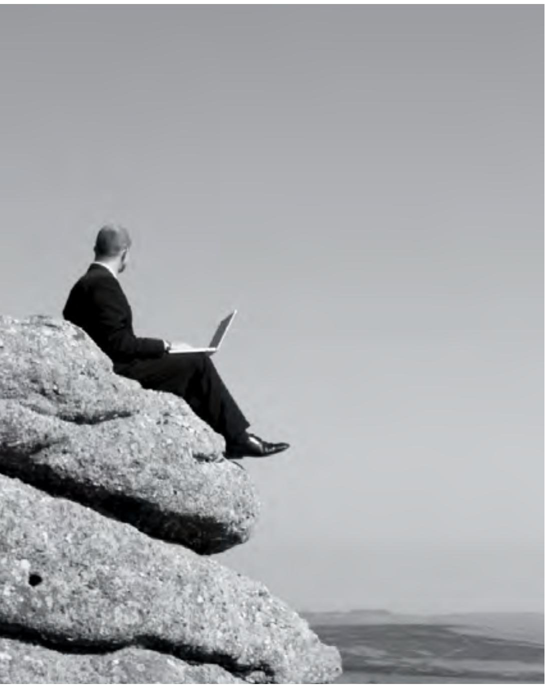
It is crucial that the decision to eliminate the practice have the full support of the highest level of management in the company. A formal endorsement by upper management will convey to all employees and business intermediaries that the company is fully committed to ending small bribes.

ADOPT A CLEAR POLICY

The essential core of any successful anti-bribery strategy is a clear and consistent message to employees, intermediaries and bribe-takers that bribes of any kind will not be paid. Such a message is most effectively conveyed through a clear written policy. Companies that have changed their policy decisively and publicly reported the fewest problems with the transition to abolishing small bribes.

In the business communities where small bribes are most common, it is difficult for employees to respond to demands by saying that they would “rather not pay.” It is far simpler if that person can say that they are prohibited from doing so by the company’s policy and that he would risk his job and possible criminal prosecution in his own country and the country of the request.

The written policy should include assurances that no employee or intermediary will be penalized for delayed performance that can be directly tied to his refusal to pay bribes.



MEDICAL AND SAFETY EMERGENCY EXCEPTION

Employees of multinational companies are often asked to travel and live abroad, occasionally in countries where the standard of living is lower than their own country and the risks to health and safety are higher. Many companies currently rely on the good judgment of their employees in these situations, but some have created a formal medical and safety emergency exception. The situation should be a true emergency and the payment should be accounted for appropriately and reported through management channels both to conform to books and records requirements and to ensure that management is apprised of the risks to personnel in that country.

> "The situation should be a true emergency and the payment should be accounted for appropriately..."

THE TRACE POLICY

No offer, payment, promise or gift of anything of value may be made to a government official in exchange for a business advantage, including a commitment to expedite or perform a routine governmental action, unless (1) it is necessary to secure governmental services (e.g. police protection, medical evacuation) in response to a medical or safety emergency or (2) the person reasonably believes that he is in imminent jeopardy of serious harm and no other prudent alternatives are available to him.

- Small bribes are indistinguishable from large bribes legally and ethically.
- Support for these bribes fosters a disregard for foreign laws and foreign legal systems.
- Payment of small bribes often results in a misrepresentation on the company's books and records.
- Conflicting laws on small bribes make it difficult for multinational companies to manage different internal policies.
- Payment of small bribes invites more demands and greater administrative and regulatory burden.

ASSESS

A comprehensive inventory of past payments will enable companies to address each risk area appropriately. This assessment should include a review of the company's areas of operation that pose a high risk of exposure, any past legal or ethical problems, existing policies, procedures and compliance efforts and all relevant laws and regulations.

One of the key aspects of the internal assessment is the employee interview. It is crucial that those conducting the assessment speak to the right people. The companies interviewed for this guidebook stressed this point more emphatically than any other. It is not possible to make good policy decisions about small bribes without speaking to the employees in the field.

- They understand the local challenges better than the head office.
- Their participation in a change of policy will be critical to its success.
- They can identify situations for which a small bribe has been useful, and help devise alternative approaches.
- They know when a small bribe is not necessary.

The last point is important. Most of the people interviewed recounted stories of employees, new to a foreign assignment and primed with rumors about corruption in the local business community, thrusting money at a government official at the first mention of delay.

TRAIN

After management commitment, training is the most critical step in abolishing small bribes.

EMPLOYEES

As with any corporate compliance policy, an effective anti-bribery policy must include comprehensive training for employees. Employees should also be required to sign a statement verifying that they have participated in the training and that they will comply with the company's antibribery policy.

BUSINESS INTERMEDIARIES

A company can be held responsible for the actions of its business intermediaries – sales agents, consultants, suppliers, contractors and local partners. Consequently, intermediaries should receive the same rigorous anti-bribery training and a copy of the company's antibribery policy. Their contract should include a requirement that they comply with the company's policy.

TYPES OF PAYMENTS

Payments identified during the assessment are likely to fall into one of four categories and a different response may be required for each.

EXPEDITING PAYMENTS: These payments are usually demanded by entrepreneurial government officials who threaten delay and red tape if they are not paid small amounts at regular intervals. Historically, it may have been easier to pay than to argue.

This category includes payments to secure licenses, to overcome unwarranted delays at customs, to resolve disputes over inflated taxation, to end harassment by local police or military and to ensure that basic governmental services are forthcoming.

SIX SUGGESTED RESPONSES TO DEMANDS FOR EXPEDITING PAYMENTS:

1. **Meet with the individual** in question and explain the change in policy.
2. **Avoid the embarrassment of including superiors** in discussions unless it is clear that it is necessary or that they are a part of the problem. If the junior official has been required to funnel a portion of the bribes he collects to a superior, the superior will have to be included in the conversation.
3. **Acknowledge that small payments** have been a part of the business relationship until now, but that these will no longer be made. Again, explain the change in company policy.
4. **Prepare to reject suggestions** on how things might be structured to reach the same end by different means such as re-characterizing the payment or channeling payments through third parties.
5. **Prioritize shipments or administrative tasks** where possible so that the least urgent requests are presented immediately after a change in company policy. For some companies, this has helped to minimize the expense and inconvenience associated with the period immediately after payment of small bribes ceases.
6. **Maintain records** of additional expense resulting from a refusal to make payments and provide copies to senior officials of the relevant government ministry. If the government is either a partner or the customer, pass along a portion of the cost of refusing the bribe, together with a detailed explanation. Companies that have done this report a significant reduction in demands for bribes.

> "As soon as I arrive in-country, I tell the officials I meet with what a pleasure it is to be in a country where one isn't constantly shaken-down for bribes. It is very difficult for them to raise the issue after that."
>
> U.S. Aerospace/Defense Company

ADDITIONAL SERVICES: These payments are generally made for a legitimate service that is being purchased through inappropriate channels. Services may include overtime work, work during local holidays, or duties outside the scope of the official's job description. It is important that real value be provided and that these payments do not simply become a way to legitimize bribery.

THREE SUGGESTED RESPONSES TO REQUESTS FOR ADDITIONAL SERVICES:

1. **Assess the value** of the service that has been provided and formalize the relationship. One company stopped paying overtime directly to border guards and began working through the border guard office, requesting a formal agreement and invoices. The result was the same service at the same price, but with new control and transparency.
2. **Recognize** that in a very small number of countries, certain government officials receive no pay at all from their government. Instead, they are expected to create their own income – and supplement their superiors' income – through corruption. In these rare cases, the previous response also has worked. By formalizing and documenting the arrangement, the official is paid for his service, but the haggling and secrecy are brought to an end.
3. **Seek the approval of the official's superior,** where feasible, to hire him under a separate agreement. In some countries, government officials are permitted to hold second jobs. The goal is not to impoverish already badly paid officials.

TRADITIONAL COMMERCIAL BRIBES: These are payments to obtain a business advantage and are not permitted under any legal exception for small bribes. The suggested response to a traditional commercial bribe:

> If a bribe is paid in order to obtain a business advantage, the employee involved should be sanctioned and the company protected to the extent possible from the consequences by prompt remedial action. The company's broader policy on bribery of foreign government officials should be invoked to address these situations.

EXTORTION: These payments amount to clear, criminal extortion – for example, an employee held at a security check and released only upon payment.

THINGS TO CONSIDER WHEN AN EXTORTIONATE DEMAND IS MADE:

- If a demand is clearly extortionate and criminal, the employee's safety must be the paramount consideration.
- Once an emergency has passed, companies should advise their embassy and ask that it pursue the matter at the responsible level of government.
- These situations are of real concern, but the embarrassment they can generate for the host country can result in unexpected leverage for companies. Anecdotes of this kind quickly place countries in the "too hard to do business" category – a label that many dread. Most companies agree that the best response is to manage the situation in the short term and publicize it in the long term.

GENERAL TRAINING GUIDELINES

THE POINTS THAT FOLLOW APPLY REGARDLESS OF THE TYPE OF BRIBERY BEING ADDRESSED:

- The anti-bribery policy should be disseminated to every employee and business intermediary.
- Employees and intermediaries should be assured that they will not be penalized for diminished productivity directly attributable to their refusal to pay bribes.
- Employees who are posted overseas or whose jobs require frequent travel should receive training on the company policy and on how to deal with demands for bribes. This training should include an opportunity to meet with employees who have worked in the territory to which they will be sent. This will give them a good overview of the scope of the problem as well as "war stories" about what techniques have proven successful in that country.
- Employees affected most directly — those in the international sector, marketing, operations and finance — should have an opportunity to ask specific questions about the situations they expect to face.
- Company auditors should be alerted to the possibility that rogue employees and intermediaries may attempt to circumvent the new policy by mischaracterizing small bribes as permitted expenses.
- Auditors, in-house lawyers or compliance officers should ensure that payments made under the medical and safety emergency exception are reviewed for potential abuse.

ENFORCE AND FOLLOW-UP

It is important for management to stay focused during the implementation and transition period. Anticipated difficulties have proven to be short-lived. Dire warnings that profitability will plummet and business will grind to a halt are not supported by the experiences of any of the companies interviewed. Most of the companies interviewed reported delays and unusual additional bureaucratic steps in the first 30 to 60 days after abolishing small bribes. After this period, business "more or less returned to normal."

CONCLUSION

Addressing all forms of business corruption at the same time with a single, coherent message is preferable to laboring under an equivocal policy and waiting until some future ideal time to tackle small bribes.

Many companies have adopted strong policies against the payment of small bribes and the consensus has been that the transition has been simpler, faster and less painful than was expected. By comparison, companies that vacillate – paying small bribes in some cases and not in others – find themselves mired in an almost perpetual negotiation that runs parallel to their real business and consumes significant resources.

Companies report the benefits of acting decisively by sending a clear message from senior management to employees and business intermediaries — local and foreign — and to the markets in which they do business. The short-term result for many of the companies interviewed has been relief from constant demands for small bribes; the long-term results will be reduced bureaucracy, enhanced predictability and a more stable business environment.

TRACE Anti-Bribery Compliance Solutions

TRACE International Inc.
www.TRACEinternational.org

About TRACE

TRACE provides an end-to-end, cost-effective and practical solution for anti-bribery and third party compliance. TRACE International, the leading anti-bribery standard setting business association, pools resources to provide members with technology-enabled compliance tools and an expansive knowledge center. TRACE members include hundreds of multinational corporations, as well as thousands of small and medium-sized enterprises throughout the world. TRACE International works with TRACE Incorporated to offer both members and non-members customizable risk-based due diligence, training and advisory services. With a shared mission to advance commercial transparency, TRACE International and TRACE Incorporated provide companies with one complete anti-bribery and third party compliance solution.

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