Outsourcing – a great strategy, but with greater risks of corruption?

Business risk expert John Burbidge-King highlights the impact of anti-bribery legislation on companies involved in outsourcing.

As the economy continues to play havoc with the fortunes of companies – large, medium and small – outsourcing remains an attractive option for many businesses to reduce their overheads by moving back office processing and manufacturing to more cost effective locations. Other companies in the supply chain may be able to supply services more efficiently and cost-effectively, especially if direct costs, such as labour, materials and expenses, are cheaper elsewhere.

In tough trading conditions, particularly where business is flat in the traditional markets of the EU and North America, more and more companies are actively seeking new customers in less familiar overseas markets, in countries such as Brazil, Russia, China and Indonesia. There are opportunities either directly (by setting up their own operations) or by going through third parties, such as agents and intermediaries. Such strategies may be right for businesses, but equally they carry more inherent risk.

When it comes to outsourcing and the risk of bribery and corruption, there are three key issues.

Firstly, some businesses may be operating in geographic markets that carry higher risks of corruption. Some territories are attractive because of their low cost base, but this may also mean an environment where corruption is more prevalent and an established way of doing business.

Secondly, anti-bribery legislation, such as the UK Bribery Act and US Foreign Corrupt Practices Act, as well as a general tightening of the screw by governments and law enforcement agencies around the globe, means that businesses are under increased scrutiny. Over the past year there have been several high profile cases of businesses facing massive fines for their involvement in corruption; and the number of such cases will increase as the economic cost of corruption becomes better understood.

Businesses also need to be aware of sector-specific regulations, such as the International Traffic in Arms Regulations (ITAR) in the aerospace industry.

And thirdly, by its very nature, outsourcing inevitably means that businesses must conduct their commercial affairs at arms length, again raising the level of risk for any company that is unable to account for the actions of third parties. Companies can outsource their commercial activities, but they may remain directly accountable for bribery and corruption.

The UK Bribery Act, which came into force in July 2011, applies to all companies, regardless of their size. The sting in the tail of the Act is the Section 7 corporate offence of a company not having in place adequate procedures to prevent bribery. The burden of proof rests on the company to prove it had procedures in place – in other words, the outsourcer, not the company or agent being outsourced to.

Guidance issued with the Act sets out six principles to help organisations proportionately and appropriately implement these procedures:

1. Proportionate procedures – clear, practical policies and procedures
2. Top level commitment - top down culture where bribery is unacceptable
3. Risk assessment - assessment of both external and internal risk
4. Due diligence – really knowing with whom you are doing business
5. Communication (including training) – embedding the messages
6. Monitoring and review - auditing and financial controls

The penalties for individuals and companies are harsh - up to 10 years imprisonment, an unlimited fine and a criminal record. Companies can be subject to unlimited fines.

Bribery is global, although it is more prevalent in certain countries. Each year, Transparency International, the world's leading non-governmental anti-corruption organisation, publishes its Corruption Perceptions Index (CPI).

In 2011, two thirds of countries covered by the CPI were given scores of less than 5, which means they are considered significantly corrupt.

The CPI scores countries from zero to 10, with zero indicating high levels of corruption and 10, low levels. The most corrupt places are those with unstable governments, often with a recent history of conflict. Afghanistan and Myanmar share second to last place with a score of 1.5, with Somalia and North Korea - measured for the first time in the CPI - coming in last with a score of 1.

Peaceful countries score best with corruption least likely to occur in New Zealand, Denmark, Finland, Sweden and Singapore.

Putting aside the CPI, there is still a widely held belief that it is impossible to conduct honest business in certain markets because bribery is the norm – "if we don't bribe, we don't win the contract". Few companies start out by developing an outsourcing strategy that is based on assessing the risk, determining how to manage the risk so as not to bribe.

The case of Panalpina

Several oil and gas sector companies outsourced their freight forwarding to

Panalpina, the Swiss based international shipping and freight business.

Five of Panalpina's oil service customers agreed to pay $236.5 million to settle probes by the U.S. Justice Department and Securities and Exchange Commission in respect of allegations of bribery. Panalpina, which admitted to bribing government officials in hundreds of ways in seven nations, paid $81.5 million. Shell paid $48.1 million.

Panalpina paid at least $49 million in bribes to government officials in Angola, Azerbaijan, Brazil, Kazakhstan, Nigeria, Russia and Turkmenistan, to let its clients avoid the customs process, pass off phony documents or smuggle contraband such as medicines and explosives.

Its workers used no less than 160 descriptions for bribes, like "evacuations" and "export formalities," while its Kazakh workers called them "sunshine" and "black cash".

The level of international enforcement has dramatically increased recently. New laws have been introduced in countries including Brazil, Russia, China and Indonesia. These are accompanied by stern enforcement action.

Commonly, businesses taking the outsourcing route may rely on other companies to represent them, especially abroad where revenues can sometimes be a sizeable proportion of a company's turnover.

The problem for many businesses outsourcing is a failure to plan for and manage compliance; either they choose to ignore the risks or they do not have the budgets to pay for knowledge and skills, particularly smaller companies willing to take the risk.

So how do you tackle this problem?

Firstly, it is essential to have an understanding of the Bribery Act and other similar legislation.

Secondly, there are some simple steps that enable businesses to help resolve concerns.

Questions that a business might ask are:

- In placing outsourcing contracts or seeking outsourcing partners, are there agents or other intermediaries involved? These may not be simply so-called "middlemen", but local professional advisers.
- If so, how ethical are those intermediaries and has integrity due diligence been done to ensure you really know with whom you are doing business?

- Has the company conducted a formal risk assessment of both the impact of bribery and what measures it will take in relation to an outsourcing contract?
- Has the bribery risk been assessed by your legal advisors in respect of the containment of liabilities with an outsourcing contract?
- Is there a nominated executive in your company with responsibility for ensuring compliance with the Act?
- Does the company have adequate procedures in place to prevent bribery within the company and those with whom it is associated? Are you aware of the Ministry of Justice guidance on this?
- Will the company's insurers cover the costs of an investigation, and in the worst case the defence, especially in relation to the allegation arising out of an outsourcing contract?

Steps that a company can take to mitigate risk include:

- Introduce a clearly articulated and communicated anti-bribery compliance (ABC) culture, visibly driven from the top.

- Documentation and evidencing of ABC on the board's agenda and the risk register.

- Implement policies to address conduct (including sanctions), ethics, hospitality and gifts, facilitation payments, commissions, monitoring and 'speak up' mechanisms, political and other lobbying, and conflicts of interest.

- Demonstrate accountability and responsibility, from employees to boardroom including any non-executive directors.

- Robust processes for the appointment, due diligence and management of all third parties such as agents/advisers/distributors and flow this down to supply chain and outsourced operations.

- Conduct a company-wide health check of policies and processes.

All of this may sound like a lot of extra work, but actually the fact of putting in place a clear strategy and plan for dealing with bribery and corruption can lead to better business in the longer term and a competitive differentiator and advantage. And it is much cheaper than the cost of legal defence, let alone the reputational damage to a business if it is found to be involved in corruption.

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