



Fighting Corruption in the Supply Chain

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A Supply Chain Hypothetical

- A manufacturer of food products receives certain ingredients from a supplier. The supplier is subject to inspection by the local health department. During such an inspection the local health official informs the supplier that some of its perishable items are beyond their expiration date and may not be used as ingredients in food products for public consumption. A supplier employee pays the inspector a bribe to ignore the problem, and the supplier ships its ingredients to the customer. A supplier employee who witnessed the bribe calls the customer's reporting hotline and informs the customer of the bribe and the shipment of the ingredients.

A Supply Chain Hypothetical

- How would you prevent such corruption?
- How would you respond to such corruption?

Corruption in the Supply Chain

- There is little hard data, but it has been estimated that corruption adds 25% to the cost of procurement contracts in developing countries
- Companies are direct victims of procurement fraud by suppliers and employees. Suppliers often attempt to corrupt employees through gifts, entertainment and direct bribes or kickbacks.
- Government-related corruption by suppliers adds significant indirect costs through product quality, and reputational damage and possible legal exposure
 - e.g., toys, milk products and pet food from China

Corruption in the Supply Chain

- Questionnaire to UNGC participants
- Greatest corruption risks in supply chain:
 - Suppliers attempting to corrupt employees to gain business
 - Customs and tariff bribery
 - Steady-state bribery of government officials by local suppliers in corrupt environments
 - Bid rigging

What Companies Are Doing

- 2007 Conference Board & Ethics and Compliance Officers' Association (ECOA) Survey
 - 169 companies (\$5-10 billion median revenue) in a variety of industries, doing business around the world
 - About two-thirds have written anti-corruption policy that applies to third parties
 - Only about half perform due diligence or background checks on suppliers
 - mostly credit and financial
 - fewer check reputation or inquire about supplier e&c program
 - Only about a third extend training to third parties
 - Only about a third audit third parties for compliance

What Companies Are Doing

- UNGC Questionnaire
 - Similar results to Conference Board-ECOIA Survey
 - Supplier codes of conduct are common
 - Very little training of suppliers
 - Auditing in almost all cases limited to UNGC Principle 1-9 issues: human rights, labour and environment

Challenges to Preventing Corruption in the Supply Chain

- From Conference Board–ECOIA survey:
 - Participants rated challenges, 1=not difficult, 4=extremely difficult:
 - Monitoring third party behavior for compliance – 3.18
 - Assessing third party e&c risk – 2.57
 - Dealing with differing cultural views of appropriate conduct – 2.46
 - Ensuring appropriate due diligence – 2.38
- Similar results from UNGC questionnaire

UNGC 10th Principle

Sub-Working Group on Supply Chain

- Focus initially on MNCs' dealings with suppliers and contractors on issues of anti-corruption
- Ultimate goal to help create a level playing field among UNGC participants, especially SMEs, to counter bribery in the supply chain
- Once deliverables are achieved, we can adopt framework to dealings with consultants, agents, JVs and other business partners

Sub-Working Group on Supply Chain Deliverable

- Fighting Corruption in the Supply Chain: A Guide for Customers and Suppliers
 - Business Case
 - Customer-Supplier Engagement
 - Practical Guidance on Preventing and Responding to Corruption in the Supply chain
 - Model Tools and Resources

Fighting Corruption in the Supply
Chain:
A Guide for Customers and Suppliers
(condensed version)

The Business Case for Fighting Corruption in the Supply Chain

The Customer's Perspective

- Many MNCs engage suppliers on human rights, labour and the environment. These programs are a key element of good corporate citizenship and burnish the reputations of those companies.
- The same is true for anti-corruption. Firms that engage their supply chain on corruption can improve product quality, reduce fraud and create a more sustainable platform for future growth.
- Moreover, purchasers can be held legally accountable for the corrupt actions of suppliers. And firms will pay in damage to their reputation when supply chain corruption affects consumers.

The Business Case for Fighting Corruption in the Supply Chain

The Supplier's Perspective

- Suppliers who establish effective programs to combat corruption will improve product quality, reduce costs and avoid liability.
- They also will ease relationships with customers, who will have more trust and feel less need to mandate standards and engage in monitoring and enforcement.
- Suppliers who engage honestly with their customers and with public actors benefit their own reputations, to their ultimate advantage.

Customer-Supplier Engagement

- Cooperation and communication are key
- In many instances, suppliers are as large or larger than customers. In other cases, suppliers are small and medium size local businesses that may either be unsophisticated about the expectations of MNCs, or may be operating under various pressures that increase the risk of corruption.
- Customers must go beyond dictating compliance, and move toward comprehension and capacity building. Ideally, suppliers will adopt their own programs for preventing corruption.
- Suppliers should understand why preventing corruption and doing business with integrity is in *their* interest
- In working with suppliers on these issues, customers should emphasize collaboration and education, where appropriate

Customer-Supplier Engagement

Assessing Risk – Questions to Ask

- Fighting corruption in the supply chain, like any business decision, requires an assessment of risks and a balancing of costs and benefits
- To make these assessments, businesses must ask a series of questions about their own operations and about the nature of their suppliers
- The answers will help direct anti-corruption resources to their most value-added objectives

Customer-Supplier Engagement Questions to Ask

Questions about the Customer's Business

- What controls are in place to prevent, detect, and respond to internal fraud and supplier fraud?
- Elements to consider include:
 - Written standards of conduct
 - Employee training
 - Reporting mechanisms
 - Mechanisms to investigate and deter employee misconduct
 - Spending controls, including multiple levels of review
- Companies also must consider controls in relation to supplier engagement, including:
 - The supplier evaluation process
 - Supplier contract terms
 - Supplier training
 - The contract management process, including mechanisms for monitoring the quality of products or services provided

Customer-Supplier Engagement

Questions to Ask

Questions about the Supplier's Business

- How large and sophisticated is the supplier?
- Where is the supplier located?
- Where are the goods or services to be produced/delivered?
- What is the supplier's reputation for integrity and ethical conduct?
- How was the supplier identified?
- What controls does the supplier have in place to prevent corruption?

Customer-Supplier Engagement Questions to Ask

Questions about the Engagement

- What is the nature of the goods or services to be supplied?
- Is the supplier in an industry with a reputation for corrupt practices, e.g., real estate?
- What is the size of the contract?
- What are the possible touch points with government corruption?
- How costly would supply chain disruption be if the supplier engaged in corruption?
- What is the remedy if there is a problem with the supplier?
- How will the customer control the damage in each case?
- Are there alternative sources of supply?

Customer-Supplier Engagement

Supplier Education

- When dealing with unsophisticated suppliers, customers should consider training supplier personnel as they train their own
- To achieve efficiency, and to help level the playing field, customers may consider bringing key personnel from multiple suppliers together for joint education sessions
- Ultimately, suppliers should run their own education programs for their employees

Customer-Supplier Engagement

Synergy: Integrating Corruption Controls with Existing Supply Chain Controls

- MNCs typically are sophisticated about supply chain management, including supplier selection, cost control, logistics, inventory control and quality assurance
- Many MNCs also have programs for dealing with human rights, labour and environmental issues among suppliers, and many companies attempt to prevent corruption in the supply chain
- Unfortunately, in most of organizations these supply chain management efforts are not coordinated
- Coordinated supply chain management can provide a clearer and more comprehensive understanding of the strengths and weaknesses of the supply chain
- Companies need to see supply-chain management as a unified whole, with a common set of policies and practices that include corruption prevention

Practical Guidance on Preventing and Responding to Corruption

- Two sections:
 - General guidance
 - Scenario specific guidance
- Within each section, guidance on:
 - Corruption **prevention**
 - Corruption **response**

Practical Guidance on Preventing and Responding to Corruption

Corruption Prevention

- **General company anti-corruption policies**
 - Code of Conduct, including a zero tolerance anti-corruption policy
 - Reporting mechanisms
 - Training to all personnel on anti-corruption laws and policies; the consequences of bribery and corruption; and how to respond to such demands
- **Policies for company representatives involved in purchasing and bidding processes**
 - Clear rules and procedures for choosing a supplier.
 - Prohibit or strictly regulate gifts, entertainment, sponsorship and donations activity before, during and after the bid process

Practical Guidance on Preventing and Responding to Corruption

Corruption Prevention

- **Additional controls for purchasing and bidding**
 - Internal audits in the areas involved in the purchasing and bidding processes
 - Access restriction for the most important information related to all phases of the purchasing and bid processes
 - Automated segregation of duties in the purchasing and bid processes
 - Review payments involving heightened risk
 - Anti-corruption technology to increase monitoring effectiveness
- **Risk assessment and due diligence**
 - Process to evaluate corruption risk prior to entering into a customer-supplier relationship
 - Due diligence on suppliers, customers, and intermediaries

Practical Guidance on Preventing and Responding to Corruption

Corruption Prevention

- **Supplier management and control processes**
 - Code of conduct for suppliers, including expectations about corruption
 - Ensure that supplier personnel receive training on anti-corruption
 - Monitor supplier anti-corruption efforts through questionnaires and audits
- **Contractual precautions**
 - Anti-corruption provisions in contracts with suppliers
 - If the supply contract includes requirements and penalties related to timely performance, contract should exclude liability delays resulting from bribery demands from relevant government (e.g., customs) officials
- **Collective action**
 - Work with industry associations and NGOs to establish:
 - Mechanisms for common supplier anti-corruption training
 - Common supplier anti-corruption audit standards and mechanisms for common supplier anti-corruption auditing
 - The exchange of information about supplier anti-corruption practices and acts of corruption

Practical Guidance on Preventing and Responding to Corruption

Corruption Response

- Refuse to accept or make a corrupt payment on the grounds that any solicitation violates the business principles of your company and may violate applicable laws
- Make a record of the relevant interaction and immediately report to management
- Report the solicitation (directly or anonymously) to the appropriate level of the supplier or customer's organization
- Investigate whether the solicitation or act of corruption was an isolated incident or indicative of a systemic practice
- Develop a strategy to promptly assess possible legal, operational and reputational risks arising from act of corruption
- Investigate the entire engagement as well as past deals with the same supplier or customer
- Discipline all employees involved in act of corruption, up to and including termination of employment
- Retrain employees on policies against corruption

Practical Guidance on Preventing and Responding to Corruption

Corruption Response

- If suspicions are substantiated, consider external disclosure to:
 - Government agencies responsible for investigating corruption
 - Embassy or consulate representing home country to seek guidance and support
 - Financing institutions, if any export credit financing or coverage is proposed
 - Industry initiatives:
 - Leverage industry initiatives to communicate bribery demands and other corruption
 - Expose known corrupt organizations
 - Regulators
 - Media/NGOs: Leverage public scrutiny of corruption
- In a bidding process, eliminate from consideration any supplier who approaches with a bribe or kickback, and increase scrutiny of the bidding process
- If corruption is detected in ongoing contract, calculate the costs associated with exercising the termination clause in the supplier agreement

Practical Guidance on Preventing and Responding to Corruption

Corruption Scenarios

1. Procurement manager demands a kickback from potential supplier to secure contract or provide inside information on bid process
2. Potential supplier offers kickback to procurement manager to secure contract or provide inside information on bid process
3. Potential supplier offers gifts and entertainment to procurement manager
4. Supplier offers a bribe to a contract manager to overlook out of spec or inferior goods or services
5. Procurement manager selects supplier because of personal/family relationship
6. Customer employee demands that supplier purchase from company owned by or related to customer employee

Practical Guidance on Preventing and Responding to Corruption

Corruption Scenarios

7. Monopoly supplier demands that purchaser pay bribe or kickback to secure goods or services
8. Supplier submits false invoice for work done or employee work hours
9. Customs official demands a bribe from a supplier to speed goods through customs or to pass nonconforming goods through customs
10. Supplier bribes government officials in order to pass health and safety inspections
11. Supplier offers a bribe to auditors in order to pass an audit for quality, labor standards, environment, etc.

Scenario 10

- A manufacturer of food products receives certain ingredients from a supplier. The supplier is subject to inspection by the local health department. During such an inspection the local health official informs the supplier that some of its perishable items are beyond their expiration date and may not be used as ingredients in food products for public consumption. A supplier employee pays the inspector a bribe to ignore the problem, and the supplier ships its ingredients to the customer. A supplier employee who witnessed the bribe calls the customer's reporting hotline and informs the customer of the bribe and the shipment of the ingredients.

Scenario 10

Corruption Prevention

- Customer should implement a process to evaluate corruption risk prior to entering into customer-supplier relationship
- Perform due diligence on potential suppliers
- Establish a code of conduct for suppliers, including expectations about corruption
- Ensure that supplier personnel receive training on anti-corruption
- Monitor existing suppliers to ensure they continue to meet ethical and performance standards
- Establish and promote reporting mechanisms, encouraging reports of suspected bribery and other unethical business practices by the company and its suppliers and other business partners

Scenario 10

Corruption Prevention

- Supplier should implement and enforce a company-wide Code of Conduct, including a zero tolerance anti-corruption policy
 - The Code of Conduct should address the corruption issue as a whole and specific examples, including bribery of government officials
- Set up clear company directives and related effective sanctions for non-compliance
- Provide training to all personnel on anti-corruption laws and policies
- Emphasize in training sessions the criminal and reputation risks not only for the company but also for the exposed employees themselves

Scenario 10

Corruption Response

- Customer should cease use of the ingredients and promptly assess all legal, operational and reputational risks
 - Conduct an independent audit to assess any actual risks to product or consumer health and safety
 - Ensure that your company's product recall and other contingency plans are up-to-date
- Customer should notify the supplier that it is not accepting the ingredients because of the bribe and that supplier shall cooperate fully in a complete investigation of the matter
- Investigate, in conjunction with supplier management, whether the bribe was an isolated incident or indicative of a systemic practice
 - If an isolated incident, inform the supplier that any additional such incidents will result in termination of the contract
 - If a systematic practice, terminate the contract and bar the supplier from further contracts
- Inform the health inspector's supervisor of the incident
- Report the incident to a relevant national body responsible for dealing with anti-corruption practices. Consider also that customer may have an obligation to disclosure to its own country's anti-corruption enforcement authority.
- Report the government official's acceptance of the bribe through www.bribeline.com

Scenario 10

Corruption Response

- Supplier should discipline all employees involved in the bribe, up to and including termination of employment
- Supplier should notify customer of corrective action taken
- Supplier should retrain employees on policies against corruption, and the possible sanctions for non-compliance

Model Tools

- Code of business conduct for suppliers
- Model supplier contract language
- Due diligence protocol
- Supplier questionnaire / auditing protocol
- Supplier training materials

Supplier Questionnaire

(sample questions)

- Does the company have a written policy that focuses on corruption, either stand-alone or part of a broader Code of Conduct for employees? If so, please provide a copy.
- If the policy exists, is the policy communicated to all employees? If so, how and how often? If not, to whom is it communicated and how often is the distribution list reviewed?
- Do you provide training to your employees on issues of corruption? If yes, what employees receive such training and how often is the training repeated?
- Do you have mechanisms in place to monitor possible corruption in your organization and to discipline employees who engage in corruption? If so, please describe these mechanisms and include a copy of any relevant policy or procedure documents.
- Has your organization been subject to an external review (such as a TRACE International due diligence review or review by external auditors) in the past 12 months? If so, please describe and include a copy of any relevant documents.

Case Studies

- We would like to include real case studies in the Guide
- What has worked for you?
 - How have you used various tools to combat corruption in the supply chain?
 - How have you handled difficult supply chain scenarios?
 - Have you used various collective action mechanisms successfully?
- Please let us know about any success for inclusion in the Guide

Next Steps

- Complete draft of Guide by mid-summer
- Circulate to various stakeholders for comments and collection of additional case studies
- Pilot implementation through various UNGC Local Networks
- Publication late in year



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