

Corruption II: Firm-level Issues

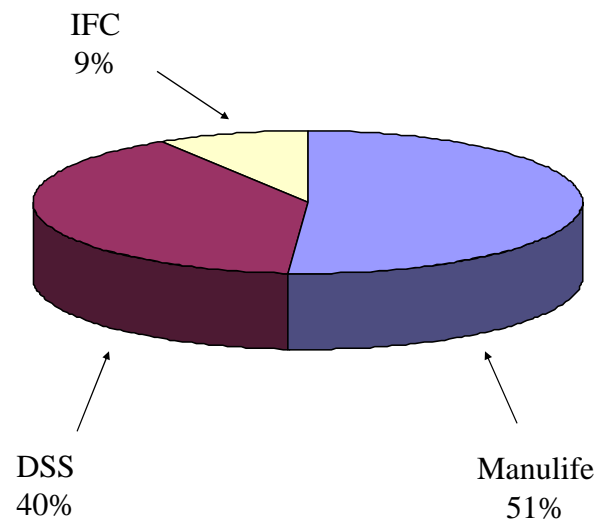
- Manulife in Indonesia
- To Bribe or Not to Bribe
- Controlling Corruption

Manulife Case

- The Setting & the Players
- DSS's Strategy
- Manulife's Strategy



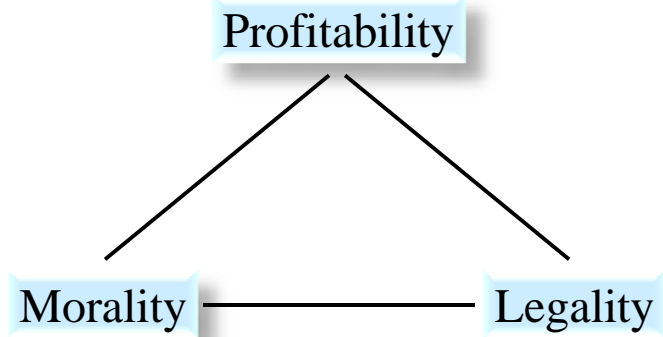
AJMI: Life Insurance Joint Venture in Indonesia



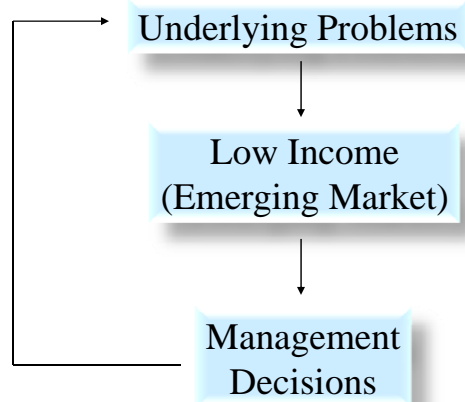
Corruption II: Firm-level Issues

- Manulife Case
- **To Bribe or Not to Bribe**
- Controlling corruption

To Bribe or Not to Bribe?



Morality & Bribery



- To bribe is to reinforce a bad equilibrium with real costs for local economy

Legality & Bribery

- Foreign Corrupt Practices Act (USA)
- Anti-Bribery Convention of OECD

FCPA: Basic Provisions

- U.S.-based companies and affiliates are forbidden from giving or promising foreign government officials either money or material items of value in return for assistance in obtaining or retaining business
- Applies to *intent*
- Includes payments to agents or consultants that will offer payments to foreign officials for prohibited purposes
- Applies to U.S. based firms; foreign firms that issue stock in U.S.; U.S. citizens, nationals and residents, regardless of employer
- Also enacts accounting rules, to make bribery harder to hide

FCPA: Exceptions/Loopholes

- Payments to facilitate or expedite “routine government action”
- “Payments that are legal under written laws of the host country”
- “Bona fide expenditures incurred for the promotion of products or services of U.S. business interest”
- Belief that a payment is not a bribe

FCPA: The Enforcement Explosion

Maximum punishments

Corporation

- \$2 million (criminal)
- \$25 million + 2x benefits of bribe (civil)

Individual

- \$250,000 (may not be paid by employer)
- 5 year imprisonment

Lax enforcement 1977-1999

- ~ 1 judgment per year
- Avg fine of \$1.2 million
- 2 incarcerations in 22 yrs



Enforcement “explosion”

- 10 judgments in 2007
- Many \$20+ million fines
- DOJ has 100 cases 10/2007
- First “sting” operation in 1/2010

Recent cases: Monsanto, Halliburton, Norway’s Statoil...

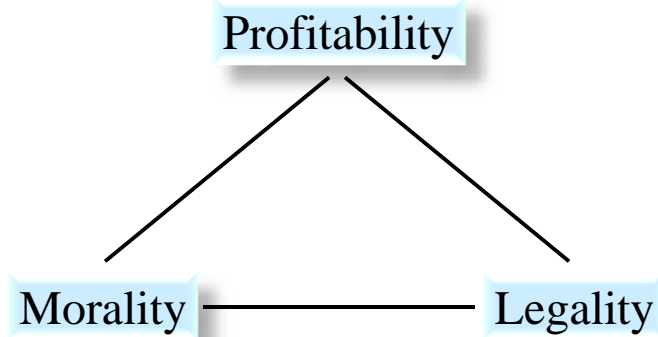
FCPA: Effect on U.S. Businesses Abroad?

- Hines (1995)
 - Compares investment by U.S. businesses in corrupt vs. non-corrupt countries
 - Finds relatively small growth of U.S. business activity in corrupt countries after FCPA passed
 - Claims this is evidence that FCPA hurts U.S. businesses
- Shang-Jin Wei (2000)
 - Compares U.S. FDI vs. FDI from other countries
 - Finds that corruption kills FDI generally
 - No special cost to U.S. firms due to FCPA
 - More compelling method than Hines (1995)

Anti-Bribery Convention of OECD

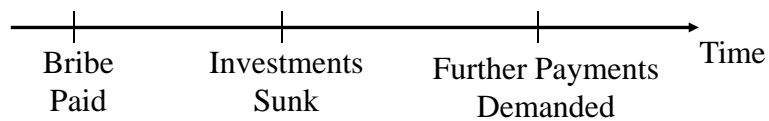
- Prior to 1997: few restrictions in other countries
 - Bribes often deductible!
 - US firms complain for years and years
- All signatories agreed to pass legislation similar to FCPA.
Requirements:
 - “Strong” penalties
 - Mutual legal assistance
- 36 countries have established FCPA-like laws to date
- Enforcement now increasing too
 - e.g. BAE (UK), Siemens (Germany)

To Bribe or Not to Bribe?



Profitability & Bribery

- Short term gain: Win Project
- Long term cost #1: Hold-up & Renegotiation
 - If counterparty wants bribe initially, it is likely that
 - counterparty's incentives are based on personal gain
 - counterparty is relatively unconstrained by law
 - Little to prevent renegotiation and hold-up

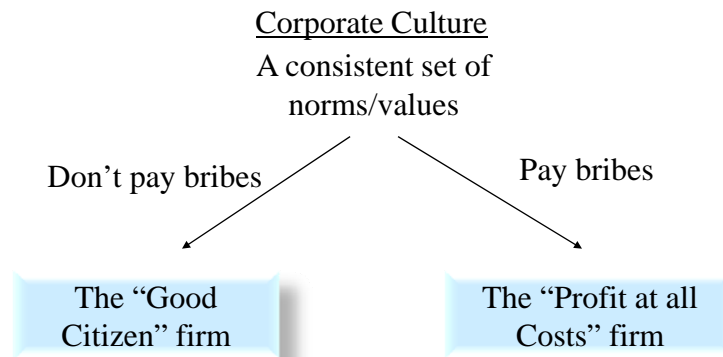


Profitability & Bribery

- Short term gain: Win Project
- Long term cost #2: Firm reputation for paying bribes
 - In future relationships with other counterparties, your firm may be seen as an “easy target”
 - Greater expectations that you will pay bribes
 - Little credible bargaining power to refuse when asked to pay a bribe (or in negotiations over how much)

Profitability & Bribery

- Short term gain: Win Project
- Long term cost #3: Internal Corporate Culture



Profitability & Bribery

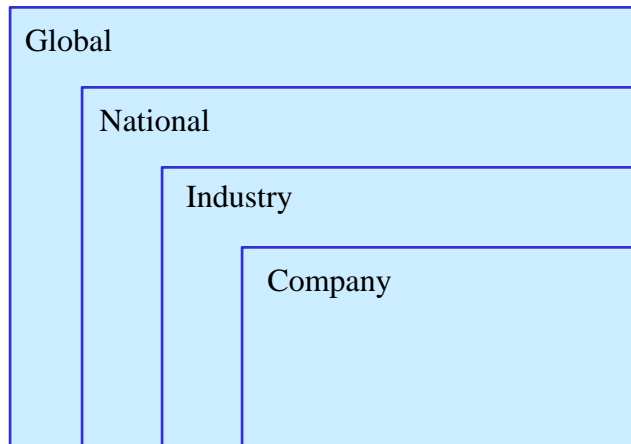
- Firm culture that permits bribery may create/ reinforce other behaviors that may be undesirable

	“Good Citizen”	“Profit at all Costs”
Customer Treatment	Quality	Opportunism
Time Horizon	Long	Short
Incentives	Loyalty	Stock options
Other Laws or Firm Rules	Obey	Break

Tough Calls

- Deciding whether or not to pay bribes is a question of firm strategy with legal, moral, and profit implications
- Even if you “do not want to pay bribes”, there are difficult gray areas
 - Relationship-building vs. graft
 - Facilitation vs. extortion
 - Gift-giving and “culture”
- My advice to you
 - Do not break the law (consult FCPA attorney)
 - Be careful about reputation
 - Make honest moral choices in gray areas
 - Always seek better options...

Strategies to Control Corruption



Strategies to Control Corruption: Global

- Create leverage over countries that take bribes or pay bribes

Countries that pay bribes

Countries that take bribes

International Law

- FCPA, OECD convention

Foreign Aid

- World Bank, IMF
- US Millennium Challenge

International Reputation

- Transparency International's BPI

International Reputation

- Transparency International's CPI; private rating agencies

Strategies to Control Corruption: National

If leaders are willing...

Temptations & Enforcement

- Raise public sector wages (plus monitoring!)
- Reform enforcement institutions (courts, police)

Regulatory Reform

- Public monitoring. Ensure transparency– public bidding on contracts, accounting of state entities, etc
- Simplify and eliminate “sand in the gears” regulations.
- Avoid “toll booth” systems. Instead, create multiple, competing routes by which firms can satisfy regulations.

Strategies to Control Corruption: Industry

- Industry coalitions can commit to not paying bribes
- But how stable are these coalitions? A prisoner’s dilemma...

		Hyundai	
		Pay Bribe	Be Honest
Daewoo	Pay Bribe	4,4	8,0
	Be Honest	0,8	5,5

- Reputation and monitoring within coalition are important to prevent defection
- Coalition must provide *other* benefits firms do not want to lose

Company-Level I: External Strategy

Goal	Avoid being asked/forced to pay bribe	
Method	Create Leverage <i>Align incentives of individuals/institutions with superior decision rights/bargaining power</i>	Higher up in government International support
Modes	<ul style="list-style-type: none"> • Equity partnership (stake in firm's performance) • Reputation 	
Examples	<ul style="list-style-type: none"> • Manulife • BP's "publish what you pump" 	

Company-Level II: Internal Strategy

Goal	Prevent employees from paying bribes	
Method #1	<i>Define internal rules</i>	
General Advantages: Good Citizen Firm	}	<ul style="list-style-type: none"> • Explicit: define corruption for employees • Implicit: top managers lead by example • Examples: Corporate charters (e.g. Texaco) Corporate training Reputation commitments (Islands of Integrity)
Method #2		<i>Establish monitoring/enforcement mechanisms</i>
	<ul style="list-style-type: none"> • Vertical monitoring: record keeping, auditing • Horizontal monitoring: whistle-blower provisions 	

END