
The corruption trap



By [Angela Garvey Hammond](#)

Emerging markets are where money is to be made: pent up consumer demand, cheap labour, few regulations. But just under the surface lies the murky world of corruption, ready to derail even the most scrupulous businessperson. Now what?

“Moscow, it's a web of illogical bureaucracy, which can best be described as a moving target. Once you get a handle on the processes involved, someone in the administration gets fired, the rules change, and you start again. We found ourselves often being forced to take two steps back because of this. However, you persevere, and you launch,” so says Alex Shrifin, a Canadian entrepreneur selling soup on the streets of Moscow. He came up with the canny idea of selling soup on-the-go three years ago and, with a small team of investors, eventually managed to open his first street kiosk in April last year. He knows Moscow well and the Russian way of doing business, as he describes it “the trickle-down effect of corruption”.

“Deep infrastructural corruption tends to affect larger operations than ours. Corruption leads to massive inefficiencies, lack of vision on the part of regulators, and a general state of cynicism. While we've had to deal with the occasional corrupt small official, the biggest problem is that there is truly

little in the way of helping small business get off the ground and survive.”

Alex is shrewd. He can see the opportunities in Russia but he is under no illusions about the risks. The anti-corruption watchdog, Transparency International rates Russia as one of the most corrupt countries in the world - giving it a score of 2.1 out of 10. At the other end of the ‘corruption scale’ is Alex’s home country Canada with a score of 8.9 - one of the cleanest nations.

It's not only Russia

Of course Russia is not the only country tainted by the practice. Travel around the world and China and India are on a par with the former Soviet state. So what makes one country clean and honest and another not? If one looks at the various definitions of corruption and bribery the general consensus is the abuse of public or official power for personal gain. But it is a two-way process. For every corrupt official demanding a bribe, there is a business or investor ready to pay it to get things done his way. Many argue it’s this “supply chain” of individuals and companies with their huge slush funds that is exacerbating the problem. Then there is the West which can hardly claim to be squeaky clean.

N. Craig Smith, INSEAD Chaired Professor of Ethics and Social Responsibility, highlights the case of Siemens. For years the German industrial and engineering giant paid bribes to foreign officials - a practice which was not illegal under German law and was considered a necessary cost of doing business abroad.

“The company, in a sense, continued with a practice that had been in place for many years but didn’t realise the ramifications of the introduction of the OECD convention against bribery and the laws put in place that governed it as a German company. Historically it was tax deductible - the cost of bribing a foreign government official.” As a result of the OECD legislation, in 2008 Siemens had to pay a hefty penalty of up to 5 billion euros. The scandal damaged its reputation and business and 50 of its top executives were sacked.

Siemens has cleaned up its act and learned its lesson. Russia is making moves in the same direction. The country is taking steps to become a member of the OECD’s anti-bribery Convention. The treaty demands signatory countries to address the “supply side” of corruption in international business dealings by banning the practice of foreign companies lining the

pockets of local government officials. Participating countries are regularly screened by fellow nations and have to account for any lapses in their anti-bribery legislation and implementation. Such goals and agreements are commendable but with Russia's track record are they really achievable?



INSEAD's Professor [Douglas Webber](#) has his doubts. An expert in political science he predicts "two factors will make it very hard for this kind of agreement to bite in Russia. One is the Russian economy's heavy dependence on natural resources and particularly oil and gas, where state plays a dominant role, and the other is the generally central role of state intervention in the Russian economy."

Bribery, kick-backs, grafts, back-handers whatever way you phrase it - the practice is ancient and embedded in almost every society and culture. As I was investigating this issue I met, by chance, an Indian philosophy lecturer teaching at a British University. He was very proud and insightful about India. Within seconds of our conversation he had listed a string of personal incidents from the flight home to customs and jumping the airport queues which automatically required an unofficial payment.

Add up all these "unofficial payments" and corruption is having a crippling effect on the country. Global Financial Integrity, a task force which aims to curtail the cross border flow of illegal money estimates that more than 16 billion US dollars in illicit money leaves India every year. Ordinary Indian households may not be aware of the exact figures but know all too well what is going on. A string of major corruption scandals in the telecoms sector and the alleged fraud surrounding the Commonwealth Games in Delhi last year has outraged thousands particularly those who have benefitted from India's economic boom. They have turned their frustrations into support for the anti-corruption campaigner Anna Hazare who is pushing for a new anti-corruption ombudsman with the right to investigate every level of society and government.

Some positive signs

The movement is being closely followed by members of India's highly-skilled business community working abroad like Bhavin Dalal. He is an IT specialist with a very successful career in North America. He left India as a young professional in his early twenties. Now in his late 30s he can see huge changes in his home country.

"Corruption has been prevalent in India even before its independence from the British. That's for socio-economic reasons as well as cultural ones - under the pretext of religion, patriotism or "the greater good." Between the time I

grew up in India and went on to start my early professional life, until today, a lot has changed. The literacy rate has grown immensely and is at about 75 percent today, a far cry from less than 30 percent when I was growing up. While corruption is visible, there is a part of the society which openly rejects it.”

Professor N. Craig Smith points to other glimmers of hope; Tata, the Indian conglomerate whose chairman, Ratan N. Tata, has admitted to losing out on big contracts because he refused to slip the right person “a graft”. In spite of that Tata is still a vast and highly profitable business.

“There are companies who are successful in taking a stance against bribery. In India Tata has been able to build a reputation for itself for not paying. It took a non-corruption stance at some considerable cost.”

Calculating the exact cost of corruption to the global economy is impossible because, by its very nature, the illicit flows of money are well hidden and involve a complex web at all levels of society.

Journalist **Misha Glenny** has spent years investigating the darker side of societies around the world and the underground global economy after 1989 with the collapse of the Soviet Union. He points to the surge in a whole new area of employment; the “protection services to new businessmen”. Then there is the emergence of a “huge legal grey area as to what is licit business and what is illicit business” which has opened up in Eastern Europe and the BRIC countries of Brazil, Russia, India and China following their breakneck economic transition. “The fact that China and East Asia counterfeit huge amounts of goods whose intellectual property rights reside primarily in the United States, Western Europe and Japan...is a big big issue between the major forces of the global economy.”

For his latest book, *McMafia*, he spoke to lawyers, criminals, gangsters, police officers, businesses, government officials, and journalists around the world and suggests “it’s impossible to extract corruption from the activity of organised crime. Corruption is a vast industry....I also have to include a large part of what goes on in the offshore banking sector because despite the almost divine deference given to the offshore banking sector by the licit world, governments have to understand that this is a carte blanche for money launderers and for people seeking to get money out of the black economy and into the white economy”.

There is no shortage of international institutions and government organisations trying to tackle this labyrinth but success is a long way off. Reading the findings of the 2010 Global Corruption Barometer does not offer much cheer either.

Corruption has increased over the last three years, say six out of 10 people around the world. One in four people report paying bribes in the last year. The Barometer captures the experiences and views of more than 91,000 people in 86 countries and territories. Views on corruption were most negative in Western Europe and North America, where more than two-thirds of people thought corruption had increased over the last three years.



The global banking crisis gets part of the blame, while news headlines detail the corruption endemic in so many humanitarian aid missions to disaster zones. INSEAD's Professor of Operations Management, [Luk Van Wassenhove](#), has investigated why corruption plagues so many missions.

“There are essentially three sources of corruption depending on your definition. The first and weakest one is because of lack of truly professional systems, people, and processes. For instance, poor purchasing procedures could lead to high expenses and therefore waste of money that could have been used to buy more goods. Or, allowing truck drivers to steal fuel for personal use instead of paying and controlling them properly. A second source of corruption is food being stolen in conflict areas and ending up on local markets. This is sometimes very hard to avoid. For instance, we know that food aid to Somalia is partially going to end up with the militia and serve to buy more weapons. But is this a reason not to send food to the starving people? A third source is with service providers like chartered airplanes. It is possible that a plane delivering food aid comes back with a load of arms or drugs. Again, better controls can help. Humanitarians work in extremely difficult conditions sometimes. They are not corrupt but can be subject to corruption forces. We should support them fully.”

Risk consultancy groups who specialise in offering companies advice when operating in high risk regions of the world all have list of recommendations on how to avoid the bribery trap. Many of the steps they suggest are simple and obvious but clearly needed. Whether companies or individuals actually follow them is ultimately down to individual's own integrity and perception of what constitutes an abuse of power and what doesn't.

Can ethics be taught?

It's a question that is debated time and time again at business management schools around the globe. Ethics and social responsibility are crucial components to many leadership and management programmes. Some schools have their fireside chats; others, visiting lectures from former white collar criminals. INSEAD Professor N. Craig Smith says his job is not to preach to students to be ethical business leaders but rather to challenge them “to think about the ethical issues they will face in their business lives to better understand what the various consequences might be and their obligations. At the end of the day it is their judgement which will determine what they

do”.

That may well raise a wry smile in many business circles but others like Bhavan Dalal are more sanguine.

“I am an optimist. The last few years have resonated a fair possibility of change in India. I realise that it won't be quick but considering how long bribery has prevailed, the rate of change is fast.”

Find article at

<https://knowledge.insead.edu/economics-finance/corruption-trap>

About the author(s)

Angela Garvey Hammond