Investments in emerging markets continue to be scrutinized by regulators. In 2016 several FCPA-related enforcement actions launched by the United States Securities and Exchange Commission (SEC) focused on the operations of registrants in emerging markets, including China, Panama and Russia. The first Deferred Prosecution Agreement under the UK Bribery Act signed in December 2015 focused on the activities of a local affiliate of a foreign bank in Tanzania.

At the same time, governments in emerging markets are strengthening national anti-corruption legislation. In 2015, new anti-bribery/anti-corruption legislation was introduced in many jurisdictions, including amendments to China's Criminal Law, Brazil's Clean Company legislation and the Benami Transaction Prohibition Bill in India.

In this evolving context, companies seeking to invest in emerging markets should expect their operations to be subject to significant scrutiny. While these markets present new opportunities, they also pose new risks. Identifying and navigating risks in emerging markets require an enhanced understanding of the local investment and regulatory environment and of the wider political and cultural context. The stakeholders and parties that can influence the success or otherwise of a business venture might not be readily apparent.

Combined with less familiar and evolving regulatory frameworks, such markets can present challenges to an investor, which if not addressed, can lead to failed investments or regulatory scrutiny. Our survey found that over half of all companies that exited investments in Africa, Brazil, China, Eastern Europe and India cited fraud, bribery and corruption risks as a contributory factor.
Despite the increased focus on transparency, and the increasingly coordinated efforts to investigate international corruption, the scale of the problem remains significant, particularly in emerging markets. Half of the 1,725 respondents across 39 emerging markets believe that corruption is widespread, more than double the percentage that believe corruption to be an issue in developed markets. Around one-third of respondents in emerging markets stated that they have concerns about misconduct at work.

Recent revelations regarding the potential misuse of offshore jurisdictions have focused attention on the transparency of company ownership.

An overwhelming majority of all respondents support enhanced transparency over beneficial ownership, with 91% believing that it is important to know the identity of the entities with whom they do business. Support for such initiatives is even higher in emerging markets, with 97% of African respondents and 94% of respondents in South America in favor. Respondents in emerging markets are more supportive of initiatives to publish the beneficial ownership of companies participating in public tenders than respondents from developed markets.

Despite the widespread support for transparency initiatives, our survey identified that respondents in emerging markets are not confident in the ability of national institutions to hold individuals to account.

Although new legislation has been adopted in many countries, the majority of respondents believe that enforcement efforts have decreased or stayed the same. The only market in which enforcement is believed to have improved is China, where over half of respondents believe that enforcement efforts have increased. This is likely a result of the high profile anti-corruption campaign against “Tigers” and “Flies”, which targets all participants in the corruption food chain.

Worryingly, just over half of all respondents in emerging markets believe that while their governments are willing to prosecute, they are not effective in securing convictions. These results are particularly surprising in Brazil, where there have been recent high-profile enforcement actions such as the Lava Jato investigation. This may indicate that once embedded, negative perceptions regarding enforcement activity takes time to catch-up with events.
Individual misconduct

It is not just bribery and corruption that remains a persistent problem. The willingness of executives to justify unethical behavior to improve a company’s performance is also a recurring issue – particularly in finance departments.

Our respondents in emerging markets are more willing to justify unethical conduct to improve a company’s financial performance or to survive an economic downturn than their counterparts in developed markets.

Forty percent of our respondents in emerging markets would engage in at least one form of unethical conduct in an economic downturn, while almost half would engage in unethical conduct to improve financial performance. The behavior that some respondents in emerging markets could justify is concerning: 16% would offer cash payments to secure business in an economic downturn, 15% would offer personal gifts or services, while 6% would misstate financial performance.

A significant majority of respondents in emerging markets state that their companies had policies, procedures and controls in place to combat corruption. Eighty percent of respondents in emerging markets said that they had a bribery and corruption code of conduct, with 84% believing that senior management had clearly communicated its commitment to anti-bribery and corruption policies. Our respondents from emerging markets are also more likely to believe that there are consequences for breaching these policies than respondents from those in developed markets.

In environments where cultural perceptions of acceptable behavior may differ, where perceptions that certain actions are part of the cost of doing business may exist, employees may be more likely to justify unethical conduct.

A close look at respondents from finance teams in emerging markets identified cause for concern. Our survey found that:

1 in 10 CFOs in emerging markets would extend the monthly reporting period

1 in 10 would offer cash payments or personal gifts to secure business in an economic downturn

1 in 10 would backdate a contract to improve financial performance

8% would book revenues earlier than they should to improve financial performance.

...
Whistleblowing

Business should ensure that their employees in emerging markets are able to raise concerns about ethical conduct in the workplace. While just over half of respondents in emerging markets stated that there are whistleblowing hotlines in place, and 39% believe it has become easier to report concerns, our survey identified significant barriers to blowing the whistle. One in four respondents would not blow the whistle due to loyalty to their company and 22% due to loyalty to their colleagues, higher than average of global respondents.

Companies should develop a culture that encourages employees to speak up, that promotes confidence in senior management and provides assurance that employees will be protected if they report misconduct.

Whistleblowers are a critical resource in identifying alleged misconduct, particularly in overseas operations. For whistleblowing mechanisms to be effective, companies need to reassure employees that any concerns will be dealt with in a confidential manner and investigated thoroughly.

Multinational companies should maintain close links with local offices and create a sense of allegiance to the wider brand, as opposed to the home office. Furthermore, different approaches need to be introduced to overcome any local social norms that dissuade whistleblowers from coming forward. Companies should develop a culture that encourages employees to speak up, that promotes confidence in senior management and provides assurance that employees will be protected if they report misconduct.

If such policies are not developed, it is possible that employees will seek to report misconduct externally. The SEC hotline, for example, ranked India as one of the top five countries outside of the US from which individuals have called (the others are the UK, Canada, China and Australia).

In circumstances when an employee does blow the whistle, or corruption is reported internally, undertaking such investigations in emerging markets can be challenging. Across emerging markets companies should expect a huge variation in the quality and the nature of information retained. Record-keeping practices may differ in jurisdictions, documentation and data may not be held centrally and data privacy laws may differ. Accessing relevant information can be a time-consuming and costly process. As regulatory authorities place pressure on companies to respond quickly to internal complaints, business should make sure that their compliance and investigations functions are adequately resourced to respond.
In many emerging markets, foreign companies are often required to enter into joint ventures with local partners, or engage local third parties. Businesses should be aware that entering into partnership can bring additional risks and that regulators continue to focus on third-party conduct. An OECD report in 2015 indicated that of 427 foreign bribery cases, in the vast majority of cases the bribery was perpetrated by third parties, including agents or intermediaries.

A common feature of ABAC statutes is to hold companies responsible for the conduct of agents, joint-venture parties or other third parties acting on its behalf. That means that any fines or penalties that could be levied on a company for its own actions can also be levied against it in the event that a third-party engages in inappropriate conduct.

Despite widespread recognition of the risks surrounding third parties, our survey found that respondents are not yet taking potential steps to protect their business and themselves. One in five respondents are not identifying third parties as part of their pre-transaction due diligence. A greater proportion, more than 1 in 3, are not assessing country or industry-specific risks before making investments. One in five does not undertake compliance-focused interviews on the ground prior to an investment.

In new markets, companies should invest more in understanding their business partners at the outset, visiting sites and undertaking interviews with local management as part of any pre-transaction due diligence. It is vital for companies to fully understand the background, reputation and ownership of any entities, with which they enter into any form of business relationship. Leading companies advised us that they take additional steps to mitigate third-party risks, such as requiring references for any supplier or banning the use of agents entirely.

EY’s survey found that almost two-thirds of respondents who remained in high-risk jurisdictions undertook enhanced due diligence or more frequent internal audits. Half of our respondents utilized new technologies such as forensic data analytics or transaction monitoring to identify and mitigate such risks.

**Mitigating third-party risk**

**What does good look like?**

Our survey has found that local market knowledge is imperative, and the potential ramifications of ignoring corruption and fraud risks can be significant.

**Companies should:**

- Confirm and reinforce a commitment to ethical conduct throughout the organization. Having anti-bribery and anti-corruption policies and procedures is not enough; companies must ensure that employees are clear on what constitutes a breach. This communication needs to be reinforced by action in the event of noncompliance, with employees penalized for breaching these policies.

- Build and harness local knowledge in compliance teams. Teams should include individuals with knowledge of the local business context and who are able to identify key risk areas. Companies should undertake regular fraud risk assessments, including an assessment of data-driven indicators of fraud. All bribery and corruption training should be delivered in a manner appropriate for the local business environment, utilizing relevant case studies and addressing any cultural misconceptions about appropriate behavior.

- Confirm that they understand the ownership, conduct and track record of all third parties, including direct business partners, agents, distributors and recipients of charitable support. Such reviews should be tailored to address market-specific risks, taking into account the political and cultural dynamics in the country.

- Establish clear whistleblowing policies and procedures. Companies must confirm confidentiality for employees, accepting that employees may be reluctant to come forward due to fear of repercussions, particularly in countries where the rule of law is weak. Once a complaint is made, real and visible action should be taken.

- Apply forensic data analytics as part of a proactive approach to monitoring, having regard for potential gaps in, and the nature of, data. When data is available, such analytics can automate reviews, identifying anomalies, red flags and potential indicators of fraud, allowing you to target manual reviews on the areas of greatest risks.

- Have a clear and predefined approach to investigating misconduct, with clearly allocated responsibilities between regional compliance teams and teams based at head office. Investigation functions should be properly resourced to enable them to act quickly and proportionately to identify and investigate incidents when they occur.

1 in 3 respondents are not assessing country or industry-specific risks before investment.
About the Global Fraud Survey

Between October 2015 and January 2016, our researchers – the global market research agency Ipsos Mori – conducted 2,825 interviews in the local language with senior decision-makers in a sample of large companies in 62 countries and territories. 1,725 of our respondents were from countries in emerging markets. The polling sample was designed to elicit the views of executives with responsibility for tackling fraud, mainly CFOs, CCOs, general counsel and heads of internal audit.

The full results are available in the EY report Corporate misconduct – individual consequences, which can be downloaded at ey.com/globalfraudsurvey2016