

# Corporate corruption and governance— from the perspective of China

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## Abstract

Corruption is a difficult problem that troubles developing and developed countries. With economic development and globalization, the number and extent of corporate corruption have increased to gain advantages over competitors in commercial transactions. This article introduces the definition, and causes of corruption in China. Supported with Carroll's corporate social responsibility pyramid model and Freeman's stakeholder theory, it explains the difficulties made by corruption in fulfilling corporate social responsibility and the necessity of anti-corruption. Finally, it puts forward some feasible ways to control corporate corruption through analysis of the GlaxoSmithKline bribery case.

**Key words:** *corporate corruption, corporate social responsibility, stakeholders, CSR pyramid model, case analysis, GlaxoSmithKline (GSK)*

## 1 Introduction

Corruption will cause the loss of resources, reduction of efficiency and destruction of the system, all countries in the world are in urgent need of dealing with it, while it is difficult to cure and cannot be eradicated. Corruption will bring risk to management and operation. The neglect of corruption means the company's incapability in performing social responsibility. In the second half of 2013, GlaxoSmithKline's bribery case was revealed, it put the corruption governance on the corporate agenda. Corruption governance has become a problem and needs to be studied and explored continuously.

## 2 Corruption

There is wide consensus that corruption has a negative economic effect on society (*Shleifer and Vishny*, 1993;<sup>1</sup> World Bank, 1997;<sup>2</sup> *Bardhan*,1997;<sup>3</sup> Wofensohn, 1999; <sup>4</sup>*Indira and Opi*, 2011.<sup>5</sup> According to *Tanzi*,<sup>6</sup> the negative impact include reduction in foreign direct investment because of additional cost, the productivity of public investment and infrastructure, and investment so that the national growth and development is hindered. Corruption refers to

using public power to seek private interests. The power owners use the background, political status, economic power, acquaintance relations to seek benefits, resulting in bureaucracy, causing serious political and social problems, and this is also a criminal behaviour. With the continuous development of the economy, the acceleration of the globalization of the world economy and the steady progress of China's reform and opening-up policy, both domestic enterprises and multinational enterprises are constantly strengthening their economic exchanges and contacts, then the corruption appears. Especially in China, a country which has a long tradition of culture, people focus on human relations in daily lives, the importance of the relationship network is always emphasized. And the market competition environment of our country has not been equal, the environment of the policy and system is not perfect, so corruption happens frequently, resulting in a waste of social wealth and loss and other serious consequences. It is clearly adverse for economic, social, political and cultural development.

### 3 Corruption and corporate social responsibility

In 1991, *Prof. Archie B. Carroll*<sup>7</sup> from the University of Georgia in the United States argued that CSR should include economic responsibility, legal responsibility, ethical responsibility and philanthropic responsibility.



*Fig. 1* - CSR pyramid model

Economic responsibility means to make profit, this is fundamental cause almost all activities are based on it, legal responsibility means law-abiding, abide by national laws is an important condition for the survival and development of enterprises, ethical responsibility means to act ethically, have the responsibility to do the right, fair things, to avoid damage to stakeholders, philanthropic responsibility is to become a good corporate citizen, donate resources to the community, improve the quality of life. Professor Carroll arranged them from low to high as a pyramid model, as is shown in Fig. 1. Corruption is a violation of national law and shakes one of the important foundations of corporate social responsibility—legal liability. Corruption also

cannot be tolerated in ethical aspects. And enterprises' self-discipline, it will seriously hinder and influence the fulfillment of corporate social responsibility.

According to the Stakeholder theory of *Freeman*<sup>8</sup>, corruption will also influence the suppliers, employees and government. For suppliers, enterprises' procurement and sales progress involves many different participants, including many upstream and downstream enterprises and suppliers. Corruption in those transactions will break the normal competition order, and it is unfair to other competitors and will cause the loss of corporate property; For employees, the unfairness caused by corruption will affect the company's election system in promotions and other personnel changes. It is not conducive to the development of the company, and would also affect the enthusiasm of other employees and their views on company; For the government, corruption will undermine the government operation mechanism, and the dealing with power and money will hinder the optimal allocation of social resources, affecting the implementation of the functions of government departments. Corruption will affect the corporation's image and reputation. It would also enhance the company's operating costs, which would be undertaken by consumers who buy those products and services ultimately. Therefore, corruption would break the order of fair competition. For a socially responsible enterprise, anti-corruption is not only a basic requirement of commercial transactions, but also a necessary for establishing a satisfying corporate image. Anti-corruption work of normalizing business operations and strengthening self-discipline should be important contents of corporate social responsibility.

#### **4 Analysis of GlaxoSmithKline's case**

##### ***4.1 The GlaxoSmithKline's bribery***

GlaxoSmithKline (GSK) is a merger of Glaxo Wellcome and SmithKline in 2000. The combination of the two pharmaceutical giants has laid the foundations for GSK to become the world's leading pharmaceutical giant. Since the 1980s, GSK has been actively investing in China, introducing the most advanced pharmaceutical technology, best quality products, the latest business model, the most modern management concepts and marketing techniques into China. On July 11, 2013, the Ministry of Public Security notified that some executives of GSK China was placed on file for investigation, because they were on suspicion of serious commercial bribery and other economic crimes. As shown in Fig. 2, GSK China, in order to achieve the goal of opening the drug sales market and increasing the selling price of pharmaceutical products, has used the travel agencies and other channels to commit bribery to

government officials, pharmaceutical industry associations and foundations, hospitals, doctors and others.

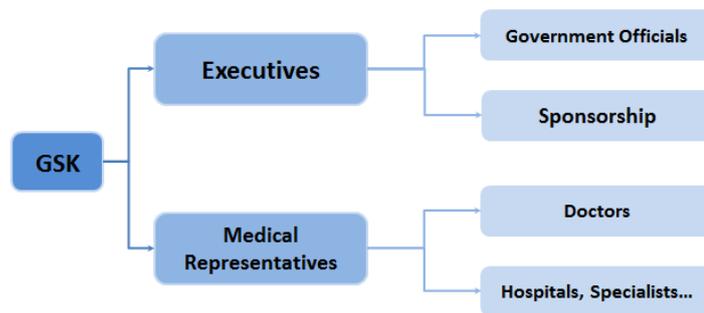


Fig. 2 - GSK's bribery chain<sup>9</sup>

Linjiang and other travel agencies faked the number of participants in meetings to gain money, which was then transferred to hands of some executives of GSK China. Since 2009, Linjiang had undertaken meetings and training programs, and returned the amount of more than 300 million dollars to some of GSK China's executives through various ways. In the six-month investigation, the police found that GSK bribed government officials, drug industry associations, foundations and hospitals to ask them to prescribe GSK drugs to patients through more than 700 intermediaries. Finally, including four executives, more than 20 pharmaceutical companies and travel agencies staff were under investigation. Executives involved were suspected of duty encroachment, non-state staff bribery and other economic crimes. Travel agency staff were suspected of bribery and assisting the duty encroachment.

#### 4.2 Influences

4 months after the disclosure of the case, GSK, for the first time acknowledged the direct losses on the performance of China. The company's 2013 third quarter report showed the company's current revenue grew 1%, net profit fell 12% on year-by-year basis. Among them, the two core business, prescription drugs and vaccines, sales decline 61% dramatically in China. This case indicates that the exposure of the bribery case had a very significant and direct impact on the performance of GSK China, not only damaged the company's image, but also led to lower profits, affected the interests of shareholders.

In addition, in this case the huge bribe costs are ultimately reflected in the products' prices which were several times higher than costs, so the burden was eventually passed on to the patients. A variety of operating costs including bribery costs lead to inflated prices. According to conservative estimates, "operating costs" accounted for 20%-30% of the cost of drug prices. This confession was made by the former vice president of GSK China and the

general operation manager of the enterprise, Liang Hong, after being arrested for serious economic crime. For example, the ex-factory of Heptodin Lamivudine tablets is 140 yuan, put aside R & D costs. Even we count the meeting fees and profit both at 20%, the actual cost of drugs is still less than 84 yuan, accounting for 60%.

Just think from the perspective of consumers, why should we pay for the bribery of pharmaceutical companies? Why should we spend so much more than actual costs of the medicine? How could we hold back our resentment when life-saving money was exploited by doctors, medical representatives, officials and companies to meet their personal interests? Such incidents have quite direct impacts on the interests of consumers in general, and are contrary to the most basic corporate social responsibility.

## **5 Feasible ways to curb corporate corruption**

To control corruption, it is necessary to upgrade management structure, strengthen internal control, improve laws and regulations, so that it can effectively reduce the possibility of corruption. These can be concluded in following points:

### ***5.1 Improve governance structure and internal management***

Enterprises need to enhance transparency in their organizational structure, operation and decision-making process, strengthen the functions of general meeting of shareholders, board of supervisors, workers' union and independent directors to improve the governance structure. To strengthen internal management, companies should make up for the management loophole, develop a variety of standards aimed at maintaining company's norms. According to the company's structure and scale, keep tight rein on accounting and auditing standards to ensure the implementation of internal audit control that help prevent and detect corruption, and ensure that the company's accounts and financial statements are in line with the appropriate audit and certification procedures.

### ***5.2 Strengthen internal ethics and self-discipline***

GSK's choice to compromise with China's business "hidden rules" reflects that the corporate ethical order was not strong enough. The GSK events revealed that company can curb the corruption internally only when a normative ethical system is established and transferred into rules in detail from top to bottom level, the key to anti-corruption is to encourage enterprises to voluntarily obey the self-discipline of business ethics, form a good corporate culture, and consciously take on the responsibilities.

### ***5.3 Improve regulations and strengthen industry management***

Effective management within the industry can prevent corruption, with more detailed provisions and management, behaviors like seeking personal advantage can be avoided. The GSK case also exposed the disorder of the pharmaceutical industry management and imperfection of related laws, China's "Drug Administration Law" has the legal ban of commercial bribery behavior on pharmaceutical companies and related institutions, but not specific on how to prohibit, nor to control the purchase and sale of drugs outside the account and solve other problems. So the soundness of law and industry regulations is breakthrough as well in fighting against corruption.

### ***5.4 Strengthen supervision mechanism and publicizing system***

Power breeds corruption, without supervision and balance, corruption would be inevitable. Sound supervision mechanism and severe punishment can have a deterrent effect on commercial bribery. First of all, establish the supervision and accountability system to effectively limit the power of leaders, correct loose management, lax law enforcement and other phenomena. Secondly, the internal parts of enterprises should be given rights to supervision, encourage the staff to take part positively. Sound supervision mechanism ensures that every violation of discipline would be punished. In addition, the role of public opinion in the media such as newspapers, radio, television, and the Internet should be made full use of. Finally, seek cooperation with other countries, strengthen supervision of cross-border commercial bribery.

## **6 Conclusions**

The negative impacts of corporate corruption arising from global business operations have received increasing attention. Business have become actors in corporate's anti-corruption, which is not only responsible for itself, but also for the whole industry and society. Insisting on self-regulation in corporate governance will have many benefits. The voluntary adoption results in the harmonization of rules readily and speedily in the face of diverse legal systems and delays in the adoption and implementation of conventions. And business can contribute to the growing regulatory framework which governs them. Company's participation in creating a more fair and reasonable market environment is conducive to the sustainable development of the industry. Although it may lose some short-term benefits, the long-term interests would be sustainable. In the future, we will make more effort to investigate the

stakeholders' attitudes, analyze the industrial guidelines and promote corporate codes in order to prevent and control the occurrence and impact of corruption.

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