

**ABSTRACT.** The cases of corruption reported by the media tend almost always to involve a private party (a citizen or a corporation) that pays, or promises to pay, money to a public party (a politician or a public official, for example) in order to obtain an advantage or avoid a disadvantage. Because of the harm it does to economic efficiency and growth, and because of its social, political and ethical consequences, private-to-public corruption has been widely studied. Private-to-private corruption, by contrast, has been relatively neglected and only recently has started to receive the attention it deserves. The purpose of this paper is to offer some thoughts on the nature and importance of private-to-private corruption; the legal treatment it receives in some of the world's leading countries; and the measures that companies can take to combat it, with special consideration of its ethical aspects.

**KEY WORDS:** bribery, corporate ethics, extortion, private-to-private corruption

## Introduction<sup>1</sup>

The cases of corruption reported by the media tend almost always to involve a private party (a citizen or a corporation) that pays, or promises to pay, money to a public party (a politician or a public official, for example) in order to obtain an advantage or avoid a disadvantage. Because of the harm it does to economic efficiency and growth, and because of its social, political and ethical consequences, private-to-public corruption has been widely studied. It is also subject to legal regulations designed to prevent and punish it in almost all countries of the world.

In contrast, private-to-private corruption has been much less studied and only recently has started to receive special attention. This relative lack of interest may be attributed to a number of factors:

- (a) It seems reasonable to assume that the private sector will be much more efficient at protecting its own interests, and so corruption of this kind will be much less likely to occur in the private sector. For example, it is assumed that the owners and senior managers of companies will take the necessary measures to prevent employees from acting in ways that are likely to harm the organization.
- (b) Likewise, it is felt that there must be fewer incentives for this type of behavior in the private sector, at least in economies in which there is effective competition and in which inefficient behavior is sooner or later penalized by the market.
- (c) There are those who think that the economic, social and ethical impact of

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*Antonio Argandoña is Professor of Economics and Chair of Economics and Ethics at IESE Business School, University of Navarra. A member of the Royal Academy of Economics and Finance, he has been the Honorary Treasurer of the European Business Ethics Network (EBEN), and founder and Secretary General of Etica, Economía y Dirección, the Spanish branch of EBEN. Author and editor of many books and articles on economic and business ethics, like People in Corporations: Ethical Responsibilities and Corporate Responsiveness (Kluwer, 1990, co-edited with Georges Enderle and Brenda Almond), La ética en la empresa (1994) and The Ethical Dimension of Financial Institutions and Markets (1995).*



private-to-private corruption must necessarily be less than that of private-to-public corruption involving politicians or public officials, because of the nature of the implied incentives.

- (d) We tend to have very little information about actual cases of private-to-private corruption because, as we shall see later, corruption suits are rarely successful and the organizations concerned usually prefer not to draw attention to themselves (one doesn't air one's dirty linen in public). Instead, they do their best to deal with such cases by means of internal disciplinary action and, occasionally, by trying to reach an agreement with the injured parties on the amount to be paid in compensation. For the same reason, aggregate data on the phenomenon of private-to-private corruption (the forms it takes, how widespread it is, and its costs) are also very thin on the ground.<sup>2</sup>

And yet there is good reason to suspect that private-to-private corruption is no less important, no less widespread, no less harmful and no less worth combating than private-to-public corruption. In fact, in recent years a number of international bodies and institutions have launched initiatives to prevent and take action against private-to-private corruption.<sup>3</sup>

The purpose of this paper is to offer some thoughts on the nature and importance of private-to-private corruption; the legal treatment it receives in some of the world's leading countries; and the measures that can be taken to combat it, with special reference to the ethical aspects of corruption. We start with a brief description of a recent case, before moving on to analyze what we mean by private-to-private corruption and the different forms it takes. We then discuss its ethical and legal dimensions, and offer a set of practical recommendations to help companies deal with it. We end with some conclusions.

The subject has become increasingly important in recent years for a variety of reasons:

- (1) The progress made in the fight against private-to-public corruption has shed light on the importance of private-to-private corruption. This has been reflected in the area of international relations, above all in the ratification of the OECD Convention and the modification of many countries' legislation to make bribery of foreign politicians or public officials a punishable offence.
- (2) The intensification of competition in many markets appears to have led to a proliferation of corrupt practices to the detriment of economic efficiency and justice in trading relations.
- (3) This same phenomenon has made companies more aware of the ways in which private-to-private bribery and corruption restrict competition.
- (4) The removal of many of the former barriers to trade between countries has created the need for a level playing field, in which there can be no room for corrupt practices.
- (5) The privatization of many publicly owned companies has shifted onto the private sector problems that previously were seen as belonging exclusively to the area of private-to-public corruption. In fact, the distinction between private-to-public and private-to-private corruption is increasingly coming to be seen as irrelevant.
- (6) Liberalization and deregulation in many countries – in the transition economies, for example – have shown very clearly what conditions the institutional, legal and moral fabric of a society must satisfy in order for the market economy and liberal democracy to take root in it.
- (7) Marketing practices have become more professional, highlighting the problems deriving from certain corrupt practices.
- (8) For long periods the moral awareness of society in general has been stultified, allowing corrupt practices to flourish. Then, as the effects of these practices have become known, society itself has started to demand stricter standards of morality in business.

### A practical example

Jack Grubman was a stock analyst at Citigroup. The only son of a modest Philadelphia family, he had notched up several major achievements in his life, including university diplomas in mathematics and statistics, a job at AT&T, and finally a star job as telecommunications analyst at Salomon Smith Barney, Citigroup's investment banking arm,<sup>4</sup> with an estimated yearly income of around 20 million dollars. And yet he was having difficulty getting his twin daughters accepted in a top-flight nursery school in 92nd Street in New York.

The story was broken by the *Wall Street Journal*, based on documents relating to a suit brought by New York State Attorney General Eliot Spitzer against Citigroup for alleged conflicts of interest between its investment banking and corporate banking divisions. It was claimed that Citigroup chief executive Sanford Weill had helped Grubman get his daughters into the school by backing the application for admission with a donation to the school by the bank of one million dollars. To return the favor, Grubman was said to have upgraded his rating on AT&T stock from "hold" to "buy" in October 1999, one month before the initial public offering of AT&T Wireless. This enabled Citigroup to strengthen its hold on the important AT&T account; Sanford Weill could be sure of the support of AT&T chief executive and Citigroup board member Michael Armstrong in his attempt to unseat John Reed as co-chairman of the group; and Jack Grubman got his daughters admitted to the school he wanted. A few weeks later, Grubman adjusted his AT&T rating back downward.<sup>5</sup>

The case is one of a long list of scandals that have swept the corporations and financial world of the United States in recent years. The judicial inquiries into Citigroup and Grubman included various possible offences: (1) gifts of stock by Citigroup to the managers of companies (WorldCom) whose IPOs it was managing (a form of private-to-private corruption); (2) regular attendance by Salomon Smith Barney analysts at meetings of the boards of directors of companies that were planning some kind

of merger (conflict of interests); (3) recommendations to buy stock in companies that were already in serious financial trouble (Global Crossing, Winstar, WorldCom);<sup>6</sup> (4) recommendations to buy the stock of companies such as AT&T and AT&T Wireless that while not in financial difficulties did not objectively warrant any such recommendation, without disclosing the conflict of interests that existed between Citigroup and the AT&T group; (5) exertion of pressure on analysts to upgrade their ratings of the stocks of companies in which the group had a special interest.<sup>7</sup> The Citigroup-Grubman case is of particular interest to us here because it is one of the few cases of private-to-private corruption that have been aired in public in any detail.

### Private-to-private corruption

Corruption is a varied and shifting phenomenon; it is difficult to define it in terms that are clear and universally valid. Our focus in this paper is on private-to-private corruption. This is the type of corruption that occurs when a manager or employee exercises a certain power or influence over the performance of a function, task or responsibility within a private organization or corporation.<sup>8</sup> Because he has a margin of discretion,<sup>9</sup> he can choose to act contrary to the duties and responsibilities of his post or job, and thus in a way that directly or indirectly harms the company or organization,<sup>10</sup> for his own benefit or for that of another person, company or organization.<sup>11</sup>

Private-to-private corruption may take a variety of specific forms: bribery (when it is the person who pays who takes the initiative); extortion or solicitation (when it is the person who receives the payment who takes the initiative, whether explicitly or otherwise); dubious commissions, gifts and favors; facilitation payments (to speed up completion of an order, delivery of goods or payment of an invoice, for example); nepotism and favoritism (in the hiring and promotion of personnel, for example); illegitimate use or trading of information (trade or industrial secrets, for example); use of undue influence to

change a valuation or recommendation (as in the case described above); and an endless array of other possibilities born of human ingenuity over the centuries.

A typical example of this type of behavior is that of a company manager or sales representative who gives, or promises to give, money, presents or other rewards or advantages to the purchasing manager or buyer of a client company in order to win an order.<sup>12</sup> It may be the payer who makes the first move (bribery), or it may be the payee (extortion or solicitation). The distinction is not always clear, however, as what at first sight appears to be bribery may conceal an act of extortion (or viceversa, an act of bribery may be justified alleging a prior attempt at extortion).

The payment may be made (allegedly) to benefit the company that secures the order; to benefit the manager or employee who pays (by helping her to meet her sales targets and so avoid a penalty or earn a bonus, for example); or to benefit both sides. The payment may be made in various forms: in cash or in kind, such as a favor or service, or a promise to exert influence on another person so that this other person will do a favor to the interested party or to a third party, etc. In some cases an agent, broker or intermediary may be used to facilitate the transaction.

The thing that the payment is supposed to obtain for the payer (an order, for example) may be something to which the payer is entitled, at least in terms of objective justice (e.g., because the terms offered are at least as good or better than those offered by other competitors); or it may be something blatantly unfair (e.g., when the aim is to persuade the payee to accept terms that are worse than those offered by other competitors in price, quality, service, etc.); or the payment may even be a means of self-defense against unfair treatment by the payee (e.g., because the payee threatens not to place any orders unless she is paid a certain amount of money, or threatens to remove the paying company from the list of potential suppliers, etc.).

Other situations that commonly arise in this type of private-to-private corruption are:

- (1) Offers of gifts to the buyer or purchasing manager of a client company not in order to obtain a special favor but to make the person receiving the gift more inclined to grant such favors in the future, if necessary.<sup>13</sup> This practice is not always easy to distinguish from the legitimate custom of making (modest) gifts in recognition of legitimate favors, “to oil the wheels of business relations”, etc.<sup>14</sup>
- (2) Payments (or other types of rewards) to the managers or employees of a manufacturer, importer, wholesaler or distributor in order to obtain a distribution agreement, license or franchise.
- (3) Payments to the managers of a financial institution in order to obtain a loan or secure more favorable terms on a transaction (to guarantee the placement of an issue of shares, for example).
- (4) Payments to obtain insider information on a company’s transactions that is likely to lead to a change in the price of the company’s shares (sale of insider information).
- (5) Payments to obtain technical or commercial information (designs, customer lists, know-how, prices offered by other companies, terms offered by rivals in a competitive tender, etc.). Some of the means employed in these practices belong to the sphere of private-to-private corruption. They include: hiring managers or employees of other companies to obtain insider information; bribing managers or employees to obtain such information, etc.<sup>15</sup>
- (6) Payments to the managers of retail distributors (supermarkets, hypermarkets, superstores, etc.) to obtain privileged shelf space.
- (7) Payments to a company’s personnel director to ensure that a particular employee or manager is hired or promoted.
- (8) Payments to independent professionals who have specific duties (accountants, auditors, consultants, financial analysts, etc.) to induce them to act contrary to those duties.<sup>16</sup>

- (9) Payments to journalists to induce them to report company news in a favorable light.

### **The ethical dimension of private-to-private corruption**<sup>17</sup>

The core of the moral problem of private-to-private corruption lies in the fact that a manager or employee of a company acts unjustly and disloyally in the performance of her (explicit or implicit) duty towards her company, taking advantage of her office or responsibility to obtain a benefit for herself or for another (a relative or a friend, for example).<sup>18</sup>

A manager or employee who acts corruptly may also do injustice:

- (a) to the other party by causing or threatening to cause her unjust harm if she refuses to pay, for example;
- (b) to the company itself by not buying or selling on the best terms as regards price, quality, service, etc., for example; by putting the company's reputation at risk; by encouraging others to act in the same way; by depriving the company of some right or property, etc.; or by creating conditions that will allow corruption to thrive and go unnoticed, such as a lack of transparency, concealment of information, falsification of company records, etc.;
- (c) to third parties, such as competitors whose bid is not accepted, despite being better than the company's own bid;
- (d) and to society in general, insofar as the action helps to build an atmosphere of corruption, distrust, etc.

The person who fosters corruption cooperates as instigator or accomplice in the disloyal behavior of the person who acts corruptly, to her own benefit or to the benefit of another person, or to avoid disadvantage. Depending on the circumstances, the corrupt action may give rise to other moral problems, by leading to injustice against other people or companies (competitors, for example, which find themselves unfairly treated), or by encouraging complicity and

setting bad examples, or by undermining basic concern for other members of society, etc.<sup>19</sup>

When analyzing the ethical implications of a situation of corruption, the rules normally applied are as follows:

- (1) A manager or employee may not solicit or demand an extortion, because it would commit her to carry out an immoral act – besides forcing the other party likewise to behave unethically, as her accomplice.<sup>20</sup>
- (2) A manager or employee may not accept bribes, for the same reason.
- (3) Nobody may offer bribes, as to do so is equivalent to instigating the other party to commit an unethical (and illegal) act.
- (4) A person may not give in to extortion to obtain something to which she is not entitled.<sup>21</sup>
- (5) In certain circumstances, a person may give in to extortion (tolerate an injustice, but not cause one) in order to obtain something to which she is entitled.<sup>22</sup> In such cases, the rules to be followed are:<sup>23</sup>
  - (a) carefully weigh up all the available options to see if the problem can be solved without resorting to corruption (or causing any more serious problem);
  - (b) the extortion must be explicit or at least sufficiently obvious – in other words, an attempt at bribery should not be covered up as if it were a response to extortion or solicitation;
  - (c) the person must act with the intention of exercising a right;
  - (d) the person must do all he can to avoid causing unjust harm to others;
  - (e) there must be objective reasons of sufficient weight, in proportion to the harm caused;
  - (f) every effort must be made to avoid scandal and the bad example that the action may give rise to;<sup>24</sup>
  - (g) steps must be taken to see to it that similar situations of collaboration with corruption are not repeated in the future.<sup>25</sup>

In practice, each case needs to be considered individually in all its circumstances and detail in

order to fully assess the moral problem and propose solutions. Because, for one thing, many cases are not at all straightforward.

For instance, a company may learn that one of its managers or employees is taking money in one of the ways described earlier, and it may consent to this. Does that change the morality of the payment? In my opinion it does not, because what defines corruption is not the fact that it is hidden, nor even the fact that a payment is actually made, but rather the failure by the corrupt manager or employee to perform her duty towards the company; that is, the manager or employee's disloyalty in making decisions for her own benefit, rather than for the benefit of the company.<sup>26</sup>

But what if it is the company itself that demands the payment? In the world of retailing, for example, a client company may demand a payment from the supplier before it will even consider the company's offer. I do not think that this is corruption, as there is no question of the manager or employee failing in her duty of loyalty to the company – although certainly there may be problems of unfairness in the treatment of different suppliers, or abuse of a dominant position by the purchasing company, or the danger that a corrupt manager may add to the payment demanded by her company an additional sum for her own pocket, in which case there would clearly be corruption.

A more complicated case would be that of a manager or employee who receives a payment in return for placing an order, but who tries invariably to act in accordance with her duty, serving the company she works for as best she can. In this case there is no disloyalty, so there is no corruption. However, accepting a payment entails at the very least a temptation to allow one's decision to be guided more by one's own interest than by one's duty to the company. And the possibility of deceiving oneself about the relative merits of one offer compared to another (cognitive dissonance) must always be taken into account.<sup>27</sup> Also, when such payments are accepted, an atmosphere of corruption starts to permeate the company, the industry and society in general; the company's reputation suffers; and the person who makes the payment is encour-

aged to think that bribery is necessary in order to succeed in business.

### **Legal treatment of private-to-private corruption**

The legal treatment of private-to-private corruption naturally does not coincide with the moral point of view. And there are considerable differences from one country to another, although almost all countries have some kind of law that more or less covers the problem we are concerned with here.<sup>28</sup>

Private-to-private corruption is considered a criminal offence in the legislation of different countries on the basis of various different principles, and often these principles overlap in one and the same country.<sup>29</sup>

- (1) On the basis of the manager or employee's fiduciary duties and duty of loyalty towards the company's shareholders or owners (mainly in the case of senior executives or board members)<sup>30</sup> or towards the employees themselves (in the case of managers and employees). Breach of trust is an offence in English and Welsh and French law; integrity of labor relations is protected under Dutch, South Korean and Swedish law; fiduciary relationships are regulated in the United States; and integrity in business-related duties is guaranteed by law in Japan. In some circumstances the application of this principle means that corrupt practices are legal so long as the employer knows about them and approves of them, even if only tacitly. It can also mean that in some circumstances the company is not responsible for the behavior of its managers or employees, although the reverse is more often the case.
- (2) On the basis of consumer or user protection, or defense of competition or of the market economy (principle of free competition). The principle of free competition and market protection is enshrined in legislation in Germany, Switzerland, the Czech Republic, and England and

Wales.<sup>31</sup> None of the parties need necessarily to have suffered any harm nor any duty of loyalty to have been violated for the offence to have been committed and to be punishable.

- (3) On the basis of the need to safeguard a company's assets and protect its owners (anti-fraud legislation). This makes it possible to take legal action against fraudulent behavior, as in Swiss and Spanish legislation – including when managers or directors fail in their duty to manage or supervise the company in accordance with the interests of its owners.
- (4) On the basis of special legal provisions: against influence peddling, insider trading, industrial espionage, abuse of office or position, etc. Legislation has developed in a haphazard, piecemeal fashion in various countries, above all in the United States.<sup>32</sup>

As a general rule, the fight against corruption may be fought:

- (1) within the framework of criminal law, which makes corrupt practices a criminal offence; or
- (2) within the framework of civil law, which allows the victim to sue for damages; or
- (3) within a framework of self-regulation, which leaves it to companies themselves to deal with the problem by establishing internal codes and rules and by setting up inter-company or industry-wide agreements.

Many experts agree on the need to develop effective criminal legislation that makes it possible to clearly identify corrupt behaviors and prosecute them.<sup>33</sup> However, the results achieved to date are very limited.<sup>34</sup>

Companies tend to prefer self-regulation (mainly to avoid the judicialisation of business relations and the high costs of legal actions), backed by civil laws that, where necessary, provide for the payment of compensation for damages.<sup>35</sup> However, the application of civil law on damages is very limited. In most countries a company may sue an employee who has breached her duty of loyalty to the company and caused

it harm; but a competitor which has suffered harm is unlikely to be able to sue, as it would have to sue for breach of contract, which would mean having to demonstrate that there was a contract in force and that the payment of a bribe by a third party caused a breach of that contract, all of which will be extremely difficult to prove.<sup>36</sup>

Self-regulation has shown itself to be an important means of ensuring that companies and business associations take the fight against corruption seriously (both private-to-public and private-to-private) and take specific measures to prohibit, detect and prosecute it. Self-regulation needs to be complemented by an effective system of independent (internal and external) audits, personnel training programs, and measures to protect whistleblowers. In any event, it seems important to continue to develop legal and judicial measures to fully define private-to-private corruption, extend the prohibition to its many variant forms, and take steps to combat it effectively.

### **Fighting private-to-private corruption<sup>37</sup>**

Fighting corruption is not an easy task. The fact that a company has an explicit policy (set out in a code of ethics or exemplified in the determined attitude of top management) against bribery and extortion and other similar practices is no guarantee that the company's employees will always behave as expected, whether out of ignorance or because their personal interests lie elsewhere, or because the actual culture of the company is at odds with its declared aims. The following are some suggestions for companies that wish to protect themselves against corruption, distinguishing between prophylactic or preventive measures and curative or corrective measures.<sup>38</sup>

#### *1. Preventive measures*

1. *Declaration of intent.* The company's top management must state very clearly its determination to fully comply with all legislation, strictly prohibiting all forms of corruption, active or passive, in the company, regardless of who pays, who gets

paid, how much, etc. This statement may be published in a code of conduct, a company credo, etc., or in open letters to employees, public speeches, company newsletters, etc. And it should be reiterated at regular intervals.

This type of public statement is unlikely to have any effect, and may even be counterproductive, unless top management backs up its words with deeds. Accordingly, it is vital that management be seen, in all its decisions, to act strictly in accordance with its stated aims. This is particularly important when it comes, for example, to awarding promotions, prizes, distinctions, etc. to employees and managers, or setting up plans and programs, etc., taking care to avoid the even slightest suspicion of using double standards.<sup>39</sup>

The company's determination not to give in to corruption but to actively fight against it must be incorporated in the strategy preparation process. Top management must see to it that this attitude becomes a part of the company's culture and policies. The company's statements must be realistic in order to be credible.

2. *Clearly defined responsibilities.* It should be very clear at all times who is in control and who bears responsibility in areas of activity where there is any possibility of corruption: contracts, authorizations, etc. In some cases it may be worth pushing ultimate responsibility up to the very highest levels in the organization.

3. *Provision of general decision-making criteria.* Top management must be in a position to provide technical, economic, legal and ethical criteria for dealing with any problems that may arise in relation to corruption. Often, these criteria will be of a general ethical nature, but on other occasions the company will need to state openly the reasons why it rejects corruption.<sup>40</sup> This may be done in a code of conduct, for example, or in discussion sessions on ethical issues held in the context of a personnel training program, etc.

The criteria will make it clear, for example, that suppliers, customers, consultants, lawyers, etc. must be selected on the basis of their quality, cost, reputation, service to the company, etc.

The criteria must also be known to customers, suppliers, etc., who have a right to know who they are negotiating with, who makes the decisions that affect them directly, who these people report to (i.e. who they can appeal or complain to), etc.

4. *Consideration of specific situations.* The issue of corruption and how to prevent it is often best tackled on the level of concrete detail, so as to establish clear guidelines (bright lines). For example:

- (1) Donations to charitable or cultural institutions should always be an expression of civic duty and should never be made in the hope of receiving favors in return. They must always be recorded in the company's accounts, indicating exactly how they were made (bank transfer, cheque, etc.) and, if necessary, the name of the person who took receipt of the donation or who acted as intermediary.
- (2) The company should explicitly prohibit the offering of gifts, payments, tips, services, commissions, etc. beyond a certain amount that could be interpreted as a violation, or an attempt to violate, the honesty and independence of judgment of the person or persons who receive them, or that could jeopardize the company's good name.
- (3) Accepting such gifts, tips, commissions etc., from any source whatever, should likewise be explicitly prohibited.
- (4) If company personnel must accept such gifts, a procedure for what to do with them should be established: for example, the employee may be required always to issue a receipt for the gift in the company's name and to hand it over to a designated company officer, who will do with it as the company deems appropriate (hold a lottery among the employees, give it to charity, etc.).
- (5) It is acceptable for managers or employees to pay or receive such commissions as are legal and customary for their services as intermediaries, provided that the



company has authorized the commissions and they cannot harm the company.

- (6) If necessary, small gifts may be accepted, out of courtesy and to facilitate the normal conduct of business relations, provided they do not exceed a certain maximum value, are in conformity with the law, do not impose an obligation on the person who accepts them, and cannot put the company in an awkward position. They may include occasional meals, drinks, invitations to musical, sporting or theatrical events, small incentives (trips, hotels, etc.), small birthday or celebratory gifts, inexpensive promotional gifts, awards in recognition of services of a caring, civic, charitable or educational nature, payment of a customer's expenses (invitations), and so on. It is a good idea to give some examples of exactly what managers and employees may and may not accept, and of what they may and may not offer. It is also advisable to provide a channel for clearing up any doubts or uncertainties.
- (7) Facilitating payments (such as tips to speed up an order or payment) should be prohibited.
- (8) Limits should be set to managers' and employees' freedom to carry on a business outside the company that may come into competition with the company; hiring and doing business with relatives, etc. should be restricted; procedures should be established for such cases (always notify the company, always obtain authorization, etc.).
- (9) Anonymity should be restricted: managers and employees should always give their names to the people they deal with on the company's behalf, even if they do so by electronic means.
- (10) Strict criteria should be established for the approval of expense claims of all kinds, including customer entertainment, travel expenses, etc. Naturally, all claims must be backed by the necessary documents (receipts, bills, etc.).
- (11) The contracts the company signs with

managers and employees who have access to privileged information (on customers, research, new products and processes, etc.) should include clauses to prevent the use of this information for the benefit of competitors for a prudent period of time after the employee has left the company.

Often, to deal with these kinds of problems it is not enough merely to know the appropriate criterion; the company must also offer solutions, alternatives and ways to safely escape from existing situations. It is as well if the company's employees and managers are actually involved in compiling examples, criteria, etc.<sup>41</sup>

5. *Reporting mechanisms.* The company personnel must always know who they can turn to to report corrupt behavior within the company, or attempts at corruption by people outside the company (a demand for an illicit payment, for example), or to obtain advice on specific conduct. This higher authority may be each person's superior, but in some circumstances it may be better to have an ever higher instance (an ethics counselor, a "red line", an ombudsman, etc.), whom people can consult either themselves or through another person, or even anonymously.<sup>42</sup>

Whenever this higher instance is called upon for advice or is informed of misconduct, it is vital that it act quickly and discreetly, respecting the rights of the person who asked for advice or reported the misconduct as well as the rights of those involved. Needless to say, whistleblowers must always be protected.

The company must always allow for the possibility of reports coming from outside, from the managers or employees of other organizations, for example, accusing the company's own managers and employees of corrupt behavior.

6. *Transparency.* All of the company's transactions that involve receipts or payments of money must be faithfully, accurately and promptly recorded in the company's accounts or in the appropriate books. False, misleading or incomplete entries must be strictly prohibited, and the people whose job it is to record such transactions must be

required always to adhere scrupulously to official accounting standards (those established by law and those of the professional associations of accountants and auditors). The confidentiality of these records must be respected at all times.

Rules should be established for accounting for dubious payments (notify the superior of the person concerned or the person responsible for the ethics hotline, for example).

The documents relating to these kinds of transactions must be kept for the stipulated period of time, particularly those relating to the kind of transactions that are most likely to give rise to accusations of corruption or legal disputes.

It is a good idea to keep a (confidential) file on the individuals with whom the company has dealings of particular significance (such as the purchasing managers of client companies), so that if ever the need arises the company has a record of who dealt with whom on a particular matter, who placed a particular order, etc.

7. *Restitution.* It should be clearly established that the company will always return illicit payments and compensate those who have suffered as a consequence of corrupt behavior by its managers or employees.

8. *Supervision and control.* The company must allocate sufficient resources (material and human) to monitoring the company's activities for evidence of corruption. Furthermore, if ever there is a suspicion that corruption may have occurred (actively or passively) within the company, the evidence must be investigated. Particular attention should be given to the offices or divisions in which problems of corruption are most likely to occur: purchasing, sales, contracts, procurement, etc.

Procedures for auditing and supervising (internally or externally) the company's accounts and, if necessary, any transactions liable to give rise to corrupt behavior must be put in place and adhered to, specifying in each case the person to whom the auditor must report. If the company keeps accounts, it is precisely so that they may be examined and used by management; therefore, those accounts must also be read and interpreted from the moral point of view.

Company personnel must be given precise instructions to collaborate with (internal or external) auditors and inspectors.

9. *Training.* Although company personnel are quite likely to have already a sound ethical training, this cannot be taken for granted. Nor can it be assumed that they will be capable of correctly identifying the situations of corruption they encounter or of acting always in accordance with established moral principles. Therefore, it may be advisable for the company to assist its employees in this area:

- (1) By offering them the necessary moral and legal training to enable them to understand what corruption consists of, why it should be rejected, and what consequences it may have. This may be done through courses, seminars, etc., or in the context of sessions held to draft or revise the ethical code.
- (2) There is no substitute for selecting and hiring ethically aware managers and employees. Particular care must be taken in judging the ethical caliber of the people who are to head the offices or departments in which problems of corruption most commonly appear.
- (3) It is a good idea to have personnel take part in some way in creating the company's ethical code or ethical rules, teaching materials on business ethics, etc. That way the company will have the benefit of their experience and they will reinforce their ethical learning.

10. *In search of excellence.* Companies cannot be content merely to avoid becoming a target for other people's corruption, or becoming guilty of corruption themselves through their managers or employees. Rather, they must actively strive always to remain strictly within the limits of the law and of morality. What's more, they should proactively seek to put an end to corruption, starting with their own industry and their own home town, region or country. To do this the company must adopt an attitude of permanent rejection of corruption, wherever it comes from and whatever its causes and effects, even if it appears to benefit the company.

The company should also work together with other companies, governments, employers' associations, NGOs, etc. in the fight against corruption, be it private or public, by volunteering information (with due respect for people's good name and privacy), offering help, not leaving those who have espoused this cause to fight the battle alone, getting employers' and business associations involved, etc.<sup>43</sup> It must also lend its backing to the professional codes and rules of accountants, auditors, consultants, legal advisers, etc., insofar as they contribute to the fight against corruption.

## 2. Corrective measures

When a conflict situation arises because the company is an active or passive party to corruption, the mechanisms mentioned earlier should be brought into play, above all those designed to identify and punish the culprits and, if necessary, revise the plan currently in place. The company must establish clear and just procedures for assigning responsibility for corrupt behavior. Any sanctions imposed must be proportionate, known and clear.

Besides dealing with the crisis, the company must make it an opportunity to take its commitment to the fight against corruption one step further – by formulating an anti-corruption strategy, for example, announcing it publicly and putting it into effect; or by scrupulously reviewing all earlier situations in which corrupt behavior may have occurred; or by redoubling its efforts to inform and train its employees (as well as its customers and suppliers), etc. In a word, the company must seize the opportunity to give fresh impetus to the fight against corruption, turning what at first sight may appear to be an embarrassment, or even a serious problem, into a competitive advantage.

## Conclusions

Private-to-private corruption is a serious problem, no less serious than private-to-public corruption. It deserves to be taken seriously by

companies because it has a high cost – not only financial (economic costs, inefficiency, fines, etc.), but also legal (accusations, suits and penalties), social (loss of reputation, creation of an atmosphere favoring corruption, etc.), and ethical (deterioration of the quality of the organization's people and of its rules and culture). The fact that our empirical knowledge of the extent, seriousness and costs of private-to-private corruption is limited should not fool us into thinking that it is not important. This concern is shared by several international bodies, which have included private-sector corruption in their efforts to improve the moral quality of business.

The battle against private-to-private corruption must be fought mainly on two fronts. First, that of criminal and civil law, with the aim of defining the phenomenon more precisely, offering a wider range of approaches for dealing with it, and making it possible for problems to be dealt with as they arise. Second, that of voluntary action in companies, so that companies are adequately protected against active and passive corruption, through internal organizational measures, industry self-regulation, inter-company agreements and the creation of an ethical atmosphere within and around organizations that makes it easier for those concerned to identify situations of corruption, affords them the means to deal with such situations, and above all gives them the necessary strength (through the development of virtues) to do so.

## Notes

<sup>1</sup> This paper is part of a research project on corruption and corporate ethics currently being carried out by the Chair of Economics and Ethics at IESE. I would like to thank the Fundación José y Ana Royo for financial assistance.

<sup>2</sup> There would seem to be little doubt that unethical, or at least ethically questionable, practices such as accepting gifts are commonplace among purchasing managers (Forker y Janson, 1990; Narayanam, 1992; Ramsey, 1989; Sibley, 1979). Wood (1995) conducted a survey among purchasing managers in an area of the United Kingdom and came to the conclusion that the most widespread dubious practices were gifts (82%), invitations to shows (27%), misuse of the bidder's

information (27%) and offers of trips and holidays (18%).

<sup>3</sup> For example, the Council of Europe's *Criminal Law Convention on Corruption* (Council of Europe, 1999a) included recommendations on active bribery (art. 7) and passive bribery (art. 8) in the private sector, trading in influence (art. 12), money laundering of proceeds from corruption offences (art. 13), falsification of accounting documents or records to make it possible (art. 14), participatory acts (art. 15), and corporate liability (art. 18). And in the *Civil Law Convention on Corruption* (Council of Europe, 1999b) it included measures for the incorporation into domestic legislation of compensation for damage suffered as a result of corruption, without distinction between public- or private-sector corruption. The International Chamber of Commerce (ICC) has set up a subcommittee to investigate and formulate proposals on private-to-private corruption, reporting to the Standing Committee on Extortion and Bribery (since renamed the Anti-Corruption Committee), and has added to its *Rules of Conduct* (International Chamber of Commerce, 1999) an explicit statement on private-to-private corruption. The OECD, through its Working Group on Bribery and Corruption, is currently studying the possibility of including private-to-private corruption in the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. The United Nations (1999) *Global Program against Corruption* is sponsoring a study that includes corruption among private corporations, mainly small and medium-sized firms. The Communication of 21 May 1997 (Com(97) 192) by the European Commission to the Council and the European Parliament on the Union's policy to combat corruption urged that measures be taken to unify EU strategy in the fight against corruption in the private sector. And the Joint Action of 22 December 1998, adopted by the Council of the EU, focused on the fight against both active and passive corruption in the private sector.

<sup>4</sup> Salomon Smith Barney was acquired by Citibank when Citibank, under the management of Sanford Weill, bought Travelers Group, led by John Reed, to form Citigroup.

<sup>5</sup> On 15 August 2002 Jack Grubman reached an agreement with Salomon Smith Barney whereby he would leave the company with a severance package worth an estimated 32 million dollars. For a very concise but substantially complete account of the case, see Pérez-Campanero (2002).

<sup>6</sup> Jack Grubman did not change his recommendation on WorldCom from "hold" to "sell" until one

week before the company filed for what was to become the largest bankruptcy in United States history.

<sup>7</sup> At first the company denied these reports as "nonsense" and "pure fantasy". Later, the group chief executive admitted: "I did suggest to Jack Grubman that he take a fresh look at AT&T in light of the dramatic transformation of the company and the industry." But he denied having made any attempt to influence Grubman's valuation: "I always believed that Mr. Grubman would conduct his own research and reach independent conclusions that were entirely his own," he said (cf. *La Vanguardia Digital*, 14 November 2002).

<sup>8</sup> This definition also applies to not-for-profit organizations, NGOs, associations, foundations, etc., and even to publicly owned companies insofar as they operate on the same basis as private companies.

<sup>9</sup> Owing to the limitations of the agency contract, which is the contract that is entered into when a principal (the owner of a company, for example) gives to her agent (a manager) powers to govern all or part of the principal's organization in accordance with the principal's instructions and serving the principal's interests. No agency contract can provide for every eventuality nor specify the response to be given in each case. Hence, the agent may exercise her mandate to her own benefit or to the benefit of a third party, to the detriment of the interests of the principal. On agency theory, see Alchian and Demsetz (1972) and Jensen and Meckling (1976).

<sup>10</sup> The harm is done, in every case, as a consequence of the breach of duty, even if the action does not directly affect the company's income statement or balance sheet. Such would be the case, for example, of a purchasing manager who demands a commission in return for placing an order with a particular supplier, without this affecting either cost or quality for the purchasing company; or that of a personnel manager who accepts a gift in return for taking on an employee who is perfectly qualified for the job for which she is hired, etc. Apart from this, there may also be direct harm to the company's interests, assets or profitability.

<sup>11</sup> This description is adapted from Argandoña (2000); see also Argandoña (2001). Other, similar definitions may be found in Ginwala (1998), Jain (1998), Johnston (1997), Tanzi (1995, 1998), etc.

<sup>12</sup> This is a typical but fairly elementary example. In practice, corruption may take far more complex forms, such as offering to include the seller in a short-list of regular suppliers, or allowing it to have a say in defining the terms of the contract to ensure that

it has the best offer, etc. The manager or employee who makes the payment may do so with or without her company's or her boss's knowledge and consent.

<sup>13</sup> The gifts may include invitations to meals, sports events, cultural events, shows, parties, holidays and trips, and also sexual favors.

<sup>14</sup> Corruption tends not to occur in isolation; rather, it tends to be embedded in social customs or practices involving widespread trading of favors, situations in which "everybody has to pay", etc.

<sup>15</sup> Cfr. Higginson (1995).

<sup>16</sup> In principle, situations in companies such as when a manager forces a subordinate to modify a report or change an accounting record, without there being any payment by a third party, would not be included under the heading of private-to-private corruption. However, certain professions (auditors, accountants, consultants, financial analysts, etc.) may be considered to have a special responsibility towards society, above and beyond their duty towards the company. Therefore, in such cases these would also be examples of private-to-private corruption.

<sup>17</sup> This section is based on Argandoña (2001).

<sup>18</sup> In any event, the person who acts corruptly harms herself because she loses virtues and acquires vices, which will make it more difficult for her to act honestly in the future.

<sup>19</sup> The person who fosters corruption will likewise experience the negative learning mentioned in the previous footnote.

<sup>20</sup> Is it acceptable for a manager or employee to extort money from the other party if she intends at all times to act with complete loyalty to her own company? Obviously not, because she would be acting unjustly towards the person who pays and because, in any case, she would be undermining the good name of the organization she serves.

<sup>21</sup> Whether or not it is easy to decide what a person is entitled to is another matter. For example, a company does not have a right to a contract when a competitor has offered better terms in all respects; nor does it have the right to have a tribunal rule in its favour when it is in the wrong.

<sup>22</sup> When a company has "no option" but to give in to extortion, it is usually because it has made some mistake in the past – allowing itself to become over-dependent on a small number of customers, for example, or failing to diversify its product portfolio, or going too far in its use of gifts and other dubious practices, etc. Now it must pay the consequences.

<sup>23</sup> These rules are a practical application of other rules that go back a long way in the history of ethics but that have received scant attention in recent

years, perhaps owing to the influence of utilitarian and deontological ethics. Cfr. Fernández (1994), Koslowski (1987), Melé (1994).

<sup>24</sup> Including the bad example given to the company's own employees.

<sup>25</sup> This is an important condition when it comes to judging the sincerity of those who say they "have no choice" but to pay up when subjected to extortion. And as corruption is a social problem, it is also important that measures be taken to curb it or prevent it from perpetuating itself.

<sup>26</sup> In some countries the fact of the payment is sufficient on its own to constitute an offence.

<sup>27</sup> For this reason, when it is difficult to reject a bribe, the right thing to do is to inform company management, pay over to the company the money or gifts received, and inform the person who paid of what has been done. In the case of independent professionals – doctors, for example – who receive gifts or commissions in return for their services – tests performed or treatment given to patients – it is common practice to make a donation to a charity and send the receipt for this donation to the person who made the payment, assuming the gift cannot be returned.

<sup>28</sup> In what follows I am indebted to the still unpublished preliminary conclusions of the study carried out at the request of the International Chamber of Commerce by the Max Planck Institute for Comparative Criminal Law in Freiburg, with funding from the Ford Foundation and covering 13 OECD countries: Germany, South Korea, Spain, United States, France, Holland, England and Wales, Italy, Japan, Poland, Czech Republic, Sweden and Switzerland.

<sup>29</sup> Cfr. International Chamber of Commerce (2002).

<sup>30</sup> The practical difficulty of founding the fight against corruption on fiduciary duties or duties of loyalty lies in the fact that these duties are not specified in managers' and employees' employment contracts, and may vary from one company, industry or country to another.

<sup>31</sup> The notion of an offence against free competition is also envisaged in the *Joint Action of the European Union* of 22 December 1998 on corruption in the private sector, provided that the conduct in question involves a distortion of competition "as a minimum within the common market" (article 2, paragraph 2).

<sup>32</sup> The purchase of trade secrets, for example, is considered an offence in England and Wales, the Czech Republic, France, Japan and Germany.

<sup>33</sup> The weaknesses of this approach are, mainly, the complex lawmaking that may be needed in order to cover all possible cases; the danger that excessively

detailed regulations will become an obstacle to the normal conduct of business; the difficulty in keeping the legislation up-to-date; and the problem of coordinating legislation in different countries with different legal systems, points of view and histories.

<sup>34</sup> The International Chamber of Commerce study mentioned earlier sheds some light on these results: very few cases in France and Japan; 63 recorded cases in Germany (with no data as to their outcome); two sentences on 64 cases in Holland; 0.05% of cases brought before federal courts in the United States (including situations of private-to-public corruption); and 200 “low-calibre” cases in Sweden. Only in South Korea, where in the wake of the 1997 financial crisis the government took measures to clean up business practices, does more forceful action appear to have been taken against private-to-private corruption, with 8,500 cases investigated in 1998–1999, 40% of which led to the arrest of employees or managers. Cfr. International Chamber of Commerce (2002). Most of the situations of corruption that come to light end in dismissal, often without recourse to the courts or with an out-of-court settlement. Cfr. Heine (2001). Additional difficulties arise from the lack of clarity in legislation, uncertainty regarding the applicable jurisdiction, and the difficulty of obtaining evidence that is acceptable in court. Cfr. Rose (2001).

<sup>35</sup> Cfr. International Chamber of Commerce (2002).

<sup>36</sup> In International Chamber of Commerce (2002) the following explanations are suggested for the fact that procedures for claiming damages in cases of private-to-private corruption are rarely used: (1) the difficulties of the procedure for making such claims; (2) the difficulty of proving the corrupt act, the harm sustained, and the causal relationship between the two; (3) the frequent separation between criminal and civil legal action (which means the two paths have to be pursued independently and often one after the other); (4) the high costs of a long legal dispute; and (5) the reluctance of the victims to report the facts, on account of the negative publicity it may entail.

<sup>37</sup> This section is a summary of Argandoña (1999).

<sup>38</sup> Vincke et al. (1999) is an example of a similar attempt, based on the rules of the International Chamber of Commerce mentioned earlier.

<sup>39</sup> Naturally, having an ethical code or similar instrument may be useful in the fight against corruption, but it should not be seen as a panacea: the key lies in how it is applied in practice, and in generating the right sort of culture.

<sup>40</sup> Including the right of employees not to be obliged or induced to engage in corrupt practices, not to be treated as morally dubious people, and not to be iden-

tified with a company that allows unethical conduct. It also includes the responsibility the company may incur as a result of the behaviour of its managers and employees, acting as the company’s representatives, or exercising authority for decision making or for the exercise of control within the company, etc., without excluding the responsibilities the company may demand from the corrupt employee or manager.

<sup>41</sup> On the role of sales agents and representatives, cfr. Davies (1999).

<sup>42</sup> It is highly advisable that the ethical instances belong to line management and not to staff, and that they have access to the uppermost levels of the company.

<sup>43</sup> The companies in the oil industry in Norway, for example, have developed a joint initiative to diffuse information that may serve these ends. In other countries agreements have been reached to create “islands of integrity” as promoted by Transparency International.

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IESE Business School,  
University of Navarra,  
Av. Pearson 21,  
08034 Barcelona,  
Spain  
E-mail: argandona@iese.edu

