

Corruption in China: What Companies Need to Know

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How can companies learn about the realities of the risk of official corruption in China? It is common knowledge that firms often find themselves obliged to make payments or give gifts to officials to do business. Things are thought to be worsening, too: in 2014 China slid 20 places on Transparency International's Corruption Perception Index, to 104 (out of 175). With multinationals squarely in the cross-hairs of President Xi Jinping's anti-graft drive, the danger corrupt practices pose to firms is steadily increasing.

But how widespread is the problem – and where is it worst? Until now, data on graft in China has been based on reputation, not behavior, and national in scope, undifferentiated by region or industry. Anecdote apart, there has been no hard evidence firms can use to assess these concerns and plan their response.

To provide the first reliable, behavior-based data on official corruption in China, this white paper presents results from our quarterly China market intelligence poll of 2293 C-level executives drawn from all regions and economic sectors conducted in February-March and 27 qualitative interviews in September 2014.

KEY FINDINGS:

- Some 35% of companies in China say they have to pay bribes or give gifts to officials to operate.
- Officials have their hands out most often around Beijing, the capital, and in the richer regions.
- Corrupt payments are more frequent among foreign and Hong Kong firms than among mainland companies.
- Corruption is worst in real estate, followed by manufacturing.
- Local officials and tax collectors get corrupt payments most often
- The chief reason offered for corrupt payments is competitive pressure.
- Most firms want more action against corruption – they don't like it.

35% of firms in China say they must give officials bribes or gifts

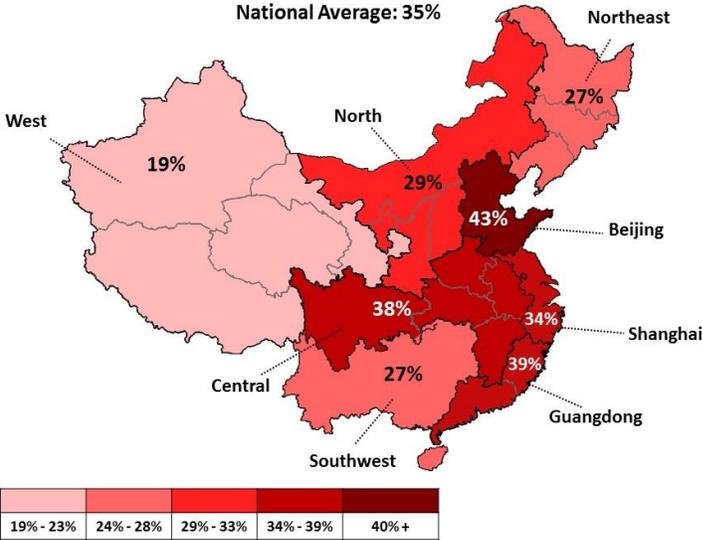


CORRUPTION INCIDENCE: REGIONAL AND INDUSTRY PROFILE

Corruption is a major problem for business in China. Over a third (35%) of the Chinese firms in our survey say they have to pay bribes, unofficial fees or make gifts to operate. The CFO of a privately-owned Hubei food processor whose firm has had to pay such bribes described the practice as “an unspoken rule.”

Regionally, corruption follows power and money. Reports of bribes were most common in the Beijing Region, where officialdom is concentrated, and least so in the West. (Fig 1.) In fact, we found the incidence of corrupt payments was above average in all the more developed and dynamic regions—Beijing (43%), Guangdong (39%), Chongqing (38%), and Shanghai (34%)—and below average in the less developed and peripheral North (29%), Northeast (27%), Southwest (27%), and West (19%).

Figure 1: Reports of Corruption – By Region (Percent reporting paying bribes to operate)

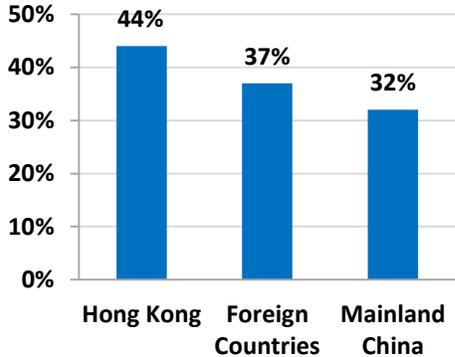


Where owners are located matters also influences graft in China. (Chart 1.) Firms are preyed on more often if they are from Hong Kong (44% report corrupt payments) or foreign-owned (37% do). By contrast, mainland companies are somewhat sheltered, 32% reporting payments.

Company size and ownership make a difference as well. (Chart 2.) Our results reveal that state-owned micro- and small firms, under officials’ thumb and with few resources to resist, are far more vulnerable (50% paid officials) than their privately-owned counterparts, where 30% did. Results from medium-and-large private and state firms fell in between, 37% of executives in each group complaining of corrupt payments.

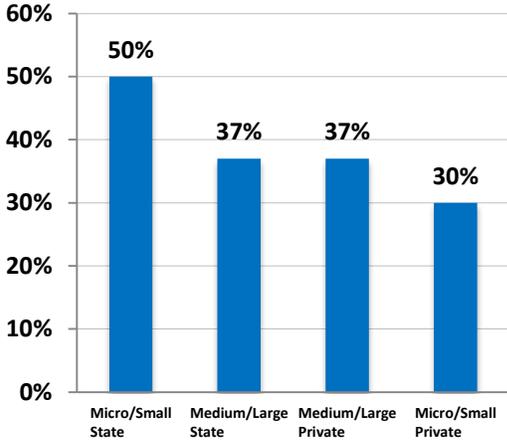
Across sectors, real estate and construction (41%) is the worst hit. More than one-third of the executives in manufacturing (36%), services (35%) and retail (34%) companies also report the need to make payoffs or gifts.

Chart 1: Firms reporting paying bribes to operate by ownership



Hong Kong and foreign firms are preyed on more often

Chart 2: Firms reporting paying bribes to operate by ownership & size



Just under that do so in transport (32%), and mining (30%). Farming (23%) is the least affected of all sectors. Across the board, corruption plagues between one- and two-fifths of firms in all sectors.

Who benefits most?

Local-level officials, who enjoy the power and regulatory control to help or make life hell for business in their domains, are also the main beneficiaries of corruption. Of the execs who said business had to bribe to operate, most (79%) said such payments and gifts were made to local government officials.* The second most-frequent takers were tax collectors (56%), who can make companies’ tax bills swell or shrink. By contrast only a third (34%) of firms said national government officials must also bribed to avoid disruption in company operations. Customs officials and road police, who influence the circulation of goods, came next, cited by 22% and 11%. These results were fairly uniform across the country, underlining that bribery risks from local and tax officials are real.

Why do companies pay?

In general, companies say payments are made to keep up with the competition.

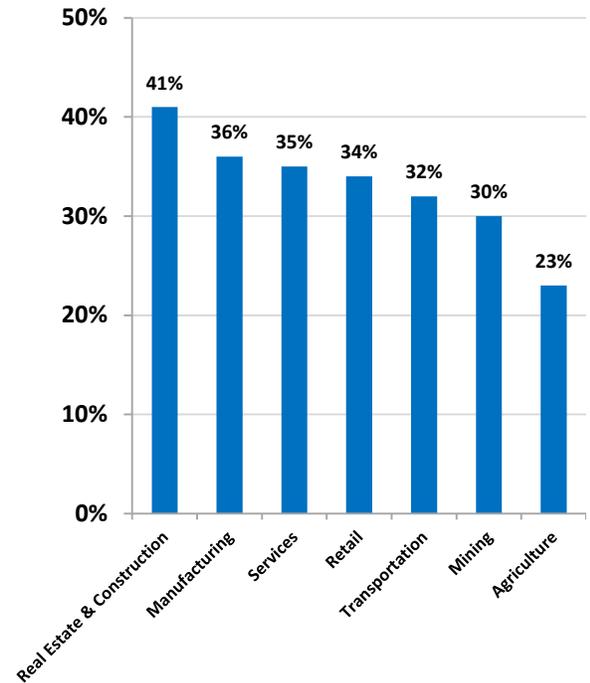
The struggle for market share emerged as a key driver in the qualitative interviews. The director of a private telecom firm in Beijing concurred, saying *“It’s common in the business field in China (to offer bribes). Peer competition for customers is fierce.”* *“Salespeople may do that kind of activity,”* said a manager at a telecom company in Harbin, Heilongjiang. *“It’s an unspoken rule of the industry.”*

Access to raw materials or supplies can also be a motive for corruption. This was highlighted by the candid remarks of an executive from a privately-owned residential builder in Shenyang province. When asked about the necessity of bribes or gifts to operate, he said, *“Of course! It’s common in our industry to compete for land.”*

Business in China is fed up with graft

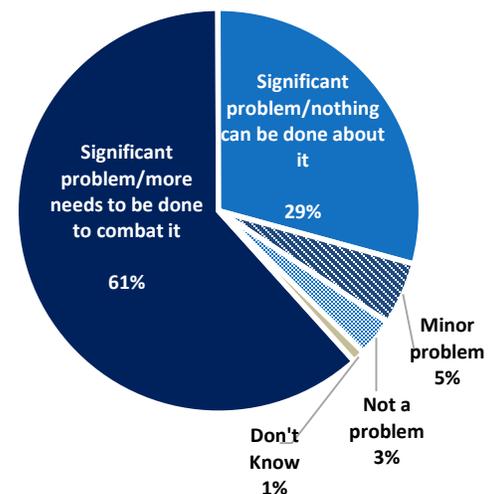
Nine firms in ten in China think corruption is a plague – and most want more action to fight it. Over three-fourths (61%) said that corruption was a significant problem and wanted more done to combat it. Another three in ten (29%) also agree that bribes and payments are a critical issue, but are too cynical to expect anything to be done to counter it.

Chart 3: Firms reporting paying bribes to operate by sector



Corruption is most common in real estate and manufacturing.

Chart 4: Business' views on graft in China



* This question was answered by 798 companies.

TROUBLE SPOTS WITHIN SECTORS

Real Estate and Construction: The highest incidence of corruption is in this sector ranging from 44% in residential realty and 42% in transport infrastructure building to 39% in commercial realty and home building.

Manufacturing: Payments to officials were most common among metal producers (46%). But even among auto makers (33%), chemical firms (33%), and textile manufacturers (32%), roughly one-third paid bribes.

Services: Telecom firms, chain restaurants, and media houses all said offering officials gifts or bribes was necessary with equal frequency (38%). Private health care firms reported the fewest (done by 25%).

Retail: Not surprisingly, reports of payments or gifts to officials were most common among luxury retailers (38%), followed by clothing stores (37%), and while car dealers were the least exposed (28%).

Transportation: The incidence of corrupt payments was reported higher among shippers (37%) than among travel agents (28%).

Corruption is most common among residential realty, transportation and commercial builders, and metal producers.

Table 1: Firms Reporting Paying Bribes to Operate by Industry

Real Estate & Construction	Residential Realty	Transportation Construction	Commercial Construction	Commercial Reality	Residential Construction		
41%	44%	42%	40%	39%	39%		
Manufacturing	Metals	Capital Goods	Food	IT	Automotive	Chemicals	Textiles
36%	46%	39%	36%	34%	33%	33%	32%
Services	Media	Chain Restaurants	Telecom/ IT Firms	Business Services	Private Healthcare		
35%	38%	38%	38%	35%	25%		
Retail	Luxury Goods	Apparel	Food	Furniture & Appliances	Automotive		
34%	38%	37%	34%	32%	28%		
Transportation	Shipping	Travel Agency					
32%	37%	28%					

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