

AN INSIGHT FROM THE BDO MANUFACTURING & DISTRIBUTION PRACTICE

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3 KEY TAKEAWAYS FOR U.S. MANUFACTURERS MITIGATING FRAUD RISK IN CHINA

BDO's on-the-ground lessons from investigating a chemical manufacturer's China-based operations

By Jesse Daves and Dawn Williford

It's no secret that foreign-owned organizations with China-based subsidiaries still face heightened risk under the U.S. Foreign Corrupt Practices Act (FCPA). [In 2016](#), 27 companies paid close to \$2.5 billion to resolve FCPA cases, 15 of which (or 55 percent) involved activities in China.

The figure underscores the challenges many foreign companies operating in China face as they navigate unfamiliar cultural and business norms.

BDO recently worked with a U.S.-based chemical manufacturer that learned this the hard way. Initial concerns around declining profits and product quality at a Chinese subsidiary uncovered larger issues of systemic process failures and ineffective corporate governance.

The case was successfully mitigated after several in-person comprehensive assessments, data analytics and employee interviews in China. But it cost the company the resignation of its CEO and VP of China Operations, along with significant customer losses and increases in compliance costs. It also required greater investments in its core management team, a revamp of its sales processes and a shift in its business culture.

Here are key takeaways manufacturers operating in China (and other locations with heightened fraud risk) should keep in mind before their own watershed moment occurs:

- 1. Cultural change doesn't happen overnight, but it does start from the top down.** The problems uncovered during our assessment stemmed from a long-standing, revenue-driven "whatever it takes" philosophy cultivated by the person initially put in charge of the sales team.

The company acted to revamp its sales cycle in a more transparent way. To do this, it parted ways with employees who were not committed to ethical business behavior, developed and conducted periodic and ongoing verifications, structured high-standard internal and external audits, and implemented continuous education for employees. A fully aligned change in culture takes years to evolve, so where required, the sooner organizations get started, the better.



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2. Understanding local culture and business customs is key, but having people on the ground is a necessity. Too often, companies think of “business in Asia” as an umbrella term. But individual markets—countries and regional jurisdictions, alike—are distinct.

“Each country is comprised of varying languages, governing bodies, and regulations and cultures—all of which come with a unique set of challenges,” Pei-Li Wong, BDO’s Asia Forensic Desk leader, explained in a recent BDO Q&A. “Acquiring the knowledge and skillsets needed to succeed in Asia is often the first step to expanding or launching operations, but ensuring compliance with laws of both the home country and overseas ups the ante.”

Improvements to the company’s internal controls resulted in the identification of more than 20 third-party sales agents with singular goals to secure customers, oftentimes through questionable payments. The salesmen saw nothing wrong with the practice, but viewed it as a necessity to securing contracts with businesses. The U.S. management team’s lack of awareness

of the local business practice allowed it to continue until the risk had escalated.

This underscores the simple but indisputable truth that continuous due diligence at the local level is required where local business practices dominate.

3. Periodic, in-person site visits are key to early risk detection and mitigation. When it comes to identifying and staying ahead of potential risks, there’s often no substitute for in-person conversations and observation.

To truly understand where operational risk lies and how business is conducted in foreign markets, organizations need to ensure they’re talking to the right people and obtaining accurate information. BDO found that the best way to accomplish this is through in-person conversations, coupled with data analytics and document review. Companies should also install leaders knowledgeable about international regulations (or regulations the parent company is subject to) and committed to compliance with company policies.

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