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Compliance and corruption in the automobile industry: Daimler's Integrity and Legal Affairs Division

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Abstract. *Due to several corruption allegations in 1998, automaker Daimler had to find a way out of negative publicity. This and other incidents stimulated Daimler in the beginning of 2011 to expand their board of directors by one person that is responsible for the new Integrity and Legal Affairs department.*

This article focuses on the significance of compliance with corporate and national regulations as a fact that has become increasingly important as regard for corporate social responsibility grows. In fact, the rising number of country specific standards and early considerations of specific compliance requirements during the development process are just some of the evidence that shows that CSR requirements for companies within the automobile industry are on the rise. Companies are requested to organize transparency and risk management. The furor about the Daimler corruption case expresses best how essential it is to have a profound CSR strategy and a whistleblower system embedded within a company. The result of such corruption cases in large enterprises usually leaves an unpleasant bequest for all stakeholders that are part of the company. In accordance, many automobile manufacturer have to deal with direct effects such as a decline in sales and a loss of image.

Keywords: automotive industry, compliance, corporate social responsibility, corruption, legal affairs, manufacturing, risk management, supply chain, transparency, whistleblowing

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Introduction

Many companies in the automobile industry are facing compliance offenses such as corruption. Therefore they are starting to set up positions for compliance authorities within the company. This case study shall give an overview of how the topic of corruption is handled in different car manufacturing companies, but especially at Daimler. In addition to that an approach of how corruption can be avoided and prevented shall be presented.

Daimler is one of the most successful car manufacturers in the world. In 2011 the German enterprise had sales of €106.5 billion (of that, €39.4 billion in Western Europe and €19.8 billion in Germany). Headquartered in Stuttgart, the company's board of directors consists of eight members. It includes chairman Dieter Zetsche as well as those responsible for the operating and functional divisions: production and purchasing Mercedes-Benz Cars and Vans; Integrity and Legal Affairs; HRM and Personnel Director; Daimler Trucks; Greater China; Finances and Managerial Accounting, Daimler Financial Services and Research and Development Mercedes-Benz Cars. The corresponding supervisory board (Aufsichtsrat), consisting of ten shareholder representatives and ten appointed employee representatives, approves the board of directors and makes important corporate decisions. Within the German Stock Index (DAX 30) the Daimler share (DAI) is rated as one of the largest individual values with 5.93 percent (end of 2011) (Daimler Annual Report, 2011, cover 2).

Daimler is a highly sophisticated and successful company. Hence it is even more fascinating how a company of that size can manage compliance. It may be assumed that size matters: the bigger the company, the harder it is to overview all incidents that might represent a breach of conduct.

In one famous case, Daimler was accused of violating US law, particularly the Foreign Corrupt Practices Act, in 22 countries in the world between 1998 and 2008. Back then, Daimler was still in a joint venture with Chrysler and had a variety of US anchors, so it was liable under US law. The car manufacturer bribed public officials of foreign countries such as Turkey, China and Russia.[1] Payments were covered up as discounts and commissions in annual reports; the company used various third-party accounts, shell companies and artificial consulting agreements, to name but a few of the methods. After an investigation that lasted several years, Daimler ended up paying US$185 million in order to settle the case (Fischer et al., 2010, para 3). The settlement with the US Securities and Exchange Commission (SEC) and the US Department of Justice was reached – and investigation suspended – on the promise that Daimler builds a corruption-prevention sys-

[1] Among the other countries in Europe were Croatia, Greece, Hungary, Montenegro, Latvia, Serbia; in Africa, there were incidents in Egypt, Ivory Coast, and Nigeria; in Asia, Indonesia, Iraq, Thailand, Turkmenistan, Uzbekistan, and Vietnam.

tem. To ensure that Daimler complies correctly, the US authorities appointed a monitor (with almost state attorney powers) within the company and continued to keep a tight watch over the firm for years (Hawranek, 2011).

In 2012, Daimler again faced negative publicity. Six former employees built up a system of bribery in cooperation with a German contracting quality company, Bayerisches Hüttenwerk Sonthofen (BHS), which reworks on certain parts. Two former Daimler employees and four BHS employees were sentenced to six to nine months prison terms on probation.

Both cases are representing only a small pitch out of many different incidents but they provide insight of what can happen if corruption is not put under control. The failure of Daimler's corporate culture and its compliance structure were all too obvious. Daimler, however, learnt from it and improved the situation through a fundamental change within its business organization (Wicke-Naber, 2012).

Integrity and compliance

Establishing the corporate field *Group Compliance* in 2006, Daimler started to create awareness towards the topic of compliance. The field of *Group Compliance* is affiliated to the functional division *Integrity and Legal Affairs* which is managed by the Group Chief Compliance Officer, Volker Barth. The organizational orientation lies upon all business areas of Daimler (Daimler Corporate Governance, 2012).

In 2011 Daimler additionally built up another board area, the so called *Integrity and Legal Affairs* division, managed by Christine Hohmann-Dennhardt. The new department comprises the treatment of corporate legal affairs, the organization of compliance and the observance of data protection. Besides that the *Integrity and Legal Affairs* division wants to raise corporate awareness towards the responsibility to respect and protect human rights as well as to anchor a sustainable culture of integrity (Daimler Board of Management, 2012).

Daimler's compliance program is based on a global systematic risk analysis which is enforced on an annual basis. In dependence of the risk situation, the affected business unit has to go through a set of various actions (e.g. additional compliance trainings).

The main goal of that program is to promote compliant work and prevent misbehavior, such as the involvement in corruption cases. In fact, corruption is the main focus of Daimler's compliance program and has highest priority.

Nevertheless, corruption represents only one part of the corporate governance. Daimler's compliance program rather includes compliant acting of each individual employee, which shall be in accordance to all applicable laws, voluntary commitments and internal corporate regulations.

One tool that helps Daimler to prevent such misbehavior is the "whistleblowing" system administered by the Business Practices Office (BPO), implemented in 2006. The BPO system gives each employee and any stakeholder the possibility to alert the BPO to suspected offenses and misconduct; the BPO promises informers fairness, protection against reprisal and confidentiality (i.e. where data privacy laws allow, anonymity).

Another part of the program is the administrative recording of a fundamental code of conduct. Daimler summarizes its principles within *The Standards of Compliant Behavior*. This includes all rules and standards which are internally defined as a good management approach. They consist of several documents and regulations and are based on fundamental corporate values (Daimler Corporate Governance, 2012).

Compliance in the auto industry

Daimler is not the only company which might be seen as a rotten apple in the automobile industry. One of the biggest breaches of compliance in the last couple of years represents the corruption incidents at MAN Nutzfahrzeuge, another leading automotive manufacturer in the world, legendary for its trucks (Hoffmann, 2012, para. 1). A former managing director of MAN subsidiary Neoman was accused of paying bribes of some €401,000 to a potential purchasing company in 2004. The money was used to support an adjudication of an order of 39 busses in Oslo. A Munich regional court condemned the manager to a ten-month suspended jail sentence and a payment of €60,000 to charities (Ex-Managerin von MAN, 2012).

Other recent news reports mention corruption cases at Ford and Mazda Europe. Ford was accused of bogus transactions with spare parts which were never distributed. In fact there are now three large-scale lawsuits running. The estimated amount of loss is up to a double-digit million Euro sum. One of three cases in which Ford was involved is bribe taking. Between 2003 and 2010 Ford executives who were in charge of new construction and modernization of production facilities in Europe received bribery payments in the amount of at least €1.2 million in cash (Verfahren gegen hundert Beschuldigte, 2012).

Mazda faced allegations of tax fraud and disloyalty. Mazda's former vice president for public relations admitted the compliance breach and terminated his employment with immediate effect in March 2012 (Razzia bei Mazda, 2012, p. 16).

It seems like no automobile company can bypass the topic of corruption within their business operations. But one possibility is to contain and defeat any corruption attempt at the roots, i.e. to address the causes rather than the symptoms.

There are many different approaches how risks of compliance can be monitored and managed. As mentioned in the previous section, Daimler decided to establish a whole new division under a board member.

Correspondingly, Volkswagen founded a new business unit called *Governance, Risk and Compliance* in 2010. The Chief Compliance Officer of the entire Volkswagen Group reports directly to the Volkswagen CEO. BMW decided to establish a compliance committee that reports to the board of directors. The topic compliance at BMW is partially attached to the finance department. The company sees here the biggest source of risks due to the fact that many regulations converge within finances (Hoffmann, 2012, para. 5).

Risk management is arguably much more important to an Original Equipment Manufacturer (OEM) than to other firms in the auto supply chain. The key reason is protection of the brand and the effectiveness of damage control. An OEM is most likely to face some kind of broad image and reputational loss which then quickly affects sales and operations, whereas an automobile supplier may still directly communicate with his clients and counteract (Hoffmann, 2012, para. 5).

Lessons and improvements

There is no generally applicable rule to prevent corruption. But what can be done is to implement compliant behavior as part of the company's corporate social responsibility (CSR) strategy which addresses internal and external stakeholders. Large companies spend much money on risk management in order to prevent corruption incidents and its bad impacts on the company. These expenses may be more efficient and effective if coupled with a broader CSR approach and understanding.

Using complex computer tools

In order to have a kind of universal system in every company sector, it makes sense to implement an IT system which monitors breaches against the principle of good faith. Anti-corruption IT tools build on the idea that computers can analyze human decision behavior, and corrupt behavior leaves typical trails of data on company systems. Sometimes the analysis is even called data forensics. The point is not only to collect evidence after the fact but to use its insights for anticipation and prevention. IT systems can also enhance the transparency of decisions and make (delegated) managers' authority more accountable.

Anton Weig, a risk analyst in charge of automotive affairs at consultancy BearingPoint (as cited in Hoffmann, 2012), recommends utilities which can be implemented in order to dam and prevent the risk of corruption and other disloyalties. These include for example the analysis and definition of risks which can occur in certain steps of business operations, for example financial flows within sales and purchasing as well as regarding internal and regulatory regulations within the development and production process.

Additional steps include adequate controls, workflows for breaking the rules and risk assessment procedures. But also classical IT tools for risk control are identity and access management solutions, which handle roles and access privileges, are still beneficial. In case of a transgression, the person responsible for it will be immediately contacted via his or her smart phone. Even more important are technologies such as business intelligence and data mining programs that analyze the patterns of cash flows which are suspicious (para. 2).

Such recommended practical tools are expensive but as the importance of compliance is growing, the more urgent it becomes to have an unwaveringly system of compliance monitoring and control. This is not only true for companies within the automobile industry but for all large companies.

Besides the aspect of decreasing the risks of compliance abuse, CSR comprises additional benefits for the company. Therefore Weber (2008, pp. 248-249) is recommending to be aware of the benefits of CSR wherein compliance is a part of it. The outcome of an implemented CSR strategy is including the following five positive business effects:

- on company image and reputation,
- on employee motivation, retention and recruitment,
- cost savings,
- revenue increases from higher sales and market share,
- CSR- related risk reduction or management.

Combining the technical and cultural

Despite the proliferation of "tools," there is still the general problem that there is no universal system for inspection and monitoring corruption-prone areas for possible breach of standards of conduct. For example, many IT providers offer software to help with the task. But every company has to be aware of its needs in order to find a suitable computer program.

In addition to that, it is necessary to have a corporate CSR strategy that works hand in hand with such applicable IT tools. Both the technical and the strategic side can work together to improve abilities to critically analyze and evaluate the risks, and to address the rather complex web of human motivation and conduct. CSR strategy needs to be implemented within all business areas. This ideally includes each individual employee of the company standing up for it.

Without those conditions it makes no sense to have such software, because there will always be a possibility to get around administrative procedures. That is one of the main drawbacks of CSR. Company culture has to be adjusted so that each employee would always act in good faith. Broader programs such as Daimler's BPO whistleblower system, identity and access management solutions represent an inception of compliance awareness. It gives each individual employee the possibility to notify and to track down such incidents in order to help the company.

As soon as a company is involved in corruption, its impacts may be overwhelming. Effects range from damaging people, physical assets, brands, employee morale and business continuity to disrupting entire organizations (Del Bosco and Misani, 2010). Developing a CSR strategy which refers to its fundamental corporate beliefs outweighs disadvantages and external pressure (see Garay and Font [2011] for a comparative approach).

Stakeholder risk

Table 1 lists the most important internal and external stakeholders of a generic car-manufacturing company. All of them belong to different major groups that have an interest in a system of keeping compliance at an automobile car manufacturer.

Table 1: Stakeholders of an Automaker
Internal stakeholders
Employees of the company
Shareholders of the company
External stakeholders
Customers and other customer-related (e.g. car dealers)
External contracting companies (e.g. in postprocessing)
External suppliers (e.g. for steel, plastics, lubricants, etc.)
General government and public authorities
Media

Table 1: Internal and external stakeholders

The Daimler company categorizes its stakeholders in dependence on their involvement and influence on their business activities (Daimler Sustainability Report 2011, p. 26):

- Customers
- Employees and trade unions
- Suppliers
- Associations
- Nongovernmental organizations (NGOs)
- Science and politics
- Local authorities, residents and neighbors at their production facility

Corruption is a topic which usually has a bad aftertaste when mentioning it within business operations, and particularly in external communications. Just because some people are very reluctant to actively pursue the topic does not mean, of course, that there are people who support a system of keeping compliance and others who do not.

An assumption that some stakeholders evidently promote corrupt procedures within business operations is normally wrong. Certainly there are no stakeholders who would indeed say so unless it is part of their culture.

There are some approaches to differentiate among stakeholders and their level of support for corruption (at least in a cultural sense, i.e. tolerance for corrupt practices as an attitude). On an international level, information of the possible range of corruption supportiveness can be inferred from the corruption perception index (CPI), which is a ranking published on an annual basis by Transparency International (TI).

"Country-specific business practices"

In the Daimler 1998-2008 bribery cases, one stakeholder stood out: governments. In many countries, government officials made purchasing decisions for cars, busses and trucks. Daimler managers bribed them so the governments would prefer Daimler vehicles over other brands.

Government actors at any level can be important stakeholders, particularly when investing and operating in foreign countries. From permissions and licenses to customs and taxes to partnering with state-owned firms, public authorities may help or hinder business. In the auto industry, their public procurement is also a key ingredient of the stakeholder relationship.

Most of the countries in which Daimler bribery happened were emerging markets. For the auto industry, emerging markets today are strategically important for sales growth as they are for manufacturing cars and car parts (much of which may be outsourced).

Any market entry strategy must adapt to country-specific beliefs, business practices and take their behaviors into account. It is a necessary component for competition, particularly in emerging markets, according to Reimann et al. (2011, pp. 2-3). To globally operating multinational enterprises (i.e. such as the big auto manufacturers and their large suppliers), this represesents a very gray zone of corruption opportunities. A firm's market entry strategy accepts, that business success depends on support given by the host government: "Such support might include a timely response to the firm's requests, the reduction of bureaucratic hurdles, fostering of a cooperative relationship by local decision makers, and the hassle-free granting of required licenses" (p. 5).

The question is how to get the local government officials to cooperate. It is well known that supporting payments to officials are somehow tolerated as a standard business practice. Acting not corruptly seems to be a deviant behavior - not normal. It is consequently not clear at all where the line between general country-specific business practices and corruption can be drawn, especially when a country's business culture values the exchange of gifts of considerable worth (rather than token, symbolic gifts) and favors to show interest and respect. This is not always linked to a financial transaction. But refusing to participate in that culture and relationship-building, may limit or even destroy business opportunities (and personal success, for that matter).

The Daimler cases make clear that the understanding of that gray zone also depends on the applicability of laws. Often it is not the local law of a host country which threatens a foreign firm with (enforceable and enforced) sanctions but a home country law or even third country law. Referring to the 2010 Daimler settlement, it was US-American law (i.e. the Foreign Corrupt Practices Act of 1977) which defined payments to foreign country officials as corruption.

In contrast to that, German law defined bribery payments in foreign countries as indictable not until 1998. While obviously not all anti-corruption laws, regulations and codes effectively promote ethical conduct, introducing legal liability may raise managers' attention in the context of their risk management approaches.

National and international corruption regulations are becoming stricter, more corruption cases are pursued, and at the same time public awareness and publicity of the corruption topic is growing. One would assume that corruption incidents consequently would decrease rather than increase. As for Germany, recent statistics by the Federal Criminal Police paint a different picture (figure 1).

Obviously, most cases are undetected and unreported, so one can only speculate about the dark figures' proportions. The recorded increase of offenses, however, does allow us to conclude that the recent change in public and media awareness and general moral climate may increase the chance of success for a comprehensive compliance system. More and more cases are being pursued and that builds up pressure on every individual employee in a company. Within that context one would assume that developing a company's compliance culture represents a huge step for any entity. But there will never be a guarantee that a company will be "very clean" or have a perfect score, due to the fact that each individual employee makes his or her own choice.

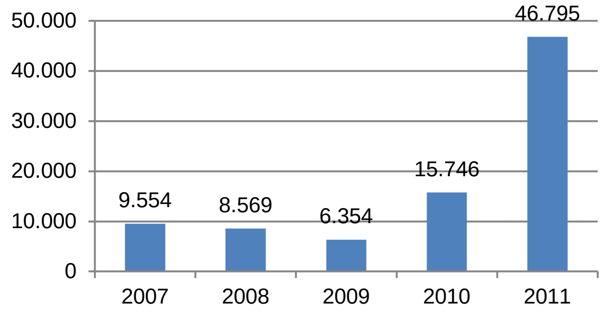

Figure 1: Corruption offenses in Germany from 2007 to 2011. Based upon numbers published by the Federal Criminal Police Office, BKA (2011, p. 7).

Conclusion

The global automotive industry surely is a "risk industry" when it comes to bribery and other non-compliance of legal and ethical rules. No company within the automobile industry can stay away from corruption. Every company that is operating on an international and national level will face corruption at some point. The question is how it will respond to it. Analytical tools and company procedures can help to avoid and prevent the chances of corrupt business procedure but cannot guarantee for actions that are done by individual employees. The limits of "technical" tools are clear, and a cultural and moral approach is a necessary part of the strategy – which is where a more comprehensive, values-based CSR understanding comes in. It is advisable for a company to have additional regular compliance trainings in connection with tests that secure that the company's compliance standards are not only communicated but lived. At the end of the day, anti-corruption risk control and CSR are just but two faces of the same coin: ethical business conduct.

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