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Navigating Compliance Risks in the Indian Subcontinent

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Capitalising on the untapped growth potential of emerging economies makes the prospect of doing business in these markets an irresistible proposition. High GDP outlook, unsaturated markets, expanding consumer bases, favourable foreign direct investment and pro-business policies, are all factors that combine to create a picture of booming business opportunities in countries like India, Indonesia, Vietnam, or Brazil. Yet these powerhouse economies are complex to operate in, and as a result can bring significant challenges to effectively navigating compliance risk.

Emerging Markets Defy a Homogeneous Identity

Each market has very different specific challenges and risks, though all generally emanate from the same factors: bureaucratic and regulatory hurdles; a somewhat institutionalised culture of tolerance toward corruption and bribery; gaps between policy and implementation at the government level; and underdeveloped ethical, governance, and transparency structures. In the Indian subcontinent, these challenges are compounded by economic inefficiencies, escalating chances of legal challenge and criminal liability and rising reliance on third parties.

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All together, these challenges jeopardise investments and heighten the chances of exposing companies to reputational disasters and frustrating or foiling business efforts by forcing companies to divert resources for containment of crises. To successfully navigate these challenges, companies must adequately assess the risk of their investment and implement adequate mitigation strategies.

Know Your Market

Known risks in emerging markets may be magnified while unknown risks are likely lurking. The combination may wreak havoc on a company's financial and reputational health unless those risks are mitigated.

Conduct In-depth Due Diligence

Investors and businesses prospecting a foray into India, frequently conduct macro risk assessment but fail to conduct adequate due diligence of local issues. The danger of being lost in translation is high. It is imperative that investors understand the local landscape and its associated risks both before making the investment and continuing once the investment is made.

The lack of a comprehensive awareness of local landscape makes the risk of regulatory investigation into possible violations very real. Consider the case of a large multinational who attracted the attention of officials in India and the U.S. after it disclosed that it had engaged in lobbying activities related to enhanced market access for investment in India. Lobbying, in the Indian context, is considered to be operating in the grey areas and thus perceived to be an inappropriate tool to further business aspirations . An in-depth knowledge of the Indian market obtained prior to investing can pre-empt such potential pitfalls.

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Look Beyond the Books

Due diligence does not stop with understanding the local landscape and reviewing the official financial statements of potential business partners and investee companies. It is necessary to dig beneath the numbers to gain an indepth understanding of the business, business partners and the risks inherent in the business. For example, related party transactions, layered transactions aimed at obfuscating a money trail, bulging intercompany debt, and significant revenues from non-core business activities are certainly areas of interest and potential abuse. Pointed probes may uncover inadequate reporting of liabilities, accounting for bribes paid through misleading entries, and suspicious transactions for masking diversion of funds. The abundance of related party relationships and transactions are symptomatic of the risk of illegal asset and money transfers.

With that in mind, information should be gathered about the business and its business partners. Even though the possibilities of open-source research have arguably never been better, it remains incumbent on companies, where appropriate depending on risk profiles, budget and nature of transaction, to consider gathering so-called 'human intelligence' from well-placed local sources.

Different Rules of the Game

A different corporate-political nexus and regulatory environment typically confronts investors in emerging markets such as India. Tolerance for corruption in a local market may adversely impact companies that must comply with anti-corruption regulations such as the UK Bribery Act or the FCPA if its competitors in the market do not follow the same rules. Management must understand the risk of operating in this environment in its decision to make, or not make, an investment.

Structure Compliance Programs with the Local Culture in Mind

Companies may find themselves in the midst of regulatory investigations related to alleged violations of FCPA, UK Bribery Act, and local corruption and money laundering laws. In addition, they may be confronted with legal risks or criminal investigations, if necessary steps are not taken to design and implement a comprehensive customised compliance program that is effectively implemented and enforced.

Without obtaining an understanding of the local business practices and social culture in India, companies may find that local business practices impede compliance with the laws and regulations. For example, payment of facilitation payments, also known as 'speed money' is a common practice in India for obtaining government approvals, permits and licences. 'Palm greasing' is entrenched so organically that even low-ranking government staff can make passage of clearance permits to higher ups conditioned upon the payment of bribes. This business environment poses bribery and corruption landmines that must be understood. Clearly, heightened control measures are needed to tactfully navigate through these challenges, particularly for industries that have numerous touch-points with the government.

Steer Clear of False Sense of Security

It is easy for even the most hesitant of investors to be lulled into a false sense of security, buoyed by the investment-boosting climate in emerging markets. Partnering with professionals that fully understand the intricacies of doing business locally will help companies acquire a complete sense of the risks of the operating environment.

Once an investment is made, a comprehensive compliance program that considers the global and local risks should be designed and enthusiastically implemented and enforced.

The compliance program in the emerging market must:

- identify junctures where corruption risks may emanate and include strategies to make 'clean' political inroads by engaging policymakers;
- include cultural conditioning at the top management level; and
- train and sensitise local employees in what can hurt the company's interests in order to help align business objectives with on-ground realities in emerging markets.

Ring fencing risks of doing business in a developing economy and protecting reputational equity in opaque business environments is possible by an informed reading of the early warning signals. On this basis, companies should establish and continuously update their mitigation strategies.

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