Retail Fraud in China

By Peter Humphrey 04/05/2011 22:17:00

While many economic sectors have been struggling with ups and downs sand uncertainties since the financial crisis, the retail industry has remained an attractive arena for expansion in China.

But retail is not only bringing in mall developers and retailers, it is also a magnet for fraudsters. The retail industry in China attracts all kinds of unsavoury rackets, and foreign invested retail chains are especially vulnerable due to the cultural and language gap, which leads to blindness. Foreign-funded enterprises have opened tens of thousands of square metres of new stores and malls over the past year or two – shops like the popular new H&M stores that now are spread all over China. Similar stories are unfolding with other retail brands in China's large cities. But are the retailers ready to tackle the fraud risks?

Take Anna, a purchasing manager at a multinational retail chain in China who found an imaginative way of making some extra money. Anna established a company under her sister's name, concealing her involvement, and then disguised this firm further by giving it a very similar name and the same address as an official approved supplier of her employer, led by a man called Fred. That way, she effectively sneaked in this proxy firm through the back door and on to the multinational's list of approved suppliers.

Fred, the head of the official supplier whose company name and address Anna used to perform this confidence trick, was complicit in the scheme – he bribed Anna in exchange for her approving Fred's supply of goods at inflated prices to the multinational, and as a bonus Fred also allowed Anna's firm to supply to the multinational by piggy-backing on his own firm. So Anna had it coming both ways: she received bribes from Fred, and enjoyed the lavish proceeds from the sales her own firm made by supplying to her own employer.

Sometimes whole firms are fraudulent. A developer of shopping centres in northern China was about to be acquired by a foreign retail firm. But this developer had scant regard for safety and a habit of cutting corners, no matter what the human cost: when a shopping centre built by the developer in central China suddenly collapsed, killing 20 people, the main person in charge of the project was somehow sprung out of jail and simply shifted over to another city where he continued to handle the same sort of projects for this unethical developer. A few years later a similar safety disaster in that city was only avoided by the narrowest of margins.

In multiple locations across China, this same developer also lured individual retailers and store tenants into paying expensive rents with promises of trendy cafés and cinemas "soon to be built" and supposed to attractive massive custom, which failed to ever materialise. In some instances the tenants' anger boiled into active rioting. But because the developer's owners had close ties to senior government officials, this swindle was never prosecuted by any court, and local media channels orchestrated a campaign against the tenants.

I led an investigation in Shanghai into a procurement fraud case involving a leading European multinational hypermarket chain. A new general manager had recently taken up his position and he had received a series of anonymous letters alleging that various purchasers were operating fraudulent or corrupt schemes and causing losses to the company.

The allegations named a number of people in various sub-departments of the buying operation as well as a number of suppliers with which they allegedly had improper relationships. We began by investigating these companies' ownership and physical operations, checking for conflicts of interest and looking into the lifestyles and affiliations of the suspects. A number of conflicts of interest were uncovered in the form of shareholdings owned by my client's employees, plus the lack of any physical existence of the suppliers (i.e. they were phantom vendors), and other unethical arrangements including kickbacks, commissions, goods rebate scams, and manipulation of the hypermarket's electronic transaction system.

External inquiries were reinforced by internal investigation including workstation searches, computer forensics, monitoring and a series of interviews with suspects and witnesses. Conclusive evidence was obtained that four senior buyers had led various fraudulent schemes and an expatriate who oversaw the buying operation had turned a blind eye in exchange for sexual favours. All these staff were interviewed and dismissed. Their suppliers were terminated.

A decisive breakthrough in this case came in connection with one of the ringleaders, a young woman who headed the sub-department buying in high-margin foods and alcohol. From interviews, it was learned that one of her key collaborators outside the firm who was operating some suppliers was her boyfriend and that he was married. The man's wife was identified and interviewed and provided significant information that helped resolve the case. Close associates and subordinates of the dismissed senior buyers were gradually removed. Business controls were strengthened. A Code of Conduct, personnel vetting and vendor screening were introduced.

An analysis to quantify the losses suggested that the company had been paying 30% more than it needed to in some instances for the goods procured by the crooked buyers, thus eroding the true potential profit margins and causing millions of dollars in losses annually.

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