

Commercial detective

As China's economy strides forward, business risks brought about by unethical practices attract more attention in a market in which many people concentrate on 'getting rich by every short cut they can think of'

AN anti-counterfeit raid by quality control authorities in a wholesale market uncovered leads indicating that a well-known global consumer brand's own staff were involved in trafficking fake goods.

When the company realized that insiders were involved, it contacted Peter Humphrey for advice on the situation. (The time, location and the name of the company are withheld by interviewee's request.)

Having spent two decades as a foreign correspondent in Asia, East Europe and the Balkans, Humphrey has worked for the past seven years as a risk management specialist and corporate detective focusing on white-collar crime prevention, fraud investigation and crisis mitigation for multinationals in China and other Asian countries.

After setting up a task force involving the company's management and local private investigation firms, Humphrey and his team launched a full-scale internal and external investigation combining the techniques of internal audit, forensic accounting, computer forensics, desk searches, security surveillance and private investigation.

Evidence was soon found and presented to the municipal Public Security Bureau (PSB) which triggered several PSB raids and arrests.

Further investigations revealed links between people, companies and transactions and found that employees in virtually every department inside the company — marketing, distribution, purchasing, logistics and R&D — had colluded with a counterfeit syndicate to produce fake goods and inject them back into the multinational's own sales and distribution channels, bringing a mix of genuine and fake products into the firm's own warehouse. The head of R&D was a shareholder of the syndicate and played a starring role in the scam, regularly passing out product updates.

"This was a very serious case where the problem of kickbacks, phantom companies and intellectual property right came together," said Humphrey.

About a dozen arrests led to some people going to jail for a year or more. In the aftermath, a number of employees were dismissed, and many relationships with suppliers and distributors were terminated. The company went through a year or two of tremendous disturbance and pain

By Li Xiaowei

dealing with the issue and reconstructing its business model.

"And this was a rare case where a certain degree of support did come from the Chinese authorities and a number of people were punished under the law," said Humphrey, "probably because the company was a significant investor in China with a big reputation."

Ambiguous panacea

While China seems to offer a panacea for the problems of international business due to its low labour costs, opening environment and potentially vast market, many businesses such as this consumer goods manufacturer have had their fingers burned by frauds, most commonly involving kickbacks, phantom companies and intellectual property rights violations, according to Humphrey.

A survey conducted in 2003 by the Boston Consulting Group showed more than half of the manufacturers of consumer goods in China claimed they were not making money. The losses were attributed to various factors such as over-extending into unfamiliar provincial locations not yet suitable for such operations, fragmented and chaotic local markets with huge differences from one place to another and so on. Yet, as Humphrey argues, risk management analysis of the situation throws up another reason for the losses, or for the failure to make significant profits: fraud, corruption and white-collar crime that are rife in the country.

"The country is undergoing a get-rich-quick social revolution, a smash-and-grab phase of development. The late reformist leader Deng Xiaoping 20 years ago told the Chinese nation 'to get rich is glorious' and set the country on a new path. That's exactly what people are doing — getting rich by every short cut they can think of," he said.

It is not surprising, then, that fraud and embezzlement are pervasive in both the public and private sectors, both in domestic enterprises and foreign-invested business operations. The equivalent of around 16 per cent of GDP is lost to fraud and embezzlement in the public sector, according to Professor Hu Angang of Tsinghua University. People in the risk management business estimate similar, if not higher, leakage in the private sector, especially in foreign-invested enterprises blind



Peter Humphrey talks in a recent interview with Shanghai Star.

Shanghai Star/
Zhou Wei

to what is going on inside their own operations.

The problem is complicated by the fact that existing Chinese law to punish fraud is not especially favourable to private companies, said Humphrey. Primarily concerned with helping the state sector, the judicial authorities find it difficult to take an interest in or to understand commercial fraud in private companies.

"I think it is very important for China's future economic development that people feel their property and investment are secure and that if they are cheated they will be able to get justice," said Humphrey. "And on this point, Chinese authorities need to consider how to strengthen the law to protect private property and investment."

Seeing there is a need for consultants to help private companies when they get into difficulties, he got involved in risk management and corporate investigations. After serving as China country manager for US risk consultancy Kroll and head of China investigations at PricewaterhouseCoopers, he founded his independent practice Chinawhys. In addition to neutralizing the counter-and-fraud syndicate mentioned above, his successes also include eliminating fraud from the buying operations of a leading megastore chain, uncovering fraudulent joint venture deals for a global appliance manufacturer, and orchestrating the resolution of a transnational custodial kidnapping in China.

Changing role

Solving problems for companies in difficulty came easily to

Humphrey, who has spent most of his life helping others, as a teacher, as a journalist, as a charity volunteer with Rotary International and now as a consultant. He said his present work was a natural progression from his humble origins.

Born to a poor working-class family in rural England, Humphrey said he was lucky to get into grammar school through competitive examination. From that school, he went on to study Chinese at the University of Durham in South England.

"When I decided to do that, the headmaster of my grammar school looked at me as if I was some crazy man, because that was a time, in 1975, when very few people in Western countries were studying China," said Humphrey.

But as a young teenager, he noticed that China was becoming interesting after Zhou Enlai took the country back into the United Nations, Richard Nixon visited China and the first Chinese students started travelling abroad.

After graduating from the University of Durham, Humphrey came to China and conducted further studies at Beijing Language and Culture University. While he was there he was invited by Chinese education authorities to teach English to the *laosanjie* students, the generation that graduated from high school during the "cultural revolution" (1966-76) and were sent to the countryside to work and thus had their higher education delayed.

In 1981, he was among the founding staff of the China Daily, the country's first English-language newspaper. After a few

months, though, he was offered a reporting position by the South China Morning Post, one of the overseas publications for which he had been freelancing, and moved to Hong Kong. He was hired by Reuters after a year or so and received training in London to become a foreign correspondent. He was then sent to Eastern Europe and spent the next 10 years covering several countries in the region, before, during and after the regime changes that took place in 1989 and 1990.

After taking a year-long academic leave at Harvard University, he rejoined Reuters and was sent to Hong Kong. After he covered the handover in 1997, Humphrey decided to leave journalism, a career which he found had lost its glamour and status.

"Journalists have lost some of their shine in the last 25 years or so with this revolution in the media involving an explosion of words and a consequent devaluation of the 'currency'," he said.

Now, as a corporate detective, instead of having his byline appearing all over the world's media, Humphrey has to keep a low profile for the nature of investigation business as well as for his personal safety.

"The changing role has never bothered me as I have never had a big ego, which many journalists are obsessed with," he said.

"I hope 10 years from now, the Chinese legal system on fraud prevention will be mature enough so people like me will not be needed any more. Then I will retreat to the countryside of England and read poetry."