THE GSK BRIBERY SCANDAL IN CHINA:
CORPORATE GOVERNANCE FAILURES OF MULTINATIONAL CORPORATIONS+

By

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On July 2, 2012, global healthcare giant, GlaxoSmithKline LLC (GSK), agreed to plead guilty and pay $3 billion to resolve its criminal and civil liability arising from the company’s unlawful promotion of certain prescription drugs, its failure to report certain safety data, and for alleged false price reporting practices in the US. GSK agreed to plead guilty to three-count criminal violation, including two counts of introducing misbranded drugs, Paxil and Wellbutrin, into interstate commerce and one count of failing to report safety data about the drug, Avandia, to the Food and Drug Administration (FDA). The fine was the largest combined federal and state healthcare fraud recovery in a single case in the history of the United States.¹

Before GSK had the chance to rebuild its image, the company was embroiled in another scandal in China. A June, 2013 criminal investigation by Chinese authorities led to allegations that GSK bribed government officials, medical associations, hospitals, and individual doctors in order to open more distribution channels and raise product prices.² Authorities alleged that the company employed more than 700 intermediaries for the purpose of channeling almost $500 million to those who prescribe GSK-manufactured pharmaceuticals.³ Directors of the GSK’s human resources and legal affairs operations in China have been detained and are awaiting prosecution.⁴ In May, 2014, investigators implicated Mark Reilly in the matter, who was the British executive in charge of the company’s China business. If officials develop these accusations into formal charges, the move will represent a rare example of the Chinese prosecuting a foreign-born executive of a multinational company.⁵ Under these circumstances, experts note that Reilly could face up to ten years in prison.⁶

Although GSK has very specific internal rules against commercial bribery,⁷ these rules are alleged to have been easily circumvented through the use of third parties, such as travel agencies.⁸ Under this scheme, executives at GSK may have procured cash from travel agencies after directing them to charge fictitious traveling expenditures to GSK’s marketing expense accounts.⁹ Allegedly, after doctors prescribed the desired drugs, funds were transferred to debit cards issued to them by GSK representatives.¹⁰

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It is further alleged that GSK offered bribes to doctors not only in China, but also to doctors in other countries. In April, 2014, a prosecutor in Poland filed corruption charges against a GSK regional manager and eleven doctors. The doctors were nominally paid for educational services and training, but the program is suspected of being a front to facilitate direct payments to doctors for promoting GSK’s asthma drug, Seretide. Official statements by GSK suggest that the company is eager to portray the incident as one involving a single employee acting outside of an otherwise strict corporate regime prohibiting such conduct. Remarks by a former GSK salesman in Poland, however, convey a more systemic concern: “It’s a bribe. We pay doctors, they give us prescriptions. We don’t pay doctors, we don’t see prescriptions…” GSK has also said that it is conducting an internal investigation following whistleblower claims that the company improperly hired medical professionals employed by the Iraqi government to sell GSK-manufactured drugs.

It is notable that the corrupt practices that allegedly took place in China, Poland, and Iraq did so in countries where doctors have dominant influence with respect to the sales of prescription drugs and where the rule of law is relatively weak. In contrast, the doctors in the US are less influential in selling prescription drugs, and the rule of law is relatively strong. Although GSK’s alleged misbehavior involving aggressive sales and marketing practices in the US market are different from the bribery practices alleged in China, Poland, and Iraq, one of the common features of these misbehaviors is the apparent attempt to acquire comparative competitive advantage by either defrauding, misleading, or coercing consumers.

Furthermore, instances of bribery by pharmaceutical companies in China are not limited to GSK. Soon after commencing its GSK inquiry, Chinese officials launched an investigation into France’s Sanofi for similar offenses. And in August 2013, a former manager at U.S. drug maker Eli Lilly accused the company of engaging in practices in its China business that were “just as bad as at GlaxoSmithKline.”

In light of these scandals, we seek to analyze the complicated harms triggered by the alleged corrupt practices of GSK and other multinational corporations (MNCs) in order to identify the causes contributing to the scandals and to provide suggestions for reform. Part I identifies some of the various harms that may be triggered by corrupt practices of MNCs while Part II offers an analysis of why the alleged GSK bribery scandal was possible in China. In Part III, we examine the need for reform of the evaluation and incentive system for professional sales representatives to help eradicate corruption, leading up to our suggestions for reform in Part IV. Concluding remarks then follow.

I. HARMS Triggered BY Corruption

This part examines the various harms which may be triggered by corrupt practices of MNCs. These include damage to fair and transparent competition and harm to consumer welfare. These harms are addressed below.

A. Damage to Fair and Transparent Competition

GSK has allegedly acquired significant comparative competitive advantages by bribing hospitals, doctors, officials, and professional medical organizations. These allegations
of bribery hurt not only Chinese domestic firms, but also MNCs doing business in China. GSK’s competitors have suffered both pecuniary and reputation damage from the alleged bribery. Therefore, the GSK scandal has depreciated the brands of other firms in the drug industry.

While authorities have suggested that these bribery offenses may have brought in some revenue in the immediate term, industry analysts have concluded that given a slightly longer outlook, these practices are likely to have been detrimental to both the firm and the industry. GSK’s China sales plummeted 61% in the bribery scandal’s wake. And the effects of the allegations were not confined to GSK’s bottom line—industry-wide sales may have suffered a 30% decline in China. Curiously though, despite devastated sales, investors did not seem deterred. Taken together, these data may reveal that a single firm’s bad practices may be more costly than profitable and likely serve to implicate the reputation of the entire industry. Perhaps of greatest consequence in light of the special circumstances of the pharmaceutical industry, this acute decline in sales probably means that disenchanted or otherwise concerned healthcare professionals delivered far fewer drugs to their patients, which may in turn suggest that these patients received significantly less treatment during this time than they otherwise would have.

There exists a host of legitimate means that a firm may pursue to gain a competitive advantage, such as diversifying and improving the quality of goods or services, developing more effective marketing and public relations strategies, bettering post-sale services, and optimizing internal controls. Unlike these fair, ethical, and lawful examples, bribery is an unfair and often illegal trade practice. For instance, commercial bribery is considered an unfair competition practice under Chinese law. To contain the unfair competition between and among firms, China passed the Anti-Unfair Competition Law in 1993. Article 8 of the law says, “Managers shall not use money or properties or the other methods to bribe to others in order to sell or purchase commodities.”

The Chinese Criminal Law also bans commercial bribery. Article 164 penalizes offering bribes to non-public employees in business companies or enterprises. Article 389 penalizes offering bribes to public employees of state-owned companies or non-profit organizations. Article 391 penalizes offering bribes to government agents, state-owned companies or non-profit organizations. Article 393 penalizes corporations offering bribes to public employees. Of course, Chinese Criminal Law is not confined to punishing domestic bribery. As more Chinese firms pursue overseas markets, Paragraph 2 of Article 164 of Chinese Criminal Law punishes Chinese firms offering bribes to public employees in foreign countries or international public organizations, for the purpose of acquiring unfair commercial interest.

If the allegations are true, it appears that GSK has broken both the Chinese Anti-Unfair Competition Law and Criminal Law. Although the Chinese court has not heard the GSK bribery case yet, serious penalties will likely be imposed if GSK is found guilty, due to the massiveness of the alleged bribery as well as the negative impacts on the integrity of and fair play among the firms. Of course, it will likely take the pharmaceutical industry, including multinational corporations doing business in China, a long time to correct their marketing activities and to restore the consumers’ confidence, even after the criminal case against GSK is finalized.
B. Harm to Consumer Welfare

According to an old Chinese proverb, “When the snipe and the clam grapple, the fisherman profits.” Consumers will be some of the most important beneficiaries of fair competition among pharmaceutical companies. The fiercer the competition, the more benefits the consumers will acquire in terms of better quality and lower prices. Yet, if competitors are interested in building their comparative competitiveness by bribery, instead of better products or services, the quality of the goods or services will not be improved and the price will not be lowered.

Fierce competition among firms produces critical consumer benefits in the form of better quality and lower prices. Bribery, however, perverts utility-maximizing market forces by distorting consumer demand. Put differently, bribery induces the market to take on goods that consumers do not want. These goods are necessarily inferior, and consumers end up paying more for less. This behavior infringes upon the right to information, the right of free choice, and the right of fair dealing that should be afforded consumers.

In the case of GSK, the company is accused of inflating its medicine prices and passing on the cost of hundreds of millions of dollars in bribes directly to consumers. These accusations have been substantiated by at least one GSK China executive, admitting after being questioned by police that part of the ten-fold mark-up in drug prices stems from bribery. Therefore, consumers are the ultimate victims of corrupt practices of firms.

II. Why the Alleged GSK Bribery was Possible in China

It is not enough to point out the seriousness and potential illegality of GSK’s behavior. It is also important to identify the possible causes for the occurrence of the alleged corrupt practices to allow for restructuring of the institutional arrangements to help prevent future recurrences. Without a deep understanding of the causes of commercial bribery, it is likely to proliferate. Though it is difficult, or even impossible, to identify all the causes of corruption, we attempt to examine some major causes. In addition to external pressures, the internal corporate governance structure of GSK may have led to a culture giving rise to the bribery allegations.

A. Maximization of Profits

To some extent, the GSK scandal may be the result of narrowly focusing on shareholder profit maximization. Many firms, including GSK, may see maximization of profits as their sole goal. In fact, exploring and expanding their market shares may be the first priority of MNCs entering the Chinese market. Yet, in the age of globalization the conservative notion of maximization of profits is being challenged by emerging theories promoting the significance of non-shareholder stakeholders and corporate social responsibility.

As early as October 27, 2005, the Chinese legislature inserted a corporate social responsibility clause into the first paragraph of Article 5 of the Company Law stating: “In its operational activities, a company shall abide by laws and administrative regulations, observe
social morals and commercial ethics, persist in honesty and good faith, accept supervision by
the government and the public, and assume social responsibility.”35 This article is one of the
earliest statutes worldwide to call for corporate social responsibility.

As the result of five years of negotiation and bargaining between and among many
different stakeholders across the world, the International Standard Organization issued ISO
provides harmonized, globally relevant guidelines for private and public sector organizations
of all types, based on an international consensus among expert representatives of the main
stakeholder groups, and encourages the implementation of best practices in social
responsibility worldwide. ISO 26000 contains voluntary guidance, not requirements, and
therefore is not used as a certification standard like ISO 9001:2008 and ISO 14001:2004.36

ISO 26000:2010 represents an international consensus to some extent, as
representatives from government, non-governmental organizations (NGOs), industry,
consumer groups and labor organizations around the world were involved in its development.
Although ISO 26000:2010 is a voluntary standard, it helps clarify social responsibility by
translating principles into effective actions, and sharing global best practices.37

We argue that optimization of profits, rather than maximization, should be the focus
of firms. We define profit optimization as requiring profits to be made in legal and ethical
ways, optimizing the interests of various stakeholders. Optimization requires that the
corporate core value framework include consideration of corporate social responsibility and
business ethics. Conversely, pure profit maximization may put so much pressure on corporate
executives to achieve profitability that they may fail to consider the legal or ethical
consequences of their actions. Without a fundamental change in corporate thinking about
maximization of profits versus profit optimization, scandals such as the one embroiling GSK
scandal are likely to continue to repeat on the global stage.

B. Misunderstanding Chinese Contemporary Culture

China might be thought of as a connection-based society38 operating in a developing
market economy. Based on this presumption, some organizations apparently believe that
bribery is how business is conducted in China.

It is true that the Chinese market economy is not yet well-developed. It took China
three decades to transform from a centrally planned economy to a free market economy since
the late 1970s when Deng Xiaoping, the late paramount leader, came to power in China. A
planned economy is based on the rule of people, while a market economy is based on the rule
of law and open, transparent legal rules. There is no legitimacy of bribery in the market
economy. There was no foreign capital in the planned economy and unspoken, hidden rules
prevailed.

Unspoken rules might not have completely disappeared in the process of transition
from a planned economy to a market economy, as the emerging twins, rule of law and market
economy, have not been fully fledged. The national People’s Congress, however, decided to
insert the rule of law into the first paragraph of Article 5 of the Constitution on March 15,
1999, declaring “the People’s Republic of China shall govern the country with the rule of law,
and shall build the socialist country with rule of law.”39 One of the latest comprehensive
reform policies made by the ruling party, the Chinese Communist Party, on November 12, 2013, endorsed the rule of law policy again. Keeping in mind the bitter lessons of the ten years of the Cultural Revolution, the rule of law has become the social consensus in contemporary China. In addition, to further detailed reform plans, China published twelve core values including national goals of prosperity, democracy, civility, and harmony; social goals of freedom, equality, justice and the rule of law; and individual values of patriotism, dedication, integrity, and friendship.

Therefore, MNCs face choices at the crossroads - either follow and endorse the dying, unspoken rules of corruption, or further weaken corruption by following and solidifying the rules of law through more transparent marketing strategies, better corporate governance, tougher anti-corruption efforts and more reliable products. Unfortunately, some MNCs have chosen to follow the local unspoken rules of corruption. Ignoring Chinese contemporary efforts and commitments to a free and open market, the rule of law and modernization of state governance, some MNCs choose to hire so-called “elites” with good connections in China to join their subsidiaries in China. Retired officers, or relatives or close friends of current officers, are favorite candidates for the positions of senior executives in China subsidiaries.

Almost every society could be considered connection based. As Lawrence M. Friedman said, “in this society, as in every society, who you know and what your connections are, whether you are rich or poor, educated or uneducated, articulate or inarticulate, has always mattered greatly—one way or the other.” The logic is very simple. No one will feel safe and secure when she or he enters into a significant transaction with a stranger. However, the same notion of a “connection” might mean more in the context of the Chinese society than in the context of society in the US.

In fact, a connection per se is neither the angel nor the devil. Rather, it is a neutral term. A connection could be used for different, or even opposite, purposes. In some circumstances, connections could be ethical and lawful and inure to the benefit of both MNCs and their stakeholders in the local market. In other circumstances, connections may be abused to advance the interests of MNCs and their corrupted partners at the price of defrauding consumers, bullying small competitors, and negatively affecting the commercial culture.

More importantly, connection-based bribery has been a special target in contemporary Chinese society. Anti-corruption efforts and reforms toward a transparent and competitive market are the key elements of the contemporary Chinese culture. Misunderstanding of the Chinese culture has created, and will continue to create, more bribery scandals on the part of the MNCs. The main point is that the bribery phenomenon in the transition of China’s economy does not represent its future direction. MNCs should pay more attention to the trend of the rule of law in the Chinese market. In addition to insulating themselves from commercial bribery, multinationals are both obligated and competent to set good examples of fair competition in the Chinese market.

C. Strengthening Corporate Governance to Address Corruption

Many MNCs, including GSK, decry corruption in their corporate policies or internal rules. The core issue is not whether the MNC has a corporate anti-corruption policy; rather, the important issue is whether the corporate governance policy regarding anti-corruption
translates well into commercial practice.

After the Chinese authorities began investigating GSK, GSK issued a statement on July 15, 2013, saying “[w]e are deeply concerned and disappointed by these serious allegations of fraudulent behavior and ethical misconduct by certain individuals at the company and third-party agencies. Such behavior would be a clear breach of GSK’s systems, governance procedures, values and standards. GSK has zero tolerance for any behavior of this nature. GSK shares the desire of the Chinese authorities to root out corruption. These allegations are shameful and we regret this has occurred.” This statement implies that GSK has specific systems, governance procedures, values, and standards designed to address the bribery scandal and other corrupt practices.

Accordingly, considering GSK’s long-standing stand against corruption, how was the GSK scandal possible? There must have been a problem in the execution of corporate governance policies and the translation of the formal anti-corruption policies and norms into practical reality. After meeting with the officials of the Chinese Ministry of Public Security, Abbas Hussain, the GSK President International – Europe, Japan, Emerging Markets & Asia Pacific, said on July 22, 2013, “Certain senior executives of GSK China who know our systems well, appear to have acted outside of our processes and controls which breaches Chinese law. We have zero tolerance for any behavior of this nature.”

Abbas Hussain’s comments apparently intended to insulate GSK from the accusation of the corporate wrongdoing at the level of corporate values and policies, and to separate the wrongdoings of senior executives from GSK China and the global GSK group. Hussain, however, effectively admitted three serious failures of GSK’s corporate governance policies. First, certain insiders, namely, senior executives of GSK China, apparently breached Chinese law. Second, it appears that the internal systems of GSK were unable to prevent GSK employees from corrupt behaviors. Third, the processes and controls of GSK were seemingly unable to identify, contain, and punish the corrupt practices of the senior executives. If the corporate governance policies of GSK functioned effectively, no crimes should have been committed.

It is easy to state corporate governance and anti-corruption rules and to organize a committee to address corruption in a corporation. It is much more difficult to insure that the corporate governance and anti-corruption rules are effective. The failure lies in the functional effectiveness of the governance norms. Therefore, it is insufficient, or even meaningless, to discuss the institutional innovations of corporate governance on the books compared to the significance of exploring the effective mechanisms to convert good norms into voluntary practices. Of course, formalization of corporate governance on anti-corruption does not mean that all the corporate rules are compatible with the direction of anti-corruption policy. To the contrary, some of GSK’s rules, especially the evaluation and incentive system for professional sales representatives, may have been key factors in triggering the bribery scandal.

III. THE NEED FOR REFORM OF THE EVALUATION AND INCENTIVE SYSTEM FOR PROFESSIONAL SALES REPRESENTATIVES

Among a number of ineffective governance rules, the evaluation and incentive
systems for professional sales representatives may help to explain why senior executives and professional sales representatives of GSK had allegedly engaged in corrupt practices. Under the traditional compensation system of GSK, bonuses for sales professionals were based on individual achievement of sales targets. Simply put, the more drugs sold, the more bonuses received.46

On its face, this compensation system sounds reasonable and fair. Yet, many professional sales representatives may have been incentivized to offer bribes to gain a competitive advantage. When GSK evaluated its senior executives and professional sales representatives based only on the revenues of the sales and the changes of market shares, many employees may have considered offering bribes, regardless of illegality, to increase sales. Great bonuses arising from bribery may have been expected, while judicial prosecution for the behavior was uncertain. From the perspective of GSK employees, bribery may have been a great game of small input and large return. Motivated by the twin goals of profit maximization for GSK and maximization of compensation for the professional sales representatives, it may have been very difficult for the management of GSK to stop or even slow down profitable bribery practices.

In fact, the sales targets orientated compensation policy is not only the driving force of bribes to doctors, but also the driving force of fraud to consumers. That is why GSK was required to execute a five-year Corporate Integrity Agreement (CIA) with the Department of Health and Human Services, Office of Inspector General (OIG) in the US in 2012. The plea agreement and the CIA included novel provisions requiring GSK to implement and/or maintain major changes to the way it does business. These changes include changing the way its sales force is compensated to remove compensation based on sales goals for territories, one of the driving forces behind much of the conduct at issue. Under the CIA, GSK is required to change its executive compensation program to permit the company to recoup annual bonuses and long-term incentives from covered executives if they, or their subordinates, engage in significant misconduct. GSK may recoup monies from executives who are current employees and those who have left the company. Among other things, the CIA also requires GSK to implement and maintain transparency in its research practices and publication policies and to follow specified policies in its contracts with various health care payors.47 To some extent, the CIA paved the way for GSK to change its traditional compensation system in China in 2014.

A. Fundamental Change in Compensation: From Unitary Sales Target Orientation to Diversified Evaluation Indicators

After realizing the relationship between the sales targets oriented evaluation and incentive system and the ever increasing amount of bribery, beginning in January, 2014, GSK started to implement fundamental changes to its evaluation and incentive system for professional sales representatives who work directly with prescribing healthcare professionals. Under the new system, all employees who interact with customers are required to be evaluated according to their technical knowledge, quality of service, and adherence to the company values of transparency, integrity, respect, and patient-focus. The new system applies to all GSK sales employees who interact with prescribing healthcare professionals including
sales representatives and sales managers. In addition to its implementation in China, the new system is to be implemented in other markets around the world during 2014. GSK promised that the new system would be fully implemented in all of the countries in which it operates by early 2015.48

Regarding the rationale behind the change of the compensation system, Hervé Gisserot, Senior Vice President and General Manager of GSK Pharmaceuticals and Vaccines China, explained: “The new sales compensation system will enable us to put patients’ needs at the heart of everything that we do. Our medical representatives are the gateway to our customers and it is important we inspire, coach and ultimately reward people working within the organization to focus on behaviors which reflect our values. I am confident that this industry-leading initiative will help GSK to continue to build a sustainable business in China and make a strong contribution to the development of the Chinese healthcare system.”49

According to Gisserot, GSK has demonstrated its determination to pursue a patient friendly business model, and find a new bridge between its core values and its sustainable development, and between the welfare of the patients and the medical representatives. The rationale behind the new system is inspiring and encouraging from the perspectives of both medical representatives and patients.

Gisserot’s comments confirmed the three failures of corporate governance described above – sole reliance on a maximization of profits-oriented philosophy, misunderstanding of Chinese contemporary culture, and the failure of the corporate governance policies to combat corruption. Identifying the corporate governance failures, however, is only the first step toward stakeholder-friendly governance. The effectiveness of the new compensation system remains to be tested by all the stakeholders, including but not confined to, the sale representatives inside GSK and the competitors outside GSK.

B. Shortcomings of the New Compensation System

The criminal investigation of the GSK scandal is one of the driving forces behind the introduction of the new compensation system. Under pressure from the public and the media, GSK had no choice but to change the visible rules directly contributing to corrupt practices. In addition to developing the strategy for public relations purposes, GSK has carefully researched the potential benefits and costs or risks associated with the new compensation system.

As announced by GSK on December 18, 2013, “these changes build on the successful introduction of GSK’s ‘Patient First’ program in the United States in 2011. Experiences from the U.S. have shown this more patient-focused approach has significantly improved customer interactions. It has also coincided with a period of growth for GSK’s U.S. business.”50 This implies that GSK sees positive effects from the CIA. The effects are in the best interests of GSK and the public, especially the patients.

Although the new compensation system successfully implemented in the US could be easily copied in the Chinese market, the new system implemented in China appears inferior to the US system. First, the new compensation system introduced in China is less detailed than its “Patient First Program” in the CIA. Under the Patient First Program outlined in the CIA, GSK agreed not to provide a financial reward (through compensation, including
incentive compensation or otherwise) or discipline (through tangible employment action) to its prescribing field sales professionals (pharmaceutical sales representatives) or their direct managers based upon the volume of sales of GSK products within a given employee’s own territory or the manager’s district. The Patient First Program includes evaluations for sales representatives based on business acumen, customer engagement, and scientific knowledge about GSK’s products. GSK is required to continue its Patient First Program, or a substantially equivalent program, during the term of the CIA. GSK committed to maintaining, for at least the duration of the CIA, absent an agreement otherwise with the OIG, the restrictions on such tangible employment decisions set forth in its “Use of Territory/Individual Sales Data” policy.\(^{51}\) In contrast, the information released on GSK’s website about the new compensation system in China is very general and ambiguous.\(^{52}\) It may be that GSK considers the details of the new compensation system in China confidential. But transparency of the new compensation system could help win the trust of the public.

Second, there is no financial recoupment program in China. In the CIA, GSK promised to establish and maintain, throughout the term of the CIA, a financial recoupment program that puts at risk of forfeiture and recoupment an amount equivalent to up to three years of annual performance pay (i.e., annual bonus, plus long term incentives) for an executive who is discovered to have been involved in any significant misconduct. This financial recoupment program shall apply to both covered executives, who are either current GSK employees or who are former GSK employees, at the time of a recoupment determination. GSK committed to maintain an recoupment program for at least the duration of the CIA, absent an agreement otherwise with the OIG.\(^{53}\) Both the incentive mechanism and the restraint mechanism are essential to preventing the excessive emphasis on the sales target. Although GSK promised a new compensation system in China, it has not announced a recoupment program in China.

Third, there is no independent review mechanism from third parties in China equivalent to the independent review provided in the CIA in the US. In the CIA, GSK is required to engage an entity (or entities), such as an accounting, auditing, or consulting firm, to perform reviews to assist GSK in assessing and evaluating certain functions. More specifically, the independent review entities must assess certain GSK systems, processes, policies, procedures, and practices.\(^{54}\) Without independent verification and oversight, it is difficult for the public to be convinced of the effectiveness of the new Chinese compensation program. Theoretically speaking, GSK would benefit from the independent review mechanism in terms of both a better corporate image and long-term development.

Fourth, there is no mechanism for the Chinese government to punish GSK for failure to comply with its compensation reform promises. The CIA of 2012 has a special part dealing with “breach and default provisions.” GSK and the OIG agree that failure to comply with the obligations to establish and implement the employee and executive incentive compensation and recoupment programs as required by the agreement may lead to the imposition of stipulated penalty of $2,500 for each day.\(^{55}\) As the new compensation system in China is a unilateral policy declared by GSK, it is up to GSK to discipline any breach and to adopt an effective system of internal controls. The public, however, might not trust the effectiveness of any new internal controls of GSK, as they have witnessed the failure of the internal controls in the bribery scandal in 2013.
Fifth, no comprehensive corporate integrity obligation was imposed on GSK in the new compensation system in China. In the CIA of 2012 in the US, GSK promised to establish and maintain a compliance program setting up responsibilities of certain GSK employees and the board of directors. The CIA further requires appointment of a Compliance Officer and a Compliance Committee. In addition, the CIA mandates that the board of directors certify management accountability and adopt a written Code of Conduct, written policies and procedures, and train relevant employees, members of management and the board.56

Despite the shortcomings of the new compensation system of GSK, many pharmaceutical multinational corporations are eager to know its fate. Although other pharmaceuticals have not yet followed GSK’s new compensation model, they may be willing to follow it to avoid the regulatory risks. On the other hand, many multinationals may be reluctant to follow GSK’s new model before the model proves successful.57

IV. SUGGESTED CORPORATE GOVERNANCE REFORMS

A. Reorientation of Corporate Purpose to Optimization of Profits

An ancient Chinese proverb deeply describes the profit driven world: “Jostling and joyous, the whole world comes after profit; racing and rioting, after profit the whole world goes.”58 The purpose of the corporation has traditionally been defined as maximizing the profits for its shareholders.59 Maximization of profits has been the most powerful driving force for entrepreneurship, innovation and progress in the human history, especially in the corporate age. Maximization of profits, however, may cause some corporations to become desperate for profits at the expense of the interests of other stakeholders.60

The issue is that although many business leaders condemn corruption and declare zero tolerance for corrupt practices in their corporate policies,61 such promises and policies tend to be subordinate to the maximizing profits. It may be that some anti-corruption policies fail because corruption is sometimes considered the price the corporation has to pay in certain circumstances to maximize profits.

We propose that corporations, as important members in society, rethink and readjust their mission and purpose of profit maximization and replace “maximization” with “optimization.” First, profit optimization implies a broader scope of stakeholders. Traditionally, in the US, the shareholder has been considered as the primary corporate stakeholder.62 Yet, the purpose of the modern corporation is to create wealth for its shareholders and other stakeholders harmoniously, but not necessarily in the same ways.63 Profit maximization is not adequate to describe the purpose of a corporation, as the interests or stakes owned by the non-shareholder constituencies do not necessarily take the form of profit. It is illogical to narrowly interpret corporate interest as shareholder interest.

Second, optimization of profits implies demands profits to be acquired for various stakeholders in a lawful, ethical, and respected way. Optimization of profits does not prohibit corporations from making profits. Profitability is not the problem. The problem occurs when profit or wealth is taken from the hands of various stakeholders in an illegal, unethical way.

Third, optimization of profits implies the maximum common denominator of various core interests between and among the corporation, the shareholders, the employees, the
consumers, the creditors, the competitors, the suppliers, the retailers, the community, future generations of people, the natural environment, and other stakeholders. We argue that profit optimization requires compromise, tolerance, and inclusiveness. Corruption has seriously eroded the common denominator between and among the corporation and its stakeholders, infringed upon the rights of the consumers and the fellow competitors, and thereby destroyed the confidence of the business community and the public in fair competition in the free market.

Fourth, optimization of profits implies the sustainable development of the corporation. Indeed, there are tensions between short-term interests and long-term interests, between the shareholders’ interests and the non-shareholder constituencies’ interest, between the visible financial interest and invisible public reputation, between the short-term tactics and the long-term strategy, and between the short-term revenue and the long-term competitiveness. Multinational corporations may consciously or unconsciously favor short-term interests, the shareholder’s interest, the visible financial interest, short-term tactics and short-term revenue. Optimization of profits, however, guides the corporation with a long-term vision of sustainable development and helps to pave the way to a sustainable business success. No multinational corporation could go far without due regard to its long-term interest, its invisible public reputation, its long-term strategy, its long-term competitiveness, and the core interests of its non-shareholder constituencies.

People are rational creatures. A small step forward in the corporate philosophy about its real purpose and value might lead to another great leap forward in anti-corruption in the global market. It is up to MNCs to choose between the philosophy of maximization of profits for shareholders and the philosophy of optimization of profits for shareholders and other stakeholders. If GSK and other MNCs are deeply committed to act in a socially responsible manner, they will likely garner the respect of most, if not all, the stakeholders and constituencies, while hopefully, eliminating corruption.

B. The Need for Understanding Chinese Culture and Society

One cannot appreciate the complexities of today’s China without acknowledging its extensive history. Although its embrace of the rule of law and progress toward a market economy are relatively recent trends in light of its 5,000-year existence as a connection-based, agricultural civilization, today’s Chinese culture and society does not tolerate or encourage commercial corruption.

First, Chinese culture, especially the mainstream philosophy as presented by its leaders, stands firmly against any form of corruption. As President Xi Jinpin outlined in his speech at the College of Europe on April 1, 2014, China’s civilization is over 5,000 years old. Over 2,000 years ago, there was “the period of one hundred masters and schools of thought.” Great thinkers such as Laozi, Confucius and Mozi, explored a wide range of topics from the universe to the Earth, from men’s relationship with nature to relations among people, and between the individual and society. The extensive and profound schools of thought they established covered many important ideas, such as the moral injunction of fidelity to one’s parents and brothers and to the monarch and friends, the sense of propriety, justice, integrity and honor, the emphasis on benevolence and kindness towards fellow people,
and the belief that man should be in harmony with nature, follow nature’s course, and constantly pursue self-perfection. These values and teachings still carry a profound impact on the Chinese people’s way of life today, underpinning the unique value system in the Chinese outlook of the world, of society and of life itself. Several observers have argued that the ethical principles that emerge from these philosophies can not only survive in the context of today’s Chinese corporations, but rather can “give substance and meaning to many corporate codes of conduct because [they are] most compatible with accepted managerial principles and can foster ethics in business organization.” Therefore, corruption is inherently inconsistent with a Chinese culture that places significant value on the integrity and morality of its people.

Second, China’s rapidly expanding body of law lends legitimacy to its emerging market economy. To be sure, these laws must be animated by consistent enforcement and reliable prosecution, but as indicated earlier, both the Anti-Unfair Competition Law and the Criminal Law prohibit commercial bribery and other corrupt practices. According to the white paper on the Socialist System of Laws with Chinese Characteristics, published by the Information Office of the State Council on October 27, 2011, by the end of August 2011, the Chinese legislature had enacted 240 effective laws including the current Constitution, 706 administrative regulations, and over 8,600 local regulations. Taken together, the breadth of these laws is an encouraging sign that China is working to fortify its market economy with a regulatory environment that can help ensure its fairness and legitimacy.

Third, corrupt practices are contrary to the current trajectory of reforms in China. The rise of new leadership in China in November, 2012 represents another potential catalyst in this significant trend. As President Xi Jinping said in his speech at the College of Europe on April 1, 2014, “China is a country undergoing profound changes. Reform, which was first forced upon us by problems, goes deeper in addressing the problems. We know keenly that reform and opening-up is an ongoing process that will never stop. China’s reform has entered a deep water zone, where problems crying to be resolved are all difficult ones. What we need is the courage to move the reform forward.” In addition to ambitious and comprehensive reform policies on the market economy and the rule of law declared by the Chinese Communist Party on November 12, 2013, China has been vigorously fighting corruption. One report notes that Chinese courts convicted and punished 31,000 criminals in 29,000 cases of embezzlement, bribery and breach of duty, including several serious cases such as Bo Xilai, the former party chief of Chongqing Municipality, and Liu Zhijun, former minister of railways.

Therefore, MNCs need to bear in mind both China’s past and present and to draw conclusions from both China’s accomplishments, and the Chinese way of thinking. One can hardly understand China well without a proper understanding of China’s history, culture, the Chinese people’s way of thinking and the profound changes taking place in China today. It is thus unwise for MNCs to follow the so-called “unspoken rules” of corruption. The right choice for MNCs is to conduct the business in a lawful and ethical way, and to adopt the policy of zero tolerance of corruption, despite heavy pressure from the competition. The most important issue is to gain a deeper and more objective understanding of Chinese culture and rule of law, which prohibits corrupt practices.

C. Corporate Governance Practices Must Address Corruption
As mentioned above, many MNCs, including GSK, have adopted internal rules against corruption. Unfortunately, the philosophy and the norms of good corporate governance on anti-corruption have not always been translated into practice. Good governance does not only mean adopting rules, but it also requires voluntarily practicing good governance. Thus, the key issue is how to implement good corporate governance policies regarding anti-corruption. To achieve the practice of good governance, three factors would be equally important: good people, good norms, and good culture.

First, a consumer friendly compensation system should be implemented by MNCs to better reflect the competence and performance of the marketing employees or representatives based on the needs of the consumer, rather than simple sales. Although it was encouraging for GSK to announce a new compensation system in late 2013, as noted above, its system still has shortcomings and weaknesses. We have several suggestions for reform for GSK and other MNCs facing the similar challenges.

The most important suggestion is for the executives to hear the opinions of consumers, including patients. It is unlikely that a compensation system will be truly consumer friendly if the system has not been heard, debated, and discussed by the public consumers. Another important requirement for a revised compensation system is that it must accommodate the core interest of the employees or representatives. Without the support of the marketing employees or representatives, it would be unlikely that a consumer friendly compensation system would succeed. In addition, a consumer friendly compensation system should be made transparent in order to enable and facilitate public supervision. Finally, both corporate employees and independent sales representatives or agents should be evaluated by the compensation system. To control the legal risks of corruption, some MNCs might attempt to outsource marketing to independent agents, representatives, or intermediaries reasoning that this strategy may insulate the firm from corruption. We argue that MNCs should also be held accountable for the selection and oversight of independent intermediaries. Independent intermediaries must also be prohibited from engaging in bribery.

Second, internal punishments, including financial recoupm, should be adopted to improve governance on anti-corruption. As discussed above, in the CIA of 2012 in the US, GSK promised to establish and maintain a financial recoupment program that puts at risk of forfeiture and recoupment an amount equivalent to up to three years of annual performance pay for an executive who is discovered to have been involved in any significant misconduct. GSK, however, has not announced a similar program in China. A recoupment program could effectively deter and prevent executives of MNCs from misconduct, including consumer fraud and bribery. In addition to the executives, the directors and marketing employees should be subject to the recoupment program. To increase the cost of corruption, firms could seek to impose punitive damages on the directors, executives and employees, in the case of intentional misconduct or gross negligence resulting in corruption.

Third, an independent third party review mechanism should be established to fight against corruption. An MNC’s internal review of the effectiveness and weaknesses of anti-corruption practices is unreliable from the perspective of the public, including competitors and consumers. Furthermore, if an independent review organization is selected and paid by the corporation, there is a possibility that the corporation will in effect control the
review organization. Some review organizations might thus close their eyes to ongoing corrupt practices. Therefore, the remuneration of the review organizations should be paid for by the corporations, but the members of the organizations should not be nominated by the corporations. We recommend that independent review organizations be selected by a government agency based on open, fair, transparent, and competitive procurement procedures. Further, the public should be entitled to inspect the review documents and raise questions to the independent review organizations, either individually or at a hearing procedure organized by the government agency.

Fourth, penalties should be imposed on multinational corporations for corrupt practices. The market has eyes, the law has teeth. Civil liabilities, administrative liabilities, and criminal liabilities are different, but interconnected. In addition, consumers should be entitled to take legal actions against MNCs for damages suffered from corruption. In the case of massive infringement of consumer rights, the China Consumers’ Association or the consumers associations at the provincial level may take up public interest lawsuits on the behalf of the victim consumers. In the case of administrative or criminal penalties imposed on a wrongdoing corporation, the fine should not exclude a consumer’s claim to damages. In addition to consumer litigation, the victim competitors should be permitted to file lawsuits against a wrongdoing corporation for compensation and injunctions. In China, the penalties imposed on those offering bribes are usually less harsh than those imposed on the bribe recipients in order to encourage the bribing firms to report to the government or the judicial system. Both sides of the transaction, however, benefit from bribes. As a result, MNCs, as the providers and beneficiaries of bribes, are not motivated to act as whistleblowers with respect to corrupt practices. The administrative penalties prescribed by Article 22 of the Unfair Competition Law of 1993 are minimal - in the case of bribes not serious enough to amount to crime, the regulator may fine from RMB 10,000 (equivalent to USD 1,600) up to RMB 200,000 (equivalent to USD 32,000) depending on the circumstances and the illegal income. Therefore, criminal and administrative penalties need to be made harsher in order to deter and punish corporate corruption. Although a plea bargain is unfamiliar to Chinese law, it is highly recommended that it be introduced in order to decrease the costs of investigation and improve the efficiency of legal enforcement, given the limited resources of regulators and the judicial system.

Fifth, anti-corruption practices should be added to the corporate governance structures of MNCs. Based on the successful experience of the corporate integrity obligation imposed by the CIA of 2012, corporations should be encouraged to establish an anti-corruption committee under the board of directors, and to create the position of Chief Anti-Corruption Officer (CACO) at the management level. The board of directors should be responsible for the CACO’s nomination and removal and the CACO should report on a timely basis. The board of directors should have a duty to monitor and evaluate whether corruption exists within the corporation. A practical Code of Conduct of anti-corruption should be learned and followed by the employees, especially those engaged in marketing. Needless to say, as MNCs and their directors, executives, and employees are sensitive to the negative impacts to their reputations, the corruption records of the directors, executives and employees should be made available to the public.
CONCLUSION

Although it is impossible to eliminate corruption once and for all in the global market, a policy of zero tolerance of corruption should become a global consensus. In addition to tougher punishments of corrupt practices and a more liberal, transparent, and competitive market based on the rule of law in the host countries of the MNCs, a more efficient international coordination mechanism based on shared information and mutual assistance should be expected. The reason is simple - corrupt practices are the common enemy in the global economy. MNCs should play the leading role in changing the traditional corporate governance in terms of reorienting corporate purpose, more deeply understanding of the real culture and society in the host countries, and adopting and employing serious corporate governance policies against corruption.

1 Press Release, United States Dep’t of Justice, GlaxoSmithKline to Plead Guilty and Pay $3 Billion to Resolve Fraud Allegations and Failure to Report Safety Data (July 2, 2012).
2 Laurie Burkitt & Jeanne Whalen, China Targets Big Pharma --- GlaxoSmithKline Hit with Bribery Allegations as Health-Care Sector Soars, WALL ST. J., July 16, 2013.
4 David Barboza & Katie Thomas, Former Head of Glaxo in China Is Accused of Bribery, N.Y. TIMES, May 15, 2014.
5 Id.
8 See Burkitt & Whalen, supra note 2.
13 See GSK Admits Under Bribery Investigation in Poland, supra note 11.
14 See Dean & Thompson, supra note 12.
16 Pharm. Multinationals Rethink Rebate Mkts. in China, XINHUA NEWS AGENCY, Apr. 11, 2014.
18 Barboza & Thomas, supra, note 4.
The Third Plenary Session of the 18th Communist Party of China Central Committee, which concluded on Nov. 12, issued a Communiqué and a Decision, laying down broad policy directions for comprehensively deepening reform and further opening-up. The Decision is widely regarded as being the blueprint for China’s future development. Comprehensively deepening reform (Quan mian shen hua gai ge), China Daily, Nov. 22, 2013, http://www.chinadaily.com.cn/china/201311/22/content_17123196.htm. For the full text of the Decision, please see: Nov. 18, 2013 http://www.ce.cn/xwzx/gnsz/szyw/201311/18/t20131118_1767104.shtml.

22. GSK’s China Sales May Be Down 30 Percent on Bribery Scandal: Analysts, supra note 20.
25. UNIV. OF MD., SER. ON CONTEMP. CHINESE LAW § 12:39.
26. Id. at § 17:15.
27. KENNETH A. CUTSHAW ET AL., CORP. COUNS. GD. TO DOING BUS. IN CHINA § 13:25 (3d ed.).
29. UNIV. OF MD., supra note 25.
32. See LIU JUNHAI, CORPORATE SOCIAL RESPONSIBILITY (1999).
38. See generally Douglas Guthrie, The Declining Significance of Guanxi in China’s Economic Transition, 1998 CHINA Q. 254 (1998); see also CORP. COUNS. GD. TO DOING BUS. IN CHINA, supra note 27, at § 2:4; Phil Taylor, The Risks of the Middle Kingdom, 65 No. 4 IBA GLOBAL INSIGHT 49 (2011) (distinguishing types of guanxi and arguing that a limited engagement of guanxi may be most effective); Jingchen Zhao & Shuangge Wen, Gift Giving, Guanxi and Confucianism in a Harmonious Society: What Chinese Law Could Learn from English Law on Aspects of Directors’ Duties, COMP. LAW. 2013, 34(12), 381-389 (illustrating the tension between guanxi-related traditions and directors’ fiduciary duties); Ian Lancaster, The Chinese Approach to Business and Law, 18 NO. 1 E. ASIAN EXECUTIVE REP. 10 (1996) (analogizing the more benign forms of guanxi with “good old boy networks or lobbying in the West”).
39. XIANFA [CONSTITUTION], March 15, 1999, art. 5 (China).
42 Lawrence M. Friedman, Law in America: A Short History 32 (The Modern Library, 2002).

43 See Anderlini & Mitchell, supra note 9.


47 See Dep’t of Justice, supra note 1.

48 GSK China to Implement New Comp. Programme, supra note 46.

49 Id.

50 Id.


52 New Comp. Programme, supra note 46.

53 See CIA, supra note 51.

54 Id. at 35.

55 Id. at 32.

56 Id. at 5-25.


58 Sima Qian, Shi JI, Biographies of Merchants (Shi Ji, Shi Huo Zhi Lie ZHUAN).


60 See generally 1 TREATISE ON THE LAW OF CORPORATIONS § 4:10 (3d) (offering a broad framework of competing arguments over shareholder primacy).


62 See Principles of Corp. Governance § 2.01, supra note 59; see also D. Gordon Smith, supra note 59.


68 H.E. Xi Jinping, supra note 65.


70 H.E. Xi Jinping, supra note 65.

71 See Mark S. Schwartz, supra note 61.

72 CIA, supra note 51, at 32.


74 On one hand, under Article 163 of the Chinese Criminal Law, the bribery recipients in a corporation shall be sentenced to a maximum of five years of imprisonment for a bribery crime of a significant amount. For a large bribe, the recipient can be sentenced between five and twenty years. On the other hand, under Article 164 of Chinese Criminal Law, the bribe providers in corporations shall be sentenced only to a maximum of three years of imprisonment for a bribe of significant amount, or sentenced to three to ten years for large bribes. Furthermore, the bribery providers, who have voluntarily confessed to the bribery prior to the initiation of prosecution procedure, shall be entitled to mitigated punishment or even exemption from punishment.


76 On March 1, 2013, the State Authority of Industry and Commerce launched a website with the credit information of every firm in China: http://gsxt.saic.gov.cn.