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Walmart's Discounted Ethics

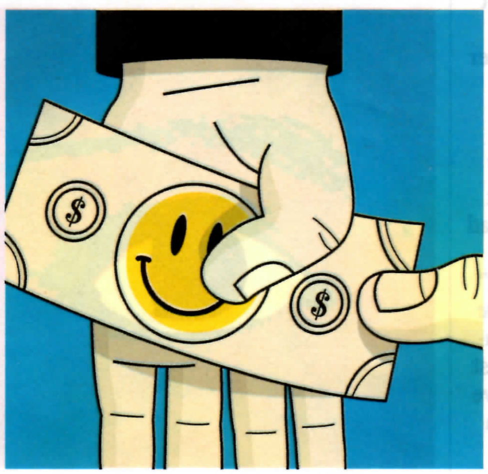
Its Mexican bribery scandal shows the perils of bowing to local "custom"

Walmart became the world's largest retailer by offering "everyday low prices" around the globe. Apparently, though, Walmart was offering something else too. The company has been plunged into a major scandal since a New York *Times* investigation revealed that Walmart's Mexico subsidiary paid $24 million in bribes to local officials to sidestep regulations and obtain construction permits for new stores. The worst part: the story alleges that then CEO H. Lee Scott and other top executives knew exactly what was going on and tried to hush it up. "This looks to me like a comprehensive failure on the part of Walmart's board," says Stephen Davis, director of the Millstein Center for Corporate Governance at Yale.

The markets agree. Walmart's stock has already fallen 7.5%, knocking $17 billion in value off the company. If there is a too-big-to-fail retailer, Walmart would have to be it. It has sales of $444 billion, employs 2 million people and supports tens of thousands of suppliers, some of them consumer-product giants in their own right. Its stock is held by many of the world's major pension funds—meaning that Walmart's troubles are very likely affecting your retirement money right now.

The bad news is that the corruption scandal doesn't seem to stop with Mexico. According to the *Times*, the company received 31 similar reports of "significant" allegations of corporate violations, including potential crimes by senior executives, in various global markets in 2006 alone. (The company wouldn't respond to TIME's questions about any of this; that might "compromise the investigation," said a spokesperson.) It seems that many of those cases were buried, just like the problems in Mexico. Ironically, at home Walmart has strict policies for its buyers: they can't accept so much as a coffee mug from vendors.

The scandal tells you that doing business in the world's fastest-growing markets can be fraught with peril. Emerging markets now account for the bulk of the world's economic growth, as well as about 30% to 60% of the revenues at many U.S. multinational firms. Indeed, one of the reasons that the stock market



has done relatively well throughout the downturn is that it was buoyed by U.S. multinationals earning more and more of their money in these still relatively fast-growing economies. This is particularly true of packaged-goods and retail firms like Walmart.

Many of these markets are rife with corruption—but graft is not necessarily perceived as a serious crime in some places. It's more a way of doing business. In Mexico, "the bulk of retailers pay bribes," says one veteran Mexican fund manager for a large U.S. financial institution. Indeed, Mexican firms are the third most likely to have to pay bribes, right after Russian and Chinese ones, according to Transparency International, an anticorruption NGO.

Most of the hottest markets—Mexico, China, India and others—score quite badly on TI's overall corruption index. But the nuances of corruption differ. I once interviewed a British businessman who led an international rollout for a major U.K. retailer and asked him which emerging markets had the most corruption. He said, only slightly tongue in cheek, "In China, you might pay 20¢ on the dollar to get your project done, and it will get done quickly. In India, it's 40¢, and it will get done in a few years. In Russia, it's 80¢—and you may get shot before it gets done."

There are no such nuances for American companies subject to the Foreign Corrupt Practices Act (FCPA): regardless of the local practice, bribery is illegal. And as U.S. firms' business in foreign markets has grown, so has the Justice Department's aggressiveness in pursuing FCPA cases, which have been on the rise over the past few years. A number of big retailers have decided that the risk-reward ratio in such markets simply isn't good enough. Ikea, for example, stopped opening stores in Russia because of corruption and delayed its India expansion in part because it didn't believe it could adequately police complex local supply chains there.

It was an unusually proactive move; another lesson from the Walmart case is that it usually takes a crisis to spur real change. Siemens, the German industrial conglomerate, has been rehabilitating itself since a 2006 corruption scandal involving more than $1 billion in bribes across several countries torpedoed its reputation and stock price. After Siemens worked with Justice officials, its codes of conduct became a competitive selling point and were widely copied by other firms. Walmart should take note. As anyone familiar with Watergate knows, the cover-up is usually worse than the crime. ■