Walmart de Mexico and the Foreign Corrupt Practices Act: Stepping Over the Border and Stepping Over the Line

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This case examines the allegations of bribery of government officials by Walmart's Mexican subsidiary and the subsequent investigation carried out by the U.S. Department of Justice. The primary subject matter of the case is the Foreign Corrupt Practices Act (FCPA) and the potential lack of effective leadership. The case reviews the important components of the FCPA, looks into the specific acts of potentially illegal behavior in Mexico and the United States relative to the incident, and proposes the question of how Walmart could have handled the situation more effectively. The case provides a view into potential pitfalls MNCs encounter when conducting business in developing countries with differing ethical standards.

INTRODUCTION

On April 21, 2012 a shocking report was published in *The New York Times* by David Barstow detailing allegations that Walmart de México y Centro América (Walmart de Mexico) had made illegal bribes to Mexican government officials in order to facilitate its rapid and successful store expansion inside the country. The allegations were that Walmart executives in the United States knew as early as 2005 that American and Mexican laws were being violated and that more than $24 million was paid to government officials in bribes. It is alleged that Walmart executives in Mexico paid bribes to mayors and other politicians as well as to government officials who could speed up approval for construction of its stores in Mexico. It is alleged that Walmart executives in the home office at Bentonville, Arkansas were made aware of the illegal activity and did little to correct the situation. Only after the company got wind of the investigation by *The New York Times* did it contact the U.S. Department of Justice (DOJ) to indicate that the company may have violated the Foreign Corrupt Practices Act (FCPA). In the days following publication of the article Walmart lost $17 billion in stock valuation and action from Bentonville needed to be taken. It was clear that ignoring federal law and a lack of oversight might be very costly for Walmart and its stakeholders.

FOREIGN CORRUPT PRACTICES ACT

The history of the FCPA can be traced back to a cold day in 1975. On that day – February 3, 1975 – Eli Black, president and chairman of United Brands (now Chiquita) went to work at his 44th floor office in Manhattan, broke out a window, and then jumped to his death. Mr. Black was the subject of an investigation by the United States Securities and Exchange Commission (SEC) into payments made to the president of Honduras. The investigation found that Mr. Black had made a $2.5 million payment into a Swiss bank account for the president which resulted in a lowering of export taxes on bananas, resulting in saving United Brands an even larger sum of money. The bribery and subsequent reduction in export taxes in Honduras lead to the collapse of the banana cartel operating in Central and South America. This incident, which helped spur further investigations, discovered that hundreds of American companies were paying bribes to foreign officials, thus leading Congress to pass the FCPA in 1977. Prior to passage of the Act it was not illegal to pay bribes, but it was unlawful under SEC rules not to disclose those payments.

The FCPA, as amended, makes illegal the payment to foreign government officials anything of value which secures or retains business. The payment of money or anything of value, or the promise of a payment is illegal under the Act. Payments made through intermediaries are also prohibited. Penalties can be both criminal and civil and include fines of up to $2 million (possibly more based on the expected benefit from the bribe) and up to five years of imprisonment for violators. Both individuals as well as corporations can be liable under the Act. There are also accounting provisions in the FCPA for listed firms in the United States. Those provisions facilitate enforcement of the Act. An amendment was added to the Act that extended its reach to foreign firms operating in the United States.

In addition to banning American companies from paying bribes abroad, the FCPA serves another useful economic purpose. It helps ease the billions of dollars lost in the economy and the reduction in potential investment brought about by bribery and corruption.

There are exceptions to the Act that include "facilitating payments" made for "routine government action." The exemption includes payments to facilitate or expedite processing of government paperwork, obtaining licenses, unloading cargo, and other such actions. In doing so, however, government officials must not act contrary to their duties as a public servant.

The Act not only covers American companies, but also foreign companies if the action occurs in the United States or the company is listed on an American exchange, including American Depository Receipts (ADRs). In fact the largest case to date in terms of fines ($3.5 billion) was the case brought by the Department of Justice and the SEC against the Brazilian companies, Odebrecht and Braskem, for paying hundreds of millions of dollars in bribes around the world. The company pleaded guilty to bribing government officials in Brazil and several other countries through a number of shell companies including their Miami division. The companies also used a number of international banks, including banks in the United States, to hide the illegal transactions. The bribes were believed to have produced over $3 billion in profit for the companies.

While the Act was passed in 1977, it was seldom enforced. And while few individuals have actually gone to jail for violating the FCPA (the most notable being Albert Stanley of KBR/Halliburton who served 30 months for bribing Nigerian officials), enforcement has now significantly increased and more companies and individuals have been prosecuted. In 2016, a record year for FCPA violations, the government settled charges against 27 companies including some well-known American companies such as JPMorgan, Johnson Controls, Las Vegas Sands, and the once American owned company, Anheuser Busch InBev.

Critics of the FCPA believe that the Act is bad for American business. They feel that the law puts American businesses at a disadvantage in conducting business abroad. Corruption and bribery of government officials is a common occurrence in many countries, and it is sometimes simply viewed as a cost of doing business in that country. When American companies compete with companies from countries without anti-bribery laws, American firms are at a disadvantage. While the United States was alone in 1977 in having such a law, in 1999 the Organization for Economic Cooperation and Development (OECD) put in force its Anti-Bribery Convention. The Convention, which now covers 39 countries, agreed to make bribery of foreign officials a criminal offense in their countries. The United States is a signatory to the Convention, along with Canada, Germany, the United Kingdom, Russia, Mexico, and others. Many of the OECD signatory counties, however, have a poor enforcement record of the Convention. Some critics, including the U.S. Chamber of Commerce, have called for amending the FCPA to make it fairer to American businesses. One recommendation is to reduce liability for American companies when their foreign subsidiaries violate the Act.

WHEN IN MEXICO ….

It was in September 2005 that Walmart's home office received word that the company was in possible violation of the FCPA. In an email from Sergio Cicero Zapata, a Walmart de Mexico executive, to Maritza Munich, general counsel of Walmart International, it was alleged that illegal bribes were being paid to Mexican officials. Cicero told Munich that he had been involved in the bribery and that the bribery was directed by then CEO of Walmart de Mexico, Eduardo Castro-Wright.

After receiving the disturbing email Munich informed Walmart top management personnel of the bribery allegations and the company soon hired a legal firm with expertise in the FPCA. The law firm recommended an intensive investigation of the allegations. However, Walmart executives instead decided to do an in-house investigation first using its corporate investigations department, a unit with little expertise in this area of law. The investigation was headed by Ronald Halter, a retired FBI agent. By November 2005, Halter and his group of investigators were in Mexico. The team had found that Walmart regularly used what were called "gestores," or intermediaries, to make payments to government officials. The team further concluded that while Walmart de Mexico CEO, Eduardo Castro-Wright might very well have been aware of the payments, the team was not allowed to interview him. After conducting his investigation, Halter, concluded that there was reason to believe that American and Mexican laws had in fact been broken. He too recommended a more extensive investigation and one that included an investigation into the role of Castro-Wright and the gestores. The investigation by Halter had mixed stances back in Bentonville. There was a difference of opinion as to how to proceed. Maritza Munich resigned from her position in 2006 after recommending a full and complete investigation of the Walmart de Mexico activities. She was one of many Walmart executives to leave the company since the investigation.

In February 2006 a meeting was convened by then Walmart CEO, H. Lee Scott. At the meeting a new protocol was developed to assess the appropriate response to investigations. Serious allegations of wrongdoing would be investigated by the home office and less serious ones would be investigated by the local office where the wrongdoing was alleged to have occurred. The Mexico issue was then turned over to José Luis Rodriguez Macedo Rivera, general counsel for Walmart de Mexico. Mr. Rodriguez Macedo did a quick investigation and concluded that no bribery had occurred in Mexico. Walmart invoked an attorney-client privilege to keep Ms. Munich from speaking on the issue.

Sergio Cicero, who had been the person to first bring the issue to light in Bentonville, was fired according to Rodriguez Macedo, and it was alleged that he had probably pocketed the millions of dollars that were alleged to have been paid to the gestores. As far as Rodriquez Macedo was concerned, the case was closed. Company records, however, show that Cicero had resigned and had been paid a bonus for his service to the company. He was never charged with stealing the millions of dollars Rodriquez Macedo alleged. In 2008 Walmart de Mexico's CEO, Castro-Wright, was promoted to vice chairman of Walmart Stores, Inc. for his success in making Mexico a star in Walmart's international portfolio of operations.

Some have argued that when conducting business in countries with high levels of corruption it is nearly impossible not to engage in corruption in order to be successful. They claim that adaptation to local practices is necessary, and in some cases, simply good business practice. Corruption is widespread in

Mexico. The watchdog group, Transparency International, ranks Mexico 123rd out of the 176 countries it tracks in terms of corruption. The higher the ranking (for example, 176) the more corrupt the practices of the country. Mexico ties with countries such as Laos, Sierra Leon, and Azerbaijan and is considered to be more corrupt than Pakistan and Ethiopia. It was rumored that Carrefour, the giant French retailer and competitor of Walmart, left Mexico in 2005 due to its corruption. In a country where laws can be vague, including those concerning building permits and zoning, the process of approval can take a long time. The right bribe to the right government official can greatly speed up the approval process, while not providing a bribe can double the process time. With this and the general acceptance of bribery, it can sometimes be tempting to forego. Many multinational corporations have instituted codes of conduct to help when these temptations arise.

WALMART AND INTEGRITY

Walmart had a statement on corporate ethics and it began with what were referred to as the *Three Basic Beliefs*: 1) respect for the individual, 2) respect for the customer, and 3) striving for excellence. The Statement of Ethics, which was revised in 2008, is actually a quite lengthy document consisting of 34 pages covering issues such as financial integrity, conflict of interest, harassment, fair competition, and many other potentially ethical issues. Areas of particular interest to this case, termed Anti-Corruption and Political Involvement state:

> *We do not tolerate, permit, or engage in bribery, corruption, or unethical practices of any kind. Bribery of public officials in the U.S. and abroad is illegal under both U.S. law and the local law of the countries in which we operate. Walmart's policy goes beyond these legal requirements and prohibits corrupt payments in all circumstances, whether in dealings with public officials or individuals in the private sector.*

On April 12, 2012, in anticipation of *The New York Times* article, Walmart created a webpage with a video featuring David Tovar, Vice President for Corporate Communications. Mr. Tovar explained how Walmart was handling the investigation and what steps had been taken in Mexico to avoid future problems. Further, in their Global Statement of Ethics Report, Lee Scott is quoted as saying, "Integrity is the single most important characteristic of a leader." The report defines integrity as being honest and fair while operating in compliance with all laws and company policies. A commitment to complying with all applicable antitrust laws is reinforced as a need to enable open markets.

Excerpts from the video included the following statements: 1) *Many of the alleged activities in The New York Times article are more than six years old*, 2) *… we have established a dedicated FCPA compliance director in Mexico that reports directly to our Home Office in Bentonville*, 3) *Over the last several years, Walmart has focused diligently on FCPA compliance and implemented a series of changes to our compliance program*, and 4) *In a large global enterprise such as Walmart, sometimes issues arise despite our best efforts and intentions*. The webpage indicated that Walmart was investing more in training, internal controls, and policies in order to make sure its ethical principles are followed.

Walmart de Mexico supposedly shared the Three Basic Beliefs of its parent company in its statement of values, but is much more limited in what it provided the public via its corporate website. Walmart de Mexico states on its site (in Spanish) that *"Walmart de Mexico and Central America is a company dedicated to trade. We operate in six countries: Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Nicaragua"* (translated into English). The site goes on to state: "*Our Vision is to help improve the quality of life of families in Mexico and Central America*."

Walmart has in many ways improved the lives of the people of Mexico. The company hires over 200,000 Mexican workers and is the country's largest private employer. Not only has Walmart brought jobs to Mexico, but Walmart has also increased shopping opportunities for Mexican consumers. With over 2,000 stores in Mexico, Walmart is bringing “everyday low prices” to Mexican customers who in general appreciate the entry of Walmart into their country.

Walmart has had its share of bad publicity in the past, including charges of discrimination, problems with foreign suppliers over their employee’s working conditions, and allegations that the company kills local businesses who can’t compete with the retail giant. Walmart has made great strides in improving its public persona and has tried to be a good corporate citizen, especially in recent years. The company has contributed billions of dollars to various charities, championed environmentally friendly business and products, and has provided employment to millions of people, many of whom may be marginalized in society.

WALMART’S LEADERSHIP AND NATIONAL CULTURE

Some call Walmart de Mexico’s bribery scandal one of the most closely-watched cases of alleged malfeasance by one of the world’s largest companies. Its cover-up by the Bentonville, Arkansas headquarters raises a gamut of leadership and governance issues. Others call it a deplorable leadership failure by a global company, making it a cautionary tale for corporate executives.

The story reported in the *Times* alleged that Walmart de Mexico, directed by the then country CEO, Mike Duke, and his General Counsel, Thomas Mars, bribed local officials to get clearances and permits for new stores. To do so, they falsified records of their transactions. When a lawyer working for Walmart de Mexico exposed the plot in 2005, senior leadership in the U.S. and in Mexico put a halt to two efforts by company officials in Bentonville to complete an independent investigation. The whistleblower’s story was returned to Mexico and buried. At issue are when and what these company leaders told the board and what oversight processes were available to the board.

Through January, 2014, Walmart has spent $439 million on investigations into the alleged bribery charges and violations of the FCPA. According to a May, 2017 report, it is estimated that the company will spend at least $300 million more to settle the case. Total costs may reach $1 billion.

One question that can legitimately be asked is whether the bribery actions in Mexico, despite the investigation costs and loss of reputation, are in part culturally motivated. In many cases, the values, norms, and beliefs of a company may be partially imposed by the national culture. Research housed by the Hofstede Institute shows that Mexico is a masculine culture that is high on uncertainty avoidance and indulgence. In general, Mexican society values competition in work, risk taking, and ambition. Walmart de Mexico’s drive to be financially successful and the star performer in the corporation, even if legal risks had to be taken, are examples of masculine cultural behavior. As a country, the Mexican people are also uncomfortable with unknown or surprising situations. They need clarity and structure. For example, they are likely to have a low tolerance for whether a zoning permit would be granted or a new store opened by a specific target date. As an indulgent culture, Mexican people place a higher importance on leisure and believe that maintaining order in the nation is not a high priority. For the leadership at Walmart de Mexico this likely suggests that making fast money and subverting the laws prohibiting bribery are normative actions.

Personal values are important in understanding leadership. They define character and in part, determine the management style of CEOs and top executives. At times, managers may have to choose between having compassion for the needs of their subordinates and duty to their organizations. The tension between such choices can result in core value conflict. Failing to respect basic human, social, cultural, and professional values can diminish a leader’s effectiveness and bring reputational damage to his/her company.

The amount of risk Walmart’s Mexico unit took to be a financial star and the willingness of officials to possibly violate the FCPA may be related to the company’s ethical stance. The moral principles influencing conduct at the top of the organization in Bentonville set the ethical tone that filtered downward to Walmart de Mexico. If directors set a bad example by valuing expansion and profits over integrity and respect for anti-bribery laws, their behavior was emulated by subordinates. Walmart’s ethics simply increased the type and degree of risk taking that the company deemed acceptable. With a culture of greed so entrenched in Walmart's ethical stance, the threat of reputational damage was not enough to prompt decisive action from the top. Instead, calls for interrogations and transparency fell on leadership's deaf ears. What followed were obfuscation and management changes designed to facilitate a cover up.

Writers have rightfully commented that "it's no longer prudent to judge corporate leaders' performance solely on the extent to which they create wealth for investors." What they propose as an alternative metric to gauge leadership is the extent to which CEOs and corporate officials create companies that are economically, ethically, and socially sustainable. What occurred at Walmart related to the bribery in Mexico was a prolonged struggle at the highest levels of the company that pitted its "much publicized commitment to the highest moral and ethical standards against its relentless pursuit of growth." The *New York Times* story detailing the events that ensued is more than a black eye to Walmart, "it's a sucker punch to U.S. business, which begs the question – does morality and ethical leadership matter?

WALMART MOVES FORWARD

In 2009 Michael Duke replaced H. Lee Scott as CEO of Walmart. Mr. Duke had been in charge of Walmart's international operations when the alleged Mexican bribery was occurring. The allegations made in *The New York Times* article presented Mr. Duke with some difficulties. Fallout from the allegations was widespread ranging from issues of public relations to a lawsuit filed by the California State Teachers Retirement System on behalf of Walmart itself. The suit sought damages for Walmart and its shareholders from specific individuals that include Walmart's board of directors, Michael Duke, H. Lee Scott, Eduardo Castro-Wright, and others.

While the FCPA case dragged on Michael Duke was replaced by Doug McMillon and Eduardo Castro-Wright retired from the company. Since the *New York Times* article was published the company has instituted a number of changes including the establishment of The Global Ethics Compliance & Risk Committee and greater responsibility for the Audit Committee to investigate allegations of corruption. Walmart has spent in excess of $837 million on investigation and compliance matters. The company has established a hotline for employees to report issues of corruption and now issues a Global Ethics and Compliance Program update with its financial statements. Walmart still faces potentially large fines and penalties as a result of the FCPA case. While it is not likely that individuals involved will receive jail time for their alleged involvement in the case, if Walmart pleads guilty to the crime, the company faces the possible loss of being able to participate in the federal Supplemental Nutrition Assistance Program (food stamps), which represents a significant revenue stream for the company. As the case winds down, fines in the range of $300-600 million have been proposed by the U.S. government, which Walmart's financial position can absorb. Questions still remain concerning how the problem arose and how it should have been handled.

The activities and decisions that were made by Walmart's top managers will likely result in well over a $1 billion loss to shareholders. Questions that remain include what risk management procedures were in place or should have been in place when Walmart began its expansion into Mexico? Being a large and successful international player, did Walmart act on any potential red flags that may have arisen in its success at getting permits in Mexico so quickly? Should Walmart have acted sooner in self-reporting its discovery of possible violations to the DOJ and the SEC? What role should the Board have played in preventing this activity and did it fulfill its fiduciary duty? In countries where bribery is said to be essential for businesses, what should leaders do to ensure ethical practices while still establishing their company?

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