Impact of culture on retail industry compliance

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Key Words
Retail Industry, Compliance, Globalization, Culture, Corporate Conscience, and Corporate Social Responsibility.

Abstract

This paper covers Retail Management, globalization, ethical and legal issues related to the Retail Industry. Specifically the paper looks to a connection between a company's emphases on culture as a mechanism to assure compliance. This paper looks at some relatively recent current events by Retail Industry giants like Walmart and Kroger. Leveraging secondary research these events will be discussed. In addition this paper will leverage primary and secondary research to help highlight a company's culture as a very effective mechanism to prevent compliance failures.

The primary research included in this paper was conducted via anonymous phone interviews. Interviewees were assured of anonymity, and provided the aggregated anonymous research results for their efforts. Interviewees were asked a script of questions that range from Yes/No questions, to scale questions and open ended questions. The interviewees included in the survey were confirmed to be senior-level human resource professionals with a focus on compliance. This primary research is not positioned to be statistically representative of all global retailers. This primary research does reflect a perceptive given the reach and size of the selected companies that participated. The primary research in support of this paper is limited to only a select few respondents. This is likely due to the nature of the compliance function in companies erring on the side of caution.

Global retailers have many, large forces that have created a large degree of competitiveness. There are several studies and anecdotes that tell the story around cost of compliance outweighing the cost of non-compliance.

1. Introduction

The definition of "retailing" is very well known, however, to ensure a common understanding retailing as discussed in this paper is the business of selling goods and/or services directly to consumers. This paper focuses on some of the world's largest retailing organizations. The retail industry as a whole has become quite competitive. As such, retailers need to strategize and differentiate their price, customer service, delivery and quality of work in order to succeed. "Successful retailers must become more service oriented, offering better value in price and quality; more promotion-oriented; and better attuned to their customers' needs. (Dunne, 2008)" Globalization is another well-known trend that has transformed the retail industry.

"Compliance generally refers to the conformance to a set of laws, regulations, policies, best practices, or service-level agreements. Compliance governance refers to the set of procedures, methodologies, and technologies put in place by a corporation to carry out, monitor, and manage compliance. Compliance governance is an important, expensive, and complex problem to deal with. (Silveira, 2012)" According to findings published by AMR Research in 2008 companies will spend more than $32 Billion on governance, risk management and compliance (McGreevy, 2008).

The increasing competitiveness and globalization have made it more difficult for retail giants to ensure compliance (Shelton, 2003). Another competitive dynamic at play is the rise of online retailing as well. This is evident in some of the very public compliance misconduct that has hit the news, which includes noteworthy examples like Walmart's Mexico bribery scandal (Barstow, 2012) and Ralph Grocery's union strike rehire scandal (Green, 2006).

This article will discuss some retail industry dynamics, specifics on the two noteworthy examples of retail compliance failures, data points from select secondary and primary research, as well as thoughts for academics and practitioners in the retail space.

2. Literature Review

2.1 Retail Industry Overview

The size and breadth of the retail industry's global footprint is staggering. According to Deloitte and STORES Magazine's annual "Global Powers of Retailing" report the top 250 global retailers had aggregate revenue of over $4Trillion in 2011. Even with the recovering global economy, this is the largest aggregate revenue for the top 250 retailers to date. The average top 250 global retail company has a footprint of at least 9 countries. Additionally, 23.8% of the top 250 global retailers came from revenue generated outside of the respective companies' domestic headquarters (Deloitte, 2013).

Laws, regulations and other government policies have a number of positive or negative effects on the retail industry. For example, government backed loans and subsidies can help retailers grow meanwhile government regulation can be costly for retailers such as requiring retailers to implement a new system, procedures, and/or increasing the minimum wage rate. Societal factors impact retailers. Retailers are under pressure to develop and implement socially responsible business practices such as; selling environmentally friendly products. Retailers that fail to conform to new social norms often lose business to companies that are willing to adapt to changing societal values. Research has shown that companies that invest in the necessary compliance activities (i.e. procedures, technology, training, etc…) see an economic benefit over those companies that fall out of compliance. Research conducted by the Ponemon Institute approximated that the non-compliance cost is 2.65 times the cost of compliance, based on its primary research involving 46 organizations. According to this research the biggest impact from non-compliance was not seen in fines and penalties as one may initially suspect. The most significant cost from non-compliance is actually seen from disruption to the regular business routines. That is non-compliance events usually require employees to deal with these events rather than their normal duties. The top 4 impacts to an organization for non-compliance, in order of magnitude, include: business disruption, productivity loss, revenue loss and then fines/penalties (Ponemon, 2011).

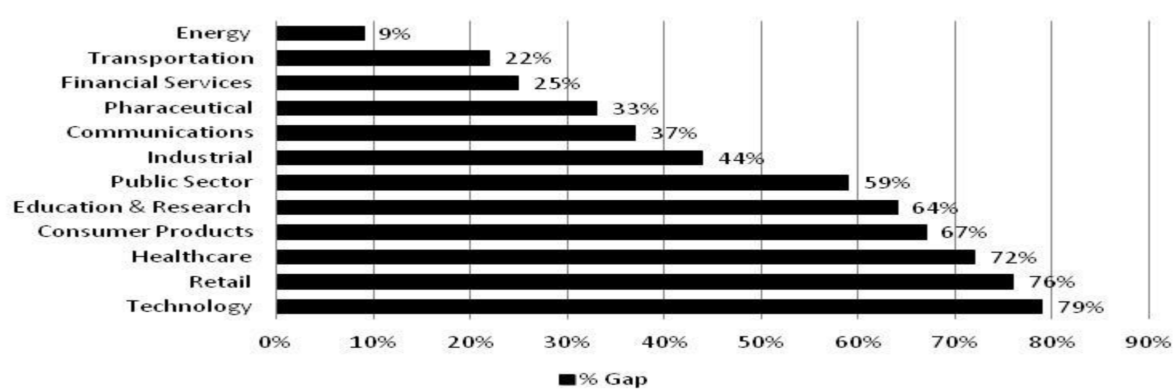

Figure 1 – Percentage Gap between Non-Compliance and Compliance Cost by Industry (Ponemon, 2011)

The figure reproduced above highlights another interesting aspect of the Ponemon study, which is that the Retail industry has one of the largest gaps between non-compliance and compliance cost. That is the study suggests the retail industry is quite vulnerable to failures in compliance. This is likely due to the high volume and customer touch nature of the retail industry, as well as the power of the brand and word of mouth.

Looking further into the retail industry as a whole, especially around the industry's compliance arena, the "Addendum to State of Compliance 2013 Survey Retail and Consumer Industry Report" published by PricewaterhouseCoopers LLP provides additional insights. This report is part of PricewaterhouseCoopers' periodic survey on compliance patterns from multiple industries. The report includes the results of 780 company leader respondents, of which retail leaders comprised 48 of the total respondents. One insight can be seen in the chart recreated below, which summaries the top 3 risks facing a company. The responses are compared between the overall survey respondents (all industries) versus only the retail industry. The top 3 risks for retail industries were Strategic Risk, Anti-Corruption/Anti-Bribery and a 3-way tie between Data Privacy/Confidentiality, Safety/Environment and Business Continuity. The retail industry had a noticeable gap in Strategic Risk as the number concern when compared to the industry. It is also interesting to notice that Anti-Corruption / Anti-Bribery having a 5% gap as the second choice (Bernstein, 2013). Without seeing the details of the companies representing the retail industry, there is no way to know to what extent the largest retail companies in the world fell between these top two choices. Given their global brand and the potential for very public consequences around bribery and corruption violations one may think this risk category would be higher in the rank. Given the competitive and global pressures on retail companies, it seems the strategic risk may be an indicator of a focus more around growth and revenue.

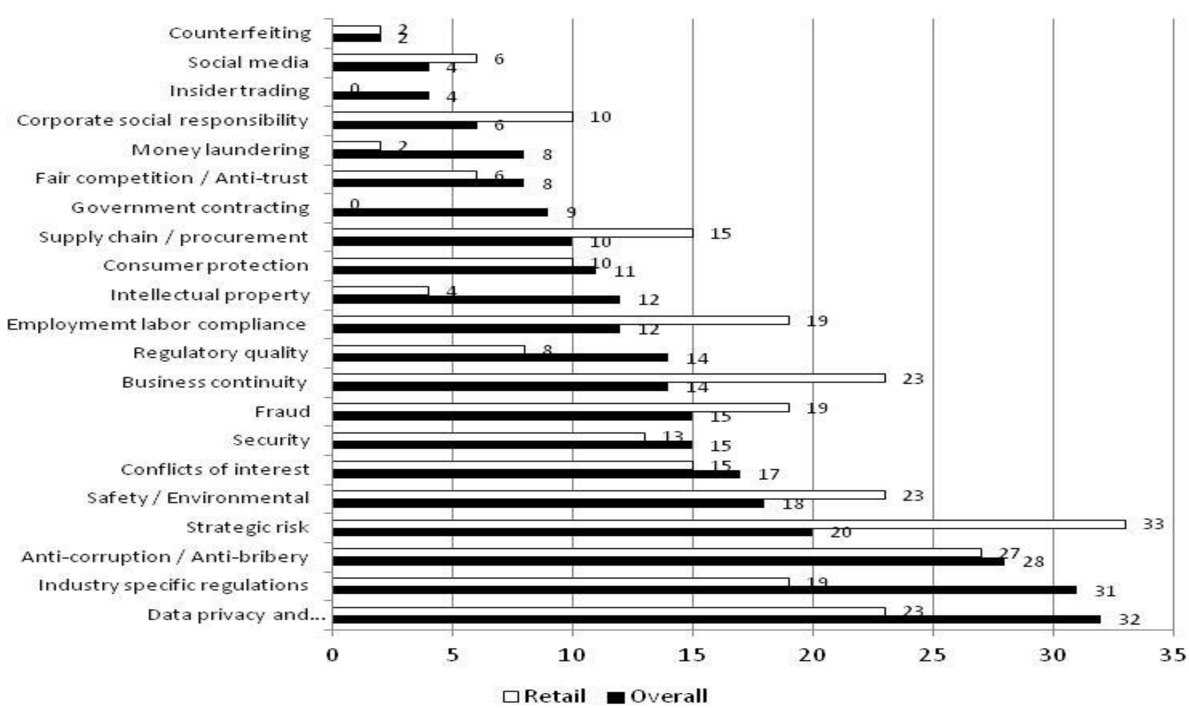

Figure 2 – Top 3 Areas or Perceived Risk (Overall Industries versus Retail) (Bernstein, 2013)

The report goes on to convey other interesting highlights, including the number one use of technology in assisting with risk mitigation being its use for training (delivery, testing and tracking). A majority of retail companies now also have a Chief Compliance Officer, or an equivalent title to indicate an individual in the head compliance role for the company. The survey indicated this was the case in 63% of retail companies, although what is interesting is that is a 17% gap when compared to all industries (Bernstein, 2013). This may signal the fact that the retail industry continues to evolve in considering compliance a key concern for the company. To extend this thought the survey goes further by stating "Day-to-day reporting to a Chief Risk Officer is less common in R&C companies (2%) than in companies in other industries (10%)" (Bernstein, 2013). This shows that relatively few companies have their Chief Risk Officer setup for day-to-day reporting, but this is even more so with only 2% of retail companies doing so.

Retail corporations need to be concerned with ethics, social responsibility, and the overall environment. There is a great deal of government legislation that impacts not only retail corporations' internal operations, but also their interactions with their various channel partners. These partners can include suppliers, competitors, collaborations, employees and end customers. Legal restrictions can touch on a company's pricing, product, promotion, distribution, trademarks and human resources policies.

3. Noteworthy Example of Retail Compliance Failures

3.1 Walmart Bribery Scandal

When discussing retail giants it is hard not to immediately think of the world's largest retailing company, Walmart. Walmart alone exceeds 10% of the top 205 global retailers' revenue (Deloitte, 2013).

In 1991 Walmart entered into a joint venture with Cifra with the opening of a Sam's club in Mexico City, the first market in Walmart's international division. In 1997 Walmart acquired a majority position in Cifra and in February 2000 the name changed to Walmart de Mexico (WALMEX). In 2006 Walmart de Mexico received a license from Mexico's finance ministry to organize and operate a bank in the country. In 2007 Bunco de Walmart began operations with 16 branches in five states of Mexico (Walmart, 2014).

Like many retail powerhouses, Walmart has made international growth a primary focus. This includes the growth into the Mexico. In a short period time of about 11 years (2003 to present), Walmart has since become Mexico's largest private employer with over 200,000 employees. The controversy portion of this growth is reported to date back to 2003 when Walmart is alleged to have engaged in bribery with an official in a local town in order to modify the zoning to allow Walmart to open a store in that location at an accelerated rate. The store in question opened in 2004, just in time for the Christmas holiday shopping season. Initially the official response from Walmart was that the United States headquarters was not aware of the bribery details in Mexico. After some time lapsed, additional documents revealed that the former legal head of the Walmart Mexico division reached out to a senior Walmart lawyer in 2005 of the allegations. From information revealed, the senior lawyer coordinated with the US headquarters to uncover a "campaign of bribery" that is thought to have totaled over $24 million in payments. The reports suggest the bribery helped greatly expedite the creation of at least 19 stores across the country. After further investigations were requested by the senior lawyer in the company, allegedly the Walmart executive leadership decided to shut down the investigation. As far as records can tell, no law enforcement officials were notified, and no leaders in Walmart Mexico were disciplined by the company. The reported head of the Mexico division, Eduardo Castro-Wright, even moved on until 2008 to become Vice-Chairman. Reportedly, the matter was essentially buried within Walmart until word of the New York

Times reports came to light in Dec 2011. The New York Times details a very in-depth and fascinating case of conflicts of interest when dealing with the internal investigation, with several high ranking individuals who were part of the accused group able to voice their conclusion that no wrong doing had taken place. Shortly after the New York Times informed Walmart of the article, Walmart reported to the United States Justice Department of an internal investigation and potential violations of the United States “Foreign Corrupt Practices Act” (Barstow, 2012). Since that time additional details have come to light, such as Walmart allegedly leveraging a Mexico Governor to help facilitate $156,000 in bribe payments. Walmart’s internal investigation ultimately expanded beyond Mexico and into Brazil, China and India (Feeley, 2013).

The impact to Walmart is still uncertain. Some impacts that have come to light from this scandal include: multiple investor derivative lawsuits, Department of Justice and Securities Exchange Commission investigations into violations of the Foreign Corrupt Practices Act, brand damage and so on. As of December 2013, Walmart has projected the company “will have spent more than $400 million by end of its fiscal year in January” 2014 (Friedman, 2013). An analysis of “Foreign Corrupt Practices Act” violations indicate that investigations into violations can take anywhere between two to six years. Prior penalties for violations of FCPA have been 1% to 2% of annual sales that were derived due to the violation in question. The UBS investigation suggests that should Walmart be found guilty of violating the FCPA, the company may be penalized at least $4.5 billion. Additionally, these allegations may slow down Walmart’s projected growth in Mexico by 5%, which the UBS analysis approximates at a loss of $1.3 billion (Brown, 2012).

3.2 Ralph’s Grocery Rehiring Scandal

Another retail giant is the Kroger Company, which is the second largest US retailer in the world at 2011 revenue of over $92 billion. Kroger Company owns several grocery chain stores in various countries, including Ralph’s Grocery in Southern California (Deloitte, 2013). Like many grocery store chains in the United States, Ralph’s Grocery works with unionized employees. In 2003 – 2004 Ralph’s Grocery was engaged in a labor dispute. Ultimately the dispute escalated to a lockout of Ralph’s approximately 19,000 employees. The scandal materializes in what Ralph’s did during the lockout. Ralph’s admitted to a California Federal court that during the lockout the company forged identities in order to rehire a subset of union employees during the lockout, but at lower wages and benefits. The exact numbers of employees rehired is not disclosed, but has been listed in the hundreds. Ultimately the prevailing United States District Judge Percy Anderson stated in his ruling that Ralph’s Grocer had a "pervasive and powerful corporate culture" that "exalted profits" with a "win-at-any costs" approach. In the end, Ralph’s Grocery agreed to a plea arrangement of $70 million in criminal fines, which includes $50 million going towards a “restitution fund” for the employees and unions. The remaining $20 million was paid as a criminal fine to the US DOJ (Mrozek, 2006).

4. Primary Research

4.1 Retail Industry

The primary research conducted for this paper was focused on the top global US retailers by revenue, according to Deloitte (Deloitte, 2013). The research was conducted via anonymous phone interviews. Interviewees were asked a script of questions that range from Yes/No questions, to scale questions and open ended questions. The interviewees included in the survey were confirmed to be senior management and/or executive level human resource professionals with a focus on compliance. This primary research is not positioned to be statistically representative of all global retailers given the fairly small sample size, however, does provide a relevant insight given the reach and size of the selected companies that participated. Companies that were contacted as part of the primary research include: Costco, Home Depot, Kroger's, Safeway, Target, Walgreens and Walmart. Ultimately, primary research interviews were held with a subset of the seven companies contact. Specifically primary research discussions were held with Costco, Kroger's and Target.

All companies interviewed indicated the presence of a whistle blower policy, as well as companywide training on ethics. The most widely used delivery method for the ethics training was via web-based technology. When asked if the Walmart Mexico scandal impacted the perceived confidence in their company's compliance controls, all respondents indicated the scandal did not impact their perception. Interestingly, Costco and Target indicated one reason they believed their companies were well positioned to prevent compliance violations was due to their respective company cultures. Comments about employees holding the company's reputation in high regards, and close relationship with the communities were emphasized by both Costco and Target. One of the respondents with Target went on to state that companies who have a singular focus on the "bottom line" often create a greater risk of violating their compliance / ethics controls. Hence her belief that Target's focus on culture and the community is a strong mitigating factor that couples with compliance protocols and training (Church, N. Primary Research Interviews, December 18, 2013).

6. Discussions and Conclusion

Judge Anderson's message around a "win-at-any costs" approach seems to reflect a commonly observed theme in both of these incidents. Although both companies reported robust compliance procedures and whistle blowing policies, it seems feasible that the companies' cultures may have ultimately fostered an environment that allowed such violations to occur. The secondary research prevented above suggests that companies that do engage in compliance violations may receive a short-term benefit, but that benefit is likely to not outweigh the costs of the violations. One could look at the US Automobile industry as an example of this lesson. In 2010 Toyota went through a compliance failure in a very large scale and public recall. Ultimately the full cost of this recall is still in process; however, a class action lawsuit alone is expected to require a payment of over $1 billion from the largest automaker in the world. This is in addition to lawsuits from Attorney Generals in 28 states, a $60 million fine from the National Highway Traffic Safety Administration, and reputation damage that impacted sales greatly until Toyota engaged in steep sales to counteract (Vlasic, 2012). This example reflects the damage a lapse in compliance can have on a corporation, and the struggle between a "corporate conscience" versus a bottom line only view.

The articles, reports and literature discussed above conveyed a consistent pattern around the cost for compliance exceeding the cost for non-compliance. Additionally, research from the Ethisphere Institute suggests the companies that are proactively compliant and ethical (i.e. embrace a corporate social responsibility framework) outperform the average company. Specifically companies that are included in their "World's Most Ethical (WME)" index have outperformed the Standard & Poor 500 index. WME companies from 2007 – 2011 delivered a 27% return to shareholders, compared to a negative 8.5% shareholder return for the S&P 500 during the same period (Parker, 2011).

As discussed above, retail giants are uniquely exposed to competitive pressures, globalization and the impact of online commerce. Also discussed, the retail industry has a larger exposure to non-compliance than the market at large. Walmart and Kroger's Ralphs Grocery stores were discussed as two high-profile compliance failures. Such failures can take years to fully understand the costs, but research suggests there will be material impact to both giants.

The primary research provides a very interesting insight by senior level compliance individuals at Costco and Target that suggested above all compliance tools a company's culture may be the strongest deterrence to compliance failures.

7. Limitations and further research

The primary research conducted for this paper was limited by the response rate from senior compliance personnel in major retail companies. Many potential respondents were hesitant to share their opinions due to the sensitive nature of their role. Expanding the primary research would continue to yield additional insight.

Further research that would extend this qualitative assessment may include a look into Ethisphere's "World's Most Ethical" companies, and focusing specifically on the retail companies listed. In 2013, Target was one of the very few retail companies listed (Ethisphere, 2013). Additional insight may be gained by comparing more closely Target versus Walmart or Kroger. This is not to suggest that Walmart or Kroger are consistently non-compliant, but a comparison may yield cultural aspects the companies struggled with in order to remain compliant in relation to the highlighted current events. This could be supplemented with steps taken since and even a potential gauge if the steps in question go far enough.

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Appendix

Primary Research Questions

1) Please describe your role.
2) Does your company have a whistle blowing policy? Can you describe it?
3) Does your company have any training around ethics?
    a. Web Based Training Y/N
    b. Onsite Y/N
    c. Distributed material Y/N
4) If you do have ethics training, what is the frequency of the training?
5) Are you aware of the Wal-Mart Mexico bribery scandal? Yes/No
6) What were your reactions to the scandal in question, if any?

7) In your opinion, what allowed the Wal-Mart Mexico scandal to happen?
8) Before the scandal was publicized, how confident were you in your company's controls to prevent a similar scandal? (Scale of 1 – 10, with 1 being least confident and 10 being most confident.)
9) After the scandal was publicized, how confident were you in your company's controls to prevent a similar scandal? (Scale of 1 – 10, with 1 being least confident and 10 being most confident.)
    a. Why?
10) Although the scandal was with Wal-Mart, do you feel your company has felt increased pressure from regulators?
11) What do you think is the biggest risk in your company to mitigate, in order to prevent a similar scenario from taking place?
12) Any other comments you may have around this topic of ethics in the retail industry and your company?
13) What additional steps would you recommend for your company and other retailers to implement in order to assure avoidance of the above scenario (Wal-Mart Mexico bribery)?