

# Economic crime: people, culture & controls

The 4th biennial Global Economic Crime Survey  
Industrial manufacturing industry supplement



Economic crime is a serious issue for industrial manufacturing companies, which reported notably higher costs than did executives in other sectors. Our survey only looks at detected economic crime; actual rates of fraud are likely to be much higher. The Association of Certified Fraud Examiners (ACFE) estimates that economic crime levels are probably closer to around 5% of company revenues<sup>1</sup>.

And while the direct financial costs of economic crime are likely substantial, the indirect or collateral damage to one of industrial manufacturing companies' most value assets – their reputation and their brand value – may potentially have even more far-reaching negative consequences. Economic crime consists of more than just stealing goods – substituting inferior materials or knowingly failing to meet quality standards can be far more damaging than outright theft as it may impact relationships with customers or the value of the brand. Intellectual property (IP) infringement such as counterfeiting of goods is equally becoming increasingly prevalent, and can also have serious repercussions on company reputation.

These results are some of the highlights of PwC's industrial manufacturing industry supplement to *Economic crime: people, culture & controls: The 4th biennial Global Economic Crime Survey*<sup>2</sup>. In this industry summary we examine data from respondents from 777 industrial manufacturing companies in 40 countries. We compare and contrast their views with those of executives across all industries, as well as with industrial manufacturing respondents interviewed in our 2005 survey. We hope this report will help to highlight the importance of this issue to industrial manufacturing industry executives, stimulate discussion, and aid in the development of increasingly effective means of combating economic crime.

### Economic crime is a significant issue

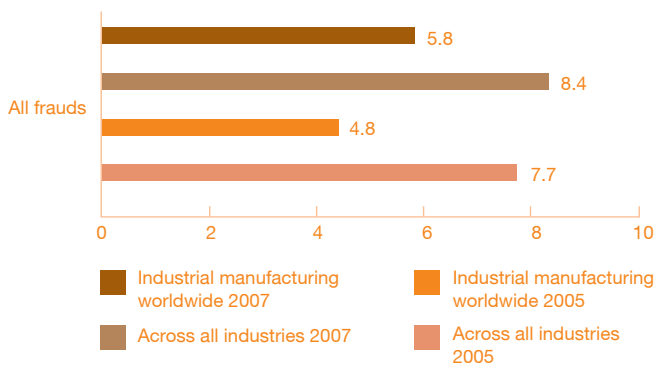
More than two-fifths (42%) of organisations in the manufacturing industry – and nearly half of those in North America (48%) – report that their organisations have been subject to economic crime over the past two years. This rate is in line with the global average across all industries. In terms of

the mean number of incidents, industrial manufacturing companies were faring somewhat better, with a reported 5.8 incidents reported on average, compared with 8.4 across all industries. Both industrial manufacturing companies and their peers across all industries reported a higher rate of incidents than in our 2005 survey (see figure 1).

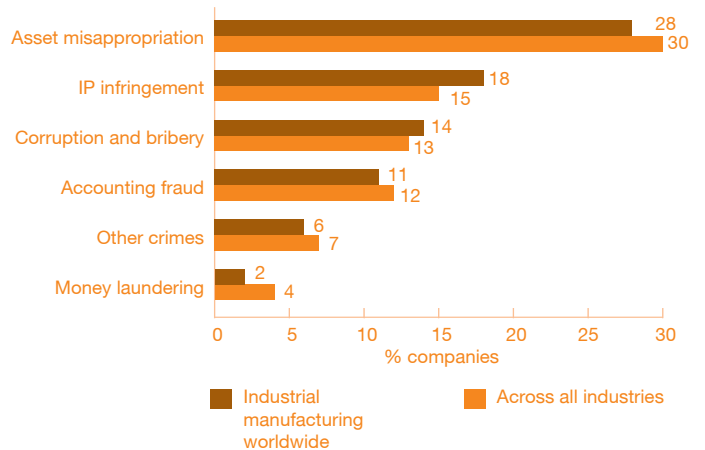
Asset misappropriation was by far the most common type of economic crime in the industrial manufacturing industry, with 28% of manufacturing respondents reporting cases, a level in line with the average across all industries (see figure 2). Physical assets pose less opportunities for theft in industrial manufacturing than they do in some other sectors such as consumer goods; in this industry, asset misappropriation is more likely to include fraud schemes, including fraudulent disbursements such as payments to ghost employees, fictitious vendors, pay-and-return schemes, over-billing schemes, unauthorised overtime schemes, and expense report schemes.

Intellectual property (IP) infringement was the next most common type of economic crime suffered in this sector; industrial

1 Mean number of incidents of economic crime reported in the industrial manufacturing industry compared to all industries



2 Percentage of companies surveyed reporting different types of economic crime



1 Association of Certified Fraud Examiners (ACFE), *ACFE Report to the Nation on Occupational Fraud & Abuse*, 2006, 4.

2 *Economic crime: people, culture & controls: The 4th biennial Global Economic Crime Survey* is available for download at [pwc.com/crimesurvey](http://pwc.com/crimesurvey). The survey is based on interviews with executives responsible for detecting economic fraud in 5428 companies in 40 countries.

manufacturers reported a slightly greater incidence of IP infringement, 18%, than did peers in other industries. IP infringement for the industrial manufacturing sector primarily takes the form of counterfeiting of trademarked goods. While high-volume, low-value goods such as circuit breakers are often targeted, some more sophisticated counterfeiters are re-engineering the technology used in higher-end products as well. Competition from counterfeit products poses a risk not only to sales directly, but also to the overall value of the brand, particularly if quality standards are lower. In some cases, counterfeit goods may be produced by companies' own suppliers, adding substantially to the overall cost of sourcing in low-cost countries. Indeed, industrial manufacturing companies need to take a close look at their supply chains to ensure not only that suppliers are not producing illicit products on the side, but also that they are meeting agreed-upon quality standards. Appropriate governance, risk and compliance practices are critical to determining if necessary levels of quality are being met. While some failures may stem from negligence, in other instances

suppliers may be deliberately and knowingly substituting inferior materials to reduce costs, a serious type of economic crime.

### Financial and collateral damage

Economic crime came with a high price tag in the industrial manufacturing industry. Overall financial losses for industrial manufacturing companies were notably higher than the global average across all industries (US\$4.34 million vs. across all industries: US\$2.42 million). This result is in stark contrast to our 2005 survey, where industrial manufacturing companies actually reported much lower losses.

Economic crime costs substantially more than the losses directly generated by the crime. Companies also need to consider the costs of managing incidents, and the estimated average costs for industrial manufacturing companies were again notably higher, and were particularly high in North America.

As noted, detected crime is probably only the tip of the iceberg. Further, direct losses are only the beginning – economic

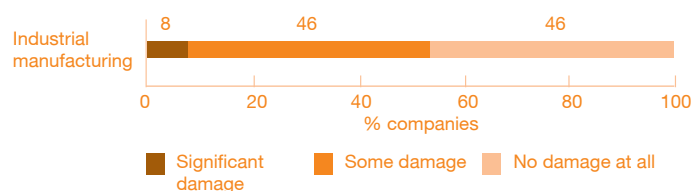
crime can have a much more far-reaching impact. Collateral damage can include damage to a company's brand or to its position with regulators. Staff morale may be impacted, with a resultant drop in productivity. Negative publicity from fraud can also affect a company's share price. More than half of industrial manufacturing companies (54%) report sustaining some collateral damage from incidents suffered, although relatively few companies described this damage as significant (see figure 3).

North American industrial manufacturing companies fared somewhat better than those in other regions, except in the case of corruption and bribery, where 57% reported some damage. This is probably due to the much more rigorous US regulations, as well as the correspondingly more sensitive public media coverage.

### The emerging markets

Industrial manufacturing is becoming a truly global industry. In the industrial manufacturing industry supplement to PwC's *11th Annual Global CEO Survey: Compete and Collaborate*, industrial

### 3 Estimates of the impact of intangible damage of the most serious incidents of economic crime



manufacturing CEOs saw improved sourcing and supply chain management as a key source of competitive advantage at a higher rate than their peers in other industries. Achieving more cost effective sourcing most often means increasing operations in emerging markets. While this strategy provides substantial opportunities for industrial manufacturing companies, it triggers substantial risks as well. Companies in the industrial manufacturing industry suffered above-average victimisation through fraudulent offences in the E7 (Brazil, China, India, Indonesia, Mexico, Russia, Turkey) emerging markets – 48% of industrial manufacturing companies report victimisation in this region. IP infringement stands out as a particular problem, with more than a quarter of industrial manufacturing respondents reporting suffering incidents in the E7.

Losses from economic crime in the E7 region were steep – in fact industrial manufacturing companies topped the list of industries, with an average loss of US\$8.53 million (across all industries, US\$5.05 million). But foreign companies aren't the only ones suffering in these territories. Industrial manufacturing

companies in Central & Eastern Europe reported average losses of US\$8.95 million – and the tab was even higher in South & Central America, at US\$15.90 million. Managing costs were also highest for countries in the E7.

E7 experts in the industrial manufacturing sector more frequently reported cases of corruption and bribery than their peers around the world. In China, in particular, the rate was higher than other industry peers.

Compared to respondents in other sectors, companies in the industrial manufacturing industry assigned notably less importance to economic crime when it came to decision-making around investments in China. The size of this market seems to make companies forget the risks, and some companies may see some level of economic crime as simply a 'cost of doing business' in China. Companies cannot afford to turn a blind eye to many types of crime, though – incidents of corruption and bribery could potentially lead to costly breaches of domestic regulations such as the Foreign Corrupt Practices Act (FCPA) in the US. The US is not the only country taking a

hard line – other nations are following suit, with high-profile corruption and bribery scandals making the news in countries such as Germany.

Of the 42% of industrial manufacturing companies that reported economic crime, more than three-quarters (78%) reported that a party external to the company played a role in the fraud, similar to the rate across all industries. In over one-third of cases (36%), the external offender came from abroad. When foreign offenders were involved, they most frequently came from Central & Eastern Europe (28%) and China (25%) – two of the most popular destinations for manufacturing investment. Companies entering new territories need to take care in selecting business partners and establish robust control systems to mitigate the risk of increased economic crime.

## Detection

Many industrial manufacturing companies have instituted whistle blowing systems, and survey results suggest that these are quite effective. A full 15% of serious incidents of economic crime were

**Industrial manufacturing companies entering new territories need to take care in selecting business partners and establish robust control systems to mitigate the risk of increased economic crime**

detected via whistle blowing systems, vs. only 8% across all industries (see figure 4), and sharply up from industrial manufacturing companies' abysmal 2% detection rate from these systems in 2005. In North America, where such systems are required by regulation, they proved particularly effective for industrial manufacturing companies, detecting nearly a third (32%) of economic crime. This higher rate of success in the US was not mirrored across industries.

While effective whistle-blowing systems are certainly a useful tool in the fight against economic crime, the high level of detection via this means sends a mixed message, as it suggests that other mechanisms, such as internal controls and the internal audit function, are actually less effective in detecting economic crime. Relying on employees to continue to blow the whistle on their colleagues may be a less promising strategy than implementing more rigorous control systems.

### Reporting, investigations, recovery of lost assets

Discovering fraud is only the first step. Companies also need to decide how to deal with the perpetrator, and attempt to recover lost assets.

Upon the discovery of fraud, and consistent with the global results, the most common response of industrial manufacturing organisations was to inform their executive management (83%). Investigation was primarily undertaken by internal departments. These findings are consistent with results across all industries. Around 53% also reported fraud to law enforcement, and another 34% called in external lawyers.

Around half of cases (47%) resulted in the company pressing criminal charges, with North American companies the most likely to do so (58%). Nearly one-fifth of industrial manufacturing companies (19%), however, chose to do nothing in response to most serious incidents. Consistent sanctions against fraudsters are an important factor in deterring future fraud, so companies may need to re-assess their responses to economic crime.

Recovery of losses proved difficult. Only around 39% were able to recover some of their losses. Very few losses were recovered through insurance providers; in contrast, almost two-thirds of companies pressing criminal charges report having recovered at least a part of their losses through court proceedings (64%).

### Some key preventive measures still lacking

North American industrial manufacturing companies have by far the most extensive control and prevention systems in place, reporting an average of 11 measures to fight economic crime, compared to a global average across all industries of nine measures. Western European companies, in contrast, tended to be below average in their provisions for fighting economic crime (seven measures).

Industrial manufacturing companies' prevention measures could stand improvement in some areas. Overall, companies in the sector somewhat less frequently report control measures such as fraud risk management and whistle blowing systems – and as previously noted, whistle blowing systems in

#### 4 Methods of detection of most serious incidents of economic crime



Note: Categories with response rates of less than 2% have been omitted

particular have proved particularly effective at companies using them. Industrial manufacturing companies report fewer uses of some types of preventive measures such as compliance programmes, ethical guidelines, and anti-corruption programmes.

Industrial manufacturing companies worldwide also less frequently sought advice on the possibilities of crime prevention (25% vs. 31% across all industries), and less frequently implemented their own specific fraud training (24% vs. 30% across all industries).

### Undue optimism?

Like their peers in other industries, respondents in the industrial manufacturing industry tended to be overly optimistic regarding future economic crime. Although 42% of respondents reported that their company had been the victim of economic crime in the last two years, only 10% expect that their company will be subjected to economic crime in the next two years (see figure 5).

Not surprisingly, North American industrial manufacturing companies were somewhat more likely to report having

strengthened their control measures in recent years (51%), whereas Western European companies showed below average efforts (37%).

### High levels of fraud by senior/top managers and middle managers

More than half of offenders of serious incidents of economic crime in the industrial manufacturing sector came from within the company, slightly more than the rate across all industries (55% vs. 50% across all industries). The proportion of offenders with no business relationship to the company was significantly higher in this industry. This might be an indication that the industrial manufacturing companies could benefit from adding security measures to counter, for example, cyber crime by unknown persons.

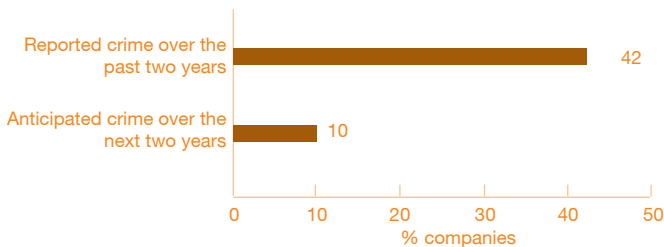
Internal perpetrators were fairly likely to have come from the ranks of senior/top management in 2008, with a substantial 24% coming from the top ranks (see figure 6), compared to 20% across all in industries. Middle managers were also more likely to commit fraud than in other industries. This trend is cause for concern, as our global survey results indicate that fraud by senior managers

is much more likely to negatively impact staff morale, particularly when top-ranking fraudsters are seen to have been let off lightly.

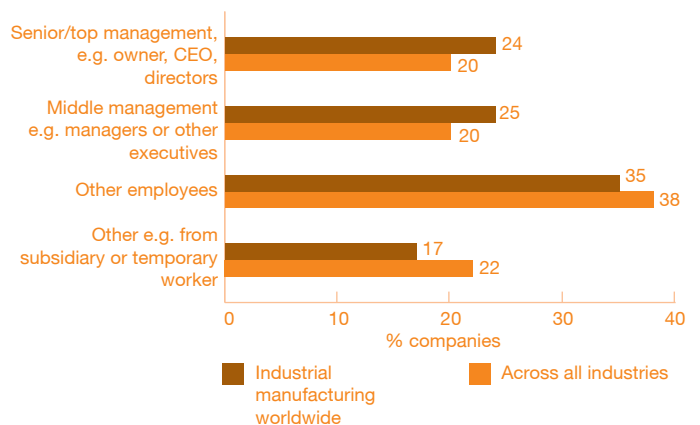
Overall individual causes of fraud were ranked more highly than corporate causes; the most frequently cited corporate causes included 'insufficient internal controls' or 'low commitment to the company'.

Significant corporate changes such as a merger, acquisition, sale or outsourcing of the company or its businesses, or staff reduction have been shown to increase the risk of economic crime. Respondents in the industrial manufacturing sector reported a slightly higher rate of change that their peers across all industries (at least one change: 60% vs. 55% across all industries), so companies would do well to be especially vigilant in the near future.

## 5 Industrial manufacturing executives' perception vs reality: Actual and anticipated levels of economic crime



## 6 Level of perpetrator of most serious incidents of economic crime



## Concluding thoughts

Industrial manufacturing companies are operating in a dynamic, changing business environment. Our research shows that increasingly, industrial manufacturing company executives are looking to innovation as a main source of competitive advantage. In the industrial manufacturing industry supplement to PwC's *11th Annual Global CEO Survey: Compete and Collaborate*, we found that roughly three-quarters of industrial manufacturing CEOs are looking to technological innovation as a source of competitive advantage, compared to 65% of respondents across all industries, and nearly a third (30%) rate it as their main means of achieving growth, compared to 22% across all industries.

Industrial manufacturing CEOs also reported a higher level of participation in collaborative networks to drive innovation. But with new ways of working come new risks – as the high level and cost of IP infringement shows. China and other emerging markets provide significant opportunities for the global industry; but these emerging markets can also provide substantial challenges, with increased levels of economic crime.

While some economic crime may be a cost of doing business, companies need to be wary of developing an attitude of complacency and relying on programmes such as whistle-blowing systems to detect crime. Some types of crime, such as corruption and bribery, should not be tolerated at all – otherwise companies risk substantial penalties from regulators, and potential serious damage to company brand and share price. Executives also need to continue to ensure they maintain an appropriate 'tone at the top' and convey a consistent, strong message around economic crime to their entire organisation, particularly as they continue expanding business operations into new and emerging markets.

**Industrial manufacturing executives need to continue to maintain 'tone at the top' and convey a consistent, strong message around economic crime to their entire organisation**

## Contacts

### Graeme Billings

Global Industrial Manufacturing  
Leader  
Tel: +61 (3) 8603 3007  
Email: graeme.billings@au.pwc.com

### Chris Hibbs

UK Industrial Manufacturing Leader  
Tel: +44 (121) 265 5705  
Email: chris.d.hibbs@uk.pwc.com

### Barry Misthal

US Industrial Manufacturing Leader  
Tel: +1 (267) 330 2146  
Email: barry.misthal@us.pwc.com

### Martin Bork

Germany Industrial Manufacturing  
Coordinator  
Tel: +49 (69) 9585 5602  
Email: martin.bork@de.pwc.com

### Matthew Pottle

Central and Eastern Europe  
Industrial Manufacturing Leader  
Tel: + 4212 59350 402  
matt.pottle@sk.pwc.com

### Claudia Nestler

Germany Forensics Leader and  
Survey Sponsor  
Tel: +49 (69) 9585 5552  
Email: claudia.nestler@de.pwc.com

### Steven Skalak

Global & US Investigations Leader  
Tel: +1 (646) 471 5950  
Email: steven.skalak@us.pwc.com

## Acknowledgements:

Data analysis for this industry summary was provided by Prof. Dr. Kai Bussmann, Chair of Criminology & Penal Law, Martin-Luther-University (Halle-Wittenberg, Germany). Thanks go to Elizabeth Montgomery for writing and editorial input. Tony Parton, Graeme Billings, Barry Misthal, Marie-Dominique Ortiz-landazabal, Richard Sykes, and Anthony White provided technical and industry review and input.