Examining the Consequences of Ericsson's Bribery Case in China by Discussing the Accountability System and Internal Control Measures

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Abstract. This article aims to explore the application of management control systems in business processes during Ericsson's operation in China until 2016. It employs PEST Analysis and Porter's Five Forces Model to conduct commercial analysis on Ericsson, and defines accountability in the context of the bribery incident, drawing from relevant literature. The research applies the Fraud Triangle as a basis to describe the circumstances surrounding the control failures and suggests two solutions that could have mitigated the failure. Finally, it evaluates the accountability provided by Ericsson in response to the control failure.

Keywords: PEST Analysis; Porter's Five Forces Model; Accountability; Fraud Triangle Theory.

1. Introduction

According to the 2019 report of the U.S. Department of Justice, Ericsson's bribery spanned 17 years and involved at least 5 countries, including China, Vietnam, Kuwait, and other countries, and even bribed terrorist organizations in Iraq, all to achieve the core goal of increasing profits. Ericsson frequently changed CEOs from 1998 to 2016, but bribery in various countries continued (Wigstrand, 2016). Therefore, the occurrence of bribery in Ericsson is not only due to personal moral issue, but also a kind of corporate culture of Ericsson as well as a means and strategy for Ericsson to participate in the competition.

2. Literature Review

2.1 The Internal Accountability

Governance issues have long been one of the most important areas of corporate development, and accountability is even more important at a time when companies are increasingly worried about the occurrence of wrongdoing. A common trend in many kinds of literature is to define accountability through Principal-Agent Models. For example, the editors of Accountability: A Synthesis defined accountability as "The obligation of A (a person or institution) to act on behalf of B in a certain way, and for which A is accountable to B (Akpanuko and Asogwa, 2013)." They therefore argue that accountability refers to a relationship of power and a particular kind of authority, according to this definition, accountability usually takes the form of principals and agents, and the principal delegate's power to the agent, and the agent shall act on behalf of the principal. This point of view focuses on the company's internal accountability, shareholders are the principals and the managers are the agents, firm management may face consequences if it fails to carry out its obligations to parties like shareholders, creditors, and debt holders and fails to provide a reasonable justification for its actions. Shareholders generally judge the company's operation through the level of dividends and the stock price rise and fall, while the management actually runs the business and has access to more inside information, which will cause asymmetry in the information that shareholders and management have. On the other hand, shareholders as corporate investors, give more attention to the company's long-term interests, whilst management focuses more on short-term concerns due to tenure restrictions, which leads to different goals of shareholders and management. Thus, managers engage in unethical behaviour to ensure the company's good performance during their tenure, such as in Ericsson's bribery

incident. However, due to the fact that the bribery incident will not be carried out with great fanfare, shareholders cannot quickly hold the management accountable.

2.2 The External Accountability

The internal accountability system of Ericsson's bribery incident in China should not only the shareholders hold the management accountable, but also the management should hold the Chinese branch accountable. But Ericsson doesn't just bribe China, it has bribed at least 5 countries in 17 years, so the responsibility for bribery is not only the responsibility of the Chinese branch company, but also the responsibility of Ericsson as a whole. Therefore, internal accountability cannot play its greatest role and should be implemented in conjunction with external accountability. As analyzed by Bovens, whose views are similar to those of Akpanuko and Asogwa, but his focus is on external accountability. Bovens believes that accountability can also be regarded as a social relationship or mechanism. He defines accountability as "The relationship between actors (A) and forums (B), In this relationship, A is obliged to explain and justify its actions, B can ask questions and make judgments, and A may face consequences (Bovens, 2010)." This can be called passive accountability, that is, the forum is responsible for the actor's actions afterward. The accountability forum for Ericsson's bribery incident can be the US Securities and Exchange Commission (SEC), and the actor is Ericsson. This is because Ericsson's large-scale bribery incident violated the Foreign Corrupt Practices Act. In the legal process, it is usually the organization that needs to provide an account as a corporate entity, which means that Ericsson is responsible to the SEC. Accountability is composed of at least three elements or stages. First, before defining the relationship as an accountability relationship, after the bribery incident occurs, Ericsson is obliged to inform the forum and provide reasons for the bribery. Second, the SEC needs the possibility to question actors and challenge the adequacy or legality of the information. Third, the forum can make a judgment on the behaviour of the actor. When making a negative judgment, the SEC will impose a fine on Ericsson.

2.3 Definition of Accountability

Therefore, combining the views of Akpanuko and Asogwa and Bovens, I define the accountability system as "Once there are irregularities with the affairs of organizations at all levels within the jurisdiction of the accountability subject, then the subject must investigate the responsibility of the relevant responsible persons and require them to bear the consequences. Among them, the actor is responsible to the forum, and the agent among the actors is responsible to the principal."

3. Commercial analysis of Ericsson through PEST analysis and the Porter's 5 Forces

3.1 Rivalry among Existing Competitors

The main competitors of Ericsson's Chinese company are divided into two categories, domestic equipment manufacturers, and foreign companies that are gaining momentum in China. It can be seen from Figure 1, Nokia and Siemens accounted for 13.16% and 6.49% of the market share respectively when they were not merged. After the merger, Nokia Siemens Networks was established, the new company accounted for 19.65% and ranked second after Ericsson (30.95%). In order to maintain support to original customers, Nokia Siemens Networks publicly stated that it would maintain the original production line (Reuters, 2006). For the fourth-ranked Huawei, its advantage lies in its keen grasp of the market and its effective market strategy, and its ability to adopt an active price competition strategy. By 2016, Huawei's revenue was about US$75 billion, while the revenue of Nokia and Ericsson was only US$20-$26 billion (Bicheno, 2017). Huawei's ascent has put huge competitive pressure on traditional telecom equipment makers such as Ericsson.

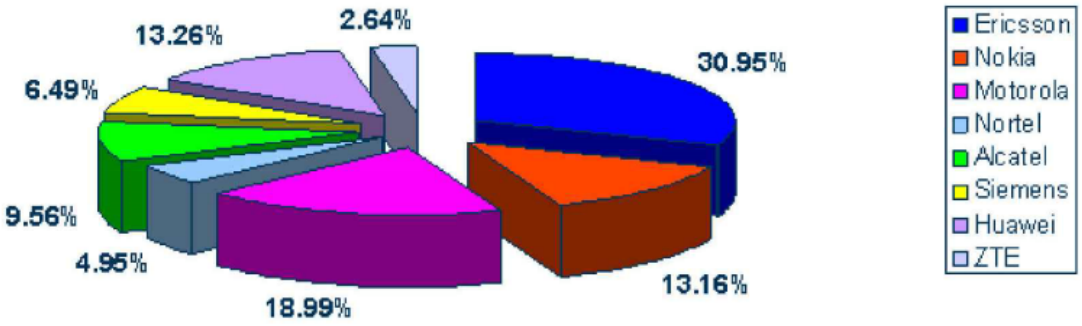


Figure 1. Market share distribution of mobile equipment bidding in 2006
Sources: Ericsson Company Market Statistics 2006

3.2 New Entrants and Substitute Products or Services

Combined with the analysis of political factors in PEST, the Chinese government's regulation of the communication industry is constantly tilted towards basic telecommunications services, and telecommunications services themselves are receiving an increasing amount of attention. To protect consumers, this will serve as a function for government regulation. Relevant measures of the government in this regard include the promulgation of the Telecommunications Regulations of the People's Republic of China, which establishes rules for construction, tariffs, security, and commercial licences (RegistrationChina, 2020). According to Porter's point of view, entry threats depend on entry barriers, and the management of national policies has caused high entry barriers in the communication industry.

Due to fierce industry competition, a relatively clear and stable industry structure as well as high industry barriers, coupled with the substitutes of the communications industry mostly uses wireless digital transmission, and compared with the existing fixed wireless terminal transmission in the industry, the technology and direction are completely different. Many electronic equipment manufacturers entering the communication industry have to find their own way, trying to gain share of the existing market through new technologies. Based on the analysis of the technical environment by PEST, at the beginning of the 21st Century, the development of mobile communication technology entered the third generation, commonly known as 3G. As a countermeasure to 3G, China has suggested the TD.SCDMA technological standard with autonomous intellectual property rights. This project has gained substantial government support in China, and its research and development are late, it has many advantages that ordinary existing products do not have. The system it requires has functions such as smart antenna technology, uplink and downlink asymmetric transmission, and HARO, all of which are cutting-edge wireless innovations that have developed over time since 2000 (Li et al., 2005). Costs are reduced as technology becomes more advanced, and TD.SCDMA creates the conditions for entry into the market with cheaper building costs and improved performance. ZTE made a significant contribution to the worldwide CDMA market in 2007 and quickly came to prominence after winning the China TD.SCDMA network access certificate (Chcom, 2013). Because of these, TD. SCDMA is a solid alternative, and ZTE is a brand-new, significant rival with lots of promise.

3.3 Bargaining Power of Buyers and Suppliers

Using PEST to analyze China's economy and society at that time, the information industry represented by mobile communication played a decisive role in the economy and society. The establishment of universal service funds under the Tenth Five-Year Plan (2001–2005), which had developed as its primary goal and improved economic efficiency as a means of achieving rapid growth, helped to raise China's per capita GDP (Figure 2). Investment and financing in the information sector are crucial for economic growth, and venture capital can be used to advance the

advancement of information technology (NPC, 2010). Ericsson's main business in China is the sales of mobile communication systems (Ericsson, 2010). When judging the bargaining power of buyers on Ericsson's competitiveness, the bargaining power of the two mobile operators, China Unicom and China Mobile Limited, is undoubtedly the most important. These two companies are listed companies, The annual cost of purchasing equipment will immediately impact the performance of these two companies, hence their price sensitivity is considerable. On the other hand, there are some merchants and wholesalers in the market in addition to a number of equipment suppliers including Huawei, ZTE, Nokia, and others. Any business has the ability to produce its own equipment. Therefore, the bargaining power of China Unicom and China Mobile Limited even among other buyers is very strong.

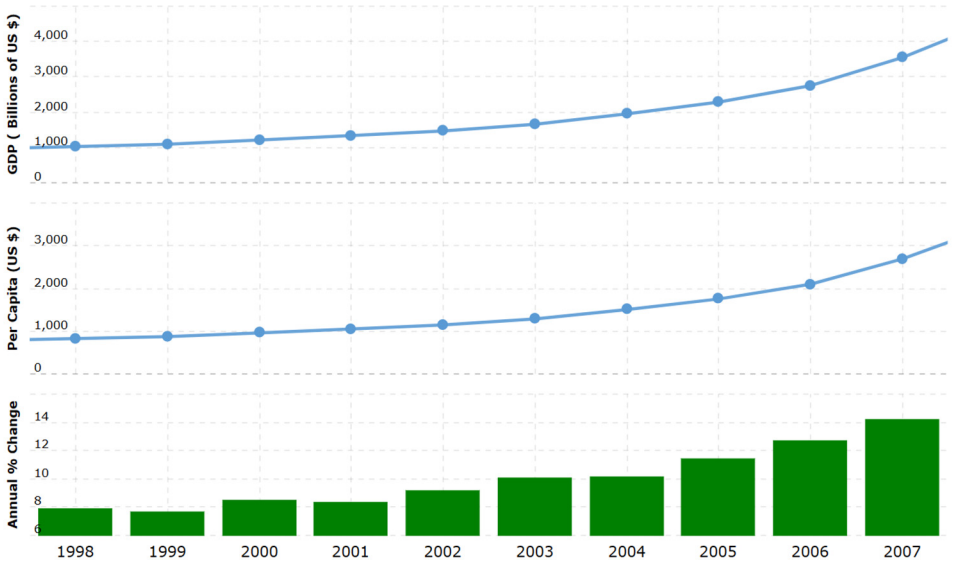


Figure 2. China's per capita GDP from 1998 to 2007
Sources: China GDP 1998-2007 (macrotrends.net)

From Figure 3, it can be found that Ericsson, as a new technology industry, has relatively small influence factors on raw material costs, and production costs primarily arise from R&D and sales expenditures. Despite the industry's poor overall revenue growth, prices for raw materials largely remain consistent since communication equipment businesses. As a result, the supplier's bargaining power has relatively little effect on Ericsson, while R&D costs and sales costs need to be strictly controlled.

Ericsson	2007	2006	2005
Raw Materials	1108	1008	591
Materialcost/Total revenue	3.81%	3.84%	3.09%
R&D	4,462.00	4020.00	3076.00
R&D in Gross Operating Profit	35.06%	36.74%	32.53%

Figure 3. Raw material costs and R&D investment of Ericsson from 2005 to 2007
Sources: Raw material costs and R&D investment of Ericsson (ericsson.com)

4. Analysis Control Failure based on the Fraud Triangle Theory

4.1 Opportunity

Ericsson's branches in China adopt a centralized organizational structure (Figure 4), with power concentrated at the top and subordinates lacking the necessary autonomy. Information transmission routes are long and feedback is slow. There is a poor connection between various functional departments, a lack of supervision, and almost all management functions are centralized by one person. In this instance, it is easier for its managers and staff to use bribery and record-keeping fraud (Office of Public Affairs, 2019). From Figure 5, due to the global economic recession caused by the Y2K scare, Ericsson's market share dropped to a record low in 2001 (Amadeo, 2021). Coupled with the improper management of the company's management, the 17-year bribery in China was beginning. From 2000 to 2016, the branch paid bribes to Chinese officials using third-party agents, often employed under false contracts and paid under false invoices, without their payments being properly accounted for in Ericsson's books and records (Office of Public Affairs, 2019).

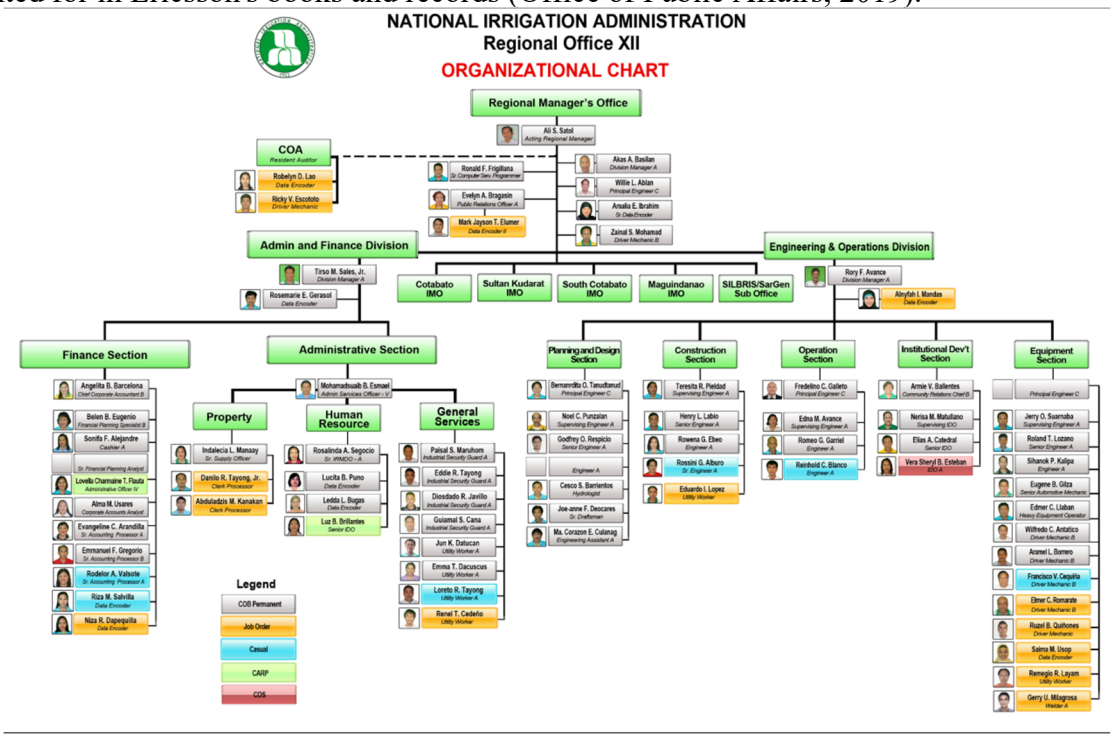


Figure 4. Ericsson Organizational Structure in China in 2015
Sources: EricssonOrganizational Structure in China (bing.com)

The most common reason companies use bribes is to gain an advantage in entering into public contracts with foreign governments (Ferdman, 2014). In 2011, the Chongqing NO.5 Intermediate People's Court confirmed that the former general manager of Chongqing Mobile Changfu Shen received bribery through benefits in share transfer, project contracting and equipment supply, and received a total of more than 36.2 million yuan in the property. Ericsson paid bribes for the longest time and the largest amount, before 2010, Changfu Shen successively received more than 17.47 million yuan in bribes from Ericsson (Deng, 2011). On the other hand, in addition to bribes offered by companies for their own benefit, there are cases where officials demand bribes from companies. In a report published by Caixin global in 2017, it was recorded that in early 1999, the former deputy director of the China Post and Telecommunications Administration and the deputy general manager of China Netcom Group Corporation Rongquan Leng took advantage of his position to provide assistance to Ericsson (China) Co., Ltd. in winning the bid for the China Post and Telecommunications Administration's international switch capacity expansion project supply contract project in Beijing, Shanghai and Guangzhou. In 2001, Rongquan Leng through his brother

LENG extorted bribes from former Ericsson vice president ZHANG by $800,000 in the name of signing a false agency contract to collect agency fees, and in 2013, Rongquan Leng took another US$500,000 from LENG (Yang, 2017).

4.2 Pressure

Ericsson has performed well in the global 3G market through its own researched technology and has a dominant market position in the 3G market (Erisson, 2008). However, compared with Ericsson which always develops according to its own technical route, Chinese local company Huawei is willing to develop products with differentiated technology for operators, provide improved services, and find a breakthrough for Huawei's global expansion. Therefore, Huawei's successful globalization strategy transformation in 2007 and rapid development after expanding from China to the world market (Zen and Li, 2019), and became an important factor for Ericsson's sharp decline in market share again in 2008 (Figure 5). Comparing the annual report data of Huawei and Ericsson in 2012, Huawei's total revenue of US$34.95 billion is very close to that of Ericsson (US$35.9 billion), and even in 2013, the annual income of US$39.5 billion exceeded Ericsson's US$4.2 billion (Huawei, 2013 and Ericsson, 2013). Ericsson was forced to give up its No. 1 position in the world, and its sales in the market were far less than before (Figure 6). Therefore, facing these pressures, between 2013 and 2016, they paid third-party service providers approximately $31.5 million, part of which was used to fund Chinese officials' travel expenses account, including gift expenses, travel and entertainment expenses, etc. (Bruce, 2019). The purpose of these payments is to make third-party dealers in China sell more Ericsson products.



Figure 5. Ericsson's market share from 2001-2023
Sources: Ericsson (ERIC) - Market capitalization (companiesmarketcap.com)

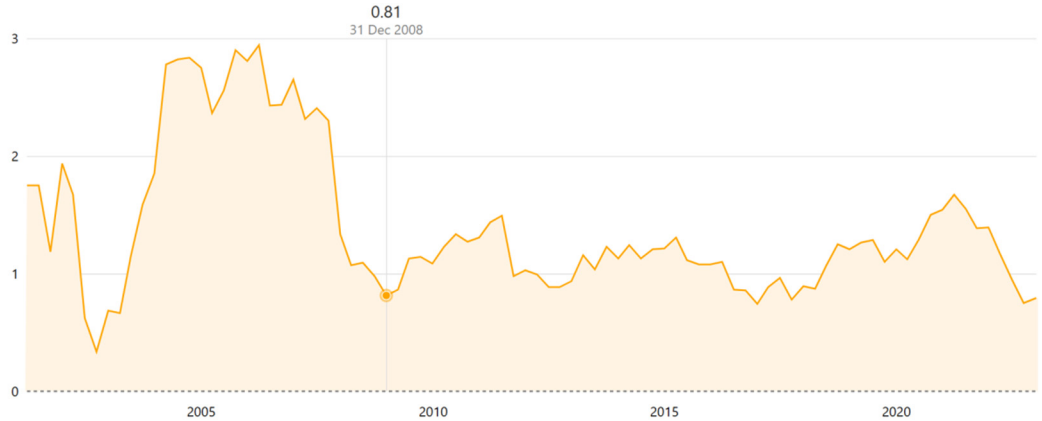


Figure 6. Ericsson's Price-to-Sale Ratio from 2001-2022
Sources: Ericsson (ERIC) - P/S ratio (companiesmarketcap.com)

4.3 Sophistry and Results

Ericsson CEO Borje Ekholm defended in the investigation that "Certain market executives and some staff engaged in dishonest behaviour and wilfully neglected to implement necessary controls (Sutherland, 2019)." and attribute the responsibilities of the 17-year bribery to the personal behaviour of the executives in Chinese branches. But Ericsson also admitted to engaging in bribery from 2000 to 2016 and violating FCPA. In 2019, Ericsson entered into a Deferred Prosecution Agreement (DPA) with the US Department of Justice, and agreed to pay more than $1 billion in fines (Office of Public Affairs, 2019).

5. Suggesting Two Solutions

According to the DPA, Ericsson promises to change the original company strategy, re-examine the company culture, and abide by strict and effective control measures (Sutherland, 2019).

5.1 The Internal Whistle-blower Reward Policies

Bribery is often done in secret, thereby limiting shareholders' and prosecutorial authorities' awareness of specific actions taken by a company's sales managers or agents. In order to discover and stop the occurrence of bribery incidents, multinational corporations like Ericsson can use the monitoring capabilities of employees and combined with bottom-up supervision and top-down auditing (Serra, 2011), to formulate internal whistle-blower reward policies, and open multiple barrier-free channels that employees and customers can easily access, such as the Office of the Ombudsman. Most whistle-blowers can obtain private information, such as the driver of the briber, relatives, and related customers, by observing patterns of bribery and reporting such behaviour to the Office of the Ombudsman who then report to superiors, and the organization will employ specialized personnel from a non-stakeholder third-party institution and set up a team to audit the reported person to ensure the fairness of the information processed. If the investigation is true, employees can be rewarded with a certain percentage of bonuses, for example, 10% of the fines avoided through the contents of the whistle-blower's report are used as the whistle-blower's bonus (Teichmann, 2019). Although the bonuses in some cases may be expensive for the company, the cost of being caught by the authorities may be even higher. Therefore, this measure can detect and stop losses in time after abnormal behaviours occur, reducing the company's losses.

However, there are downsides to the whistle-blower reward system, which can prompt employees to report without evidence to earn a bonus, leading to organizations being inundated with whistle-blowing reports, and moreover, some people think that whistleblower is regarded as a kind of condemnation morally. Additionally, there is a risk that the company would shield prominent workers rather than whistleblowers (Teichmann, 2019). In such cases, potential whistleblowers may be concerned that themselves can be punished with severe consequences, rather than management, who should be held accountable for intentional bribery, including demotion, termination of employment, or inability to find work in the industry.

5.2 The Expense Payment Process System

Formulate a sound internal audit and complete expense payment process system (Wang, 1997), strictly review the authenticity, integrity, legality and compliance of invoices, settlement vouchers and other related vouchers. First, the project supervisor conducts a preliminary review of the project application, and then the department supervisor conducts a review of the project to show responsibility. The financial reviewer reviews the applications reported by the heads of various departments according to the company's relevant payment and reimbursement policies and standards. The most important thing is the authenticity of the project, the legality and integrity of the documents, etc., which will be reviewed again by the financial manager, and reported to the vice president of finance for approval, and then the general manager will approve and sign the payment application. The cashier checks the documents before payment, and the financial supervisor needs to check the

correctness and compliance of the documents again. Finally, the general ledger accountant regularly collects information and analyzes the use of some expenses. If any abnormality is found, it should be reported to the internal control and compliance department in time. The employee in this whole process should be responsible for their actions. The internal control compliance department should also conduct regular routine inspections and irregular surprise inspections of various departments, and if any non-compliance or violations are found, should be held the above-mentioned personnel accountable. This solution is used because the operation of this process makes it impossible for the briber to withdraw funds for bribery, it can be effectively controlled before the bribery occurs.

6. Evaluation of the Accountability

Ericsson was not properly accounted for the control failure, Ericsson settles the bribery case by signing with the US Department of Justice and the US Securities and Exchange Commission into a Deferred Prosecution Agreement (DPA) in 2019, and had to pay a total of $520,650,432 in criminal penalties and $539,920,000 worth of Return of earnings and interest on prejudgment debt (Sutherland, 2019). These fines may seem like a lot, but for Ericsson, the accumulation of more than ten years has already allowed it to earn huge profits far higher than the fines. Therefore, the US Securities Regulatory Commission and the Department of Justice just imposed huge fines and required their companies to rectify themselves, and other measures did not seem to have a deterrent effect.

According to the definition of accountability in task 2, it has not assumed all the responsibilities that he should have assumed, and fines alone cannot prevent the recurrence of bribery incidents, the US Securities Regulatory Commission and the Department of Justice should impose stricter penalties on Ericsson, such as delisting it from the market and prohibiting transactions in the country where the bribery incident occurred. Ericsson's competitors can also file a lawsuit against Ericsson for unfair competition in the market, and Ericsson should bear the legal responsibility for the lawsuit.

7. Conclusion

Combined with the analysis of internal accountability in task 2, during Ericsson’s 17-year bribery process in China, the company did not take any preventive measures for monitoring or disclosure mechanisms, and when bribery occurred, there were no corrective measures to punish bribery. These are closely related to Ericsson’s organizational culture which encourages bribery. However, Ericsson has not taken any measures to change the culture in 17 years. It has not conducted professional ethics education and compliance review for executives, and still condones employees to continue to bribe, thereby enhancing Ericsson's status in the bribery country. These problems are the responsibility that Ericsson should take, but it is not serious and responsible.

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