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JEXTRA NEIGHBOURHOOD STORES IN MALAYSIA

In October 2010, Tom Chong was on his way to his office and thinking about several issues he would have to deal with in the coming weeks. Chong was Jextra Stores (Jextra) country manager for the Neighbourhood Markets Division in Malaysia. One issue involved a conversation with the mayor of Klang, a town near Malaysia's capital city of Kuala Lumpur. Chong had been seeking to expand to Klang for some time. The mayor surprised Chong with an offer to help with land zoning if Jextra would help finance a new primary school (or at least Chong thought that was what he had been asked for).

The second issue involved the job performance of Arif Alam, Jextra's top-performing buyer. Alam, a buyer of fresh fruit and vegetables, consistently negotiated better contracts than Jextra's fifteen other buyers and, Chong believed, better than Jextra's competitors. The contracts negotiated by Alam certainly contributed to the excellent financial performance of Jextra Malaysia. Nevertheless, Chong could not help wondering if there was more to the picture than he was aware of. The retail industry in Malaysia was notorious for buyers accepting money and gifts from suppliers. A few days ago, Chong had accidentally overheard two of his accounting employees speculating that Alam must be accepting gifts, or even taking bribes—how else could he get such good contracts?

Chong was not sure what to do. Should he confront Alam? Or, to use one of his English colleague's favorite expressions, should he let sleeping dogs lie? Chong knew that his boss expected him to aggressively grow the business, so perhaps it would be best to accept the mayor's offer and deal with Alam later.

Jextra Malaysia

Jextra Stores, a large Asian retailer, was based in Hong Kong and was owned by Sim Lim Holdings, a large publicly traded industrial group. Sim Lim Holdings was traded on the Hong Kong and London stock exchanges. Jextra operated retail stores in Hong Kong, China, Philippines, Viet Nam, Malaysia, Thailand, and Singapore. The company operated supermarkets, hypermarkets, and convenience stores.

Jextra entered Malaysia, a stable and prosperous nation of 28 million multi-ethnic people, in 2005 and was very successful. The company operated supermarkets in Malaysia using the name Neighbourhood Markets. There were now ten Neighbourhood Markets, and breakeven had been reached quickly. Jextra was planning to enter the Malaysian convenience store sector in a few years. Although other Asian and European retailers were entering Malaysia, Tom Chong saw plenty of growth opportunities for supermarkets, and his boss in Hong Kong had approved an aggressive five-year investment strategy.

Tom Chong

Tom Chong, a Hong Kong native, had been in his position for eight months, and expected to remain there for another two to three years. Malaysia was Chong's first assignment as country manager. Prior to moving to Malaysia, Chong held various positions in corporate headquarters in Hong Kong, and then moved to Malaysia as finance director. After two years in finance, he moved into his current role as country manager for Neighbourhood Markets. His new assignment in Malaysia was his first experience with real operational issues and profit and loss responsibilities.

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Chong reported to a Regional Operating Officer responsible for Singapore, Malaysia, and Thailand, and was in constant contact with the CEO and the CFO of the Supermarket and Hypermarket Divisions of Jextra in Hong Kong. Chong was evaluated based on various financial measures, including Economic Value Added. As a country manager in a young market, the number of new stores opened was an important element in his overall evaluation, and a factor in determining his career prospects. In a fast-growing market like Malaysia, a failure to open new stores would be viewed negatively at corporate headquarters. The number of new stores opened would also be a factor in determining his discretionary bonus. In recent years, Chong's performance had been among the best for Jextra managers of his age and experience.

A New Store in Klang

Jextra was doing well in Malaysia and actively seeking to expand. Chong and his team had identified a potential site in Klang for a new Neighbourhood Market. Klang, a town located about 30 km west of Malaysia's capital, Kuala Lumpur, was growing and was viewed as an attractive location for a new store. Although the potential site was not zoned for retail and commercial purposes, it had good road access and plenty of space for parking. Chong knew that several other retailers were also interested in expansion in Klang, especially with the opening of a new highway connecting Klang to the southeastern edge of Kuala Lumpur.

At a recent meeting between Chong and the mayor of Klang:

Chong: As you know, we have identified Klang as one of the most attractive cities in Malaysia for Jextra investment. We are interested in opening a Jextra Neighbourhood Market there.

Mayor: We are pleased that you are considering our city for your next investment. Klang is a growing community, and the new highway makes our city much more attractive as a place for families to live and commute to the capital. Where does your investment analysis stand?

Chong: We have done some preliminary work. We have identified some potential sites. There is one site of interest near the new sports arena, and we have had some conversations with your officials since the land is currently not zoned for commercial use. Unfortunately, our previous investments in Malaysia have all encountered difficulty with land development. Our newest store was delayed by more than eight months because of zoning issues. We hope that will not be a problem in Klang.

Mayor: We have a unique community in Klang, and want to protect our cultural heritage. We scrutinize all proposed real estate developments very carefully. With your store, perhaps we can help each other.

Chong: Can you be more specific?

Mayor: Our community is growing quite rapidly, and we have a lot of young families moving in. We desperately need a new primary school. Without it, families may choose to live elsewhere. People do not want to live in a city with inadequate school facilities. Unfortunately, our school budget is quite tight, and we may not be able to build the school for at least two years. If Jextra were willing to consider supporting a primary school development fund, I am sure I could speed up the land zoning process.

Chong: Interesting....Can you tell me a bit more about the primary school project? Do you have any preliminary estimates of the cost?

Mayor: My Director of Schools has told me that we need about 350,000 ringgit to make up a budget shortfall for a new primary school. Jextra's support would greatly help the community. Also, if you were to build your store on the proposed site, road and electricity developments would be necessary. A flyover at the intersection of Jalan Mantin and Jalan Subang on the east side of the site would be necessary to ensure smooth traffic flow. We would, of course, expect

Jextra to help pay for the flyover. I understand one of your competitors in Shah Alam [a community close to Klang] helped pay for a new fire truck when they entered the market. This is quite normal for new investment in Malaysia.

Chong: Well, Mr. Mayor, thank you for your time. We will continue with our analysis, and certainly hope that we can do something that is good for Klang and good for Jextra.

With that, Chong left the meeting. The conversation with the mayor had caught him by surprise. The mayor's zoning proposal was unexpected, but could certainly speed up development. However, Chong was not sure what he asked for. Was he being asked to pay the entire 5 million ringgit or just a part of the cost? Would he pay for it before the primary school was built, or after? Would he pay the city or a contractor? If he said no, would that mean a denial of the zoning change?

Chong made a few calls, and learned that the mayor's sister was on the school board and was one of the major supporters of a new primary school. Chong also learned that planning for the flyover had started several months before Jextra had ever expressed an interest in the nearby site. In addition, Jextra had already determined that traffic to and from the store parking lot would be routed through the west side of the lot, using a lightly used commercial street and not on either of the roads close to the planned flyover. Chong wondered about the mayor's motives in asking Jextra to pay for the flyover.

Jextra Business Conduct Code

Jextra's Business Conduct Code was very clear: employees could not offer benefits to third parties in connection with business matters (see the Appendix for excerpts from the Code). If Jextra were to contribute to a primary school, the benefit would be a contribution to a school development fund, and the benefit would go to the school and the community, not individuals. Chong had discussed a hypothetical situation with a Malaysian friend who was also a lawyer (he did not reveal the specifics of the mayor's request). He was told that Malaysian law was unclear in the area of business payments for social purposes made specifically for regulatory approval. He was also told that although not widespread in Malaysia, the practice of businesses contributing to city projects was common in Klang and other areas around Kuala Lumpur, and the local mayor prided himself on being able to obtain these payments for schools and roads in particular.

Jextra's corporate office in Hong Kong had a small group of employees that managed the Jextra Social Fund. The Jextra Social Fund provided funding for various social and educational programs, mainly in Hong Kong. One of the fund's specific initiatives was providing university scholarships in Hong Kong for children of lower-income families. As Jextra expanded in Asia, the fund was slowly looking at ways to contribute to more local programs.

However, Chong knew that recently there had been some concerns in the Philippines involving the Jextra Social Fund and some funds for a community center in a city in which Jextra planned to build a store. Chong did not know the details, but the rumors were that much of the money went to local politicians instead of the community center. Not long after the incident, Jextra's country manager in the Philippines was transferred back to Hong Kong to a position that looked like a demotion.

Legal in Malaysia?

Chong thought that the primary school contribution could be illegal in Hong Kong if it circumvented the Jextra Social Fund. But, perhaps this was normal practice in Malaysia. Chong's friend said that some local lawyers would probably advise him to make the payments, but to keep the school and flyover payments independent, which would blur the line as to whether the behavior was indeed illegal. Complicating the issue was the question of the expected outcome from the primary school payment. If the school payment speeded up the development process, it could be legal; if it was necessary to make the payment solely as a prerequisite to obtaining the permit, it could be considered a bribe. If the payment was made after the store was built and went directly to a school board budget for future operating expenses, would that be illegal? Chong did not know the answer to these questions.

Various scandals involving alleged bribes and corporate contributions had contributed to the recent “retirement” of various elected officials in Malaysia. Both state and federal politicians were using “clean government” as part of their political platforms. The State Investment, Trade and Industry Committee Chairman said that his government would separate itself from the historically tight ties between business, government, and political campaign contributions. At the federal level, the government had promised that foreign direct investment in Malaysia would become transparent, and that giveaways to foreign investors would stop (exactly what giveaways he meant were never specifically identified).

Chong knew that, in the last year, there had been several foreign investors who were rumored to have helped fund different government programs in exchange for favorable treatment. So far, there was no evidence that any of these efforts were illegal or even of much interest to voters and legislators. When a European electronics company opened a new plant in Malaysia, there were many rumors that the company paid a substantial amount of money to a government “education fund.” Chong’s teammate from his football club told him confidentially that the company had paid 2.5 million ringgit to the fund, and that the fund was controlled personally by the Industry and Development Minister, a well-known businessman turned politician, whose wife was dean of the Communications School at the Malaysian Institute of Technology.

Jextra’s Competitors and the Mayor’s Offer

Chong was aware that Super-Value, one of Jextra’s competitors, was also actively looking at Klang for a new store. Would the mayor make the same offer to Super-Value as he had made to Jextra? If so, when would the offer be made, and would Super-Value be willing to accept it? Perhaps Super-Value was interested in the same site as Jextra. Before Chong could even consider agreeing to the mayor’s primary school request, he needed to think through the details. How would he get the money for the school? Would he identify it in the investment proposal, or try to hide it with other items? Should he get legal advice on his possible criminal liability in Hong Kong? What if he went ahead with the payment, and the money ended up not going to the school? If the press found out, Jextra and Chong could be in big trouble.

Perhaps the best approach would be to decline the mayor’s offer and work through regular channels to get the zoning approval. If that was successful, he would worry about the flyover request later. On the other hand, he did not want to lose access to a prime retail site, and his boss, who was aware of the Klang site, wanted an update on the project next week.

Category Management

A very simplified view of Jextra’s category management and buying process is as follows. Category managers (CMs) were responsible for driving category direction and leading an operationally efficient category team to deliver the budget within the framework of the corporate goals. A key area of responsibility for category managers was working with suppliers to determine the products to order, together with their negotiating prices. For a new supplier, establishing a relationship with a category manager was crucial in getting its products listed by Neighbourhood Markets. Category managers negotiated contracts, rebates, equipment, placement, incentives, and other financial and logistical arrangement for their category. Neighbourhood Markets in Malaysia had category managers for product lines such as fruits and vegetables, meat, frozen foods, and beverages. Product buyers managed the bundling of orders and actual buying from suppliers at the negotiated prices. Over and above this organizational setup, there were few defined processes, leaving a fair amount of leeway to the category managers because they decided what to order and what not to order.

Arif Alam

Arif Alam was 32 years old, and had been with Jextra in Malaysia since the company entered the market. He had worked his way up from a sales apprentice position to category manager for fruits and vegetables. His responsibilities included building and managing contacts with suppliers, listing suppliers and products, negotiating prices, and working closely with buyers to ensure that the supplier relationship was smoothly managed.

As Alam's boss, Chong had a reasonable understanding of how the Malaysian buying process worked, but he did not know all the details, and certainly was not involved in day-to-day activities. What Chong had learned over the past few months was that there were ample opportunities for CMs to exploit the system for personal gain. One typical scheme involved company samples and rewards. Most suppliers provided CMs with a large supply of product samples that could be sold on the grey market. CMs and their spouses often traveled extensively to product presentations of certain suppliers. These events usually took place at luxury hotels, and often in resort settings. Since Alam was a CM for fruits and vegetables, he might be provided with other products, such as small appliances like toasters or coffeemakers. Another typical scheme was for suppliers to provide rewards tied to performance and sales. These could range from household appliances to expensive jewelry and watches. These rewards could be kept or sold. There were even cases where companies owned by relatives of CMs had to be paid by suppliers in order for the suppliers to get their products sold by Jextra.

Besides his suspicions that Alam was accepting gifts, or even taking bribes, Chong had heard rumors about a scheme between Alam and his father-in-law. Alam referred suppliers willing to be listed for a new product to his father-in-law who, as a side job, ran a trading agency that "established contact to Jextra Stores." The agency received a commission of 0.5 percent for all goods covered by the agency agreement. It was rumored that Alam rarely listed suppliers and products not covered by the agency.

Bribery

The bribery issue was particularly troubling. Bribery of retail buyers was as old as the retail industry itself. The bribery process works as shown in the following example. A buyer who paid 50 ringgit for a pair of blue jeans the previous year negotiates a 45 ringgit price based on a larger order. Another clothesmaker offers the same pants for 42 ringgit each. In order to retain the big order, the first vendor matches the 42 ringgit price and gives the buyer 2 ringgit for each pair of blue jeans. The bribe is undetectable, because the buyer sets up a phony company that serves as a middleman in the transaction. The vendor bills the retailer for 42 ringgit a pair and funnels the 2 ringgit to the buyer through the dummy corporation, calling it "an agency commission." After the deal is done, the vendor keeps the order and the retailer pays less for the pants than a year ago. The buyer looks good because the price paid was lower than a year ago. The buyer believes, "I deserve the money because I am helping the company." For a few years, the retailer may benefit by having lower costs. Longer term, the retailer's costs may increase because the buyer has an obligation to the vendor and may end up paying less-competitive prices. The retailer may also end up with merchandise that is inferior in quality and difficult to sell because it was purchased by a corrupt buyer.

Chong's Decision

Chong had a dilemma. Although he suspected that Alam was involved in "dirty" buying, how could he find out? His colleagues might know, but they could be involved in the same activities. Jextra was doing well and, as far as Chong knew, except for bribery, most of the behaviors were not criminal in Malaysia. What if he set up an investigation? If he found nothing, he could alienate his people and lose personal credibility. He might find that large parts of his product category management were engaged in similar actions. What should he do then? The whole business might be at risk if he were to shut it down. He could lose his top CMs and disrupt supplier relationships. Plus, how would he actually investigate the CMs—hire an outside investigator? Talk with suppliers? Find a disgruntled employee? Spy on his employees? This was all new to him.

Proving any of his suspicions would be difficult. Alam was a respected member of the team. Aside from rumors and hearsay, Chong had no real evidence of bribery or kickbacks. Alam's lifestyle did not seem out of the ordinary. Chong would need clear evidence, and an outside investigator would mean added cost. The investigation could take months, or even years, and Chong might be gone from Malaysia by the time the process was completed. In addition, this would take a lot of his time, and he was already working almost 60 hours a week.

Chong needed to keep growing the business and meet his financial targets. It was critical for him to deal with the mayor's proposal appropriately and ensure that Jextra's chosen site did not end up with one of his competitors. Maybe he should wait before doing anything about Alam.

Appendix: Excerpts from Jextra's Business Conduct Code

Summary

Jextra is an international company with a strong reputation for providing quality products. We continually seek to deliver the best results for the Company, the highest return to our shareholders, and the most beneficial service to our customers.

Ethical conduct is defined as conduct that is morally correct and honourable. To maintain our valuable reputation and to build on our success, we must conduct our business in a manner that is ethical as well as legal. This Business Conduct Code establishes Jextra's commitment to following ethical business practices. It details the fundamental principles of ethical business behaviour, and defines the responsibilities of all directors, officers, associates, and Company representatives.

Jextra is committed to conducting business lawfully and ethically. Every associate is obligated to act at all times with honesty and integrity. We expect you to bring good judgment and a sense of integrity to all your business decisions. While it is not possible to list all policies and laws to be observed, or all conflicts of interest or prohibited business practices to be avoided, this Business Conduct Code details the company's expectations for associate conduct, and helps associates make the right decisions. Associates are expected to know the company's policies and comply with them.

Applicability

Associates who supervise others have an important responsibility to lead by example and maintain the highest standards of behaviour. If you supervise others, you should create an environment where employees understand their responsibilities and feel comfortable raising issues and concerns without fear of retaliation. If an issue is raised, you must take prompt action to address the concerns and correct problems that arise.

You must also make sure that each associate under your supervision understands our Code and the policies, laws, and regulations that affect our workplace. Most importantly, you must ensure that employees understand that business performance is never more important than ethical business conduct.

As a Jextra employee, you are expected to comply with both the letter and the spirit of our Code. This means you must understand and comply with all of the company policies, laws, and regulations that apply to your job, even if you feel pressured to do otherwise. Our Code also requires you to seek guidance if you have questions or concerns, and to cooperate fully in any investigation of suspected violations of the Code that may arise in the course of your employment.

Bribery

It is illegal to pay or receive a bribe intended to influence business conduct or behaviour. Our guideline goes beyond the standard set by the law, and prohibits any activity that creates the appearance of anything improper, anything that may embarrass the company, or anything that may harm our corporate reputation. No assets of the company or other funds may be used to bribe or influence any decision by an officer, director, employee, or agent of another company, or any governmental employee or official.

It may be acceptable to entertain or provide minor gifts to guests or suppliers, as long as the expenses are reasonable, consistent with good business practices, and do not appear improper. Any gift, entertainment, or benefit provided must be modest in scope and value. You should consult with your supervisor if you have any questions about whether any gift-giving activity is appropriate. Never provide a gift, entertainment, or benefit that contravenes any applicable law or contract term or that is large enough to influence, or appear to influence, the recipient's business decisions.

Associates should not accept money, gifts, or excessive entertainment from any guest, contractor, or supplier at any time. For more information on gifts, entertainment, and related issues, see the Conflicts of Interest guidelines.

International laws strictly prohibit giving, promising, or offering money, or anything else of value, directly or indirectly, to officials of foreign governments or foreign political candidates in order to obtain or retain business or any improper business advantage. Never give, promise, offer or authorize, directly or indirectly, any payments to government officials of any country.

Conflicts of Interest

Associates must avoid any situation in which their personal interests conflict with the interests of Jextra. If a circumstance arises in which your interests could potentially conflict with the interests of Jextra, it must be disclosed immediately to both your supervisor and Human Resources for review. Associates should be vigilant about recognizing potential conflicts. You must always consider whether your activities and associations with other individuals could negatively affect your ability to make business decisions in the best interest of the company or result in disclosing nonpublic company information. If so, you may have a real or perceived conflict of interest. Below is a list of potential conflicts of interest.

- Owning a substantial amount of stock in any competing business or in any organization that does business with us.
- Serving as a director, manager, consultant, employee, or independent contractor for any organisation that does business with us, or is a competitor—except with our company's specific prior knowledge and consent.
- Accepting or receiving gifts of any value or favours, compensation, loans, excessive entertainment, or similar activities from any individual or organization that does business or wants to do business with us, or is a competitor.
- Taking personal advantage of a business opportunity that is within the scope of Jextra's business—such as by purchasing property that Jextra is interested in acquiring.

Related Party Transactions

Employees and immediate family or household members may not serve as a supplier or customer of the Company, or otherwise engage in business dealings with the Company, without the written consent of a member of the Executive Management Team. You or a member of your immediate family or household may not accept business opportunities, commissions, or advantageous financial arrangements from a customer, supplier, or business partner of the Company. You may not purchase for personal use the goods or services of the Company's suppliers on terms other than those available to the general public or established by Company policy. You may not take advantage of any business opportunity that you learn about in the course of your employment.