



CORRUPTION: An Invisible Cost to Business Operations



Corruption is a global issue affecting both governments and the private sector. This article explores the consequences of corruption on operating costs through embezzlement, fraud, bribery, nepotism, favoritism, and related practices. Corruption inflates an organization's operating expenses by introducing undue, illegal, and unethical costs.

These expenses cannot be directly declared in financial statements due to their unlawful nature. Instead, they are often disguised under headings such as commissions, entertainment, donations, consultation fees, marketing expenses, or through fake invoices and dummy vendors or suppliers. In this article, we will examine the types of corruption, its direct and indirect effects, real-world examples, strategies to mitigate it, and case studies.

What is Corruption?

Corruption is the abuse of power for illegal or unethical personal gain. It occurs when individuals in positions of authority—such as government officials or corporate executives—use their influence to obtain benefits that are neither ethically nor legally justified.

The World Bank defines corruption as “the abuse of public power for private benefit.” However, this definition does not imply that corruption exists only in the public sector. In large private organizations, corruption is also prevalent—particularly in procurement and human resource departments.

In Pakistan, corruption is widespread at all levels of both public and private organizations. It ranges from petty issues like daily cash disbursements to large-scale corruption involving major government projects or capital expenditures in the corporate sector. According to a global ranking released in February 2025, Pakistan was placed 135th out of 180 countries. The key factors contributing to corruption in Pakistan include poor governance, lack of accountability, a predominantly cash-based economy, and weak enforcement of laws.

Corruption as an Operational Cost

Corruption acts as a hidden cost that increases operational expenses. A business that is forced to pay bribes or engage in unethical practices incurs extra costs that reduce profitability. In environments where it becomes impossible to operate without engaging in corrupt practices, business owners often choose to pay these costs to keep their operations running — viewing it as a

“cost of doing business.”

According to estimates by the World Economic Forum and the United Nations, corruption accounts for approximately 5% of the global GDP. Given that the world's total GDP was estimated at \$100 trillion in 2024, this implies a staggering \$5 trillion lost annually to corruption.



There are many types of corruption, including bribery, nepotism, embezzlement, extortion, abuse of power by regulators, influence peddling, favoritism, selective enforcement of laws, cronyism, and fraud. Each type results in financial loss or causes inefficiencies in operations, which ultimately inflate operational costs. Each type results in financial loss or causes operational inefficiency, which ultimately inflates operational costs.

Direct Impact of Corruption on Operating Costs

- 1) Transactional Costs** – Where corruption is a normal part of doing business, operating costs increase due to undue payments made to achieve business objectives such as securing contracts, licenses, work permits, etc.
- 2) Compliance or Legal Costs** – In a corrupt economy, it is impossible to fulfill 100% legal compliance. To avoid legal hurdles, businesses often make undue payments to illegally attain the appearance of compliance.
- 3) Procurement Costs** – The procurement department accommodates corruption by inflating purchase costs through kickbacks or commissions offered to vendors or suppliers by business executives. When corruption affects procurement, the quality of materials, products, or services is compromised, leading to increased operating costs.
- 4) Financing Costs** – Corruption increases the risk factor for lenders, ultimately leading to higher interest rates for borrowers. As a result, business operating costs rise.

Indirect Impact of Corruption on Operating Costs

- 1) **Damage to Goodwill** – When a business engages in corrupt practices, it affects its goodwill and reputation in the eyes of consumers and the market. This leads to slow or negative growth and declining revenues, as consumers avoid dealing with such businesses.
- 2) **Damage to Productivity** – When corruption is prevalent in an organization, employee morale is negatively affected, particularly due to nepotistic appointments. This results in lower productivity, which ultimately increases operating costs.
- 3) **Penalties by Law Enforcement Agencies** – When an organization is caught engaging in corruption, government agencies may impose fines and penalties, contributing to higher operating costs.
- 4) **Operational Disruptions** – Corruption can adversely affect an organization's supply chain, especially when managers accept commissions or kickbacks in exchange for purchasing low-quality materials or dealing with inefficient vendors, suppliers, or contractors. Consequently, operating costs increase.

Sector-wise Examples of Corruption

- 1) **Healthcare Sector** - In the healthcare sector, corruption plays a significant role—especially in getting medicines approved by the Drug Regulatory Authority. Due to lengthy and complex approval procedures, businesses often resort to unofficial payments to expedite the process. These payments increase operating costs.
- 2) **Construction and Infrastructure Development Sector** - Private organizations seeking contracts for roads, bridges, sewerage systems, or buildings often pay undue amounts to the approving authorities. This not only raises their operating costs but also inflates government expenditures due to the use of substandard materials, which require frequent repairs and maintenance.
- 3) **Tax Departments** - Corruption is prevalent in tax departments, where businesses attempt to reduce their tax liabilities through unofficial means. Illegal tax avoidance practices may lead to legal notices and penalties. During the resolution process, corruption between tax officials and the business may occur. This results in increased legal expenses and operating costs.
- 4) **Legal Compliance Departments** - Departments involved in company registration and regulatory



compliance are often affected by corruption. When a business fails to meet legal requirements or misses deadlines, it may resort to bribery to settle issues. Such practices lead to higher operating costs.

- 5) **Energy Sector (Electricity, Gas, Fuel, Water)** - Corruption in the energy sector is widespread. For example, setting up a new electricity connection for a factory often requires unofficial payments, increasing setup costs. If an organization is involved in electricity theft or exceeds its legal load limits, kickbacks are often paid to avoid penalties. In the case of petrol pumps, significant unofficial payments are made to obtain licenses, and ongoing corruption includes government officials using fuel for free—further increasing operational expenses.
- 6) **Food Sector** - Each province in Pakistan has a food authority responsible for licensing food businesses. Compliance requirements include hygienic food preparation, clean premises, and staff medical checks. If these are not met, businesses may face fines. In some cases, corruption is used to avoid compliance or penalties, which increases operating costs.
- 7) **Cross-Border Trade Sector** - In cross-border trade, customs and border security departments are often involved in corrupt practices. Even for fully compliant legal imports, officials may demand commissions or kickbacks for clearance. These delays and extra costs increase operating expenses for importers and exporters and may result in additional storage fees due to delayed clearance.

Strategies to Reduce Corruption

- 1) **Capacity Building of Institutions** – The capacity of anti-corruption institutions, including the National Accountability Bureau (NAB), needs to be enhanced to deliver meaningful results in reducing corruption in Pakistan.

- 2) **Ease of Doing Business** – The government should simplify legal and regulatory requirements to ease business operations. This will reduce opportunities for corruption. Reforms in institutions such as the Federal Board of Revenue (FBR) and the Securities and Exchange Commission of Pakistan (SECP) should focus on minimizing human interference.
- 3) **Digital Economy** – Transitioning to a digital economy can reduce cash-based transactions and promote documentation. As a result, increases in the assets of government officials and private executives can be better justified, thereby reducing the presence of black money.



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- 4) **Safety and Encouragement for Whistleblowers** – The government should take effective steps to protect whistleblowers who expose corrupt practices. Financial incentives and legal protection should also be offered to encourage more individuals to come forward.
- 5) **Strengthen Judicial System** – A strong judicial system can play a vital role in reducing corruption by ensuring the swift prosecution of corruption cases without political or external pressure.
- 6) **Strengthen Audit and Control Systems** – Robust audit and internal control mechanisms can deter corruption in both public and private organizations. A strong internal compliance department should ensure timely and accurate fulfillment of legal requirements to reduce the likelihood of corrupt practices.
- 7) **Multi-Level Approval System** – Implementing a multi-tiered approval process for key business and

administrative decisions can significantly curb corruption and reduce unnecessary operating costs.

- 8) **Staff Training** – Regular training sessions for employees on ethics, compliance, and transparency should be conducted to cultivate an anti-corruption culture within organizations.

Conclusion

In Pakistan, corruption significantly contributes to inflated operational costs. However, it can be controlled through digitalization of the economy, reduced human involvement in compliance processes, simplified legal procedures, structural reforms in institutions, the use of modern technology, and strict legal enforcement.

Organizations can reduce operating costs and improve efficiency by adopting ethical governance, strong internal controls, and effective accountability systems. At the societal level, corruption can be curbed by incorporating ethics education at all stages of academic learning. When a nation becomes fully aware of the implications of corruption, citizens begin to hold authorities accountable and reject unethical practices. Though this is a long-term solution, it plays a vital role in building a more transparent and accountable society.

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