

**Presentation to:
The Global Council on Business Conduct
David Nussbaum, Chief Executive
Transparency International
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Ladies and gentlemen, Good Morning. It is a pleasure to be asked to speak to you today. I've chosen to focus my remarks on corruption and the corporate response. As I hope you all know by now, TI sees the private sector as a key player in the fight against corruption. I hope that my presentation will be as relevant and practical as possible.

Some Basic Choices

In thinking in broad terms about the corruption issue and the questions it poses for many companies in many of the countries they operate in, I would like to suggest two opposing scenarios which illustrate the contrast of the situation as it very often is for the international corporate environment, particularly in many of the countries that find themselves in the lower-half of TI's Corruption Perception Index and what we, TI, think the situation should be, hopefully, in a future that is not too distant.

Scenario A

Bribes are inevitable. Simply the cost of doing business.

In Scenario A we have a situation where corruption is pervasive:

- New investors are expected to make a substantial payment to at least one senior government official;
- Established investors are expected to make on-going payments through an ostensible charitable trust to the political party in office;
- Joint venture partners are involved in complex and convoluted relationships with Government;
- All port handling is subject to personal payments to individual in port authorities;
- Local distribution of goods for sale subject to cost of extortion at road blocks;
- Actual tax levels are determined by payments to individuals in revenue departments.

In many parts of the world this might be described as the current situation. Not surprisingly, companies have found ways of adapting to it. Unhappy with the detail, and its implications for their conscience, many of their staff nonetheless have come to describe the situation as inevitable and without an alternative. In other cases, they have genuinely convinced themselves that forms of bribery are an entirely legitimate way to secure business.

If the situation was to be more or less the opposite of this in, say, twenty years' time. What would it look like?

Scenario B

High standards of integrity. No hidden costs to business.

In scenario B we have a situation where corruption is no longer part of the business landscape:

- The cost of new investments is assessed only at their face value ; no 'hidden costs' in the form of pay-offs to government during the development phase or later;
- Direct and indirect party political donations are off the agenda;
- Joint venture partners are selected entirely on technical merit;
- Containers are shipped through ports without contrived delays;
- Road blocks are no longer a hazard for drivers and distribution staff;
- Taxes are assessed and paid according to the official fiscal regime.

The unrepentant businessman

“Having been involved in exporting to various countries in the Middle East and Far East and in Africa, I have bribed government ministers and officials of all grades, in the form of cash payments, commissions, introductory fees, new cars, hospital treatment and so on for more than forty years. If I were not now retired I would continue to do so. That is the way one does business in those places...”

*John Hembry of Saxmundham, Suffolk, England
(Letter to the Daily Telegraph (UK), 26 June 2000*

This quote illustrates an attitude which was prevalent and very much in the spirit of Scenario A. We are happy to say that this sort thinking is fortunately on the wane.

Is Business part of the problem or the solution?

I imagine that every one here would agree that Scenario B is vastly preferably to scenario 'A'. The question of course is whether it is possible to get there. In the past, the condition laid down for this kind of change was nothing short of direct divine intervention – without it, we have been frequently told, nothing can happen. But there are now a significant number of linked initiatives which suggest that human-inspired change is indeed possible, and whose cumulative potential requires companies to take stock of where they stand.

In short companies need to ask themselves two questions: first, are we part of the problem or part of the solution? And, second, if we part of the solution are we prepared to act as part of a relatively small number of 'reformers' in taking initiatives which may in the short run lose us some business opportunities ?

Change at the country level

As many of you will know, TI's Corruption Perception Index ranks countries according to 'perceived levels of corruption' as indicated by a cross section of (mainly) international business opinion. It ranks countries according to perceived levels of corruption in the public sector. The cleanest countries are at the top of the Index and very corrupt at the bottom. Many of the companies represented here may do business in the countries rank the lowest in the CPI. These are difficult countries to operate in, not least from an anti-corruption perspective.

But corruption is a dynamic phenomenon and is never static, and neither is the public response to it. In each of the four countries that are underlined significant change is taking place. Take India, for instance, the question of corporate governance has shot up the agenda in the last five years, and the Indian Stock Exchange has recently issued new reporting regulations which have significance for all aspects of corporate governance.

In Cameroon, the conditions on which the Cameroon-Chad oil pipeline has been financed are unique in spelling out a series of conditions designed to tie down the ways in which revenue is allocated and spent.

In a number of oil producing countries like Nigeria, in the developing world, the pressure to which the governments have been subjected to through the 'Publish What You Pay' Campaign and the 'Extractive Industries Transparency Initiative' has led to growing recognition of the need for extractive industries tax and royalty arrangements to be open to public scrutiny.

In the Ukraine, the new government of Viktor Yushenko has vowed to oppose corruption. Each of these developments represents a change in the context in which companies operate, and one which at least reduces the scope for corrupt practices. Any responsible company operating in these national environments is bound to take stock of the situation and consider its position.

The International Context

These changes in a small sample of countries are of course writ large at the international level, where a number of 'legal', 'regulatory' and voluntary measures have changed the formal landscape in the last six years. I use the word 'formal' because, as you will see, I do not wish to argue that they have yet changed the environment decisively, but that they collectively provide an opportunity – and in some cases an incentive – for companies to be much more pro-active in the position which they take on corruption. Let us look at each one of them in turn.

The legal framework

The OECD Anti-Bribery Convention, as has already been said, has been a great success in the sense of take-up. The issue is now very much one of enforcement. In TI we take the view that peer review by countries that are signatories to the Convention has been an effective mechanism.

TI is just about to publish a Progress Report on OECD enforcement and I cannot at this point reveal the details of the report but I think it I can safely say that we now have evidence that the Convention is beginning to have some traction. A number of investigations and prosecutions are in the pipeline in a number of countries.

I must also mention here the bribery provisions in the revised OECD guidelines for multinationals which are binding on countries and with which you are no doubt familiar.

A number of other regional conventions against corruption are now in effect in the Americas, in Africa and in Europe. Here we have not only the EU itself, but also the Council of Europe Conventions on Corruption, which are both civil and criminal, cast a very wide net, and of course necessarily include accession countries.

The UN Convention which was signed by more than 100 countries in Merida, Mexico over a year ago is seen as a breakthrough for the global fight against corruption. The UN Convention addresses what were glaring inadequacies in other conventions: mutual legal assistance and repatriation of funds sent abroad by corrupt officials.

Everybody here will be aware of Sarbanes-Oxley Act in the US and the fact that this puts chief executives on the line to take personal responsibility for their own companies in a way which could be fudged in the past.

The legal framework is very different to that which prevailed a decade or so ago when TI got its start.

Corporate governance

On the issue of corporate governance, obviously people in this room will be more than aware of changes in that area but it does mean, from the perspective of this issue, that it seems to be increasingly unlikely that boards of companies will be prepared to turn a blind eye to corruption and bribery committed in the name of their business, however well hidden and however obscure.

In the EU, there have been initiatives within individual countries and these have made very significant changes to the ways in which corporate governance is going to be conducted in those countries.

UK: **The Higgs and Smith Reports**

Germany: **The Cromme Report**

France: **The Daniel Bouton Report**

Of course, in the US, not only do we have the Sarbanes-Oxley Act, but a huge debate about corporate governance and responsibility. That movement, too, is going to make it easier, in our view, to ensure good corporate principles in relation to bribery and corruption.

Corporate Social Responsibility

Finally, in relation to the broader picture of corporate social responsibility, there has been some debate about whether or not the issue of corruption really belongs in the corporate social responsibility agenda. In TI we are keen to see it placed there. For any international company, a legally based compliance programme can quickly become unmanageable because of the different laws in operation in each country. Many enterprises have therefore fostered values and overall business policies so that their anti-bribery strategies can be carried out effectively and consistently.

Launched in 2000, the UN Global Compact is a direct initiative of Secretary General Kofi Annan, which aimed to bring together companies to support an initial list of nine principles in the areas of human rights, labour and the environment.

From the inception, questions were raised regarding the need for a principle-based approach to fighting corruption within the Global Compact framework. With the signing of the UN Convention against Corruption, the issue gained new relevance and in early 2004 the Secretary-General started a consultation with the then 1200-or-so participating companies to solicit their views on the introduction of a new principle dealing with corruption.

The results of this consultation indicated that respondents were overwhelmingly in favour of the addition of a 10th Anti-Bribery Principle. The 10th Principle was officially launched at a Global Compact Leaders Summit held in New York on 24 June 2004. The wording of the 10th principle reads as follows:

“Businesses should work against corruption in all its forms, including extortion and bribery.”

Transparency International pressed vigorously for the addition of the 10th Anti-Bribery principle and was very pleased when this important development came about. We think that the overwhelmingly positive response of Global Compact participants to the addition of an anti-bribery principle showed very clearly that companies are waking up to the need to fight corruption. TI particularly looks forward to the development of a work programme for the Global Compact participants who now have to implement the 10th principle.

TI is co-operating actively with the Global Compact which has given considerable prominence to the Business Principles for Countering Bribery, an anti-bribery code developed by TI in collaboration with business and other non-corporate

stakeholders and which many of you are familiar with - some of you have even contributed to their development) - and the TI Integrity Pact as tools for implementing the 10th Global Compact Principle.

The Global Reporting Initiative, a framework in which companies are being encouraged to report across a whole range of non-financial issues, corruption which has been factored into the reporting mechanism for a couple of years is being further developed. We are having some input in this and we hope that the next generation of guidelines to be issued in 2006 will be strengthened.

Finally, in ethical investing, we are seeing much more of an emphasis on what companies are doing about corruption. It now looks as if the Pension Fund Trustee Guidelines' approach, which has already been adopted in the UK, will be made mandatory across the EU. That requires pension fund trustees to state every year the context in which they have evaluated social and environmental responsibilities, including the issue of bribery and corruption.

One step forward...

But in spite of the progress achieved, some issues arise as to the effectiveness of the changes I've just mentioned. In the case of the legal measures the main issue is whether the prosecuting authorities in a majority of OECD countries will commit adequate resources to ensure that a significant number of prosecutions take place.

In the case of the regulatory measures the issue is (a) whether organisations like the World Bank are prepared to black list some of its member states 'flagship' contractors. The World Bank has made some progress on this score by blacklisting Acres International which was found guilty of paying bribes in the context of the Lesotho Highlands water project. As a result of TI pressure, the Bank has recently changed its bidding requirements for large public works (above \$10 million) and now requires companies to certify that they have in place policies to prevent corruption.

Will Export Credit Agencies be prepared to penalise important customers. In that respect, we have experience an important set back in the UK, where the Export Credits Guarantee Department, under pressure from UK business, rolled-back some newly-adopted –and quite enlightened- anti-corruption requirements. Finally will corporate governance codes will be adopted effectively by, say, a majority of listed companies. In the case of the strictly voluntary initiatives the question is and will be whether they will be adopted only in a limited number of individual cases or whether the uptake will be sufficient to make a difference.

The 'business case' for change

The arguments for change implied by the factors I have mentioned so far are driven largely by the deterrent effect of changes in the broadly defined national and international regulatory environment. This stands a 'business case' for change which is rather different, though inter connected.

This has two key strands:

First: the question of corporate reputation and its reflection in financial markets,

And:

Second: the impact of corrupt practices on the internal culture and processes of the company.

In the first case, fund managers are paying increasing attention to the track record of companies in relation to 'Corporate Social Responsibility', within which corruption is moving up the agenda. A recent EU Directive requires all pension fund managers to state the basis on which they are taking account of ethical objectives. Legislation of this kind has been operative in the UK for about four years and guidelines prepared for fund managers in this category explicitly identify the measures which investee companies are expected to take in relation to the avoidance of corruption. The managers of explicitly 'ethical' funds are of course also focusing on corporate anti-corruption strategy as one of the criteria for investment. The fact that the FTSE4Good Index is now working on a corruption indicator will provide an easily accessible initial guide as to whether companies have taken a position on this.

The second question is more complex and tends to be underrated as a problem for companies who routinely use bribery as a means to expand markets, but are in fact significantly compromised by it. The key assumption is that to obtain a contract or secure an investment opportunity payments have to be made to at least one strategically placed individual, company or political party. The compromise which follows from this has the following elements:

- A need to set prices in such a way that such payments are offset to avoid loss of net income;
- A need to maintain accounts in such a way that payments are disguised;
- An acceptance of 'backhanders' (or 'kickbacks') being common practice in the allocation of local contracts, and therefore a practice which comes to pervade the company;
- An acceptance of 'facilitation payments' as inevitable.

Taken together these represent a major departure from accepted business practice as embodied in recently re-inforced international accounting standards. An objective audit of a company compromised in this way would fail to meet the criteria embodied in the formal SEC listing requirement in the US (as reinforced by Sarbanes Oxley). It would fail also the increasingly accepted International Accounting Standard and the relevant corporate governance codes in, for example, the UK, India and South Africa. More importantly they create a climate of distrust and resentment in the company since none of these arrangements are transparent. And it is not clear whether specific individuals are benefiting from them in a personal way. This has particular implications for the loyalty of

junior executive staff who may be aware of corrupt deals, resent them, but feel unable to do anything about them.

Both these factors - the question of the value the market places on ethical behaviour, and the question of the internal impact of external corrupt practices – form central elements of the ‘business case’ for developing a strong corporate anti corruption strategy.

What is an anti-corruption strategy?

I mentioned earlier the Business Principles for Countering Bribery which TI developed with Social Accountability International and a multi-stakeholder Steering Group involving leading multinationals. These are based on two key pillars to an anti corruption strategy. The first one is a stated commitment to a refusal to pay bribes to secure or carry out business, and the second is the effective dissemination of the strategy throughout the company to ensure that compliance is effective.

The key components of the Business Principles are as follows:

- A refusal to pay a bribe in any form or use other routes and channels to Provide improper benefits to customers, agents, suppliers or government officials and political parties associated with the Government;
- The adoption of an effective system to ensure that no company employee solicits or accepts a kickback from any stakeholder;
- no direct or indirect contributions to political parties as a means of obtaining business ; if contributions are made for other reasons they should be publicly disclosed;
- Charitable contributions should be verified as not being an indirect route to Secure a contract;
- Facilitation, or ‘grease’ payments, being a form of bribery should be eliminated Over a defined period of time
- The receipt or offer of gifts, hospitality and expenses should be prohibited whenever they are designed to affect the outcome of a business transaction.

The toughest hurdle to be overcome in implementing these is probably the ‘adjustment of expectations’ amongst that part of the company’s stakeholders who are used to things being done in a different way. Thus joint venture partners, agents and suppliers may all have their assumptions about how business is conducted, swept aside, or find that they are no longer the favoured partner.

What constitutes compliance?

Effective compliance depends on both company employees and out of house partners adopting and supporting the strategy. There is no doubt that subsidiary companies have been the main vehicle by which corrupt payments have been made by multinational companies in the past. This, one could argue, is indicated by the relatively low number of prosecutions which have been secured in the US under the Foreign Corrupt Practices Act over the last twenty six years¹, which has effectively excluded foreign subsidiaries. Only in 2001 was the legislation changed to address this point.

Of nearly equal importance, and probably of greater importance in the case of the Near East, are joint ventures. In a number of countries in the Gulf the establishment of a joint venture with a well connected local company has been a condition of doing business, and these arrangements have provided an obvious channel for the payment of bribes. A commitment to an anti corruption strategy means that Joint Venture partners will be selected on the basis of their technical competence rather than their ability to funnel money in the 'right' direction. A useful background step in this direction is that such requirements are forbidden under WTO, and an increasing number of Gulf States are now changing their legislation in this regard.

A further key requirement is that 'agents' should also be committed to the strategy, and fully aware that their job is not to funnel payments to senior officials and Ministers. Finally, sub-contractors and suppliers have to expect that procurement will be genuinely competitive and that they are likely to be subject to 'due diligence' in relation to their own record.

Of course the question of securing internal compliance is closely related to the question of leadership from the top and the establishment of a culture within the company. If senior staff feel that there is a strong commitment originating at Board level the response will be far more positive than if they sense that the commitment is formalistic. But even in this case there will be a need for a clear written guidance material which deals with situations which staff may face in a variety of national contexts. Here I would draw attention to the excellent work completed by the organisation TRACE INTERNATIONAL in the case of facilitation payments and agents. In all of these cases it is essential to ensure that remuneration systems recognise that some contracts may have been lost as a result of the no-bribery policy and that responsible staff should not be penalised for this.

All of this confirms that the implementation of this package is not be easy and takes time. Even those companies which have publicly embraced an anti-bribery strategy in recent years have been periodically embarrassed by lapses within their ranks. However, since corruption is essentially hydra headed, with an exceptional capacity for re-growth in a different form, any strategy designed to deal with it must be at least as comprehensive as that outlined in the Business Principles.

¹ There were about 60 either criminal (by the Department of Justice) or civil prosecutions (by the SEC) under the FCPA between 1977 and 2000.

New horizons in corporate anti corruption strategy

Do these measures constitute all that a major company can do to fight corruption? We don't think so. In collaboration with others we think it is possible for companies to influence the business environment on a wider front. Initiatives such as the TI Integrity Pact, the Extractive Industries Initiative EITI, and the PACI initiative of the World Economic Forum, to name a few, are creating opportunities for companies to take a position and to contribute to change.

The TI Integrity Pact

The Integrity Pact is an arrangement whereby companies bidding on a particular project agree, as part of a formal scheme, to commit themselves to not paying a bribe in order to secure a contract or implement it. Two defining features of the pact are that (a) it provides a mechanism whereby an 'offended' party (i.e. one which considers that the winning company has behaved corruptly) can claim financial compensation if the claim of corrupt behaviour is sustained by an agreed tribunal, and (b) the contract award and its subsequent implementation is subject to supervision by a civil society organisation. The chapter of TI in Colombia has successfully applied the pact to a large number of projects, together worth close to \$2 billion in several sectors. Companies participating in public procurement bids in Colombia now expect to see the pact applied and have recognised that it reduces the costs of doing business and so can increase profitability.

In early February, Transparency International announced that the TI chapter in Germany was to work with Berlin-Schönefeld on a no-bribes Integrity Pact and independent monitoring for airport development.

EITI

The Extractive Industries Transparency Initiative, as many of you will know, is an initiative which was triggered by the work of the NGO Global Witness as a result of its campaign for the full disclosure to the Angolans of oil revenues accruing to the government of Angola. This campaign was started under the banner of 'Publish What You Pay' an NGO initiative. The Extractive Industries Transparency Initiative is a parallel initiative which was launched by the UK Prime Minister, Tony Blair in 2002 at the World Summit on Sustainable Development in Johannesburg. Both aim to increase transparency in transactions between governments and companies within extractive industries. Whilst PWYP calls for mandatory disclosure requirements, PWYP is voluntary initiative.

The main concept is that Governments and companies should agree that the value of all pre-signature bonuses, royalties and taxes should be in the public domain, with the objective that the declarations made by companies can be measured against the government's reported revenue.

Following a number of several high level international meetings – one at Ministerial level – a number of countries have agreed to pilot this initiative. Azerbaijan, Ghana, the Kyrgyz Republic, and Nigeria are the first wave of countries working on implementing EITI. Discussions on possible implementation are ongoing in several countries including: Angola, Chad, the Republic of Congo, Gabon, Sao Tome and Principe, and Timor Leste.

A company's willingness to participate in this process is, in our view, a fair measure of its commitment to transparency as a means of fighting corruption.

World Economic Forum

A few weeks ago at the World Economic Forum in Davos, 63 companies signed a public anti-corruption commitment. The commitment is based on voluntary principles derived from the Business Principles for Countering Bribery.

The WEF Partnering against Corruption Initiative, as it called, is an important first step towards zero tolerance of corruption. It is a move towards the comprehensive approach taken in TI's Business Principles for Countering Bribery and we welcome the increasing number of companies that voluntarily sign up to anti-bribery principles.

One word of caution, however: It is essential that these companies now turn words into actions by detailed implementation and public disclosure of their anti-corruption policies. Their policies have to be backed up by clear reporting lines, advisory structures and whistleblower protection, and the creation of a culture where employees and business partners know that bribery is not tolerated. It is important that companies include anti-bribery training for staff at all levels and in all locations, in particular in frontline developing countries where the bribery is most likely to take place.

TI is now working on tools to develop tools that will assist companies in monitoring their performance in relation to anti-bribery policies.

What should companies do?

What are we asking of companies? First of all, we are asking them to make sure they have proper policies in place to counter bribery. If they have no detailed principles themselves, we are suggesting they have a look at the Business Principles for Countering Bribery and see whether they can be implemented. If they already have principles, then they should use these as a benchmark to make sure that the principles they are applying are indeed state-of-the-art, as represented by the Business Principles for Countering Bribery and, very importantly, there must be a buy-in by senior management. That is why we are so grateful to many of you who have made the effort to come to this presentation because it is very important that senior members of businesses buy into the principle. There is a lot of detailed work in implementation, which needs to be done throughout organisations and through many of the subsidiary leaders, HR departments, training programmes and so on.

I hope that my remarks have confirmed that attitudes to corruption both in individual countries and at the international level are changing. I have also sought to show that whilst companies can simply be reactive in response to this, and assume that not much will change at a practical level, they can also be proactive and seek to push the anti corruption agenda further forward.

We realise that eschewing bribery may not immediately profit the bottom line but the legal and reputational risks companies take by engaging in corrupt practices may end up being very costly.

THANK YOU VERY MUCH