

# Executive summary

## Transparency International

It may be that in no other time in history have entrepreneurship, private economic activity and markets been more important and intertwined with the economic prosperity, political stability and environmental sustainability of societies than they are at present. The financial crisis and the economic turmoil that this crisis has triggered have thrown this insight into sharp relief.

The private sector can be a source of dynamic innovation and growth. Nonetheless, as Transparency International's *Global Corruption Report 2009* clearly demonstrates, it can also fail to live up to its potential, if corruption goes unchecked, and turn into a destructive force that undermines fair competition, stifles economic growth and political development and ultimately undercuts its own existence.

Despite prominent corruption scandals and the lack of transparency and accountability that has been shown to lie at the root of the financial crisis, there has been encouraging and real progress towards stronger corporate integrity. Corporate performance in the fight against corruption often does not yet match corporate commitments, however. Crucial corruption risks, as well as loopholes in transparency, accountability and oversight, persist across all industries and all countries. Dynamic markets continue to produce new and subtle corruption challenges.

After a first broad wave of anti-corruption activism and corporate social responsibility (CSR) activities, business worldwide now has a *clearer responsibility, more profound self-interest and greater potential* to assume a vital role in the fight against corruption. This is a key message of the *Global Corruption Report 2009*, which brings together more than eighty recognised experts, practitioners and scholars to present the most comprehensive analysis to date of corruption and remedies for the business sector in all world regions.

The lesson from the analysis is clear: more of the same simply will not do. A step change in strategy and action is required to ensure that corruption in the business sector is tackled effectively.

- *Business* needs to recognise that corruption risks start with bribery and go beyond, requiring an integrated approach to corporate integrity and corporate citizenship.
- *Governments* need to take advantage of a new generation of innovative tools and thereby put much more emphasis on regulatory capabilities, actual enforcement and international cooperation.
- *Civil society* needs to become fully aware of how corruption in business is at the core of many other social, developmental and environmental challenges, and must forge much broader and more effective partnerships to support corporate integrity.
- *Stakeholders* – from business owners, executives and workers to auditors, investors,

regulators and anti-corruption activists – have to acknowledge that corporate integrity is a multi-stakeholder effort that requires collective action across sectors, borders and institutional boundaries.

## Descriptions of a growing and complex problem

The evidence presented by the *Global Corruption Report 2009* is conclusive and troublesome: corruption is a central and growing challenge for business and society, from informal vendors in the least developed countries to multinational companies in industrialised ones, for citizens, communities and nations, all over the world.

### Bribery and corruption in the value chain are a persistent challenge and more destructive than previously understood

Business continues to play a very exposed role as the supplier of corrupt payments to civil servants, members of government and political parties. Kickbacks may be actively solicited, extorted or offered proactively. Irrespective of the degree of coercion involved, the fact remains that bribery fosters a culture of impunity and repeat corruption, undermines the functioning of public institutions and fuels a public perception that governments and bureaucracies are up for sale to the highest bidder.

The scale and scope of bribery in business is staggering. Nearly two in five polled business executives have been asked to pay a bribe when dealing with public institutions. Half estimated that corruption raised project costs by at least 10 per cent. One in five claimed to have lost business because of bribes by a competitor. More than a third felt that corruption is getting worse.

The consequences are dramatic. In developing and transition countries alone, corrupt politicians and government officials receive bribes believed to total between US\$20 and 40 billion annually – the equivalent of some 20 to 40 per cent of official development assistance. The cost is measurable in more than money. When corruption allows reckless companies to disregard the law, the consequences range from water shortages in Spain, exploitative work conditions in China or illegal logging in Indonesia to unsafe medicines in Nigeria and poorly constructed buildings in Turkey that collapse with deadly consequences. Even facilitation payments – the many, often small payments made by companies to ‘get things done’ – are found to be harmful, as they are funnelled up through the system and help nurture and sustain corrupt bureaucracies, political parties and governments.

The corruption challenge is much broader, more complex and more subtle than paying bribes

The *Global Corruption Report 2009* examines corruption in the private sector in a comprehensive way and finds that corrupt payments to public officials are only one part of the problem.

- **Nepotism and corruption in private business interactions are two issues that require much more attention**

Almost a half of the executives from the Organisation for Economic Co-operation and Development (OECD) countries who were polled reported that *personal and familiar relationships* are used to win public contracts in the non-OECD countries they do business in, pointing to corruption challenges that are more difficult to police and legislate for than direct corrupt payments.

In addition, senior executives cite corruption *within* the private sector more frequently as an obstacle to their business operations than infrastructure issues or the functioning of the judiciary. This issue so far has received very limited attention.

- **Corruption inside the enterprise is a widespread threat to sustainable performance and accountability**

Corruption not only affects business relationships but poses a considerable risk inside an enterprise. This report documents many cases of managers, majority shareholders and other actors inside corporations who abuse their entrusted powers for personal gain, to the detriment of owners, investors, employees and society at large. *Executives*, for example, may focus opportunistically on securing generous payouts to themselves, rather than on long-term profitability and sustainability – a phenomenon that has been identified as an important factor in the current financial crisis. *Majority owners* may try to leverage their influence on corporate strategy to expropriate smaller shareholders through 'self-dealing' and similar practices. The benefits of majority control are estimated to exceed 30 per cent of equity value in countries such as Austria, Italy, Mexico and Turkey. They amount to as much as 60 per cent or so of equity value in the Czech Republic and Brazil, raising serious concerns about checks on the powers of these actors.

The report underlines the fact that these and other types of corruption inside an enterprise are common in many countries, indicating serious shortcomings in internal checks and balances. In the long run, corruption compromises the core ability of companies to deliver value for all their stakeholders and act as responsible corporate citizens.

- **Corruption in the marketplace undermines fair competition, fair prices and efficiency worldwide**

Price-fixing cartels and other collusion schemes can cause serious harm to consumers, markets and the world economy. The *Global Corruption Report 2009* presents compelling evidence that a new and potent wave of globalised cartel activity has been sweeping through the world since the 1980s, often implicating well-known brand names and hitting developing countries particularly hard. Key market sectors worldwide have been corrupted, from food and vitamins to infrastructure projects, from anti-malaria medicines to the most sophisticated high-tech products and consumer services.

Experts believe that only between one in three or one in six cartels is exposed, yet even the cases that have come to light attest to a problem of enormous scale. More than 283 private international cartels that came to light between 1990 and 2005 caused direct economic losses to consumers through overcharges totalling some US\$300 billion. In just one year, 1997, developing countries imported US\$54.7 billion of goods from a sample of nineteen industries

that participated in price-fixing conspiracies. Estimates suggest that direct economic losses due to overcharges by international cartel activities alone could match or even exceed the total volume of development aid given to developing countries.

- **Corruption risks in corporate lobbying can turn legitimate participation into undue influence and put the legitimacy of governments and business itself at risk**

Businesses are entitled to be heard in the democratic decision-making process, and lobbying conveys important information and opinion to political representatives and public officials. There is a risk, however, that powerful private sector players capture policies and governments and profoundly thwart democratic decisions, posing a significant threat to accountable and inclusive governance everywhere.

The *Global Corruption Report 2009* presents evidence of persistently close linkages between business and governments in developing and industrialised countries alike, multiple conflicts of interest and the growing risks of disproportionate influence on the part of corporate lobbying. Case studies from Bangladesh, Germany, Malaysia and Trinidad and Tobago all document a precariously close nexus between private business and public institutions. In the United Kingdom, politically connected firms are estimated to account for almost 40 per cent of market capitalisation – a level that rises to a staggering 80 per cent in Russia. In addition, the scale and rapid growth of lobbying raises serious concerns about equal visibility and the right to get heard for citizens who cannot afford to hire lobbyists. In Brussels an estimated 2,500 lobbying organisations with 15,000 lobbyists vie for influence on EU policy-making. In the United States, lobbying expenditures by companies have risen sharply and, at state level, lobbying expenditures average US\$200,000 per legislator, while five lobbyists vie for the attention of each lawmaker.

- **The business case for fighting corruption has never been stronger**

At the level of the individual firm, corruption raises costs and introduces uncertainties, reputational risks and vulnerability to extortion. It makes access to capital more expensive, depresses company valuations and corrodes staff morale. In the broader market environment, corruption undermines fair competition, leads to lost business opportunities and nurtures corrupt bureaucracies. Corruption in and by business hollows out the very basis on which its own existence and success depends: the functioning and sound governance of markets. Corrupt practices invalidate the social licence to operate, breaking the legitimacy and trust that business depends upon in society.

Strong internal governance and corporate integrity are found to pay ‘integrity dividends’, dispelling the claim that companies can ill afford to abstain from corrupt practices without spoiling their business prospects. Companies with anti-corruption programmes and ethical guidelines are found to suffer up to 50 per cent fewer incidents of corruption, and to be less likely to lose business opportunities than companies without such programmes. Companies with superior performance as corporate citizens are shown not only to match but often to out-perform their peers. Better corporate governance in companies located in emerging economies is associated with better performance and market valuation.

## Lessons in strengthening corporate integrity

The *Global Corruption Report 2009* takes stock of the achievements of a first generation of CSR and anti-corruption efforts and draws a number of important conclusions.

- **Corruption risks for business are interlinked and mutually reinforcing, and must not therefore be tackled in isolation**

The *Global Corruption Report 2009* emphasises that the policy debate must be extended from core bribery issues to broader types of corrupt business practice. All forms of corruption take advantage of shortcomings in transparency, internal governance and oversight. Each fosters covert organisational practices and an opportunistic climate that make it difficult to root out individual incidences of corruption. For example, condemning bribery as illegal, or even morally wrong, will not work if practices seen as equally illegal and harmful, such as price-fixing, are condoned.

- **Progress is discernible, but many shortcomings remain**

More companies than ever have adopted business codes and report on their environmental and social performance. Governments in some countries have stepped up their efforts to tackle corporate corruption, leading to high-level prosecutions, such as that against the German company Siemens, thereby providing a much more credible deterrent to corrupt behaviour. Civil society groups have contributed to these moves, taking a keen interest in stronger corporate disclosure and commitments to the community.

The persistent and growing corruption risks described earlier underline the fact that current efforts are not sufficient, however. This report lists several key shortcomings. Internal checks and balances are far from fully effective. Almost one in three companies in a large international survey told of incidences of asset misappropriation and more than one in ten reported being affected by accounting fraud during a four-year period, while senior and middle management were found to be involved in a half of all cases of economic crime.

- **Awareness, training and monitoring need to be fully supported by all stakeholders**

In France, Germany, the United Kingdom and the United States, all major foreign investors and exporters and more than 80 per cent of surveyed executives admitted to 'not being familiar at all' with one of the most important legal frameworks in global business, the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Only a third or so of companies surveyed by other polls in the construction and power sector – industries with high corruption risks – had training programmes for executives on how to avoid corruption.

Monitoring progress and verifying corporate disclosure is not widespread either. Almost 90 per cent of the top 200 businesses worldwide have adopted business codes, but fewer than half report that they monitor compliance. Although more than 3,000 companies have published CSR reports in 2007, fewer than a third were verified through independent assurance.

- **Legal frameworks for tackling corruption must pay more attention to business-specific issues**

The country report section in the *Global Corruption Report 2009* indicates that many countries have passed or updated anti-corruption laws or established new anti-corruption agencies. At the same time, rules that deal specifically with some of the most prevalent corruption risks for business are still evolving and far from widely adopted. Stronger sanctions for the suppliers of corruption, better coverage of incidences of private-to-private bribery, influence-peddling and the use of intermediaries, as well as the criminal liability of companies and a clear approach to facilitation payments, are major areas of continuing concern in many countries. Establishing an effective review mechanism for the United Nations Convention against Corruption is an important task in this regard at international level, in order to track progress and speed up the strengthening of legal frameworks at country level.

- **Efforts for stronger corporate integrity need to address new players and new markets**

Countries such as Brazil, China and India already boast some of the world's largest markets, and their companies play an increasingly active and important role in global business. As this report documents, encouraging efforts are under way to update many aspects of regulatory and governance standards in these countries. Nevertheless, these efforts need to be deepened and extended beyond the 'first in class' companies. Firms from India, China and Brazil are regarded by their peers as among the most corrupt when doing business abroad.

Market solutions to public policy challenges also raise the risk of new arenas for corrupt practices. Corruption risks in new markets need to be addressed proactively. A rapidly growing market for trade in carbon emissions is an integral part of the global answer to climate change, but it faces serious transparency and accountability issues. Sovereign wealth funds have emerged as powerful actors in the investment arena. As managers of significant portions of nations' public wealth, they should live up to particularly high standards of public transparency and accountability. Many fail to do so.

- **A rethink in strategy and stronger action must take place to take sustainable corporate integrity to the next level**

Closing loopholes, strengthening compliance and bringing new players into the fold are important factors for progress. By themselves, though, they will not suffice. A threefold shift in strategy and action is required to address corruption in the sector more effectively.

First, this report clearly highlights the fact that many more stakeholders must join business executives and regulators in tackling corruption in business. These allies include owners, investors and workers, financial intermediaries and auditors and, in the broader business environment, the media, citizens as consumers and – last but not least – civil society. Taken together, they constitute *corporate integrity systems*, providing a web of vital checks, balances and incentives that make corporate integrity sound and sustainable. The report highlights the impact made by all these actors, but also underlines the fact that their contributions are put at risk by conflicts of interests, a lack of whistleblower protection, insufficient disclosure

and reporting and other obstacles, all of which need to receive more attention in the policy debate.

Second, the focus of attention has to go beyond setting rules and pledging commitment to issues of implementation, monitoring and accountability for results to be achieved. Commitments, codes and laws matter, but they are only as good as their verifiable enforcement.

Third, collective action and collaboration need to be better recognised as essential principles in addressing corruption challenges in business. Collective action by companies can stimulate learning, contain the costly fragmentation and proliferation of reporting and compliance standards, protect against free-riding and create peer pressures that are instrumental to rooting out bribery in competition for contracts. Joint pressure allows investors and consumers to bundle their influence in holding business to account. More cooperation among small and medium enterprises enables them to pool their resource and defences against corruption, while more collaboration among national regulators can help close transnational loopholes.

### **Corporate corruption and the global financial and economic crisis: a closely linked policy agenda**

Only over time will the full picture of the eventual scale of the global financial crisis and the economic downturn in 2009 emerge. One key insight, however, is already reflected in several contributions to the *Global Corruption Report 2009*: many of the conditions enabling the crisis are closely linked to corruption risks for business. These conditions include serious shortcomings in corporate integrity systems, such as conflicts of interest entangling key gatekeepers; insufficient transparency and accountability on the part of important markets, market players and oversight mechanisms; and serious lapses in corporate due diligence, governance and integrity.

The crisis also illustrates the hazardous implications of corporate strategies that seek to exploit weak regulation and disclosure standards in some pockets of the global economy. Similar strategies and the structures they generate can also blunt the ability to tackle transnational corruption. They can be abused to establish slush funds for large-scale bribery, while hindering the recovery of public assets stolen by corrupt rulers.

With regard to public oversight and supervision, the crisis has focused attention on the failings of regulators, related shortcomings in resources and staffing, and serious problems in international cooperation – issues that the *Global Corruption Report 2009* also identifies as concerns for the effective prevention and punishment of corruption in business.

All these interlinkages highlight one message: building fully effective corporate integrity systems is not just a question of tackling corruption in business. It is also important for financial and economic stability and the ongoing reforms of the global financial architecture, thereby lending additional urgency and momentum to this task.

## Actions for sustainable corporate integrity

The *Global Corruption Report 2009* translates all these insights into a number of concrete policy proposals.

### *Recommended actions for business*

#### **1 Report on key aspects of corporate citizenship**

Businesses have made great progress in communicating their corporate responsibility activities and environmental performance to the public. They need to match these efforts by reporting on other equally important elements of corporate citizenship:

- their anti-corruption and compliance activities, as the basic safeguards for respecting laws and regulations;
- their lobbying and political finance activities, so that their investors, workers and customers, and the wider public understand how some of the most powerful organisations in their country define their political interests and make their voices heard in the democratic arena; and
- their revenues and payments to governments for each country they do business in, so that local communities can fully understand how companies contribute to and benefit from the public good.

#### **2 Make all commitments binding, verifiable and open to monitors of compliance**

The independent monitoring and verification of compliance with the various codes and commitments that an increasing number of businesses are undertaking to strengthen their corporate integrity is essential, both for maximum effectiveness and public credibility. There is a great opportunity for top performers to lead by example and turn promises into credible performance.

#### **3 Do not go it alone but, where possible, support existing standards and collective action frameworks**

A growing commitment to disclosure and reporting can easily lead to a cacophony of individual information streams that are difficult to compile, compare and understand by investors and the larger public. In order to turn disclosure into meaningful transparency, business should adopt, support and actively engage in the development of related standards, such as the Global Reporting Initiative. Additionally, businesses should join and actively promulgate collective action frameworks for corporate integrity, which exist for anything from individual tendering processes and sectors to supply chain integrity, or multi-stakeholder action in key development areas from extractive industries to health and construction.

### *Recommended actions for governments and regulators*

#### **4 Put stronger emphasis on enforcing rules, the resources required and the measurement and performance of enforcement**

Enforcement matters, but the resources devoted to it and the outputs achieved vary widely between countries and are difficult to monitor and compare. Governments and regulators need to make enforcement efficiency and effectiveness more transparent and accountable. They need to pay more attention to ensuring that adequate resources for regulators and enforcement activities are made available. In addition, those responsible for public oversight should report more fully on the money and staffing devoted to different types of enforcement action and the 'outputs' they produce, in terms of investigations, cases brought, fines and other sanctions imposed.

#### **5 Use and further refine innovative tools for smart regulation and enforcement**

Some countries have successfully experimented with a host of more flexible regulatory tools, which reach beyond rigid command and control approaches to rework incentives more strategically. Tools such as mandatory disclosure, blacklisting, deferred prosecution agreements and compliance monitors can be adopted and adapted by regulators and enforcement agencies in many more countries.

#### **6 Strengthen international cooperation between regulators and make it truly global**

Addressing corruption in global business requires a global approach, involving cooperation across borders for anti-corruption agencies, the competition and tax authorities and financial market regulators. The financial crisis provides a potent reminder that blind spots with regard to transparency and oversight can destabilise the entire global economy. Governments should seize the momentum for reform in terms of stronger cooperation between regulators and enforcement agencies – for all countries, markets and market actors.

### *Recommended actions for civil society*

#### **7 Make corporate integrity and anti-corruption assessments an integral part of monitoring initiatives on corporate social responsibility and performance**

A business that cannot control corruption and thus ensure compliance with laws and regulations cannot live up to its commitments on social, environmental or other corporate citizenship issues. Assessments of corporate anti-corruption efforts need to be mainstreamed into the many metrics and initiatives to assess supply chain integrity, environmental performance, sustainability and responsible corporate citizenship more broadly.

## **8 Advocate for the development, widespread adoption and sound legal protection of complaints and whistleblower systems for employees in the private sector**

Employees are found to play a pivotal role in ensuring corporate integrity. They can provide an early warning system for shortcomings in supply chain integrity, corporate governance structures and business culture or for corrupt business practices. They are also found to be the single most important source of public disclosure of corporate fraud after self-reporting by companies. Empowering workers to become drivers for corporate integrity requires strong provisions for legal protection, as well as sincere commitments by companies to establish effective complaints and whistleblower systems and align human resource management with incentives for ethical behaviour. Business watchdog groups and labour unions can encourage companies and legislators alike to create such an enabling environment.

## **9 Forge broader coalitions for corporate integrity and ensure that citizens and their interests are taken fully into account**

Corporate integrity and anti-corruption compliance are common concerns for owners, investors, consumers, employees and non-governmental organisations working on many different public policy issues. This provides excellent opportunities for all these groups to work more closely together to monitor and advocate for corporate integrity.

Stronger linkages should also be established with the research community. Much important empirical work on corporate corruption and regulation is undertaken by business or law schools. The insights gained are often shared only among small groups of experts, even though they could provide important inputs to civil-society-based policy and advocacy efforts.

Finally, civil society coalitions that straddle borders, link grass-roots campaigners to policy experts and adopt a focus that is independent of national governments or business play an essential role as a third force, ensuring that citizens and their interests are given due weight and oversight in policy-making. Such civil society groups can act as independent watchdogs. They can serve as an important channel for citizens to engage with business and business-related governance frameworks. Finally, civil society coalitions can act as credible catalysts of multi-stakeholder action on a large number of issues related to corruption in the private sector, giving voice and creating capacity for citizens to influence the rules of the game for companies, markets and society. Only strong civil society participation can build the societal consensus that is necessary to tackle corruption in all its forms.