

The Private Corporate Sector

Having been involved in exporting to various countries in the Middle 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 40 years. If I were not now retired I would continue to do so. That is the way one does business in those places....

We expect people from overseas to conduct their business affairs in this country according to our laws and customs; it is both grossly impertinent and extremely naïve to suggest that we should not then respect their customs and conduct ourselves in their country as they would wish...

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

The private sector has a special role to play in the maintenance of a country's national integrity – not only where corporations are based, but also in the markets where they choose to operate. Corporations exist to make profits, and if they fail, their employees and those of associated enterprises, suffer along with their shareholders. To make those profits, corporations have to live in the world the way it actually is – and not the world as many of us would like it to be.

Fortunately, the traditional view that corporations exist solely to make profits for their shareholders – all that matters is a profitable bottom line – is giving way to a new sense of a wider corporate responsibility, not only to customers and clients, but also to the communities and societies in which they operate. It also recognises that “people seem happier working for organisations they regard as ethical [and that] in a booming jobs market, that can become a powerful incentive to do the right thing”.¹

Given the increasing role of the private sector in providing essential goods and services, many of which for generations have been the preserve of government agencies, improved corporate responsibility is a powerful tool in fighting corruption. With the passing of control to the private sector, accountability through Parliaments and Legislatures is, of course, effectively diminished, if not completely lost.

In this process, the private sector is coming to see itself more as a part of civil society than it has in the past. In the pursuit of profit, private sector players are simply self-serving; however, when they address community and society objectives and enter into coalitions with others to pursue a wider public benefit, they are acting as a civil society member.² Corporations are increasingly seeking partnerships with relevant non-governmental organisations, and in par-

¹ *The Economist*, 19 April 2000.

² A similar distinction applies with, e.g. a Law Society. Where it is defending its members' fees, it is acting as a trade union; when it pursues the public interest it is not. And trade unions themselves, when addressing their own members' terms and

conditions, are simply unions of workers; but when they are addressing wider issues, they rightly see their place as being side by side with civil society organisations.

ticular with Transparency International. The views of major corporations are increasingly far-sighted and, in many parts of the world, there are arguably the highest standards of ethical leadership being demonstrated by business leaders. There is also a challenge here for legal systems. Courts in a growing number of countries have seen themselves as having an oversight role – through judicial review – of the legality of public actions. As noted elsewhere, a whole body of law has been developed to act as a check on the abuse of public power. Similar

“Banks must stop covering up fraud...”

British banks must abandon their long-held practice of hushing up fraud committed by staff and outsiders, says the head of Britain’s Serious Fraud Office. “Fraud does not get reported because it is not felt to be in the interests of a bank to [say] that it has been the dupe of a clever criminal or con-man”, Rosalind Wright will tell the British Bankers Association. The days of giving crooked staff, at worst, a neutral reference must end. “Fraudsters who stay unidentified and unprosecuted live to defraud another day – and another victim.” She also will condemn paying “security consultancy fees” to computer hackers who penetrate their computer systems.

Banks told to stop shielding fraudsters, Guardian (UK), 14 March 2000

jurisprudence is likely to become increasingly relevant for governing at least some of the activities of the private sector, where these impact on the public interest to a major degree.

Social Accounting is being increasingly recognised as a necessity, not just a desirable activity. Standards of corporate governance are being developed to provide greater protection, not only for corporations and their shareholders, but for all those who have a stake in the success of the private sector, which includes just about everyone.³ Legitimising “whistle-blowers” is also being recognised as important in protecting the public interest. Employees who raise matters of public concern that arise in the course of their employment, but which their employers may be trying to hide, must be protected.⁴ Examples include the health risks of company products, the presence of unsafe signals on railway lines, not to mention the abuse and misuse of public funds.

In parallel, regulatory structures are being developed in many countries, simply to impose standards and ensure that ordinary people are not being exploited by monopolies and near monopolies.⁵ The United States has been the leader in this area. Critics of the market economy should reflect on the fact that in the USA, the Bell Telephone Corporation was broken up on the insistence of regulators, simply because it had been so successful as to be unduly dominant. It is a myth that under ‘capitalism’, the market is everything and ‘capitalists’ are free to do what they wish. For a system of competition to work, it is crucial that dominant positions are not abused (e.g. aggressively undercutting prices to drive a smaller newcomer to the wall, as was the case with British Airways and Virgin.) If the market-place is to serve the needs of all, then it must be effective, efficient and fair – and above all, it cannot be corrupt without negatively impacting on everyone. As well, actions within the private sector, for better or for worse, impact on others within the sector. For example, when banks give neutral references for staff who they are dismissing for reasons of dishonesty, they are taking an easy way out. However, it is one which can lead to other employers hiring staff who they believe to be honest, but who are, in fact, the very reverse.

The activities of the private sector take place in two quite separate arena: transactions with the public sector and transactions that lie wholly within the private sector. What in the past have been traditionally seen as “public sector” activities are now increasingly passing into private hands. As privatisation proceeds apace in many countries, the importance of checking corruption in the private sector grows ever more urgent. Activities in both arena need to be purposefully addressed.

Corruption involving public officials

Corruption of public officials is explicitly or implicitly illegal in every country which has a

3 The OECD and World Bank have begun work in this area, and there have been numerous national and international initiatives. A host of NGOs are also involved.

4 Whistleblowers are discussed in detail elsewhere: see index.

5 The topic is discussed in detail in the chapter on competition policy.

legal system, therefore it should not be an option for any private sector company. There is no difference in principle between a large bribe given to a minister or top official (“grand corruption”) and a small bribe given to a junior official (“petty corruption”). However, the practicalities of working in certain countries may cause some companies to justify the distinction, describing “petty corruption” as being a “facilitation payment” to obtain what they are entitled to, for example, clearance of goods by customs or the connection of a telephone line. However, the directors of a company have a specific responsibility for ensuring that the company obeys all relevant laws.

Top management and unethical behaviour

Among top management the top four problems of unethical behaviour (comprising more than 80%) are conflict of interest, illegal kick-backs, misuse of company proprietary information and inequitable treatment of suppliers and contractors.

Survey on Business Ethics, commissioned by the ICAC of Hong Kong, March 1994.

Corruption wholly within the private sector

Corruption in the private sector is far from being as clear-cut as public sector corruption. While some countries have laws explicitly criminalising the acceptance by employees of “secret commissions” or “kick-backs”, many do not. Yet it is increasingly recognised that such activities are criminal. The recipients of kick-backs within the private sector, or who exploit their positions to sell their employers’ goods at a premium when in short supply, are effectively stealing from their employers.

As formerly publicly-owned utilities pass into the private sector, frequently in monopoly or near-monopoly situations, the need for individual countries to ensure that any loopholes in this area are closed, becomes ever more compelling.⁶

Private-to-private corruption is widespread

Private sector bribery is pervasive in all parts of the world and in numerous industry sectors.⁷ Given our global economy, it is as international in scope as public sector bribery. Foreign bank accounts are widely used as repositories for private bribes.

The Board of Certified Fraud Examiners asserts that trust, and abuse of it, is the cornerstone of occupational fraud, and it recommends striking a balance between trusting employees too much and trusting them too little.

It argues for:

- the ethical tone being set by top management;
- a written code of ethics (something many small firms do not have and who are at highest risk);
- the checking of employee references;
- the designation of a responsible person, unconnected to bank reconciliations, as the one who receives the company’s unopened bank statements and who looks for unusual patterns or disbursements;
- maintaining a “hotline” that facilitates employees reporting malpractices;
- and for creating a positive work environment where employees will not feel an urge to strike back at their employer because they believe it is treating them unfairly.

The Board predicts a continuing rise in occupational fraud and abuse, arguing that the expansion of the use of computers has drastically changed the speed of transactions and that they

6 Both the OECD and the International Chamber of Commerce are presently addressing the issue.

7 Views held by Michael Hershman (January 2000), Chairman of

‘Decision Strategies, The Fairfax Group International’, a business investigative and security firm, and also a founder member of Transparency International.

do not necessarily create the documents needed to detect fraud and abuse – although computers can, in some circumstances, also be tools for detection.

Among the major areas where private sector bribery occurs are the following:

- *Procurement*: Bribery of purchasing agents for private sector projects is just as common as bribery for government projects. Efforts made to bribe buyers for large chains, such as Wal Mart and K-Mart are very common, particularly in connection with Asian suppliers. This is also true in the procurement of high-tech electronic components. There were well-publicised scandals in the USA involving payments made by paint manufacturers to purchasing agents for major automobile companies. Closely allied, and also common, is bribery to obtain sub-contracts on major projects.
- *Distributorships, Licences and Franchises*: The German “Opelgate” scandal, where company officials accepted bribes to award lucrative distributorships, is an example of widespread corruption in the granting of distributorships.
- *Retail Display Space*: Sales representatives of consumer goods manufacturers commonly bribe store managers to provide favourable display space for their products. Likewise there is the bribery of radio disk jockeys by record companies to play their records.
- *Proprietary Technical and Commercial Data*: There are numerous cases of competitors paying a company’s technical and marketing employees to obtain copies of proprietary information such as manufacturing drawings, customer lists, and pricing information.
- *Financial Industry*: Bribery of bank officials to obtain loans or better interest rates have been common, as disclosed in investigations following bank scandals in Japan, Indonesia, as well as the USA’s Savings & Loans crisis. In the securities industry there have been cases of bribes paid by brokers to obtain special allocations of shares in attractive IPOs (initial public offerings).
- *Scrap Disposal*: This is a common area for bribery, often involving organised crime. There are several variations, including bribery of quality control inspectors to reject good products, which can then be purchased as scrap and resold as quality products.
- *Sports*: Recent examples include leading members of the International Olympic Committee accepting “inappropriate gifts”; a boxing organisation that accepted bribes from managers of fighters to grant higher rankings, which then qualify fighters for more lucrative matches; bookmakers who have bribed cricketers to under-perform; and football players rigging results.

Who is responsible for preventing private sector fraud?

“There is still much confusion over who has the responsibility for manning a system of internal control in individual businesses, and for preventing and detecting fraud... [When surveyed], just 29% and 22% respectively responded with the correct answer: the whole board.”

Price Waterhouse Survey on Corporate Governance, January 1995.

Internal concealment of bribes can lead to false accounting, false tax declarations and kick-backs to company staff. Furthermore, one of the main principles of competitive tendering is that contracts should be won by those companies offering the best combination of price and quality, with other factors such as delivery or financing terms sometimes being taken into consideration.

Corruption is an unacceptable factor which destroys such free and fair competition. It is also the case that corruption in the market-place retards private sector development. New players are effectively excluded, and inefficiencies are rewarded, rather than redressed.

Fraud and private sector procurement

Fraud, particularly in the area of financial management, is, of course, a long-standing problem for the private sector no less than for the public one. An example is the accountant who warned her superiors that a book-keeper was fiddling the books by raking money from the payments system. The book-keeper was prosecuted and sacked, but the company did nothing

to improve its management scrutiny. As a result the very same accountant started running identical scams, but for even larger amounts, writing cheques to suppliers who were, in fact, supplying herself.

In another instance, a company secretary started paying his bills with company cheques drawn on the directors' current accounts. Being careful to use the same wine merchant, travel agent and garage as the board, the swindle went undetected for a long time. Such malpractices are hard to spot, and even harder to stop. Controls are not breached, they are simply circumvented.

However, bribery to obtain contracts is still the most frequent form of fraud in the private sector, and probably more widespread than employers realise. Simply having tenders evaluated by different people at different stages is no real safeguard unless the procedures also prevent people from:

- Carefully selecting who is to tender;
- Drawing up specifications which favour one supplier over another; and
- Sending different specifications to other suppliers.

As procurement moves onto the Internet, so does fraud. However, the Internet's electronic systems record all the traffic meticulously and there are "data-mining" programmes which can unearth and expose suspicious patterns.

E-trade customer checks recommended in a recent report include:

- Checking the company name, incorporation and registration
- Looking at the last three years' accounts to check solvency
- Finding out the names and addresses of directors and shareholders
- Checking other positions for conflicts of interest
- Looking for records of court judgments or bankruptcy orders
- Verifying the trading address and registered office
- Checking that the e-mail, billing and delivery addresses match
- Checking that the mailing address is not a service bureau or a post office box
- Locating the customer's internet service provider.⁸

Procurement frauds range from creating cartels to faking invoices, but the most frequent is the kickback in exchange for a contract. As this is effectively a "refund" on the price (but paid to the employee, not the employer) it drives up the costs of business.

Other points of vulnerability

Private sector companies feel the pressure to bribe, on the grand corruption scale, in three main areas. The first concerns certain countries, particularly in the developing world, where it can be very difficult for anyone to win a major government or parastatal contract without paying a large bribe. This is normally done through a representative who receives a percentage commission when the business is secured. The commission is a generous one, and well able to withstand the payment of the necessary bribe. A company may justify its action not

Corruption boomerangs on Swiss companies

Since fewer than one in every 100 Pakistanis pays income tax, customs revenues represent the state's largest revenue source. But for decades the system has been corrupted, with businesses under-invoicing imports, or paying bribes, to escape duties.

In the 1980's Pakistan came under pressure from the International Monetary Fund to increase government revenues and to cut a runaway budget deficit. During Ms. Bhutto's first term, Pakistan entrusted pre-shipment "verification" of all major imports to two Swiss companies with blue-ribbon reputations, Societe Generale de Surveillance S.A. and a subsidiary, Cotecna Inspection S.A. But the documents suggest that this stab at improving Pakistan's fiscal soundness was quickly turned to generating profits for the Bhutto family's accounts.

In 1994, executives of the two Swiss companies wrote, promising to pay "commissions" totalling nine per cent to three off-shore companies controlled by Mr. Zardari and Nusrat Bhutto. A Cotecna letter in June 1994 was direct: "Should we receive, within six months of today, a contract for inspection and price verification of goods imported into Pakistan," it read, "we will pay you 6 per cent of the total amount invoiced and paid to the Government of Pakistan for such a contract and during the whole duration of that contract and its renewal."

Similar letters, dated March and June 1994, were sent by Societe Generale de Surveillance promising "consultancy fees" of six per cent and three per cent to two other offshore companies controlled by the Bhutto family. According to Pakistani investigators, the two Swiss companies inspected more than \$15.4 billion in imports into Pakistan from January 1995 to March 1997, making more than \$131 million. The investigators estimated that the Bhutto family companies made \$11.8 million from the deals, at least a third of which showed up in banking documents taken from the Swiss lawyer.

For Societe Generale de Surveillance, with 35,000 employees and more than \$2 billion a year in earnings, the relationship with the Bhutto family has been painful. In addition to doing customs inspections, the company awards certificates of technical quality. In effect, its business is integrity.

"House of Graft: Tracing the Bhutto Millions – A special report: Bhutto Clan Leaves Trail of Corruption", by John F. Burns, New York Times, 9 January 1998

⁸ *Procurement Fraud in E-business* by Jon Hayton (PricewaterhouseCoopers, London) reported in the *Daily Telegraph*, 10 July 2000.

only on the ground of 'business necessity', but also that it is merely conforming to local practice. If the local representative is not 'playing straight' with the principals, there have been suggestions that they may inflate the amounts claimed as needed to "buy" a Minister or a head of government, and then either keep the surplus for themselves or split it with corrupt elements within the sales staff of the company on whose behalf the bribing is being done.⁹

The second point of vulnerability is that off-shore bribery is generally condoned 'because everybody does it'. It may even be morally defended on the grounds that the resulting business is saving jobs, regardless of the fact that it may be costing jobs elsewhere. The third factor comes into play when companies, seek to create work by offering very attractive bribes to decision-makers to approve unneeded purchases or projects.

The first two points discussed above have a sufficient element of truth in them to satisfy the conscience of the company which is hungry for business and does not consider itself legally bound to reject grand corruption as a tool, particularly when used indirectly through a representative. Many company directors also feel entitled to shelter behind their ignorance of the company's operations, particularly its foreign operations. While this position is not supported legally, it is a widespread phenomenon and can lead a director to feel no responsibility to question the level of an overseas representative's commission, even if it seems excessive.

Survey on business ethics, corruption and fraud

Senior management, surveyed on where they perceived the levels of ethical standards perceived to be moderate or low responded:

- in their own profession or trade: 53.8%
- in the business community in general: 74.4%
- among youth at work: 77.4%

Survey conducted by the Ethics Development Centre.

Hong Kong, November 1994.

Bribing abroad

If a company resident in Country A bribes an official in Country A, it is committing a crime. If the same company bribes an official in Country B, it is committing a crime in Country B. Is it also committing a crime in Country A? If the company is American and therefore subject to the Foreign Corrupt Practices Act (FCPA), there is no doubt about its criminality.¹⁰ But until recently, if the company was not American and the entire transaction took place outside its own country and through a third party, it had generally not committed a crime in its own country.

This situation is now changing, and changing radically. Action at the Organization for Economic Co-operation and Development (OECD) led to the signing of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.¹¹ As described elsewhere, the Convention requires signatories to criminalise bribery of foreign public officials. It is accompanied by a raft of "soft law" requirements which parallel the "hard law" of the Convention, including a requirement to end the tax deductibility of bribes as being a "legitimate business expense".

The Convention and its "soft law" recommendations are not being left on the shelves of justice ministries' law libraries. Rather they are being closely and vigorously monitored to see that each country's laws and practices are adequate and effective. Arms control treaties apart, never before has there been an international convention which has involved peer reviews, and teams of signatories entering the territory of others to examine their practices and procedures.

9 Discussions with private sector interests in Tanzania, 1998 and with those elsewhere.

10 The US Foreign Corrupt Practices Act was passed by the Carter Administration in 1977 as a response to the political fundraising corruption revealed in the wake of the Watergate scandal and the resignation of President Nixon. It was enacted for domestic reasons, to protect US democratic institutions by closing a loophole which Nixon fundraisers had exploited. Although it is argued that the US administrations have not enforced the Act as determinedly as they might have done

(with just over 50 cases in 25 years and only seven reaching court), the energetic way in which some US private sector interests campaigned for its repeal suggests that it has had a greater effect than some are prepared to concede. Certainly, the refusal to do so by successive US administrations and the determined drive they led for an international convention to internationalise the process, redounds to their credit.

11 The text of the Convention appears in the Best Practice section of the web site version of this Source Book: www.transparency.org.

Much is at stake, and the forceful, authoritative forms of peer review provide reason to hope that the Convention will succeed. Certainly, anything less would have failed.

In the meantime, the private sector has to continue to go about its business in an environment in which the rules are in a state of flux.

Directors should understand and accept their responsibility for keeping their companies within the laws of all countries where they operate, and play an active and probing role in ensuring, wherever possible, that the spirit and the letter of the law are observed. It appears that grand corruption in international transactions, which distorts competition and has a restrictive impact on trade, will also offend the rules of the World Trade Organization.

While there is no difference, in principle, between grand and petty corruption, companies may be excused for believing that the difference is more than merely a matter of scale. Grand corruption is intended to influence decision-makers in favour of one company against another, or to favour one project or purchase over the alternatives. By contrast, “grease” or “facilitation” payments to minor officials (to do the work which they are already being paid to do, and to provide services to which the company is legally entitled) are highly undesirable; but it is recognised that, in the real world, companies cannot always be expected to adhere to the strictest principles on very small matters. For example, the American FCPA does not apply to “grease payments”, although it certainly does not condone them. Huge shipments of vitally-needed equipment may be stranded at the dockside, with customs officials demanding small payments before they will release them.

This is a complex and contradictory area, and the dilemma will subsist until there are reliable enforcement procedures in the countries concerned. In the meantime, where companies accept, however reluctantly, that on occasions they may be victims of extortion and have little option but to pay, clear rules are needed to guide their staff. All such payments should be recorded, and any payment which is more than a very small one should require authorisation at a senior level to ensure that “grease payments” do not become a gateway for grand corruption. Above all, the companies should make it clear to all staff that these practices are not condoned.

As long as the position of bribes paid in international transactions remains unclear in criminal and civil law, companies’ voluntary codes of conduct will be important to set the tone for all employees and to indicate to third parties the standards to be expected from the company. Company codes vary greatly in strength. The least useful are those which are limited to well-intentioned, but vague expressions of principle. The most effective are those which are specific in their descriptions of what employees are not allowed to do on behalf of the company. The best are those which are not only specific, but also require an annual or six-monthly signature from the chief executive to confirm that they have been observed in every respect.¹²

However, it must be recognised that the best voluntary code is only as effective as the company’s board of directors is determined to make it. Directors should take responsibility for monitoring the application and observance of company codes, recognising that they can be an effective means of discharging their liability for maintaining the company’s legal and moral

Bad publicity... Loss of trust

“[T]he law is not the only motivator. Fear of embarrassment at the hands of NGOs and the media has given business ethics an even bigger push. Companies have learnt the hard way that they live in a CNN world, in which bad behaviour in one country can be seized on by local campaigners and beamed on the evening television news to customers back home... There may still be two good reasons for companies to worry about their ethical reputation. One is anticipation: bad behaviour, once it stirs up a public fuss, may provoke legislation that companies will find more irksome than self-restraint. The other, more crucial, is trust. A company that is not trusted by its employees, partners and customers will suffer. In an electronic world, where businesses are geographically far from their customers, a reputation for trust may become even more important. Ultimately, though, companies may have to accept that virtue is sometimes its own reward. One of the eternal truths of morality has been that the bad do not always do badly and the good do not always do well.”

The Economist, 19 April 2000

¹² Examples of Company Codes of Conduct can be found in the Best Practice section of the web site version of this Source Book: www.transparency.org.

standards. Large companies should ensure that there are ethics programmes to breathe life and meaning into what are otherwise decorative documents: and these should not be lectures on what to do and what not to do, but involve real life situations and dilemmas, and active discussion among employees as to how these should be resolved. We return to the question of codes below.

It is understandable that, in the present situation of widespread grand corruption and legal uncertainties, many companies seeking international contracts are reluctant to risk losing business to those who continue to pay bribes. All companies, however, can welcome the Anti-Bribery Pacts (or Integrity Pacts) increasingly imposed by certain countries on tenderers for major public contracts. In such Pacts, all the players start on a level playing-field so that the risk of a bribe is greatly reduced.¹³

There also appears to be considerable scope for international professional associations and federations to include a mandatory anti-corruption clause in their ethics codes, with expulsion from its membership as the sanction for non-observance. When such an association is strong in terms of world-wide membership, its members have relatively little to fear from non-members gaining an unfair advantage from bribery. For example, financial institutions could be expected to support members of an appropriate professional body against non-members.

Finally, private sector companies should recognise that grand corruption is the enemy of high standards and efficiency. When the decision-maker is influenced by a bribe, opportunities are created for sub-standard performers to gain a contract at the expense of those whose product, reputation or skills would make them the likely winners of a fair competition.

Companies as victims

One of the most compelling reasons for companies to review their ethical behaviour is likely to be that of self-interest. There is a growing body of evidence which appears to indicate that companies which tolerate corruption abroad by their employees are placing themselves at risk. “Off the books” accounts, secret bank accounts, payment of staff serving prison terms and use of former senior staff as “middlemen” all cultivate an atmosphere in which the bottom-line justifies criminal activity. This is inherently dangerous, and it may be only a matter of time before the company itself finds that it is the victim of similar conduct on the part of its employees.¹⁴

In some countries the legal system does not yet permit the prosecution of corporate bodies for criminal actions, based on the premise that only living human beings are capable of forming the necessary intention to commit a crime. The effect of such a prohibition can be to greatly reduce the penalties that can be imposed, and to significantly increase the problems of gaining the necessary proof of guilt: it may be obvious that a company has broken the law, but to successfully prosecute, a prosecutor will have to name specific individuals and prove that they were personally responsible. Even if these can be identified, they may have left the company’s employ, or even the country. In any event, any financial penalties would have to be related to the individual’s ability to pay – not to the company’s, or to the profit that may have flowed to the company as a consequence of the illegal actions. Where a prosecution is successful, a company may be left paying legal costs for an employee, and continuing their salaries while

13 See the Best Practice section on the web site version for an example of an Anti-Bribery Pact and the discussion on public procurement elsewhere in this Source Book.

14 A number of German firms were involved in scandals in 1995,

including kickbacks on construction contracts to build new factories; and at least one overseas sales manager was manipulating exports to his personal benefit.

they serve prison terms, but in reality these penalties may be insignificant when set against the profits being made.

If the company finds itself in court in countries that do prosecute corporate bodies, how best can it defend itself when some of its employees have been violating the law? If the company has kept information about illicit payments to a small number of officials and away from the Board of Directors, whether the Board is aware of it or not, no judicial officer is likely to be impressed by the company management's claims of innocence. Legal systems increasingly demand that companies have internal compliance procedures in place. In doing so, they are following the lead set by more enlightened corporations.

The USA is assisting in this process. It has developed an excellent model for other countries to consider following - the Federal Sentencing Guidelines of 1991.¹⁵ The Commission which developed these Guidelines was originally established to examine the sentencing of individuals, but its greatest contribution to criminal jurisprudence came when it examined the position of corporations.

Responding to research that showed that the median fine for a corporation averaged only about 20 per cent of the losses that the offences had caused, the Commission decided that sentences should be governed by the kind of company that was involved; in other words, the 'good corporate citizenship' of the company should be assessed. This decision is not intended to penalise companies for bad corporate behaviour, but rather to reward the good. If a company is convicted of an offence, a fine would normally be about three times the size of the loss caused. However, where a company can prove that it has an effective ethics program in place, the fine can be reduced by as much as 95 per cent.¹⁶

The US Federal Sentencing Guidelines of 1991

The (US) Federal Sentencing Guidelines state that:

The hallmark of an effective program to prevent and detect violations of law is that the organisation exercised due diligence in seeking to prevent and detect criminal conduct by its employees and other agents. The concept of due diligence comprises seven steps:

- (1) There must be compliance standards and procedures to be followed by employees, etc. that are reasonably capable of reducing the prospect of criminal conduct;
- (2) There must be a specific individual or individuals assigned with overall responsibility to ensure compliance with (1);
- (3) The corporation must have taken due care in not delegating substantial discretionary authority to individuals known (or who should have been known) to have a propensity to engage in illicit activities;
- (4) The corporation must have communications and training programs in place;
- (5) It must also have taken reasonable steps to achieve compliance with its standards (perhaps including advice lines and protection for whistle-blowers);
- (6) The standards must have been enforced consistently through appropriate disciplinary mechanisms, including instances where individuals are responsible for a failure to detect an offence; and

15 The Guidelines approach also shows a way in which to limit one particular area of judicial corruption (corruptly-induced inadequate sentencing). The Guidelines enable the sentencing record of a judge to be monitored where there is doubt as to his or her integrity.

16 For discussion of the Guidelines, see *Business Ethics: The New Bottom Line* by Sheena Carmichael (Demos, London, 1995).

(7) After an offence has been detected, the corporation must have taken all reasonable steps to modify its systems to obviate repetition.

There is considerable interest in these Guidelines and the ways in which they are fostering ethical behaviour and self-policing in the corporate sector in the United States. There is every likelihood that they will also find favour elsewhere, especially since the criminal responsibility of companies is a difficult question in most systems of jurisprudence and the trend is increasingly towards self-regulation.

It has also been suggested that businesses should undertake an audit of how ethical problems are currently being dealt with, to test its behaviour both against external standards and against its own declared values.¹⁷ The European Institute of Business Ethics has developed a “Dilemma Training Device” which helps organisations to address ethical issues, to discuss them and to find ways of using them to attain the objectives of the organisation.¹⁸

Can ethical companies compete in corrupt market-places?

Can ethical companies compete in corrupt market-places? Is it ethical for them to even try? Are they not courting economic ruin and risking the jobs and livelihoods of their employees? It has been suggested that, in general terms, a business can be ethically justified in working in a culture which has certain unethical features when:

- the features are unavoidable, at least for the time being;
- one is operating for good business and social reasons; and
- one is working to change those unethical features.¹⁹

This argument points to instances where official complaints by groups of companies have changed the practice of bribery in some countries and proved to be more effective than efforts by individual firms.

The experience of responsible US corporations also suggests that, even in unethical market-places, the fact that a government is dealing with a company known to be ethical can, in itself, be a selling-point. “Deal with us, the corporation is saying, and your own people will know of your integrity.” US sales staff also claim that being able to quote the existence of the USA’s Foreign Corrupt Practices Act, and their company’s policy of compliance, can be enough to sweep any talk of kickbacks and sweeteners from the agenda.

However, it would be simplistic to suggest that, in business, profits go only to those who are ethical. The evidence is plain: large volumes of business are being won by companies through unethical behaviour which, in some sectors, has transformed competition from being one of competitive advantage to one of competitive bribery. It would, therefore, be unrealistic to ignore the impact of the FCPA on responsible American corporations, or their wish to see the same restraint applied to their competitors. It is also the case that large corporations can be in a much better position to be able to walk away from a deal once corruption becomes manifest, than a small company which has invested heavily in the project and has, comparatively, much more to lose.

¹⁷ *Ibid.*, p.51.

¹⁸ For more information see the web site of European Institute of Business Ethics, Nijenrode University, The Netherlands Business

School at www.nyenrode.nl/research_faculty/eibe/products.html
¹⁹ *Ethical Attitudes to Bribery and Extortion*, Lecture given by Jack Mahoney at the University of Hong Kong, 1994.

"Best practice"

Best practice dictates that private sector companies should:

- obey the law in all countries in which they operate;
- ensure that directors are fully aware of their legal liabilities;
- press for clarification or strengthening of the law, if current law places the company at a disadvantage relative to its competitors;
- introduce specific anti-bribery clauses into corporate codes of conduct and ensure that all employees know that these must be observed;
- encourage directors to actively monitor the application and effectiveness of corporate codes of conduct;
- encourage any international professional body to which the directors belong to include a mandatory anti-bribery clause in its code of conduct;
- support a national Anti-Bribery Pact in relation to any major off-shore tender where this is offered by a government; and
- press relevant governments, directly or through the company's relevant commercial or professional body, to support the OECD anti-corruption initiative and to encourage the World Trade Organization to recognise grand corruption as a barrier to fair trade.

Early warning signals of the possibly corrupt employee

"Red flags", indicating circumstances where managers should take a closer look include -

- the refusal of a posting, even with promotion, or the refusal to take leave;
- regularly staying late in the office when few other people are around;
- frequent and repeated purchases of small amounts of materials (from the same supplier(s));
- paying with cash, or exceptionally fast or slow payments;
- frequent reports of loss of merchandise, or in the writing-off of stock or bad debts;
- excessive purchases at discounted or staff prices; and
- excessive credit facilities.

Gifts – To whom and for what?

Personal contacts in business, as in other walks of life, frequently find expression in exchanges of gifts and hospitality. However, in business, when potential buyers and potential sellers come together, this can become a question of something rather more meaningful. The question can quickly arise as to whether a gift is appropriate, and perhaps, whether it should be described more bluntly as a bribe. For example, when a sales person works for a performance bonus, or needs to land an order to preserve his or her job, the temptations to use all means available (including presenting "gifts" to clients) can be considerable. It is therefore desirable for companies to have internal policies and rules governing the giving and receiving of gifts.

A draft "Gifts Policy" was developed by a firm of Danish consultants after new management was introduced, who decided that it was in the firm's best interest to contain practices which they felt were out of hand. In general, "visible gifts", legal in the country where the work was being carried out, were considered normal business practice and supported by the company, but "invisible gifts" were considered bribes and not supported. The only exception to the latter was "unofficial fees to carry out necessary day-to-day duties in connection with contracted work (obtain permits, visas, telephone subscription, etc.)". In such a case, however, a note was required to be attached to the expense claim, detailing the efforts made to avoid it.²⁰

Private sector initiatives

The International Chamber of Commerce's Rules of Conduct to Combat Extortion were first adopted as long ago as 1977. They were revised and brought up to date in 1996 and again, in 1999.

The ICC Rules go further than the minimum legal requirements of many countries. If followed, the Rules would induce a sea change in international business behaviour. However, the Rules are still intended "as a method of self-regulation", and in the hope that "their voluntary

²⁰ The draft code appears in the Best Practice section of the web site version of this Source Book: www.transparency.org.

Some issues to consider

The World Economic Forum launched its Initiative on Anti-Corruption Standards for Global Business at a meeting in Davos, in January, 1995. The following were among the issues considered:²³

- To what degree is it in the interest of businesses to pursue ethical practices?
- Apart from protecting management from criminal liabilities and civil sanctions, corruption has costs and creates economic distortions - even if measuring these with any precision presents analytical difficulties. There is a growing literature arguing that businesses adhering to especially high ethical standards enjoy certain inherent advantages in relation to customers as well as to suppliers, employees and regulatory agencies. But these advantages are also difficult to quantify. Does this thesis, propounded by a growing number of contemporary business ethics experts, accord with the real world?
- Do individual businesses that choose to pursue high ethical standards place themselves at a systemic disadvantage vis-à-vis competitors? Can these costs be counterbalanced in other ways?
- What is the relationship between a company's overall ethical standards and the likelihood that a company will, itself, be criminally victimised by its own employees? Do companies that place a high priority on ethics thereby purchase some insurance against costly white-collar crime within their own ranks?
- Much corporate "corruption" amounts to an adaptation to the local "rules of the game" in a given country. To what extent can business itself encourage global standardisation of ethical practices, or to what degree must the impetus come from government?
- To what degree is corruption an inhibition on a country's development? Some Russian experts are concerned that corruption and crime have risen to the point of seriously discouraging foreign investment. Do countries where official corruption is rife have greater difficulty in attracting foreign capital, or are the costs of corruption counterbalanced by other advantages, for example a low wage structure?
- To what degree can countries permitting wide-scale corruption be expected to respond to an initiative from the global business community? Can business affect its political environment by better governing itself?
- Would the articulation of global ethical standards help clarify the complex and changing legal and political environments in which multinational corporations now operate? Does it make sense for global business to attempt to lead the effort towards ethical standardisation?

acceptance by business enterprises will not only promote high standards of integrity in business transactions, but will also form a valuable defensive protection to those enterprises which are subjected to attempts at extortion."²¹

Firms have been happy to sign up, but none have actually felt obliged to obey the Rules because the voluntary nature of the ICC reduces its ability to police its members and to establish effective monitoring mechanisms. However, the ICC has been responding to criticisms by revisiting its Rules and looking for ways in which they can be made effective. Understandably, the ICC (as an organisation with a voluntary membership and dependent on subscriptions) remains cautious about the external monitoring of corporations' conduct.

At present Transparency International is undertaking a feasibility study on the development of a private sector "internal integrity management standard", an exercise in which the ICC has participated.²² This is being undertaken with a number of interested corporations, and NGOs from a variety of regions. The study is exploring the possibility of a standard which can, if particular companies wish, be independently verified. With a sharp focus on integrity, rather than a broad focus on corporate governance, and an intention that the standard be verifiable, the initiative is very different from the exercises underway in other fora dealing with areas of corporate governance and business accountability.

If much of the international activity described in this Source Book has only comparatively recently begun to show results, it nonetheless serves to demonstrate a clear and unambiguous recognition of the problem by developed and developing countries alike.

Do codes of conduct work in the private sector?

There is substantial debate over the extent to which corporate codes actually alter corporate conduct.²⁴

Although codes have become increasingly popular with companies in industrialised countries, they have by no means always been embedded within those organisations. The codes have often been seen as ends in themselves, not as a means to an end.

There have been various studies relating to corporate codes, but many simply undertake broad surveys of existing codes, rather than analysing the essence of what makes a code effective. In addition, much research relates to slightly different questions, such as whether general corporate ethics programmes promote social accountability. Nonetheless, some studies do point to possible factors which may contribute to the effectiveness of codes of conduct.

21 The Rules appear in the "Best Practice" documentation.
 22 Social Accountability International (SAI), a New York based NGO which (as CEP-AA) developed the Social Accountability standard (SA8000) is TI's partner in this initiative. Progress reports will be posted on the TI website from time to time, as the exercise proceeds.
 23 The World Economic Forum, 53 Chemin des Hauts-Crêts, CH-1223 Colony/Geneva, Switzerland. The points are summarised from a paper prepared for the Forum, *Initiative on anti-corrup-*

tion standards for global business, by Patrick Glynn, Resident Scholar, American Enterprise Institute for Public Policy Research.
 24 This section is based on research undertaken by Thomas F. McInerney of CEP-AA, entitled *Effectiveness of Codes of Conduct*, 21 February 2000, prepared for the Business Integrity Standard Feasibility Committee facilitated by CEP-AA (now SAI) and Transparency International.

One report, *Ethical Concerns and Reputation Risk Management*²⁵, focuses on the means chosen to implement business ethical norms, including the types of training they provide, which individuals play the greatest organisational role in promoting business ethics, and whether stakeholders are involved, rather than assessing the effectiveness of such efforts.

The report found that Values and Mission Statements and Codes of Conduct remain the most widely used business ethics practices, with about 80 per cent of companies implementing such programmes. These results represent substantial increases over surveys conducted three years ago when less than 60 per cent reported having codes.

Perhaps the most interesting finding of the report relates to the lack of management systems used to implement codes:

- In 20% of the companies surveyed, the codes were not made available to all employees;
- In 65% of the companies, codes were developed by legal/compliance and corporate secretariats; and
- Human resource personnel were involved in developing codes in only 43% of companies surveyed.

In other words, firms' senior management have tended to supervise the development of codes, and the codes have had a legal, rather than a behavioral focus.

Some 40 per cent of companies provided training only to selected employees. Of these, less than half related the training to practical application of their codes in realistic situations; and fewer still involved a sharing of participants' experiences. Not surprisingly, the survey concluded that the average employee in most companies was not nearly as aware of the existence of the code as were senior personnel.

The study also found that fewer than half of the companies surveyed had helplines for raising concerns or hotlines for reporting suspected misconduct – and 60 per cent of those with these facilities, reported no use being made of them. This is hardly surprising when significant numbers of companies provided no protection for callers or for alleged offenders alike.

The report concluded that many business ethics programmes fail to reflect important principles, and that many organisations still grapple with how to make their employees actually “live” their values and codes.

A different report, prepared by KPMG, on fraud among companies in Southern Africa, provides a different perspective on the most effective means of combating fraud.²⁶ Of the 540 companies which responded to the survey, 83% indicated that they had experienced an incident of fraud in the prior year. To reduce the possibility of fraud, the majority of companies surveyed indicated that they would review and improve controls (83%) and either establish a corporate code of conduct (46%) or implement a comprehensive ethics program (32%). The relatively low level of interest in implementing corporate codes or ethics programmes suggests that at the very least, such measures are perceived as not being particularly effective when compared to bolstering internal controls.

25 Based on a 1999 study undertaken by Arthur Andersen's Ethics and Responsible Business Practices Consulting group and the London Business School, which convened an advisory board with members drawn from business, the academic world, and consultancy companies. It oversaw a survey of various approaches to

business ethics among 78 UK companies drawn from the FTSE 350, as well as a number of non-listed companies.

26 In the report fraud is defined “loosely” to include “all offences of which a dishonest representation or appropriation is an element.”

In a paper prepared for the 9th International Anti-Corruption Conference in Durban, South Africa²⁷, Ronald Berenbeim argued that while codes have become widely instituted in corporations, but they have not had the impact which they should have had. Surveys undertaken by his organisation²⁸ revealed that in nearly 80 per cent of corporations, the board of directors is involved in the drafting of the codes – so they do not “belong” to staff as a whole. He notes that many corporate codes contain virtually identical provisions prohibiting corrupt practices, and argues that internal corporate procedures, which require disclosure and accountability (including whistleblower protections and other means of reporting of violations), are essential to an effective code.

Another somewhat different study prepared for the *Business & Society Journal* in 1999 concludes that their analysis did not demonstrate that good social performance “leads to” poor financial performance. The study shows that determining precisely what constitutes an “effective” corporate code of conduct is a difficult question to answer. Does “effective” mean “people behaving ethically”, or does it simply mean that no major scandal has erupted? Or does it only mean that a company is staying within the confines of the law?

The OECD, now highly active in the field of corporate governance, conducted a survey of 233 corporate codes of conduct in 1998. The survey was limited to documenting the provision of the codes rather than analysing the accomplishments or effectiveness of the codes. The results of the survey indicated that the majority (82%) of codes covered the conduct of the corporation itself, while comparatively few were codes extended to include the conduct of contractors and sub-contractors (50% and 22% respectively). In terms of the norms articulated in the corporate codes, only 18% referred to international standards explicitly. Only one of the 233 referred to the OECD Guidelines for Multinational Enterprises, and just two cited the OECD Recommendation on Combating Bribery in International Business Transactions (the precursor to the Convention on Combating Bribery of Public Officials in International Business Transactions). Other codes merely referred to “international human rights” or “universal” norms.

In the companies surveyed, the monitoring of codes received relatively little attention. The majority provided for internal corporate monitoring, and some 40 per cent did not mention monitoring at all. Only a quarter provided for corrective action, and very few stated that non-compliance could or would result in termination of a contract or business relationship.

Also in 1998, the London-based Institute of Business Ethics carried out its second survey of the use of codes of business ethics. From the responses, the Institute estimated that 57% of the largest UK companies had codes of conduct, compared with only 18% in 1987. There was wide divergence in approach between communicating codes internally and externally. Nearly all companies (93%) gave their codes some internal communications support. Only one third publicised their codes externally. Fewer than half of the companies with a code provided training of any kind as to the meaning and use of codes, and some 30% did not even furnish copies of the code to their staff. The results confirmed the impression that for many companies, the drafting and introduction of a code are seen as being an end in itself. In addition, the report found that in many firms, management perceived staff as sufficiently steeped in the ethos of the company that little or no instruction on the practical use of the code was needed.

So do corporate codes of conduct work?

Generally speaking, research on corporate codes of conduct is incomplete. The research sug-

27 Ronald Berenbeim (1999) *“How Effective are Corporate Codes in Combating Corruption?”* The paper is on the 9th IACC website,

accessible through www.transparency.org.
28 The Conference Board.

gests that codes have, indeed, had some positive influence, but such a broad conclusion still lacks a firm empirical base. The research indicates that the degree to which the code of conduct becomes “embedded”, or a part of the corporate culture, will have some positive effects on employee behaviour. However, determining precisely what “embeddedness” means in terms of organisational structures and managerial leadership, remains elusive. The key determinant in achieving organisational adherence to a code appears to be training, monitoring and enforcement activities - another conclusion still more intuitive than scientific.

Some indicators concerning the effectiveness of the private sector as an integrity pillar

- Are national private sector associations active? Do they take an active interest in developing an honest market-place? Does the national section of the International Chamber of Commerce actively promote the ICC's code of good business practices?
- Does the private sector take part in a continuing dialogue on competition policy which recognises the benefits for all which a sound policy can bring?
- Do leading companies have codes of conduct? Do these cover corruption and gift-giving? Are the codes well publicised?
- Does the private sector acknowledge that cartels and bidding rings are both illegal and damaging to the development of the private sector?
- Do companies in general obey the law?
- Do major companies have policies on gift-giving? Are these appropriate?
- Do businesses in general avoid bribing to obtain government contracts? If this is a common practice, is it one which is disliked and discouraged? Or is it tolerated and accepted?
- Do leading local companies play an active role in developing ethical business standards?
- Are political office-holders active participants in private sector activities? If so, are conflict of interest situations avoided? Is their involvement transparent?

