

Control Risks



Facing up to corruption 2007: A practical business guide

Facing up to corruption

A practical business guide

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Introduction

This report is the second, completely revised edition of *Facing up to corruption: A practical business guide*, which Control Risks published in 2002. It draws on three main sources:

- The specially commissioned *International business attitudes to corruption* survey, which involved telephone interviews with 350 companies based in the UK, the US, Germany, France, the Netherlands, Brazil and Hong Kong. The survey was jointly commissioned by Control Risks and Simmons & Simmons, and was carried out between May and July 2006 (see appendix for further details).
- A growing international literature on corruption and the means to address it.
- Control Risks' own consultancy experience with business, government institutions and not-for-profit organisations across the world.

The premise of this report is the same as with the earlier edition. Corruption is a problem that to a greater or lesser extent affects all countries and all commercial sectors. It raises costs, distorts competition and results in poor-quality goods and services. Countries and governments lose out because high levels of corruption deter honest investors. Well-managed companies lose business to unscrupulous competitors. Ordinary citizens suffer from weak governance, higher costs and poor products.

Corruption remains a complex problem that defies simplistic solutions. Nevertheless, the report argues that it is possible to cut down corrupt practices to the extent that they are seen as the exception rather than the norm. Success demands sustained, collaborative effort by governments, companies and civil society. Governments must take the lead, but companies – particularly large international companies – are far from powerless. In their own interests, and in the interests of the people among whom they work, businesses can play their part in resisting corruption and promoting reform. Like its predecessor, this report explains what they can do, and how they can do it.

Achievements and challenges

So what has changed in recent years? At first sight, the answer may seem to be 'not much', or at least 'not enough'. Nevertheless, cumulatively rather than overnight, there have been three major accomplishments:

- The first is a much greater level of awareness among governments, companies and citizens of the scale of international corruption and the damage that it causes. Civil-society organisations such as the anti-corruption NGO Transparency International (TI) have played a major part in raising awareness, as have intergovernmental agencies such as the World Bank. Even more than before, the news media highlight lapses of political and commercial integrity, in industrialised countries as much as in developing and transition economies. No informed observer can now plausibly claim that the problem of corruption is trivial, or of no consequence.
- The second achievement is that we now see the foundations of an international legal framework to combat both domestic and cross-border corruption. As will be discussed in chapter two, the US was the pioneer in this regard with the introduction of the Foreign Corrupt Practices Act (FCPA) in 1977. Since 1997, all the member states of the Organisation for Economic Co-operation and Development (OECD) have introduced similar legislation making it possible to prosecute companies based in their territories for paying bribes abroad. The UN Convention against Corruption (UNCAC) was signed in December 2003 and came into force two years later. It offers the promise of a truly global anti-corruption legal framework.
- The third is that there is an increasingly sophisticated body of best practice on measures to combat corruption, both in government and in the commercial world. We know about codes of practice and integrity checks. Technological innovations make it easier to manage public and private procurement procedures, monitor accounts and – to take one

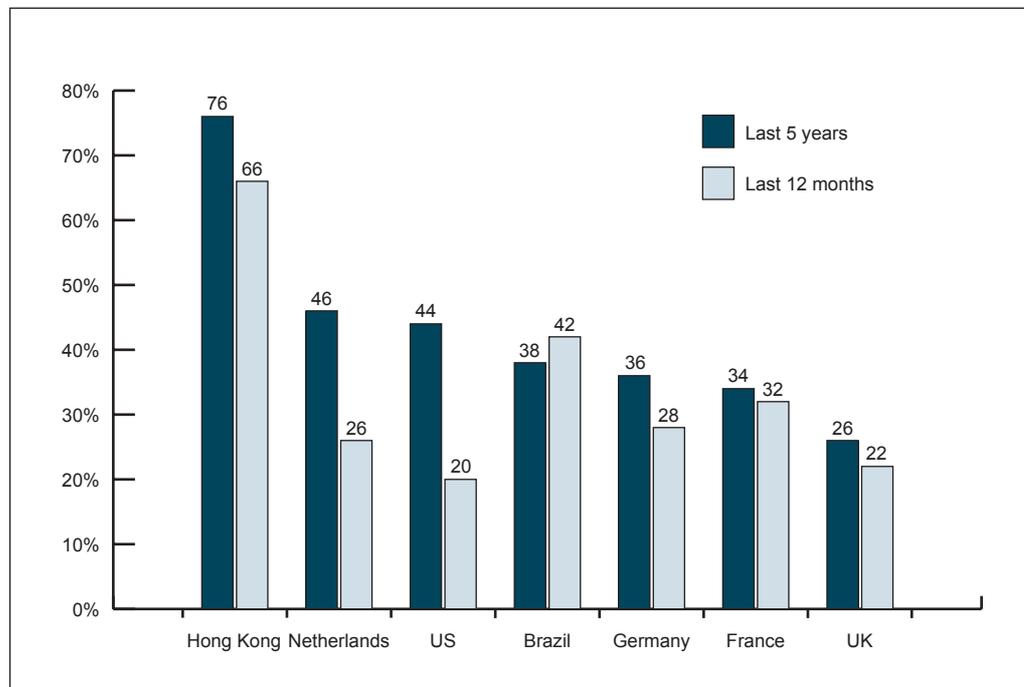
important example – reform customs services. The task is clear, and the tools are available.

Nevertheless, it would be premature to suggest that the battle against international corruption has already been won. Indeed, there is still a danger that recent anti-corruption initiatives will give rise to cynicism rather than hope unless they are implemented more effectively. So what more is needed?

Recognising the costs of corruption

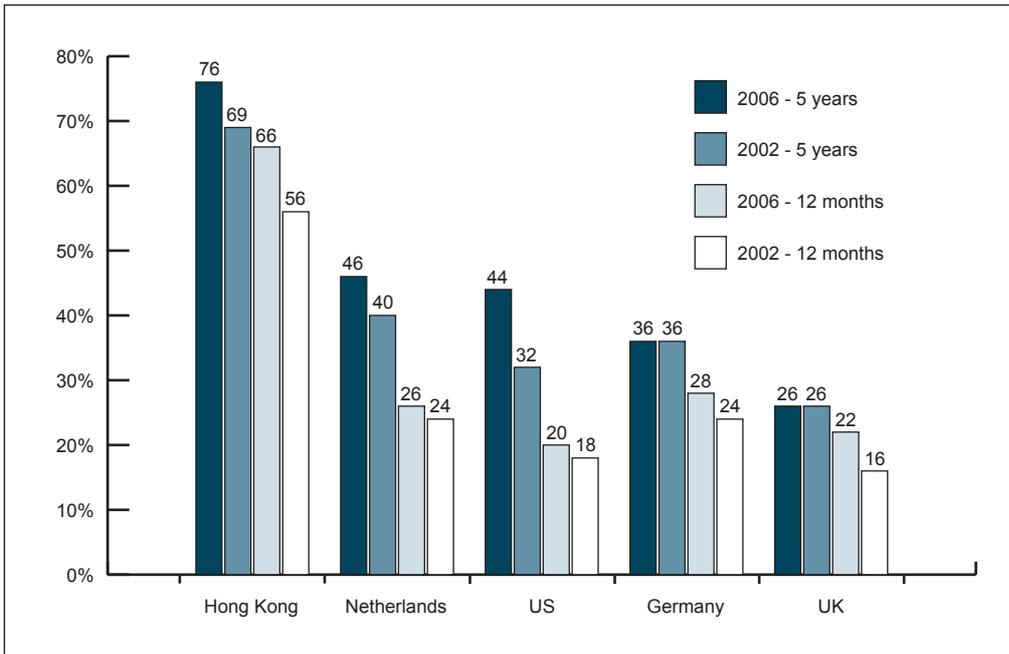
The first requirement – even now – is a clear recognition of the costs of corruption. Respondents to our survey were in little doubt on this point. Overall, 43% of respondents believed that they had failed to win business in the last five years because a competitor had paid a bribe, and one-third thought they had lost business to bribery in the last year. Hong Kong was by far the worst affected, with 76% of companies believing that they had lost business in the last five years. Even in the UK, one-quarter of UK-based international companies said that they had lost business to corrupt competitors in the last five years.

Companies believing that they had failed to win a contract or gain new business because a competitor had paid a bribe over the last five years/12 months. By country.



In three of the five jurisdictions that were covered in Control Risks' previous survey, which was conducted in 2002, there was a noticeable increase in the proportion of companies believing that they had lost business to corrupt competitors. In Hong Kong, the percentage of companies believing that they had lost business to bribery in the previous five years rose from 69% in 2002 to 76% in 2006. In the Netherlands, the percentage increased from 40% in 2002 to 46% in 2006, and in the US the figure rose from 32% to 44%. These figures suggest that the emerging international legal regime to combat corruption is not working as effectively as might have been hoped.

Companies believing that they had failed to win a contract or gain new business because a competitor had paid bribes: 2006/2002 comparisons. By country.

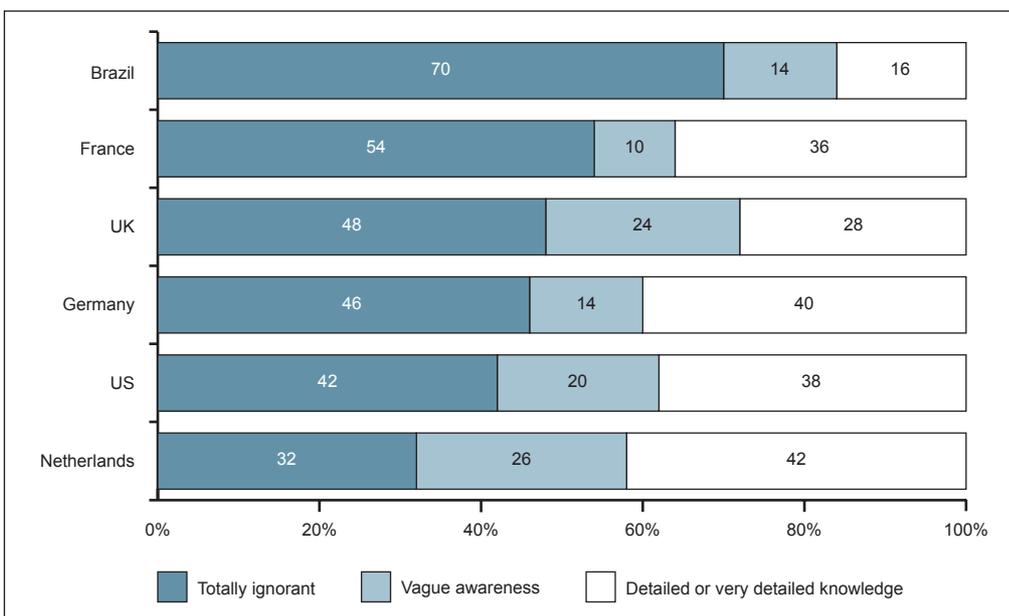


One result of these continuing problems is that good companies are deterred from otherwise attractive investments because of the risks of corruption. As will be seen in chapter five, more than 35% of companies surveyed had been deterred from an otherwise attractive investment because of the host country's reputation for corruption. When this happens, host countries also lose out: the investors that they attract are likely to have lower standards, both of integrity and professional competence.

The need to raise awareness

An effective legal regime requires both enforcement and awareness-raising, but here too our survey gave grounds for concern. The respondents were international business development directors rather than legal specialists, and they might not have been expected to have detailed legal expertise. Nevertheless, it was striking that approximately half admitted to being 'totally ignorant' of their country's legislation governing bribes paid abroad, with a further 18% having only a 'vague awareness'.

Respondents' awareness of legislation covering foreign bribery. By country.



In some cases, awareness of the law seems to have declined. New British legislation explicitly criminalising foreign bribery came into force in early 2002, a few months before our previous survey. At that time, 68% of UK respondents said that they were familiar with the main points of the foreign bribery law, perhaps because of the publicity that it had received earlier in the year. In 2006, only 28% of UK respondents claimed a 'detailed knowledge', and 24% a 'vague awareness', while 48% admitted to being 'totally ignorant'. The lack of prosecutions under the UK's new laws may in part account for reduced levels of awareness.

By contrast Germany has recently witnessed a series of scandals and high-profile investigations but, as a German interviewee commented, these may have no more than a short-term effect:

The recent scandals in Germany have had an impact because everyone saw these business executives in the news. However, we have also found that people have short memories and soon forget about this. So, the only way to make the legislation more effective is to catch more people.

The same point applies in all OECD countries apart from the US: the low number of prosecutions raises questions about the credibility of international anti-corruption laws.

The way ahead

So what is to be done? The main challenge is not to define the problems of corruption, or to identify counter-measures, but to implement them. This task requires co-ordinated action by governments, industry associations and individual companies:

- *Governments* should raise awareness of their own anti-corruption laws, and ensure that they are enforced. At the international level, they should work together to implement, monitor and provide adequate resources for international initiatives such as the OECD anti-bribery convention and the UNCAC. It will be impossible to achieve a common standard for international business unless individual governments are prepared to take the lead.
- *National and international industry associations* should work together to pool experience of anti-corruption strategies and develop common standards.
- *Companies* need to back up anti-bribery codes with effective compliance procedures. These will include training and awareness-raising programmes, guidelines on 'grey areas', and supportive mechanisms such as confidential hotlines. Companies should check the integrity records of commercial agents or other intermediaries, and ensure that all their representatives – whether employed directly or paid by commission – abide by the same rules. When operating in high-risk regions, they will need to map out corruption risks in advance, and take steps to anticipate and prevent problems rather than simply reacting when it is already too late.

This report is addressed to all three actors, but especially to business readers. It analyses the commercial costs and risks associated with corruption, reviews the emerging international legal regime and makes practical recommendations for how to tackle problems. Corruption is a worldwide problem. It is in everyone's interests that it should be tackled consistently and effectively by governments and companies alike.

Chapter one: What is corruption and why does it matter?

Companies operate in the world as it is, not the world as it should be. No one relishes paying bribes, but business people may be tempted to pay when it seems to be an accepted part of the 'system' and there is no apparent alternative. Nevertheless, illicit payments incur significant business risks, even when they are regarded as 'normal'. These risks are increasing as a result of widespread political and social change.

The first step towards tackling the problem of corruption is to understand what it is and why it occurs. This chapter explains the different varieties of corruption; the risks to companies and governments; and the pressures for change.

Definitions

'Corruption' is a broad term implying rottenness, decay and lack of integrity. Royal Dutch Shell defines corruption as *any dishonest or illegal practice which undermines the Group's business integrity*.¹ This broad definition rightly goes beyond narrow legal terminology to include any action that could damage the company's public and commercial standing.

The standard definition used by Transparency International (TI) is *the abuse of entrusted power for private gain*. Since the 1990s there has been a particular focus on the abuse of power by public officials, but this definition also covers the employees of private companies who may, for instance, use their position to demand personal kickbacks from suppliers in return for awarding them contracts.

In practice, international discussions on business corruption have focused on bribery, which TI defines as *an offer or receipt of any gift, loan, fee, reward or other advantage to or from any person as an inducement to do something which is dishonest, illegal or a breach of trust in the conduct of the enterprise's business*.² Within this definition there are two main sub-categories:

- *Grand corruption* typically consists of large bribes, often worth millions of dollars, to secure commercial contracts or some other business advantage. An extreme form of grand corruption is state capture, where corrupt interests control the state itself and twist the machinery of government to serve their private interests. President Mobutu Sese Seko's kleptocracy in what was then Zaire and Slobodan Milosovic's Serbia were classic examples.
- *Petty corruption* generally refers to small *facilitation* or *facilitating payments* to speed up some legitimate, routine transaction, such as the installation of a telephone line or the passage of goods through customs. Typical payments would be worth, say, \$10 to \$50. As will be seen in chapter three, the term 'facilitation payment' is problematic. Facilitation payments are illegal under most countries' domestic law, but are not included in the foreign bribery offence defined by the US FCPA. The term does not cover bribes paid to secure business in any circumstances.

Corruption takes many forms, not just the exchange of money. It includes obtaining business benefits by offering jobs to the relatives of an official, or even promising a position to the official himself after retirement. In other cases, bribes have taken the form of gifts of works of art, racing dogs, luxury holidays and sexual favours.

Direct and indirect bribery

Indirect bribery is one of the most sensitive policy issues facing international companies (see chapter three). A typical example would be a case where a company employs a commercial agent to help it win a government contract. The agent is paid by commission based on a percentage of the contract fee; part of that commission is passed on to a government official. The agent's employers do not know – and do not wish to know – what happened.

1. Royal Dutch Shell, *Dealing with bribery and corruption. A management primer*. www.shell.com/briberyprimer/pages/perspective.htm.

2. Transparency International, 2003, *Business principles for countering bribery*, p. 5.

Other intermediaries who may play similar roles include consultants, joint-venture partners and the operators of international consortiums in which the other partners do not have day-to-day managerial control.

The OECD anti-bribery convention (see chapter two) explicitly covers payments made 'directly or through intermediaries' to secure a business advantage. US and other international legal practice already includes several cases where companies have been prosecuted for paying bribes via agents. Ignorance – wilful or otherwise – is not a defence.

Extortion and seduction

Corrupt transactions – like legitimate deals – typically involve a degree of bargaining and negotiation. The bribe-taker is in a stronger position to demand extra favours when he or she is in a position of power with limited accountability. Bribery in such cases may be linked to extortion, and this comes in many forms. Classic examples include the traffic policeman who demands a bribe to overlook an imaginary traffic offence; the revenue official who demands a bribe to sort out a real or concocted infringement of the tax rules; and the customs official who delays clearance of perishable goods.

In other cases, the bribe-giver may take the initiative to 'seduce' the official and thus engages in 'active' bribery. They do so because officials (or commercial negotiating partners) have the power to grant something that they need – such as the award of a large contract – and they wish to gain an easy advantage over competitors.

Bribe-takers typically have many ways of indicating that they are open to offers. When government officials refuse to award contracts without extra payment, it may be difficult to say who is corrupting whom. Both sides share responsibility.

Influence

A broad understanding of corruption includes certain kinds of *influence*, although the boundary between acceptable and unacceptable forms of influence is often hard to define.

A series of cases in the US and other countries have drawn attention to the ethical issues surrounding political lobbying. In principle, political lobbying is legitimate. One of the main roles of industry associations is to lobby government on their members' behalf. Individual companies, like ordinary citizens, are entitled to seek assistance from their political and diplomatic representatives. Problems arise when such contacts appear secretive, when there is a suspicion of favouritism or when a company's influence appears to be both disproportionate and against the wider public interest.

In many societies it is common to speed up both larger and smaller transactions through personal connections. In Russia, a common term is *blat* – the ability to get things done through personal networks with people of influence. In China, people make use of *guanxi*, personal links with influential officials or business people, while the Japanese have adapted the English word 'connections' to coin a term of their own, *konne*. Pakistanis may make use of their friends' *sifarish* (recommendation) to make contact with the right official on the most favourable terms.

The use of personal contacts is both commonplace and useful. However, as with political lobbying, it becomes problematic when the connections lack transparency and when officials break rules on behalf of their business friends, or seek illicit favours in return.

In cases of doubt, the so-called 'newspaper test' provides a useful indicator: would a proposed transaction cause you or your company embarrassment when reported in the press? If it would, do not do it.

Where and why do companies pay?

A company's vulnerability to corruption depends on a variety of factors, some of which are within its direct control while others are not. The factors within the company's control include its internal policy and management structures. External factors include the way business is

Local terminology

Different cultures develop their own vocabulary for different types of corruption, and the terms often reflect a certain strained humour. The French expression for bribe is *pot de vin* (jug of wine). In Urdu and Hindi, petty bribes are known as *chai pani* (tea water), while the popular West African term is *dash*. Other terms indicate that bribes are meant to serve as a form of lubrication, as with the English 'grease' or the German *schmiergeld*. In Mozambique, corruption is known as *cabritismo*, meaning 'goatism', from the saying 'a goat eats where it is tethered'.

conducted in different commercial sectors and the wider political and social systems in the country where the company operates.

Contradictory messages

Most large US and north European companies publish ethics codes. More important than the code itself is the way that company policy is implemented. As will be seen (in chapters three and four), the key issues include:

- *Leadership*: does senior management give clear and public support for high integrity standards?
- *Training*: does the company provide training for the employees who are most likely to be exposed to ethical dilemmas?
- *Communications and support*: are there clear lines of communication for employees with ethical concerns? Does the company provide support for employees who resist pressure to compromise standards?

In practice, many integrity failures arise from weak management rather than deliberate misdeeds on the part of the top leadership. All too often, up-and-coming executives receive mixed messages on the following lines:

Profit is central. Integrity is important, but we don't need to discuss it. You will be promoted for winning the contract, not for coming up with excuses for failure.

If senior managers fail to provide the necessary training and support, they will expose their companies to future problems and, even if they do not explicitly authorise bribes, they will share responsibility for malpractice.

Political structures

The societies most exposed to corruption are those where 'checks and balances', such as a free press or an independent judiciary, either do not exist or fail to function properly. If officials have the discretion to grant or withhold an essential service (such as the award of a licence) at whim, they are more likely to exploit their power to demand bribes from both commercial applicants and ordinary citizens. As US scholar Robert Klitgaard³ expresses it:

Corruption = monopoly + discretion - accountability

If the legal system does not work effectively, companies have no recourse when there is a dispute. It may seem easier to go along with the 'system' and pay whatever is necessary.

Failures of accountability are often found in developing or transition economies with weak institutions, but there are wide variations. Botswana has a good reputation for resisting corruption, whereas most other African nations have not been so fortunate. In any case, developed economies have their own problems. The Enron, WorldCom and Tyco scandals of the early 2000s highlighted failures of corporate governance in the US. There has been a

3. Robert Klitgaard, *Controlling corruption* (Berkeley: University of California Press, 1988), p. 75.

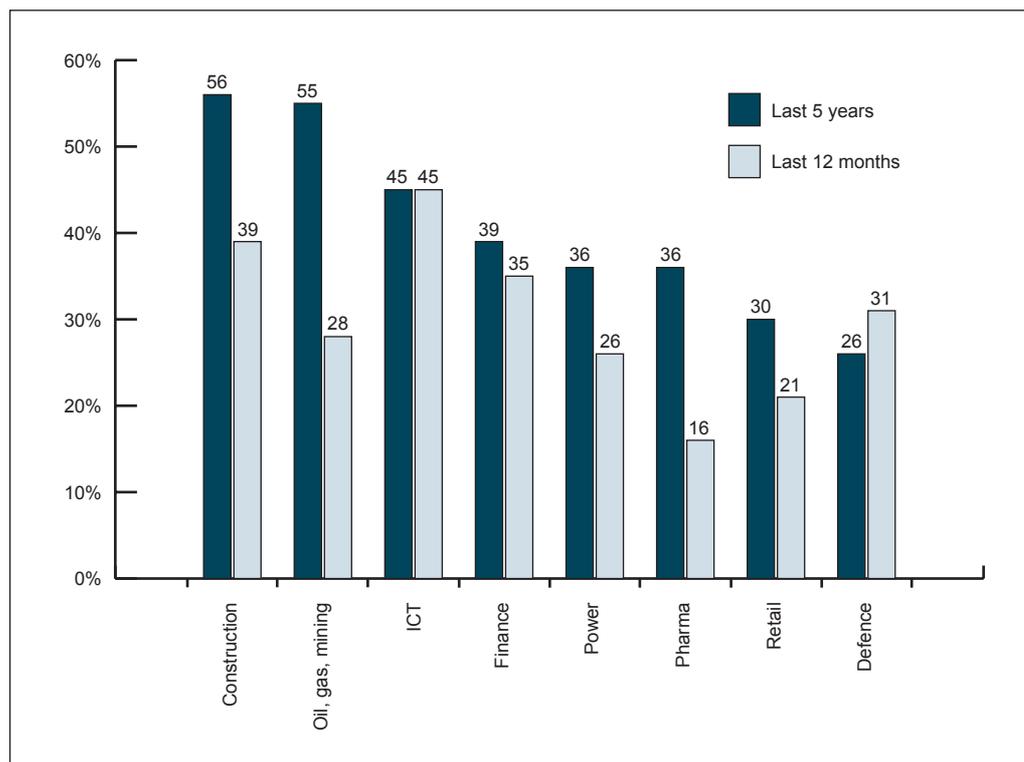
succession of cases in Japan where regional politicians are alleged to have used their influence to obtain contracts for favoured companies. Similarly, in Germany a series of scandals since 2005 has tarnished the reputations of some of the leading names in German industry.

These cases reflect a failure of political and administrative checks and balances, and it would be premature to claim that all such failures have been addressed. Nevertheless, the fact that the cases are now coming to light is a symptom of long-term change: it is harder to keep collusive relationships secret in an era when both politicians and business people face ever-closer scrutiny from the media.

Commercial sectors

The patterns and temptations of corruption vary in different industries. The temptations are obviously greater if large amounts of money are at stake and critical decisions depend on individual officials. Our survey showed that companies in the construction and the oil, gas and mining sectors have been most likely to lose business to corrupt competitors. Two main factors are at play: in both sectors the high value of projects – often running into the millions or billions of dollars – increases the temptations of bribery; and both involve negotiations with government officials who have extensive discretionary powers and may be susceptible to bribery.

Percentage of companies believing that they had failed to win a contract or gain new business because a competitor had paid a bribe. By sector.



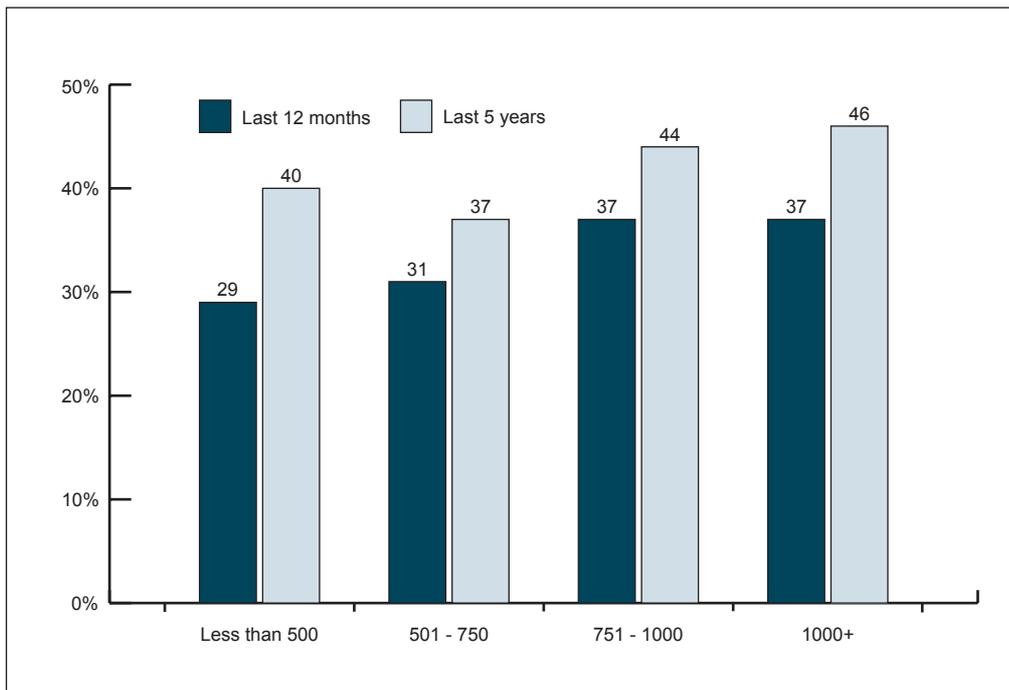
It is harder for individual companies to take a stand against corruption in cases where whole industries are affected. If a single company challenges accepted practice, it may lose out to less scrupulous competitors. One long-term solution is for industry associations to form collective initiatives to combat corruption (see chapter four).

Company size

Larger companies are more likely to have the resources to implement anti-corruption policies and structures. They are better placed to exercise influence at a senior government level, for example by putting pressure on junior officials who demand bribes. If the worst comes to the worst, they are better able to walk away from a project.

By contrast, smaller companies typically exercise much less influence and are often more dependent on the success or failure of individual projects. If they cannot afford to lose the business, they will be more vulnerable to officials demanding bribes. However, smaller companies have some important advantages. Lines of communication are shorter, and it is easier for senior executives to get to know key individuals in middle management and to be aware of the hazards that they may face. Both the 2002 and the 2006 *International business attitudes to corruption* surveys suggested that smaller companies were slightly less likely than larger companies to lose business to corrupt competitors. This may be because the larger companies were more likely to be competing for multi-million projects where the stakes – and the temptations – are higher.

Percentage of companies believing that they had failed to win a contract or gain new business because a competitor had paid a bribe. By size (number of employees).



Eternal risks: high costs, blackmail and violence

The risks of being sucked into a cycle of corruption and blackmail are illustrated by an Arab proverb:

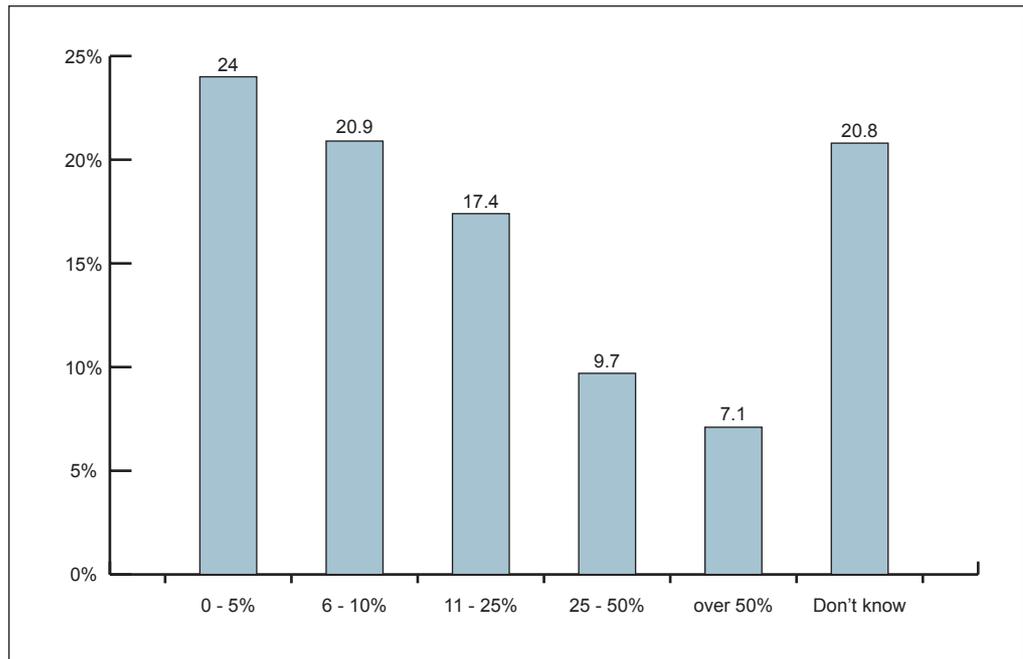
When the camel puts his head into the tent, the rest of his body soon follows.

Companies are more tempted to pay bribes if they believe that they are unlikely to be caught. However, the risks of high costs, blackmail and violence apply even in societies where corruption is commonplace, and anti-corruption laws are poorly enforced. In that sense, many of the risks associated with corruption are 'eternal'. The following examples illustrate the potential problems.

Financial costs

In the survey, respondents were asked to estimate the maximum increase that corruption can have on the costs of an international project. A quarter of respondents said that it was between 0% and 5% – already a high figure on a multi-billion dollar project. However, 9.7% said that corruption could amount to up to half of the total project costs, and 7.1% said it could be even higher. The companies estimating maximum corruption at more than a quarter of the total project cost were most likely to come from the construction (29%), defence (25%) and finance (18%) sectors. Daniel Kaufmann of the World Bank Institute estimates the annual worldwide total cost of bribery to be as high as \$1,000bn.

Respondents' estimate of the maximum percentage increase that corruption can have on the costs of an international project.



The experience of a Western joint venture in south-east Asia underlines the financial risks to the companies concerned. The Western managers were forced to delegate the selection of sub-contractors to the local partner. The selection was made on the basis of connections and kickbacks rather than competence or financial competitiveness. There was no scandal, but costs went up and the quality of the work went down. The joint venture sank to the verge of bankruptcy.⁴

Repeat demands

Companies or individuals who pay are certain to get repeat demands, and this applies as much to facilitation payments as to large-scale bribes.

An example comes from the experience of a European general manager in Latin America who faced problems with customs over the designation of some vital engineering equipment. The company argued that there was no local source of the equipment and it should therefore be free of duty. The customs official claimed otherwise, but hinted that a small personal payment would solve the problem. The manager resisted bribing the official to change his mind, even though the dispute was causing expensive delays, because he did not wish to set a precedent. However, he believed that his position had been undermined because his predecessor had been less scrupulous. The customs official took his refusal to pay a bribe less seriously, believing that the company would pay in the end.

Once a company has a reputation for paying, officials will seek an opportunity to levy their 'share'. It is hard to resist when a company's earlier behaviour suggests a willingness to pay.

Uncertain results

The fact that bribery is illegal means that the bribe-payer has no control over the outcome, and cannot complain if they do not get what they pay for.

A financial services company operating in West Africa applied for a licence to offer the same product as a competitor. The minister offered the company's local representative two envelopes, one marked 'yes' and the other 'no'. He took the envelope marked 'yes' and found

4. Names and other details in the case studies have been changed or omitted to preserve confidentiality.

that it contained details of a Swiss bank account and a suggested 'fee'. The company paid, but still failed to get the licence. It had no means of recourse.

Chinese parents bribing middlemen to secure university places for their children report similar problems: they pay, but their child still does not get into university. In those circumstances, one parent reports: 'trying to get your bribe back is like throwing a meatball to beat a dog. It is all one-way traffic.'

It is better not to pay in the first place.

Blackmail

When a company breaks the law, it renders itself vulnerable to blackmail, often from its own employees. A Western company faced an extortion demand from one of its own staff after it used illegal means to get round currency controls in the Middle East. The employee demanded substantial payments against a threat to expose the company to the local authorities.

In such cases, the company faces an uncomfortable choice: it can pay off the blackmailer (thus rendering itself vulnerable to further demands); it can try to call his bluff; or it can come clean with the authorities and pay whatever legal penalties prove necessary.

The risk of violence

Corrupt agreements may be illegal, but trying to break out of them involves a breach of trust. The other party may react violently to the loss of income, even arguing that it is doing so out of 'principle'. The regional director of a Western company in the former Soviet Union (FSU) dismissed a locally based manager after discovering that he was paying bribes to the tax police. Soon afterwards, the chief accountant in the manager's office started receiving death threats, apparently from an organised crime group linked to tax officials.

In a case such as this, it will be harder to gain support from the law-enforcement authorities if a threat of violence is linked to an earlier offence that the company has committed.

Corruption and culture

Many business people argue that corruption is 'part of the culture', particularly in developing countries. If corruption is woven into the fabric of society, it is unrealistic to expect international companies to behave differently.

This argument is hazardous. All of the world's great religious and moral traditions condemn corruption; the key variable is not so much 'culture' as power. No one likes paying bribes. If ordinary people pay, this is usually because they have no choice, not because they find the practice acceptable. CIET International (www.ciet.org) has conducted a series of surveys on attitudes to corruption in countries including the Baltic states, Tanzania, Uganda, South Africa and Bolivia. The common theme of their reports is that poorer people suffer most from petty bribery. Far from regarding petty corruption as normal, people who are excluded from corrupt networks often feel a deep sense of anger.

Companies – particularly international companies – will be judged by different standards from individuals. All forms of bribery are problematic, but most people see a clear difference between paying a small bribe to secure essential medicines and paying a large bribe to secure a defence deal. If a company's actions contradict popular values, that in itself is a source of risk. No one will come to its defence when it runs into trouble.

Political risks

Companies that pay bribes have no security of tenure. They will face new pressures – and possibly new demands – when the person they bribed leaves office. If he leaves office involuntarily, the risks are all the greater because they are associated with someone who is now discredited. Companies in Indonesia who compromised too readily with the Suharto regime subsequently faced unwelcome scrutiny from his successors.

In revolutionary times, foreign companies that have paid bribes, and therefore aligned themselves with oppressive forces, will be seen as part of the 'enemy'. Companies may be judged by higher standards because, unlike ordinary individuals, they are in a stronger position to resist corruption, if only by shifting operations to another, less corrupt jurisdiction. The growth of Islamic extremism in the Middle East is in part a reaction to governmental corruption. International companies that are too closely associated with corrupt regimes are laying up future political risks for themselves.

New risks: globalisation and pressure for change

At first sight, the temptations facing international companies have never been greater. The scale of international trade and investment has risen dramatically. Corrupt officials are as common as before, and competitive pressures have increased both the incentives and the rewards of winning business by the 'back door'. However, globalisation has created its own countervailing forces. These developments mean that the risks associated with corruption are increasing dramatically.

Communications

Improved communications mean that companies are sensitive to the need to protect their reputations worldwide. More information is more widely available to more people than ever before:

- *Satellite television networks* ensure that news travels rapidly – and vividly.
- *The internet* is both a source of information and a tool for activists co-ordinating their activities across local and international boundaries. Information on corruption cases is readily available on mainstream news sources such as the BBC World Service, as well as specialist sites such as the TI website.
- At a local level, *mobile (cellular) phones* make it easier for activists to share news and, where appropriate, co-ordinate protests.

These technological changes mean that if a major international company becomes involved in a corruption scandal in, say, Latin America, the news will be publicised worldwide.

Greater focus on governance

Improved communication in turn has led to growing public awareness of the costs of governance failures. For example, political 'cronyism' is seen as one of the main causes of the Russian and East Asian economic crashes of the late 1990s. Similarly, corruption is frequently linked to environmental damage as dishonest business people may pay bribes to evade environmental regulations, or to operate in protected areas. Corrupt deals between forestry companies and officials have been a major cause of deforestation in south-east Asia and Africa.

Ordinary citizens often suffer from the effects of corruption more than anyone else. Where companies pay bribes to secure business, or to avoid official regulations, they may seek to recoup their expenses either through inflating costs or by performing sub-standard work. The results include the construction of substandard buildings or roads that rapidly deteriorate and can even be dangerous. A Turkish journalist expressed this point succinctly after the 1999 earthquake: 'Earthquakes don't destroy buildings: corruption does'. Similar comments were made after the earthquake in Pakistan-controlled Kashmir in 2005: a large number of the casualties were children who were killed when school buildings collapsed. In many cases the buildings were constructed with substandard materials, reportedly as a result of systematic government corruption.

The need to promote good governance is now a central concern of the World Bank as well as national agencies such as the UK's Department for International Development (DFID), which in 2006 made governance – and the need to resist corruption – the central themes in its White Paper 'Eliminating world poverty. Making governance work for the poor'. DFID argues that it is difficult to encourage developing-country administrations to introduce anti-corruption reforms if Western companies are paying bribes, and has therefore provided extra funding to

the London-based Serious Fraud Office (SFO) to support its investigations of British companies involved in foreign corruption cases.

A deterrent to investors

Corruption discourages foreign investors. Our survey showed that 35% of respondents had been deterred from an otherwise attractive investment because of concerns about corruption (see chapter five). It is not an absolute deterrent – many emerging markets have benefited from high investment flows even where they are understood to have high levels of corruption. However, it imposes extra costs either in bribes or in extra management time spent trying to find honest ways of dealing with obstructive government bureaucracy. The extra costs have a similar deterrent effect to high tax rates.

Security concerns

A final factor contributing to the demand for anti-corruption reforms is the increased preoccupation with international security since the September 2001 terrorist attacks. Corruption contributes to insecurity in two respects. First, high levels of corruption feed into political dissent, for example in many of the countries of the Middle East. Failure to address concerns about corruption may in the long term boost support for violent opposition movements. Secondly, corruption subverts border controls, making it easier for international terrorists to smuggle people, weapons and money into the countries they wish to target.

Setting the agenda for legal reform

Greater awareness of the social and economic costs of corruption has boosted the national and international reform agendas, but at the same time raised new challenges for business. International companies cannot afford to operate by a different set of standards at home and abroad, but how can they compete if their rivals are playing by different rules? An important part of the long-term solution to such dilemmas will be the development of common international legal standards. The next chapter discusses how far such standards already exist, and how much progress has yet to be made.

Resources

BBC World Service – www.bbc.co.uk/worldservice

Organisation for Economic Co-operation and Development (OECD) – anti-corruption page.
www.oecd.org/corruption

Transparency International – www.transparency.org. This is a comprehensive website that includes the *Transparency International sourcebook* – (www.transparency.org/publications/sourcebook), a compendium of best practice, primarily from a government perspective. It is available online (in zip format) in English and other languages.

UK Department for International Development, 2006, *Eliminating world poverty. Making governance work for the poor*. www.dfid.gov.uk/wp2006/default.asp

U-4 Utstein Anti-Corruption Resource Centre – www.U4.no. This is an excellent database: easy to use and with a wide range of resources. The focus is on development, but many of the resources are relevant to business. The Utstein group is an alliance of European international development ministries.

Chapter two: International legal initiatives – towards a global norm?

Bribery is illegal almost everywhere. The key question is enforcement, both locally and internationally. Until the late 1990s, international companies that broke the rules in developing countries faced little risk of prosecution. Now the risk of prosecution and – still more – of reputational damage is increasing.

For 20 years from 1977, the US was the only country with a Foreign Corrupt Practices Act (FCPA) empowering its own courts to prosecute US companies for paying bribes abroad. However in 1997, 34 (now 36) industrialised countries signed an anti-corruption convention brokered by the Organisation for Economic Co-operation and Development (OECD). In doing so, they undertook to introduce legislation similar to the FCPA. From being the exception, US legislation has become the basis for an international norm agreed by all the major industrialised states – at least in principle. The UN Convention against Corruption (UNCAC), which was signed in 2003 and came into force in 2005, goes a step further by seeking to establish a global standard.

But how much of this is real? Will the OECD and other international initiatives make a difference to the way that business is conducted? Or are the new laws little more than symbolic gestures? This chapter argues that – despite continuing gaps – the new laws do make a difference. Progress towards tighter enforcement is uneven and even erratic, but no mainstream international company can afford to take the risk of being prosecuted.

Legal risks and political change

In practice, political will and social attitudes to corruption will decide how effectively anti-corruption laws are enforced. Attitudes are changing, slowly in some jurisdictions and rapidly in others. The trend is towards tighter enforcement.

If you are American, or work for a US company, there can be no doubt of the legal risks of transnational bribery. There have been relatively few prosecutions – since 1977, the Department of Justice (DoJ) has brought only 43 criminal cases under the FCPA – but those that have taken place have had a disproportionate impact. Moreover, in recent years the DoJ and the Securities and Exchange Commission (SEC) – the two US agencies responsible for investigating violations – have markedly increased their vigilance.

The penalties for an FCPA conviction can include imprisonment as well as large fines on individuals and companies. The additional costs include large legal fees, lost management time and – more critically – loss of reputation. US companies still face ethical dilemmas and they may not always make the right decisions, but leading US companies take the FCPA very seriously.

In other OECD countries, the legal risks of paying bribes abroad have not been quite so obvious, at least until recently. Most of the leading trading nations – both in Europe and in Asia – have been guilty of double standards: they enforce anti-corruption legislation relatively strictly at home, but have made little effort to discourage companies from paying bribes to win business abroad. In many jurisdictions, companies have been able to claim bribes paid abroad as tax-deductible expenses. Business people and their political allies have argued that the strict enforcement of anti-corruption laws puts them at a competitive disadvantage abroad.

Old attitudes die hard, but there are now a number of cases where companies from OECD countries other than the US have been prosecuted for paying bribes abroad, and governments are facing growing pressure to enforce the new laws. This will come from a variety of sources:

- *International pressure:* If governments persistently fail to implement anti-corruption legislation, they will face peer pressure from their foreign counterparts to improve their performance. The US in particular will continue to play a leading role in pressing for high international standards, and the OECD has introduced a peer review system of member countries' laws and enforcement records.

- *Prosecutors*: Individual government prosecutors may play a key role. In countries as diverse as France, Italy, Spain and even Japan, determined investigating magistrates have pursued international corruption cases, even when political and commercial establishments would prefer them to desist.
- *Public opinion*: New technology means that news of corruption scandals spreads faster and wider than before. Governments will face pressure from the media and from NGOs to prosecute offences that – by virtue of the new laws – come within their jurisdictions.

Ultimately, the third factor – the growing public unacceptability of foreign bribes – may prove to be the most important. Law and public opinion go hand in hand. Companies that are out of step with both are heading for disaster.

The US Foreign Corrupt Practices Act

The FCPA was passed into law in 1977 and amended in 1988 and 1998. The origin of the act lies in the aftermath of the Watergate affair, when investigations showed that major US companies had routinely been paying large bribes to win contracts not only in developing countries but also in industrialised nations such as Italy, the Netherlands and Japan. The SEC set up a voluntary disclosure programme that allowed companies to declare possible malpractice in return for immunity from prosecution: 400 companies admitted to questionable or illegal payments to foreign officials worth a total of \$300m.

The FCPA is of international significance because it has helped inspire similar legislation in other OECD countries, and US experience in implementing the act gives some indication of how other governments could implement their own new laws. Diplomatic pressure from the US has also been one of the main drivers behind international initiatives such as the OECD anti-bribery convention (see below).

What the FCPA does

The FCPA makes it an offence under US federal law to pay a bribe to a foreign official, a foreign political party or a candidate for public office to obtain or retain business. Originally, the law was restricted to offences where some action – for example the decision to pay the bribe – had been taken inside the US. Since the 1998 amendment, it has covered US citizens and companies throughout the world regardless of whether there is a specific territorial link to the US. Like the Sarbanes-Oxley laws on corporate governance, the FCPA also applies to foreign companies listed in the US.

Companies that are convicted under the act face fines of up to \$2m plus an amount equal to twice the benefit they sought to gain by making the corrupt payment, and may face additional penalties such as debarment from government contracts, loss of export privileges and suspension of investment protection abroad. Titan Corporation in March 2005 paid a penalty totalling \$28.5m, the largest FCPA penalty to date (see case study). It included a \$15.4m 'disgorgement' of illegal profits gained as a result of bribes paid. Individuals face fines of up to \$100,000, which employers may not pay on their behalf, and prison sentences of up to five years.

There are three affirmative defences under the FCPA:

It does not cover gifts or payments that are 'lawful under the written laws and regulations of the foreign official's country'.

It excludes 'facilitating' or 'facilitation' payments – small 'grease' payments made to speed up a legitimate official transaction (see chapter three).

It excludes 'legitimate business expenses', which could include travel expenses of a foreign official who visits the US to see how a product or service works in practice. However, companies who pay more than is deemed necessary, or who pay the foreign official to bring family members on the same trip, may render themselves liable to prosecution (see chapter five – Metcalfe & Eddy case).

The FCPA includes a series of 'books and records' provisions, the most obvious being that companies must not keep parallel sets of accounts (one for themselves and one for the tax collector). These accounting provisions are monitored and enforced by the SEC.

In cases of doubt, the DoJ provides published opinions to give its view of actions that companies are considering. The department has issued 43 such opinions since 1980. Recent opinion releases cover topics such as the sponsorship by US companies of study tours and training programmes for foreign officials.

The FCPA covers the actions of US citizens, companies and their employees. It is for the host government to decide whether to prosecute local receivers of bribes.

Enforcement

Between 1977 and late 2006, the DoJ brought 43 criminal prosecutions against companies and individuals under the FCPA. In addition, the DoJ instituted five civil actions, while the SEC instituted 30 actions related to the FCPA's anti-bribery provisions. In late 2006, there were reported to be more than 40 ongoing investigations under the FCPA.

Since the early 2000s, there has been a trend towards tighter enforcement of the FCPA. In 2002 there were seven new investigations, followed by 11 in 2003, 19 in 2004, seven in 2005, and at least 14 in 2006. There has also been an increase in the number of cases involving foreign corporations that fall within US jurisdiction because of their US listings: there have been seven such cases since 2004.

A second trend has been an increase in the number of voluntary disclosures by companies that have uncovered or suspect corruption in their own operations: 18 out of the 21 newly disclosed FCPA investigations in 2005 and 2006 came to light in this way. In many cases, evidence of malpractice emerged in the course of due-diligence reviews before mergers or acquisitions. The Titan case (see case study) is an example. The Sarbanes-Oxley Act, which requires corporate directors and CEOs to take personal responsibility for their companies' internal controls, has been one of the main reasons for the increase in the number of voluntary disclosures. Companies calculate that they are likely to receive reduced penalties if they take the initiative to report actual or suspected bribery cases.

A third trend has been an increase in the number of cases where companies are required to surrender or 'disgorge' profits made as a result of bribery (see the Titan and ABB cases below).

Implications for US companies

Training and compliance programmes

The FCPA has a significant impact because of the credible threat of legal action against companies that fail to comply. As a result, most large US companies operating internationally have introduced internal training and compliance programmes to ensure that employees are aware of the act and know how to avoid illegal actions. The US federal sentencing guidelines reinforce the need for such programmes. The guidelines authorise judges to impose significantly lower penalties on companies that have such programmes, but have nevertheless been let down by rogue individuals. The ingredients of an effective compliance programme are discussed in chapters three and four.

A tool for resistance

The FCPA works to US companies' advantage by helping to deter 'bare-faced demands' (in the words of one US businessman). For example, US companies in Asia make a point of translating the act into local languages and distributing it to potential business partners. The objective is to define the rules of the game in advance, making it less likely that bribes will be suggested or solicited.

The FCPA also makes it easier to resist any demands that are made, giving companies plausible grounds for refusing to pay. Arguably, the FCPA helps to make US companies more competitive. They know that they cannot compete by bribing officials, so they have to work

even harder to demonstrate that they genuinely have the best product at the best price. At least their bids are not inflated by the need to allow for the cost of illicit payments. Other international companies, which will need to adjust their sales techniques in the light of new anti-corruption laws, will take time to catch up.

Lost business?

US-based international companies often have the advantages of size and extensive resources, and this in itself may make it easier for them to resist corruption demands. Despite these benefits, there is little doubt that the FCPA can put US companies at a disadvantage when faced with unscrupulous competitors.

First, they may be deterred from entering certain markets because of the risks of corruption. Secondly, they may lose out to competitors when they put in bids. The US Trade Compliance Center's 2004 report on the OECD convention estimates that bribery of foreign officials may have affected the competition for 47 contracts worth \$18bn between 1 May 2003 and 30 April 2004 (the most recent year for which such figures have been published). US companies are believed to have lost eight of these contracts, worth \$3bn. The centre does not give details of these allegations, and the implication is that much of its evidence comes from confidential intelligence. Nevertheless, there can be little doubt that US business has lost contracts worth a significant amount of money as a result of foreign bribery, and this has been one of the main motives for US diplomatic initiatives to promote a common international regime to combat bribery.

External perceptions

External perceptions of the way that US companies behave in practice are mixed. The FCPA has made a major contribution to the anti-corruption debate internationally, as well as in the US. However, the Enron scandal in the early 2000s has undermined the US corporate sector's reputation for integrity, and business people often express scepticism about the extent to which US companies find ways of getting round the rules in ways that may not be ethical.

One concern is the extent to which US companies circumvent the FCPA by knowingly or unknowingly using middlemen – agents, subsidiaries or joint-venture partners – to pay bribes on their behalf. As the Titan case study shows, the use of third parties to make payments does not exempt US companies from FCPA liability. Moreover, the FCPA itself and US case law show that ignorance of an agent's activities does not constitute a legal defence if the employer might reasonably have anticipated that he might pay bribes. Nevertheless, the use of intermediaries remains a sensitive issue both in the US and elsewhere (see chapter three – policy requirements).

A second important question concerns the use of US political and diplomatic power to promote US business: when is this appropriate and in what circumstances could it be considered unfair? In Transparency International (TI)'s 2002 Bribe Payers Index (BPI), respondents in 15 emerging markets were asked whether governments used 'other means of gaining unfair advantage for their companies' apart from bribery. Some 68% of the respondents answered affirmatively; 58% associated the US with such practices, followed by 26% for France and 19% for the UK. The examples of 'unfair advantage' included 'diplomatic or political pressure' (cited by 66% of respondents), financial pressure (66%), commercial pricing issues (66%) and tied foreign aid (54%). TI's most recent BPI, which was published in 2006, did not go into the same amount of detail, but did rank exporting countries according to whether respondents believed that their companies were more or less likely to pay bribes. The US was ranked equal ninth in the list of 30 countries surveyed (where first is seen as least corrupt).

The debate about the appropriate use of diplomatic pressure is a reminder that companies and governments may still face ethical dilemmas even when fully complying with anti-corruption legislation. If a company faces a demand for a bribe from an official, it may well be appropriate for it to ask its embassy to intercede with the host government. On the other hand, excessive diplomatic pressure to favour one country's companies over another may well be considered an abuse of power that could backfire.

Despite these mixed perceptions, there is no doubt of the impact that the FCPA has made. As will be seen, it sets an example that other OECD countries are only just beginning to follow.

FCPA case studies

Titan in Benin

Titan Corporation, a California-based military intelligence and communications company, in March 2005 pleaded guilty to three FCPA charges relating to its telecommunications business in West Africa. The company was sentenced to pay a total of \$28.4m, made up of a \$13m criminal fine and a \$15.4m disgorgement payment. The company also agreed to retain an external consultant to implement a revised FCPA enforcement programme.

The case came to light in the course of due-diligence inquiries conducted by Lockheed Martin following a proposed merger between the two companies. Lockheed in June 2004 cancelled the merger agreement as a result of the FCPA investigations.

In the late 1990s, Titan had embarked on a project to build and operate a wireless telephone network in Benin. In 1999, it engaged the services of an agent who was the business adviser to the president of Benin. According to the FCPA charges, the company made no due-diligence inquiries to check the agent's integrity record. However, over the following three years it paid him \$3.5m for 'consulting' services that were never properly documented or shown to have been performed. This amount included more than \$2m in 'social payments' that were ostensibly for the betterment of the people of Benin, but were in fact used to support the president's 2001 re-election campaign. A large part of this sum was used to pay for T-shirts bearing the president's image. Some of the payments were made into the agent's foreign bank accounts, while \$1.1m was handed over in cash in Benin.

The SEC's complaint against Titan claimed that the company had used false invoices to conceal these payments, and violated federal tax laws by claiming the bribes as deductible expenses on its federal income tax returns. It noted that Titan had a code of ethics but did not enforce it, and that it did not provide its employees with any training or information about the FCPA.

ABB/Vetco Gray in Nigeria, Angola, Kazakhstan

The DoJ and the SEC in July 2004 announced the results of parallel criminal and civil FCPA cases against Swiss-based civil engineering company ABB Ltd and two of its subsidiaries, based in the UK and the US. The parent company and the subsidiaries between them paid a total penalty of \$16.4m. ABB had become subject to the FCPA, including the SEC's reporting requirements, in April 2001 when it began to issue American Depository Shares, which are traded on the New York Stock Exchange. The case is therefore a prime example of the application of the FCPA to non-US companies.

The charges related to the activities of the two ABB subsidiaries: ABB Vetco Gray (based in Houston, Texas) and ABB Vetco Gray UK Ltd (based in Aberdeen, Scotland). The US authorities accused them of making illicit payments totalling more than \$1m to obtain or retain business in the oil services sector in Nigeria, Angola and Kazakhstan.

According to the DoJ charge, the two companies paid bribes worth more than \$1m to officials of National Petroleum Investment Management Services (NAPIMS), a Nigerian government agency that evaluates and approves potential bidders for contract work on oil exploration projects. In exchange, they obtained confidential bid information and favourable recommendations from Nigerian government agencies in connection with seven oil and gas construction contracts from which the companies

expected to realise profits of almost \$12m. The payments were disguised as consultancy fees and made via an intermediary.

ABB's subsidiaries faced similar charges in relation to payments allegedly made to officials of Sonangol, the Angolan state-owned petroleum company. The subsidiaries reportedly paid all the officials' expenses and gave them additional cash spending money of \$120 to \$200 a day, on training trips to the US, Brazil, Norway and the UK. The officials were selected because they were considered 'future decision-makers for Sonangol'. At least one of the Angolan officials reportedly provided ABB with confidential competitor information in relation to a bid for a Sonangol contract.

In Kazakhstan, ABB's subsidiaries were accused of setting up a sham consulting contract, for services that were never performed, to channel payments to a government official employed in Kazakhstan's state oil and gas companies.

The illicit payments came to light when ABB was preparing to sell off its oil, gas and petrochemicals upstream business, including the two subsidiaries. ABB reported its initial findings to the DoJ and SEC in late 2003, and undertook to provide further 'real time disclosure' of the results of a joint investigation conducted by lawyers representing ABB and the purchasers of the Vetco Gray group of companies. This review involved more than 115 lawyers and over 44,700 man-hours. It is understood that ABB received a reduced penalty because of its voluntary disclosure and co-operation with the DoJ and the SEC.

In the DoJ criminal case, Vetco Gray US was charged under the FCPA's provisions applying to domestic concerns. Vetco Gray UK was charged under a clause introduced in the 1998 amendment of the FCPA that applies to persons who act in furtherance of a bribe of a foreign official while in the US: this may relate either to the two companies' joint planning activities on US soil, or to the fact that some of the bribes took the form of subsidised visits to the US. The two subsidiaries agreed to pay \$5.25m each after pleading guilty to charges under the FCPA's anti-bribery provisions, making a total penalty of \$10.5m.

At the same time, the SEC accused the parent company of violating both the FCPA's anti-bribery provisions and its books-and-records requirements. Its reasoning was based on the fact that the financial results of ABB's subsidiaries were components of the consolidated financial statements included in the company's filings with the SEC. ABB Ltd agreed to pay a \$10.5m penalty, which was deemed to have been met by the fines paid by the two subsidiaries, as well as a disgorgement of \$5.9m in illicit profits.

In July 2006, the SEC filed a civil injunctive action against four former employees of the two ABB subsidiaries. All four agreed to settle the charges without admitting or denying the SEC's allegations: three paid fines of \$40,000 each, while the fourth paid a fine of \$50,000 plus \$64,675 in disgorgement.

In February 2007, three wholly owned subsidiaries of Vetco International – Vetco Gray Controls Inc, Vetco Gray Controls Ltd and Vetco Gray UK Ltd – pleaded guilty to a further FCPA charge. According to the DoJ, the three companies had authorised a freight forwarding company to make at least 378 corrupt payments totalling approximately \$2.1m to Nigerian Customs Service officials between 2002 and 2005 in return for preferential treatment. The three companies agreed to pay criminal fines of \$6m, \$8m and \$12m respectively, making a total penalty of \$26m. This is the largest criminal fine to date in a DoJ FCPA prosecution.

In January 2007, General Electric agreed to purchase Vetco Gray for \$1.9bn.

OECD Anti-Bribery Convention

US diplomacy was one of the influences that led to the adoption of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (to give it its full name). The convention was signed in December 1997 by the then 29 OECD member states and five non-members. There are now a total of 36 signatories.

Like the FCPA, the OECD convention criminalises the bribery of foreign public officials. It is important because it raises the prospect that companies from all the major industrialised countries will in future compete under the same rules. It will be harder for companies to claim that they have to pay bribes to compete with unscrupulous rivals, and mutual assistance between signatories will make it easier to prosecute malefactors. Western companies have been accused of 'exporting corruption'. The OECD is tackling the 'supply side' of graft and is developing the mechanisms to ensure that its members really do adopt a collective approach.

However, there is still a gap between principle and practice. The implementation of the convention depends on political and social developments as well as legal ones.

What the convention says

The convention provides a set of objectives and principles rather than an exact legal template. Different states have different legal systems, and the phrasing of their laws varies accordingly. However, they have undertaken to draft their laws so that they achieve 'functional equivalence' with each other. The main themes of the convention are very similar to the FCPA.

Article One states that each signatory should make it a criminal offence:

to offer, promise or give any undue pecuniary or other advantage... to a foreign public official in order to obtain or retain business or other improper advantage...

'Improper advantage' includes the obtaining of permits or preferential treatment in relation to taxation, customs and judicial or legislative proceedings. One weakness of the convention is the narrow focus on public officials rather than a wider definition of sources of influence (such as political parties or officials' relatives); this may be addressed in future revisions of the convention.

Each signatory undertakes to impose:

effective, proportionate and dissuasive criminal penalties on offenders.

A state should impose sanctions:

when the offence is committed in whole or in part in its territory.

The phrase 'in part' typically refers to cases where the order to pay the bribe has been made from the home country. Article Four goes on to say that states claiming jurisdiction over their citizens on the basis of nationality should make whatever legal amendments are necessary to ensure that foreign bribery is included.

Like the FCPA, the convention contains a books and record provision. It prohibits:

the establishment of off-the-book accounts, the making of off-the-books or inadequately identified transactions, the recording of non-existent expenditures... as well as the use of false documents... for the purpose of bribing foreign officials or hiding such bribery.

The convention also provides for mutual legal assistance between signatories, including extradition for bribery offences.

Making the convention work

The convention was due to come into force after five out of the top ten exporters had deposited their instruments of ratification. This took place in early 1999, and the convention duly came into force in February that year. All signatories have now ratified the convention, and the speed of ratification has been unusually fast for this kind of international instrument.

However, ratification on its own is not enough. The new anti-corruption laws must be well crafted and they must be implemented. To ensure that this happens, the OECD has developed a peer review process. Countries that fall below the expected standards will face pressure to introduce improvements.

There are two stages. In Phase One, countries are examined by the OECD Working Group to establish whether their legislation meets the standards of the convention. Phase Two is a review of implementation procedures. For example, what steps has each member state taken to publicise its legislation against foreign bribery? Have they devoted sufficient resources to the investigation of foreign bribery cases? Have there been any prosecutions? Phase Two examinations include visits to the countries concerned by a combined team consisting of OECD officials and representatives of two member states. The OECD publishes the reports from both phases on its website (www.oecd.org/daf/nocorruption/report.htm). Many of the reviews have been quite critical.

In mid-2006, TI published its own review of the implementation of the convention. The review noted that there had been foreign bribery prosecutions in 14 out of the 31 countries that it covered. These were: Belgium (three cases), Bulgaria (three), Canada (one), Denmark (one), France (eight), Germany (three), Hungary (22), Italy (one), Norway (two), South Korea (five), Spain (two), Sweden (one), Switzerland (one), and the US (50). However, TI expressed concern at the limited evidence of enforcement in many other countries. In particular, there had been no prosecutions in three major trading nations: Japan, Netherlands and the UK. The low number of prosecutions has been an important factor limiting levels of awareness among companies based in these countries.

Implementing the convention: country case studies

France

Both before and since the OECD anti-bribery convention, there has been a series of high-profile corruption cases involving leading French companies and senior officials. Allegations of corruption by French companies at home and abroad continue to be a source of public controversy. However, the French judicial authorities have demonstrated a degree of willingness to tackle the problem.

In 2003, an eight-year investigation into corruption by the petroleum company Elf-Aquitaine (now part of Total) resulted in the conviction and imprisonment of three of the company's most senior officials. The Elf investigation concerned offences committed before the 'Act of 30 June 2000', under which France ratified the OECD convention. However, there have since been at least eight prosecutions of international bribery cases under the new law.

The interior ministry in 2003 set up a specialist unit known as the Central Brigade in the Fight Against Corruption (*Brigade Centrale de Lutte contre la Corruption* – BCLC). The BCLC comes under the authority of the National Division of Financial Investigations. TRACFIN (Unit for Intelligence Processing and Action against Secret Financial Channels) is another special unit working under the authority of the minister for the economy and finance. Its task is to investigate reports of corruption, money-laundering and related economic crimes. The establishment of these units demonstrates France's public commitment to effective enforcement.

Germany

Germany passed its new *Internationale Bestechungsgesetz* into law in September 1998. German enforcement has been complicated by Germany's federal system: the Federal Criminal Police Office (*Bundeskriminalamt* – BKA) has a co-ordinating and information-gathering role. However, the police authorities in the 16 *Länder* are responsible for investigations and prosecutions. TI and other civil society groups have therefore questioned whether Germany is yet devoting sufficient resources to the investigation of international bribery.

Despite these concerns, there has been a number of high-profile investigations of German companies accused of paying bribes abroad. These include Siemens, which in late 2006 came under investigation regarding allegations that it had maintained a 'slush fund' to finance international bribes. There have so far been three prosecutions under Germany's international anti-bribery law.

Japan

To date there have been no prosecutions or formal investigations of bribery by Japanese companies doing business abroad. Both the Phase One and the Phase Two OECD reports were critical of Japan's approach to its anti-corruption laws.

Japan met the requirements of the convention by amending its Unfair Competition Prevention Law (UCPL) to cover foreign bribery offences. In 2001, in response to criticisms in the OECD Phase One report, it made a second amendment to remove the 'main office exception' to the UCPL and to broaden the definition of foreign public officials covered by the law. A third amendment in 2004 extended the UCPL's jurisdiction to cover offences by Japanese nationals abroad, regardless of whether there was a direct territorial connection with Japan.

The OECD Phase Two report, which was published in March 2005, reported that Japan had failed to provide the Working Group with the information needed to perform an objective assessment. As a result, it had 'not demonstrated sufficient efforts to enforce the offence of bribing a foreign official', and the Working Group called for a further examination a year later. This was the first and only time that the Working Group had made such a recommendation.

In the Phase 2*bis* report, published in June 2006, the Working Group noted that there had been four preliminary 'non-filed investigations' (meaning that no prosecutor had been formally assigned to investigate the case), but that these had been dropped. The Working Group continued to express concern about the absence of formal investigations, and concluded that 'serious doubts continue about the level of Japan's commitment to the effective implementation of the convention'.

UK

The British government has faced repeated criticism from the OECD Working Group for its approach to the anti-bribery convention. By early 2007, there had been several reports of investigations of foreign bribery offences, but no prosecutions.

The UK originally signed and ratified the convention on the understanding that its existing legislation, which was based on laws passed in 1889, 1906 and 1916, covered the OECD's extraterritorial requirements, even though there had never been any prosecutions for foreign bribery offences. The OECD Phase One report challenged this view, and the UK responded by introducing a clause in the Anti-terrorism, Crime and Security Act 2001 making clear that its existing laws applied unequivocally to bribery of foreign officials abroad. Unlike the FCPA, English law applies to private-to-private corruption as well as private-to-public corruption.

The Home Office (interior ministry) has for several years promised to introduce a wholesale revision of the country's anti-bribery laws, covering both domestic and international offences. It introduced draft revisions for public and parliamentary review in 2003, but these were heavily criticised on the grounds that they were too complex. Despite further public consultations in 2006, the government has yet to follow up proposals for revised legislation.

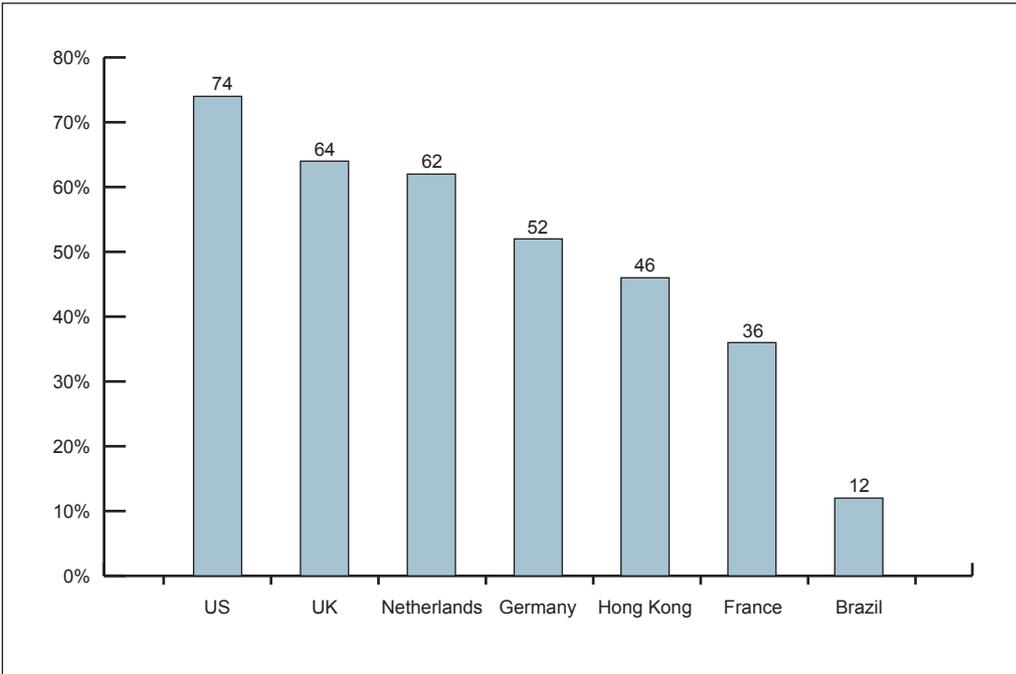
The OECD Phase Two report called on the government to follow up its plans to introduce a comprehensive new anti-bribery statute. The report included a recommendation that the Code for Crown Prosecutors should be amended to clarify that the investigation and prosecution of foreign bribery cases should 'not be influenced by considerations of national economic interest or the potential effect upon relations with another state'. It called on the British government to introduce further awareness-raising initiatives with respect to foreign bribery, and to ensure that the Serious Fraud Office (SFO) had sufficient financial and human resources to fulfil its role in investigating foreign bribery cases.

The government in 2006 responded to OECD criticism by funding a specialist team of 15 officers to work with the SFO on foreign bribery cases. The team is largely funded by the Department for International Development (DFID), and in October 2006 was reported to be working on ten foreign bribery cases. However, the attorney-general in December 2006 made a controversial decision to end an SFO inquiry into an alleged bribery case involving the defence company BAE Systems in Saudi Arabia. Prime Minister Tony Blair defended the decision on the grounds that the investigation would have damaged the national interest. The OECD Working Party announced that it would seek a formal explanation of the decision.

Business awareness of the new laws

As discussed in the introduction to this report, uneven implementation of the OECD convention is reflected in low levels of business awareness of the convention and related home-country legislation in the six signatory countries covered in our survey. Nevertheless, the increased international focus on corruption has prompted a growing proportion of companies to review their integrity procedures.

Percentage of companies that have reviewed integrity business practices and procedures in the last three years 'in the light of the increased international focus on corruption'. By country.



The *International business attitudes to corruption* survey showed that US companies were the most likely to have done so. This reflects tighter enforcement of the FCPA, as discussed above, together with the impact of the Sarbanes-Oxley Act. Among the European countries surveyed, companies from the UK and the Netherlands were most likely to have reviewed their procedures. By contrast, only just over one-third of French companies had done so, and only 12% of Brazilian companies. Brazil is not an OECD member, but has signed the anti-bribery convention.

Meanwhile, a number of high-profile corruption cases are known to be under investigation in leading OECD countries such as France, Germany and the UK. Several of these cases involve joint investigation by more than one OECD country (the Statoil case below is an example). When and if these lead to formal prosecutions, the new laws will gain greater credibility.

Statoil case study: bribery allegations in Iran

Statoil is Norway's leading petroleum company with a justified reputation for high standards of corporate integrity. However, its involvement with an Iranian business intermediary led to a breach of its own ethical standards, prompting investigations and fines by both the US and the Norwegian authorities.

Statoil in June 2002 agreed to pay \$15.2m to Horton Investment, a small consultancy registered in the Turks and Caicos Islands, in return for advice on 'financial, industrial and social issues' in Iran. The money was to be paid via a Swiss bank account. By the time that Statoil suspended the contract the following year, it had already paid \$5.2m.

In September 2003, Norway's National Authority for Investigation and Prosecution of Economic and Environmental Crime (*Økokrim*) launched an investigation into Statoil, suspecting that the consultancy arrangement with Horton was intended as a conduit for bribery to government officials. It was suspected that part of the money found its way to Mehdi Hashemi Rafsanjani, a son of the former Iranian president, who was an official of the National Iranian Oil Company (NIOC).

The case was widely reported in the national and international press, and the subsequent public controversy led to the resignation successively of Statoil's head of international exploration, its chairman and its chief executive. The headline of the London-based *Financial Times* on 23 September 2006 was 'Statoil loses chief and reputation'. Statoil's share price fell by 7% in the week after news of the police investigation became public.

Statoil in October 2004 agreed to pay an Nkr 20m (\$3m) fine imposed by Økokrim without admitting or denying the charges. These related to amendments to the Norwegian penal code that were part of Norway's implementing legislation for the OECD convention and concerned the offer of an improper advantage to a middleman in return for his exercising an influence on a decision-maker. The former head of international operations agreed to pay a separate fine of Nkr 200,000 (\$30,300).

Statoil is listed on the New York Stock Exchange, and the SEC and the DoJ therefore conducted their own parallel investigations into the affair. The outcome in October 2006 was that Statoil consented to an SEC administrative order requiring it to pay disgorgement of \$10.5m. Statoil was also required to retain an independent consultant to review its compliance with the FCPA. At the same time, the company agreed to pay a criminal penalty of \$10.5m as a result of a deferred prosecution agreement with the DoJ. The company's earlier fine to the Norwegian authorities was deemed to satisfy \$3m of the \$10.5m penalty.

OECD export credit agencies (ECAs) initiative

The OECD is co-ordinating an anti-bribery initiative involving the export credit agencies (ECAs) of member states. The OECD's Working Party on Export Credits and Credit Guarantees (ECG) in 2000 issued an 'Action Statement on Bribery and Officially Supported Export Credits', and in December 2006 this was confirmed into a formal OECD recommendation. The ECAs of OECD member countries are now expected to ensure that companies seeking official export credit support make a firm undertaking to eschew bribery. Applicants for support are expected to disclose the names of persons acting on their behalf, and the size and purpose of any commissions paid. The ECAs undertake not to provide support if there is credible evidence of bribery.

The UN Convention against Corruption (UNCAC)

The UNCAC has adopted the key principles of the OECD convention, but has a wider geographical reach: it is the first legally binding global instrument to combat corruption and therefore offers the promise of a genuine global standard. As with the OECD anti-bribery convention, the greatest challenge will be implementation. This challenge will be all the greater because – at least to start with – there is no monitoring mechanism, and limited financial resources to support the convention. It will therefore at best take several years before the full impact of the convention is felt.

The UNCAC was signed by 111 states in December 2003, and came into force in December 2005 after having been ratified by 30 countries. To date, 140 countries have signed the convention, and more than 70 have ratified it. The UN Office on Drugs and Crime (UNODC), which is based in Vienna, is the agency responsible for co-ordinating the follow-up. Several other UN organisations are addressing different aspects of corruption. These include the UN Development Programme (UNDP), which is working on corruption's development impact.

In Article 15, UNCAC defines bribery of a public official as:

The promise, offering or giving to a public official, directly or indirectly, of an undue advantage... in order that the official act or refrain from acting in the exercise of his or her official duties.

Signatories undertake to make it a criminal offence both to offer bribes to an official, and for the official to solicit them. The convention also covers private-to-private bribery (where both parties belong to the private sector). Other articles cover embezzlement of public and private property, trading in influence and money-laundering. Like the FCPA and the OECD convention, the UNCAC prohibits off-the-books accounts. The convention puts considerable emphasis on preventative measures and international co-operation, particularly in the fields of asset recovery and technical assistance.

Several provisions are discretionary rather than mandatory: these include the criminalisation of trading of influence, private-sector bribery and embezzlement of property in the private sector.

In December 2006, the first UNCAC Conference of State Parties took place in Jordan. The role of the conference is to review the implementation of the convention and to recommend improvements, including about technical assistance needs. Participants agreed in principle to set up a monitoring mechanism, but postponed discussion of the details until the next Conference of State Parties in Indonesia in 2007. They also agreed to set up two intergovernmental groups to draft recommendations on monitoring and asset recovery.

Other multilateral initiatives against corruption

The OECD convention and UNCAC are complemented by a series of regional conventions and agreements that serve to reinforce emerging anti-corruption standards.

Organization of American States

The Organization of American States (OAS) in March 1996 adopted the Inter-American Convention Against Corruption, which came into force a year later. This was the first of the

international anti-corruption conventions. It calls on member states to criminalise both domestic corruption and transnational bribery, declaring both to be extraditable offences. It also includes recommendations on a series of preventative measures, including proposals for record systems and internal controls for publicly held companies, and the encouragement of private-sector participation in fighting corruption. In many respects it therefore goes further than the OECD convention.

The OAS in 2001 set up a follow-up mechanism, which provides for a review of the extent to which states are enacting effective measures to combat corruption. This consists of two bodies: the Conference of State Parties, which meets once a year; and the Committee of Experts, which conducts review examinations. Each signatory is required to prepare a self-assessment based on a questionnaire and a set of indicators.

Council of Europe

The Council of Europe (www.coe.int) comprises 46 states from both western and eastern Europe. Its mandate covers cultural, legal and political co-operation on all issues except defence. In recent years it has been preoccupied with issues arising from political and economic reform in central Europe, and organised crime and corruption have been among its prime concerns. Its definition of corruption is broader than that of the OECD, and includes both domestic and transnational corruption, private-to-private commercial corruption and influence-peddling.

The council's main initiatives against corruption are:

- The '20 Guiding Principles' adopted in 1997, which define the main priorities for the fight against corruption.
- The Criminal Law Convention on Corruption (1999), which aims to harmonise national laws on the definition of corruption offences and improve international co-operation, including mutual legal assistance.
- The Civil Law Convention on Corruption (1999), which covers the definition of bribery, compensation for damage, liability and internal audits.
- Recommendation (2000) 10 on codes of conduct for public officials, which includes a model code of conduct.

The council has also set up a monitoring body, the Group of States Against Corruption (known, after its French acronym, as GRECO), which assesses member states' compliance with the council's anti-corruption instruments and recommends remedial actions when it identifies loopholes. GRECO sends out evaluation teams to the member states and, like its OECD counterparts, operates on the principle of peer pressure.

European Union (EU)

Since 1995, the EU has proposed a series of measures to combat transnational corruption. Initially, the driving force seems to have been a desire to combat fraud and corruption within EU institutions. However, many of the same themes that occur on the wider international scene have come up in EU discussions. These include the desirability of ending tax-deductibility on foreign bribes, and the possibility of barring offenders from future contracts. The EU has expressed its support for the OECD anti-bribery initiatives.

The main stages in EU deliberations on corruption include the following:

- July 1995: The EU adopted the Convention on the Protection of the European Communities' Financial Interests. The first and second protocols to the convention make corruption involving an EU official a criminal offence in all member states if it is damaging to the EU's financial interests. The convention and the two protocols have been signed but not yet ratified by all member states' parliaments.
- December 1995: The European Parliament passed a Resolution on Combating Corruption in Europe. Among other things it calls on member states to 'abolish tax legislation and

other legal provisions or rules that indirectly encourage corruption'. It also calls on the commission and member states to take precautionary measures to exclude market operators convicted of and sentenced for corruption from competing for public contracts for given periods of time.

- May 1997: The EU adopted the Convention on the Fight Against Corruption Involving Officials of the European Communities. This criminalises bribery of EU officials, whether or not EU financial interests are at stake.

In April 1999, following a series of scandals that led to the resignation of the entire team of EU commissioners, the EU set up the European Anti-Fraud Office (OLAF), an independent investigative body focusing on fraud, corruption and any other illegal activity affecting the EU's financial interests.

African Union Convention on Preventing and Combating Corruption

The African Union (AU) is the successor organisation to the Organisation of African Unity (OAU) and was set up in 2002. The AU convention was adopted by AU heads of state at a summit held in Mozambique in 2003. Like the other international conventions it calls for measures on prevention of corruption, criminalisation, mutual legal assistance and recovery of assets. Unlike the others, it includes mandatory provisions with regard to private-to-private corruption and transparency in political party funding. The convention provides for an advisory board to monitor progress.

The convention came into force in 2006 after 15 countries had ratified it. However, they represent less than one-third of the AU membership, and progress in implementing the convention remains slow.

The World Bank and the Multilateral Development Banks

In 1996, the then-World Bank president James Wolfensohn broke what amounted to an international taboo by denouncing the 'cancer of corruption' at the annual bank meeting in Hong Kong. His successor Paul Wolfowitz has been even more outspoken, to the extent that the fight against corruption has become one of the distinctive features of his presidency.

The bank seeks first to combat corruption in the projects that it sponsors. Wolfensohn established a Department of Internal Integrity to investigate suspected infringements of the bank's policies, and this has been strengthened under Wolfowitz. Its home page advertises an anti-corruption hotline (1-800-831-0463): both bank staff and members of the public can use this to alert investigators to suspected corruption in bank projects.

The bank's website also includes a list of companies and individuals who were found to be involved in corruption in previous projects, and who are now debarred from future World Bank-sponsored projects either indefinitely or for a limited period. For companies who do a significant amount of business, the risk of debarment is likely to be an even more significant risk than the possibility of legal fines (see Lesotho case study).

Meanwhile, the bank also seeks to build member countries' capacities, for example by strengthening their institutional frameworks to help resist corruption. Corruption was one of the leading themes of the 2006 World Bank annual meeting in Singapore.

The regional multilateral development banks have to varying degrees followed the World Bank's lead. In September 2006, they agreed on a common set of principles to combat corruption.

International opinion-formers

Governments have ultimate responsibility for implementing governance reforms, but civil society actors are increasingly setting the terms of the international debate on the role of business, and on appropriate business standards. The key actors include the following:

Transparency International

Founded in 1994, TI is the leading international anti-corruption NGO. Its headquarters is in Berlin and it has 90 international chapters. TI represents a broad coalition: it is united by a common set of principles, and its leading members include business people and former government officials. It does not conduct its own investigations with a view to 'naming and shaming' offenders. Rather, it focuses on the promotion of forward-looking reforms. It has worked closely with a number of governments and international organisations, including the OECD.

TI's views on business conduct are expressed in the TI *Business Principles for Countering Bribery*, which were first published in 2002 and are now available in seven languages on the organisation's website (www.transparency.org). The steering committee that drafted the principles included a number of corporate members representing companies such as BP, HSBC, Pfizer and PriceWaterhouseCoopers. TI has published an accompanying text, *Business principles for countering bribery: guidance document*, and this is also available on its website.

International Chamber of Commerce

The International Chamber of Commerce (ICC) says that its purpose is to act as 'the voice of world business championing the global economy as a force for economic growth, job creation and prosperity' (see: www.iccwbo.org). Its international secretariat is in Paris, and it has a global network. The ICC helps make policy on such issues as arbitration, commercial law and practice, and trade and investment policy. It is accredited as an NGO observer to the UN, and has been particularly prominent in the fight against commercial crime.

The ICC first published its *Rules of conduct to combat extortion and bribery* in 1977, soon after the FCPA was passed into US law. It published revised editions in 1996, 1999 and 2005. The ICC also publishes *Fighting corruption. A corporate practices manual*, which provides guidance on its anti-bribery rules.

UN Global Compact

The UN Global Compact is a corporate social responsibility initiative founded by then-UN Secretary-General Kofi Annan in 1999 (see: www.unglobalcompact.org). Companies that sign up to the initiative undertake to observe nine principles concerned with human rights, labour and corruption. In late 2004, after much discussion, the Compact added a tenth principle:

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

The Compact has published a *Guidance document*, which recommends both the TI Business Principles and the ICC Rules of Conduct. In April 2006, the Compact published online and print versions of another guidance document, *Business against corruption*, which gives case studies and examples of how to implement the tenth principle.

The UN Global Compact is voluntary: signatories are expected to submit reports stating how they have promoted best practice, but there is as yet no arrangement for third-party monitoring. To date 3,000 companies worldwide have signed up.

World Economic Forum – Partnering Against Corruption Initiative (PACI)

The World Economic Forum (WEF – www.weforum.org) is a private-sector think-tank best known for its annual meetings of business and government leaders in Davos (Switzerland). In the early 2000s, WEF members in the engineering and construction sector set up a working group to combat corruption in their industry. This led to the establishment in 2004 of the cross-sectoral Partnering Against Corruption Initiative (PACI). PACI has published a set of Principles for Countering Bribery (the 'PACI Principles'). These are based on two guiding ideas: the adoption of a 'zero tolerance' policy on bribery, and an effective system of internal controls to guide the policy.

Socially responsible investment agencies

The Socially Responsible Investment (SRI) movement first achieved prominence in western Europe and North America in the early 1990s. The SRI movement gives companies a positive incentive – the possibility of attracting new sources of investment funds – to meet high social and ethical standards, and these now include the implementation of anti-corruption measures.

One example is FTSE, an independent company owned by the *Financial Times* and the London Stock Exchange (see www.ftse.com). FTSE creates and manages stock exchange indices, including the FTSE4Good SRI index. Companies listed on FTSE4Good must meet certain standards of corporate social responsibility with regard to environmental sustainability, human rights and stakeholder relations. Since early 2006, companies listed on the FTSE4Good index have been expected to meet a new set of 'Countering Bribery Criteria', which are largely based on the TI Business Principles (see chapter three).

A second example – also from the UK – is F&C (formerly known as Friends, Ivory & Sime, and then as ISIS Asset Management). F&C is an investment specialist managing a total of £104bn of assets for private investors, financial advisers and institutional clients (see www.fandc.com). It has a strong tradition of 'constructive dialogue' on corporate responsibility issues with companies that are included in its investment portfolio. Its argument is that it has a direct financial interest in the sound management of the companies, and that this includes ensuring that they abide by high standards of business ethics. F&C and its predecessor companies have published a number of reports on corruption-related issues.

Host government enforcement of anti-corruption laws

The underlying principle of the emerging international framework is that legal enforcement is the joint responsibility of host countries and – where international companies are concerned – their countries of origin. In cases where host governments are unable or unwilling to enforce their own anti-corruption laws, the US and other OECD countries may exercise extra-territorial jurisdiction. However, this approach arguably is 'second best'. Ultimately, it is desirable that host government institutions should be strong enough to enforce their own laws effectively and fairly, drawing on international assistance where necessary.

Until recently, this rarely happened in developing and transition economies for two main reasons. First, powerful figures in local elites have often been complicit in corruption, and therefore have no incentive to pursue sensitive bribery cases involving foreign companies. Second, they have often lacked the resources and technical expertise. This is beginning to change. The various international conventions emphasise the importance of mutual legal assistance, and therefore strengthen the hands of host governments. In future there will be more international corruption trials in the host countries. The long-running Lesotho Highlands Water Project (LHWP) bribery case is one of the classic examples.

The Lesotho Highlands Water Project

The LHWP is one of the largest construction projects in Africa. It involves the construction of a series of dams across Lesotho's rivers to provide electricity and water both to Lesotho and to neighbouring South Africa. The overall costs of the project are estimated at \$8bn.

The LHWP corruption cases all involve Masupha Sole, a Canadian-trained engineer from Lesotho who became its first chief executive. In the early 1990s, it became apparent that Sole was living above his means. In 1994, the Lesotho Highlands Development Authority (LHDA), which administers the project, initiated an investigation. Sole was forced to give details of his Lesotho and South African bank accounts, and these in turn indicated payments from Switzerland. It eventually emerged that Sole had received \$1.6m in bribes from intermediaries representing 12 international companies, and that these payments were transmitted via Swiss bank accounts.

Sole's trial began in 1999. To ensure that the court proceedings met international standards, the Lesotho government invited Judge Cullinan from South Africa to preside. A South African barrister, Guido Penzhorn, played a leading role in the government prosecution team. Sole in May 2002 was convicted on 11 charges of bribery and two counts of fraud. In June 2002, he was sentenced to 18 years' imprisonment. In April 2003, the Lesotho Appeal Court dismissed Sole's appeal against his convictions, but reduced his prison sentence to 15 years.

The Lesotho authorities then initiated prosecutions against the companies that were said to have paid Sole. The first was Canadian company Acres International, which in August 2002 was found guilty on two charges of paying bribes to Sole through its commercial representative. A year later, the appeal court upheld the first charge against Acres but dismissed the second. The Lesotho authorities then initiated proceedings against German company Lahmeyer, which was found guilty in 2003. In February 2004, Schneider Electric of France pleaded guilty to 16 counts of bribery paid by its corporate predecessor, Spie Batignolles, in the early 1990s. Italian construction company Impregilo was also convicted of paying bribes, and in April 2006 lost its appeal.

One of the most significant features of the case has been co-operation from foreign governments. Penzhorn in 1998 applied to the Swiss authorities for the release of Swiss bank records first of Sole and then of contractors/consultants engaged on the LHWP. Not surprisingly, the owners of these accounts resisted, but in June 1999 the Swiss Federal Appeal Court ruled in Lesotho's favour. The French authorities also responded to a request from Lesotho for mutual legal assistance. The evidence provided by the Swiss bank records has been crucial to the investigations and subsequent trials.

A second feature has been the role of the international financial institutions that sponsored the project in the first place. As noted above, the World Bank has taken a strong line against corruption. Its Sanctions Committee in July 2004 announced that it was banning Acres from bidding for new bank-sponsored projects for a period of three years. In November 2006, the bank announced that it was also debaring Lahmeyer and in February 2007 the European Bank for Reconstruction and Development announced that it was blacklisting Lahmeyer for the same offence.

A third feature has been the wide publicity given to the case by international NGOs and the foreign press. At first sight Lesotho might seem remote, but events there have affected the international reputation of the companies concerned. The reputational damage and the World Bank debarments are likely to have had an even more significant impact than the fines imposed by the Lesotho courts.

Prospects for the future: clearer standards, uneven compliance

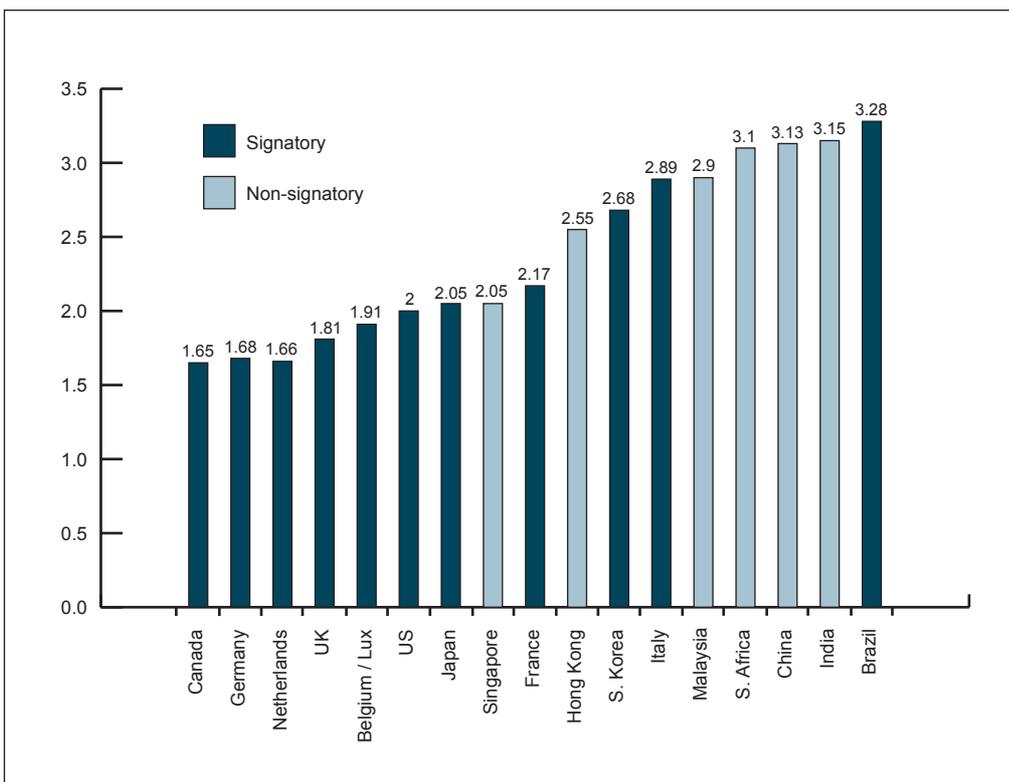
The combination of international legal initiatives and the campaigns of international opinion formers such as TI, the ICC and the Global Compact have together created a clear sense of direction. The overall worldwide trend is towards clearer standards and tighter enforcement both in government and in business. However, the pace of change will remain uneven, and companies will continue to find themselves competing against rivals with varying standards.

In our 2006 survey we asked respondents to rate the compliance standards of companies from a selection of leading trading nations both inside and outside the OECD on a four-point scale:

1	Strict compliance
2	Generally high standards of compliance, with occasional lapses
3	Companies would prefer to comply, but will pay bribes if competitors are doing so
4	Companies will always pay bribes if it is customary to do so in the host country

The results followed a similar pattern to Control Risks' earlier surveys in 1999 and 2002. Canada is perceived to have the highest standards of compliance, and most of the leading industrialised states are clustered in the bottom left of the chart. One non-OECD state – Singapore – is perceived to be on the same level as Japan: 'generally high standards of compliance with occasional lapses'. However, most of the non-OECD states included fall into the third category: 'Companies would prefer to comply, but will pay bribes if competitors are doing so'. The view that Brazil has done little to implement the convention is supported by the earlier finding – noted above – that 70% of Brazilian respondents had no knowledge of their country's laws on foreign bribery.

Perceived standards of compliance among signatories and non-signatories of the OECD anti-bribery convention. By country.



Well managed companies therefore continue to face a double challenge. On the one hand, international laws, the demands of their shareholders and their own aspirations require them to meet high integrity standards, not just in principle but also in practice. On the other hand, they need to be twice as skilful to win against the competition of unscrupulous competitors. The next two chapters discuss the principles that they need to adopt, and how to put them into practice. Chapter five discusses the challenges of operating successfully in high-risk environments.

Resources

US Foreign Corrupt Practices Act

US Department of Justice (DoJ) – www.usdoj.gov/criminal/fraud/fcpa/fcpa.html. Gives the text of the FCPA as well as DoJ 'opinion releases' giving legal opinions on semi-hypothetical situations that companies might encounter.

Securities and Exchange Commission (SEC) – www.sec.gov/investor/pubs/easyaccess.htm. Contains information about the mechanics of individual cases.

Shearman & Sterling 'Digest of FCPA cases' – www.shearman.com/publications/. Shearman & Sterling is a leading New York law firm. The digest summarises basic details of each FCPA case from 1977 until October 2006. It also issues a related publication, *Recent trends in FCPA enforcement*, www.shearman.com/lit_032706/.

OECD Anti-bribery Convention

www.oecd.org/corruption – The OECD's anti-corruption home page offers a variety of useful links. In particular, 'information by country' at the top of the page links to the Phase One and Phase Two reports on individual signatories of the convention.

UN Convention Against Corruption

www.unodc.org/unodc/crime_convention_corruption.html.

Other multilateral initiatives

European Commission, European Anti-fraud Office (OLAF) – http://ec.europa.eu/anti_fraud/index_en.html.

Organization of American States – www.oas.org/juridico/english/followup.htm. Text of the convention: www.oas.org/en/pinfo/conven/corrupt.htm.

Council of Europe – www.coe.int/greco.

World Bank – www.worldbank.org. There is a link to the bank's 'Governance and Anti-Corruption' site.

International opinion formers

F&C – www.fandc.com. F&C's approach to bribery and corruption is described at: www.fandc.com/new/aboutus/Default.aspx?id=63868.

International Chamber of Commerce (ICC) – www.iccwbo.org.

Transparency International – www.transparency.org.

UN Global Compact – www.unglobalcompact.org. Includes guidance documents on best practice.

World Economic Forum – www.wef.org.

Lesotho Highlands Water Project

To view a detailed case study on the Lesotho Highlands corruption and bribery trials, see Institute of Strategic Studies (ISS – South Africa) Internet Portal on Corruption – www.ipocafrika.org/cases/highlands/index.htm.

Chapter three: Company policy – drawing a line against corruption

When I wish to avoid battle, I may defend myself simply by drawing a line on the ground; the enemy will be unable to attack me because I divert him from going where he wishes.
Sun Tzu, Chinese military strategist, 4th century BC.

Officials know that our company doesn't pay bribes. So they don't even ask.
Western businessman operating in Africa.

If your company is known to take a strong stand against corruption, it is easier to resist demands for bribes and you are less likely to receive them in the first place, even in the most corrupt environments. However, 'drawing a line on the ground' against corruption is far from straightforward. The maintenance of company integrity requires hard work and, above all, consistency in:

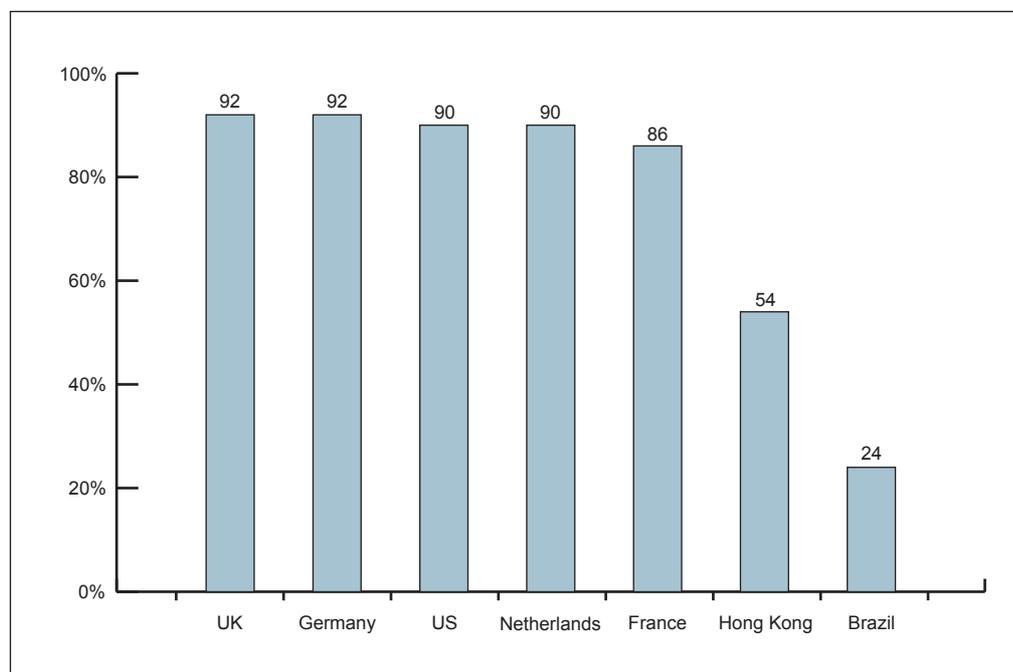
- formal policy statements ('what you say');
- management practices to implement them ('what you do').

This chapter draws on emerging international best practice to explain the policies that companies are introducing to resist corruption. Chapters four and five show how to put these policies into practice.

Codes and policy statements

Most leading international companies based in Europe and North America – and to a lesser extent in other parts of the world – now have codes of business practice. As the *International business attitudes to corruption* survey shows, these almost always contain explicit prohibitions on bribes to secure business. From a policy point of view this is essential: the company must make clear from the outset that it pays no bribes or kickbacks.

Percentage of companies with codes forbidding bribes to obtain business. By country.



These codes are intended for both internal and external audiences. The message to employees is 'don't pay bribes', while the message to officials and business partners is 'don't demand them'. Most European and North American companies now publish their codes on their websites; Japanese companies, by contrast, still tend to regard their codes as confidential documents. The Coca-Cola company's Code of Business Conduct is available in

15 different languages, ranging from Dutch, Portuguese and Norwegian to Korean, Thai and Urdu.

The purpose of these codes is to establish clear basic principles rather than cover all eventualities. They should be clearly written, free from legal jargon, and short enough to be contained in a light, easily carried pamphlet. At the same time, it is helpful to back them up with more detailed supportive guidelines. Royal Dutch Shell publishes a succinct statement of eight *Shell General Business Principles*, which was first drafted in 1977 and revised most recently in 2005. It also has a 49-page *Management primer on dealing with bribery and corruption* and a further 11-page supplement, *Dealing with dilemmas*, which is used in training workshops. All these documents are available on the company's website (www.shell.com).

The basic principles that should be included in business integrity codes are now well understood. The most important sources include the Business Principles for Countering Bribery, which were developed jointly by TI and Social Accountability International and are available on www.transparency.org, together with a guidance document and a six-step implementation process. A second important source is the International Chamber of Commerce (ICC), which has published its *Rules of conduct and recommendations to counter extortion* (see www.iccwbo.org). The Partnering Against Corruption Initiative (PACI), which is based at the WEF in Switzerland, has published a similar document: *Partnering against corruption – principles for countering bribery* (www.weforum.org).

If the code is to be effective, it needs to be supported by senior management, for example by including an introduction and statement of support from the chief executive. It also needs to be adapted to the specific needs of the company: the principles of business integrity are universal, but each industry has its particular hazards. Additionally, it needs to take into account the day-to-day pressures faced by operational staff, including in countries with high levels of corruption. If operational staff are to take the code seriously, they should be consulted at the drafting stage. This may prove to be a time-consuming exercise, but it is worth taking the trouble to achieve a document that everyone accepts.

By the same token the code and the accompanying guidelines should be reviewed regularly: What has worked well? What has not worked? Where are the major challenges, and what does the company need to do to address them?

Finally, the code needs to take a clear line on the grey or controversial areas that, in the light of experience of other international companies, tend to cause the most problems. The sections below analyse the most significant policy issues, starting with two of the most important: policies on commercial agents and on facilitation payments.

Agents, representatives and consultants

Your company is moving into a new market. You do not know the language or the culture, so you employ an agent. Of course he will need a commission. If he gets 5% or 10% of a multi-million dollar contract, that will be a sizeable sum. Perhaps he will pass on part of his commission to contacts in the government. However, he is an independent operator. Does it matter to you how he spends his money?

The problem

International companies operating in unfamiliar countries typically use a variety of commercial agents, consultants and other intermediaries who are better acquainted with local conditions than the companies are. The employment of such intermediaries is legitimate and in some jurisdictions essential. However, the use of intermediaries has emerged as one of the most sensitive issues in the anti-corruption debate – and one of the areas where ill-prepared companies are most vulnerable to prosecution.

Companies typically choose agents because of their personal connections as well as their professional expertise. As one US respondent to our survey comments:

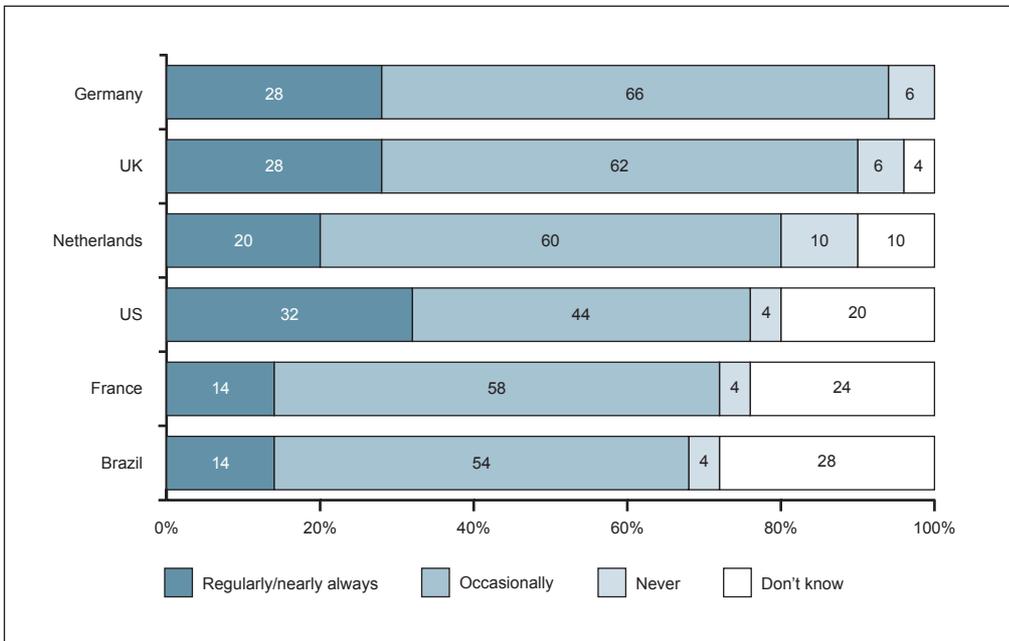
It is impossible to do business in some countries without having a local agent who has all the connections with customers and the government officials. These are not always

shady characters: some of them can be US citizens who have settled in a particular region.

In many cases, agents are former employees of government departments and have friends and former colleagues who are still in office. This enhances their value: if they know local figures personally, they are more likely to be able to win business. They will also be familiar with the local rules – what actually happens as well as what is supposed to happen. They can get things done.

Sensitivities arise because of the scale of commissions, particularly on large defence or construction contracts, and the risk that part of these commissions may be passed on as bribes. Many companies continue to believe that they can disclaim responsibility if – at least for official purposes – they can disclaim direct knowledge of their agents’ activities on their behalf. As will be seen, the idea that it is possible to circumvent anti-bribery legislation in this way is highly problematic. Nevertheless, as noted above, the *International business attitudes to corruption* survey pointed to a widespread belief that companies did try to get round the law in this way.

Respondents believing that corporations from their own country circumvent legislation on transnational bribery by using intermediaries. By country.



As one US respondent put it:

We have some close relationships [with agents] where we have known them for many years so we don't check their 'integrity record' but we know they are honest. If they choose to pay a bribe it comes out of their commission and the legal aspects are their responsibility.

A UK-based defence industry respondent expressed a similar view:

The arms and defence sector has hundreds of these people. It is not stating it too grandly to say that the industry works almost entirely through middlemen, some of whom can be high-ranking government officials. We work on a basis of trust and success. The formal process of checking their record or telling them how to run their operation and not pay a bribe where it is customary to do so is laughable.

The supposition that it is possible to circumvent anti-bribery laws by 'turning a blind eye' incurs a series of risks. At the most practical level, plausible deniability implies a degree of loss of control: the company cannot claim ignorance if it is found to have been closely involved in managing an agent's activities. Loss of control in turn exposes the company to new costs and risks in addition to the legal risks that it is trying to avoid. If a company is not

actively involved in the bargaining process, it cannot judge what payments are justified, or even whether the agent's services perform a useful function at all. If the agent regards bribepaying as normal, he will not resist demands. The costs of the project will go up; the company or its representative will receive repeat demands; and it may become subject to blackmail.

These risks apply regardless of the international legal situation. However, recent legal reforms now mean that companies face an increased risk of prosecution if agents pay bribes on their behalf.

Legal issues

Article one of the OECD anti-bribery convention states explicitly that companies may not pay bribes 'either directly or through intermediaries', and this principle has been carried through into the national laws introduced by the 36 signatories to the convention.

As with other aspects of anti-corruption legislation, the clearest legal precedents come from the US. The FCPA makes clear that companies are deemed to have knowledge of corruption if they believe that it is 'substantially likely to occur' in the circumstances. The US authorities have on several occasions taken action against companies that have allowed intermediaries to pay bribes on their behalf, and similar cases are beginning to emerge in other jurisdictions (see the Titan, ABB, Statoil and Lesotho Highlands Water Project case studies in chapter two). Even in jurisdictions where legislation is less clear than in the US, companies can still be held liable for the actions of their intermediaries on the basis of the principles of agency or by way of conspiracy charges.

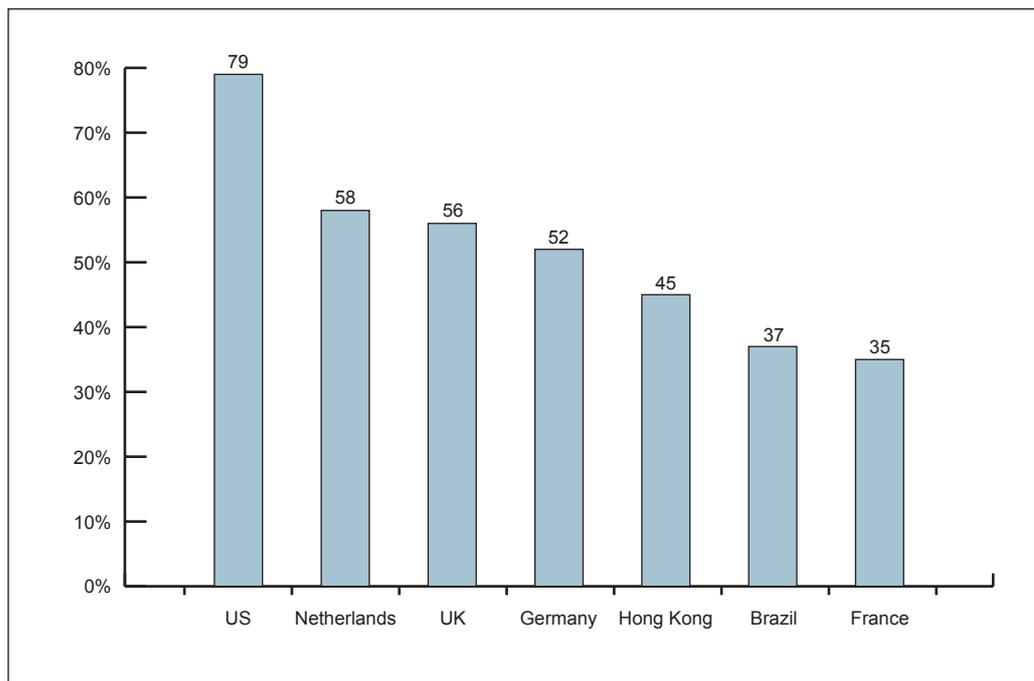
Best practice

At a minimum, a company code will need to make clear that its integrity requirements apply equally to company employees and to third parties acting on the company's behalf. As with any other integrity measure, the company's statement of principle needs to be backed up by effective management procedures to make sure that it is applied effectively.

Selection

The first step is the selection process. Our survey showed that a clear majority of US companies that employed business intermediaries had a formal process to assess their integrity record. However, the practice was much less common in other countries.

Percentage of companies that have a formal process to assess intermediaries' integrity record. By country.



The review process should check for 'red flags' that might indicate potential integrity concerns. Examples include:

- *Agents with close family relationships to key official figures.* At a minimum it is important that the agent should disclose all family links with officials. If the official concerned is in any way responsible for the project under review, the agent should not be employed.
- *Agents who want to be paid in cash, via a third party, or to a numbered bank account.* Cash payments raise obvious suspicions that the agent wishes to impede any future attempt to establish an audit trail. In addition to concerns about transparency, this practice may well infringe the host country's foreign exchange regulations.
- *Would-be intermediaries who – by apparent coincidence – volunteer their services at a time when the companies run into unexpected difficulties in their negotiations.* The apparent coincidence raises obvious suspicions that they are responding to a tip-off from an official hoping for a bribe.
- *An agent recommended by one of the officials with whom the company is negotiating.* Again there would be suspicions that the official is nominating a trusted intermediary who may serve as a conduit for bribes.
- *Agents who wish to remain anonymous.* A request for anonymity prompts the question of what the agent has to hide.
- *Agents who wish to be paid large amounts of money in advance.* As noted above, companies cannot easily enforce agreements that are in any case illegal; agents suffer from the same problem. Their own business risks include the possibility that their employers will renege on the agreement once the contract has been signed. Advance payments reduce the risk both to the agent and to the ultimate beneficiary of any bribes paid, but increase the financial and – potentially – legal risks of the employer.

The recruitment decision-making process should be clearly recorded. This is good business practice in any case, and companies may be required to demonstrate the basis of their decisions both when applying for external funds and guarantees and – in the worst case – in the event of an enquiry into corruption allegations.

The OECD Guidelines for Multinational Enterprises call on companies to maintain 'a list of agents employed in connection with public bodies and state-owned enterprises' that should be 'made available to competent authorities'. In the International business attitudes to corruption survey, almost all companies employing agents said that their identity was 'known in the market place'. The exception was the defence industry, where 21% of companies said that they employed agents whose identity was confidential.

Legal agreements

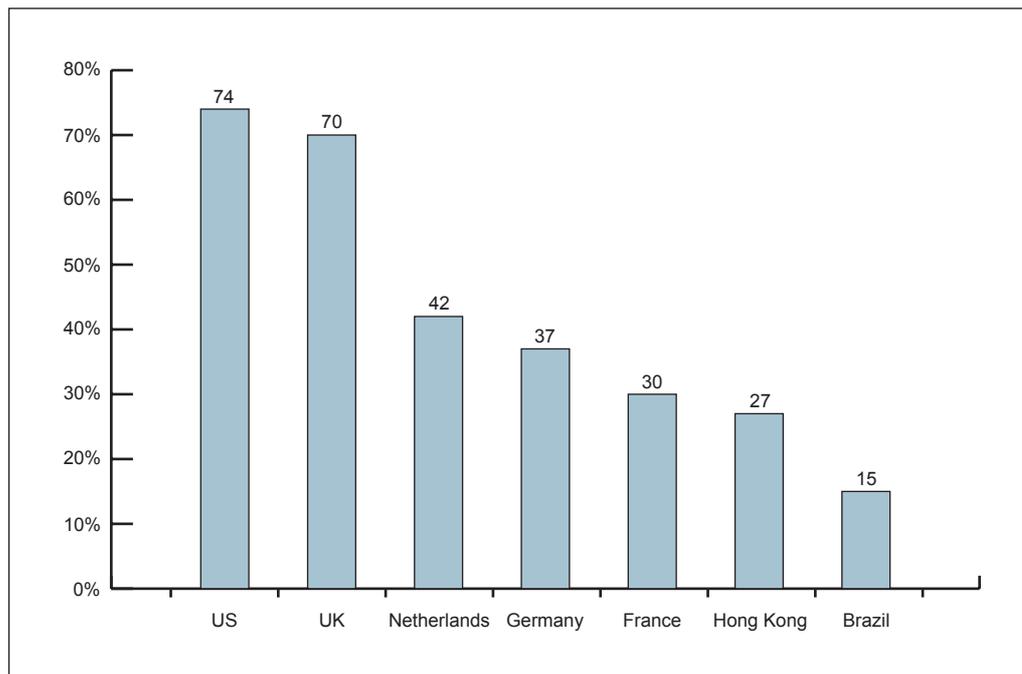
It is best practice to include a formal agreement with intermediaries to ensure that they abide by company integrity rules. The survey (see p. 38) showed that such agreements are common among US and British companies that employ intermediaries, but much less so in other countries.

The key points in the agreement should include a statement that the agent understands and will comply with the company's anti-corruption rules and procedures. Similar confirmatory statements should be signed afresh each year. The scope of services should be clearly defined. The agreement may be terminated if the agent is found to have infringed the rules. The company appointing the agent should retain the right to inspect the agent's financial and commercial records relating to its project.

Remuneration

Article 2 of the ICC's *Rules of conduct and recommendations on combating bribery and extortion* states that enterprises should ensure 'that any payment to any agent represents no more than an appropriate remuneration for legitimate services rendered by such agent'.

Percentage of companies with formal agreements with intermediaries that they will not pay bribes to secure business. By country.



Appropriate levels of remuneration remain a sensitive topic. Our survey showed that an overwhelming majority of British, Hong Kong, Brazilian and French companies paid agents a percentage of the total contract. In the case of a major defence or construction project, this could easily run into millions of dollars. Perhaps because of the difficulty of justifying such payments as 'appropriate', 64% of the US companies that employed agents paid them a 'success fee', and 35% used a combination of measures to calculate fees. Similarly, 37% of German and 36% of French companies calculated intermediaries' remuneration by a combination of measures: all the remainder simply calculated a percentage of the contract.

Managing relationships

A sound recruitment process and an appropriate legal agreement are of course essential, but these are only the beginning. Having recruited an agent, the relationship must be managed, including regular reporting to understand what he or she is doing and – where necessary – to reinforce integrity guidelines.

Case studies

A well-placed man in Africa

This case study, which is based on a series of confidential interviews, illustrates the importance of knowing exactly who one's agent is. An international investor had been invited to join a consortium bidding for a major engineering project in Africa. Its due diligence procedures included an enquiry into the background and reputation of the agent working on behalf of the consortium. The enquiry confirmed that the agent had excellent commercial and personal credentials. However, it emerged that he was simultaneously working for a rival consortium bidding for the same project, while also providing information to the government. He stood to gain handsomely whichever consortium won. In light of these manifold conflicts of interest, the investor decided not to go ahead.

An unsolicited approach

An international company was seeking a licence to set up a new operation in the former Soviet Union. The project had official approval at the highest level of government, and everything seemed to be in place except that the company still needed a document signed by a deputy minister. The company was assured that the document would arrive in due course, but after repeated delays it became apparent that there was some kind of problem. At this point the company received an unsolicited visit at its western European regional headquarters from a 'consultant' who had heard about the problem, and offered his services to resolve it. However, he expected to be paid in advance at a bank account in Switzerland.

The company had never publicly disclosed the nature of its problems. The sudden arrival of the agent therefore immediately raised questions: How did he know his services might be required? On whose behalf was he acting? Further warning signs include the fact that he required a large fee in advance, and that it was to be paid into a foreign bank account. In this case confidential investigations showed that the consultant was closely associated with the deputy minister, who himself depended on the political patronage of the head of government. In effect, his main role was to collect a bribe payment. The company decided not to pursue the project.

Facilitation payments

Your company badly needs some imported equipment that is stuck in customs. An official explains that it will take several weeks to clear if he follows normal procedures. However, there may be another way. He hints that an extra payment of \$100 would solve the problem. What do you do?

The problem

The term 'facilitation' or 'facilitating' payment applies – in the words of the FCPA – to payments 'the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official...'. A payment to speed up the processing of goods through customs would be a typical example.

In many developing countries small facilitation payments are seen as a normal part of doing business, not least because they are backed by what amounts to a form of extortion. Often the payments are part of an organised system: the minor official who received the money passes a percentage of it to his superiors at higher levels of the administrative hierarchy. If you refuse to pay you will – at a minimum – face long bureaucratic delays. In some cases, the penalty could be even more severe: failure to get a loved one admitted to hospital, or even the risk of violence at military checkpoints.

Since its 1988 amendment, the FCPA has specifically excluded facilitation payments from its definition of bribery. However, problems arise at several levels:

- Even if commonplace, facilitation payments are illegal under most countries' domestic laws.
- It may be hard to explain the distinction between an 'acceptable' facilitation payment and an 'unacceptable' bribe. By introducing such a distinction, and confusing the issues, companies weaken their own compliance programmes.
- Facilitation payments are supposed to speed up official transactions, but in the long run have the opposite effect: they give officials an incentive to create obstacles in order to be paid to remove them.
- A willingness to pay entrenches bad administrative practice. The biggest losers are not companies but ordinary citizens.

Legal issues

Although the FCPA does not include facilitation payments within its definition of the offence of foreign bribery, it requires companies to record them accurately in their books and records. Companies may therefore find themselves in the contradictory position of being obliged by US law to keep accurate accounts of a practice that is illegal in the host country.

As discussed above, the OECD anti-bribery convention focuses on payments to 'obtain or retain business or other improper advantage'. Section 9 of the convention's official commentary states that small facilitation payments do not fall within this definition, and are therefore not covered by the convention. However, the approaches taken by individual OECD member countries differ:

- Canada and Australia have followed the US example in excluding facilitation payments from their extraterritorial anti-bribery legislation. However, like the US, they insist that facilitation payments should be properly recorded in the company's accounts.
- The UK, the Netherlands and Japan make no distinction between facilitation payments and bribery in their legislation. However, in their initial guidance documents on the application of their extra-territorial anti-corruption laws, they indicated that they were unlikely to prosecute companies for making small payments in countries where the practice was customary.
- France and Germany make no distinction in their laws and – at least in principle – have left open the possibility that they might prosecute companies who make facilitation payments.

There is little or no case law on foreign facilitation payments in any of these countries, and there are therefore significant uncertainties about how the law would be applied in specific cases.

Tightening standards

The positions of the leading opinion-formers TI and the ICC have hardened since they first discussed the issue in the 1990s. Both organisations earlier took the view that it was best to concentrate attention and resources on the greater problem of 'grand corruption' to secure contracts. However, in 2002, TI stated in its *Business Principles for Countering Bribery* that:

Recognising that facilitation payments are a form of bribery, the enterprise should work to identify and eliminate them.

Similarly, the revised 2005 edition of the ICC's *Rules of conduct to combat extortion and bribery* includes a new provision referring to facilitation payments:

- a) Enterprises should not make facilitation payments. In the event that an enterprise determines, after appropriate managerial review, that facilitation payments cannot be eliminated entirely, it should establish controls and procedures to ensure that their use is limited to small payments to low-level officials for routine actions to which the enterprise is entitled.
- b) The need for the continued use of facilitation payments should be reviewed periodically with the objective of eliminating them as soon as possible.

These statements take a pragmatic approach in that they acknowledge that enterprises may not be able to eliminate facilitation payments overnight. However, if they tolerate such payments in the short term, they should nonetheless keep their policy under constant review with a view to eliminating the practice as soon as they can.

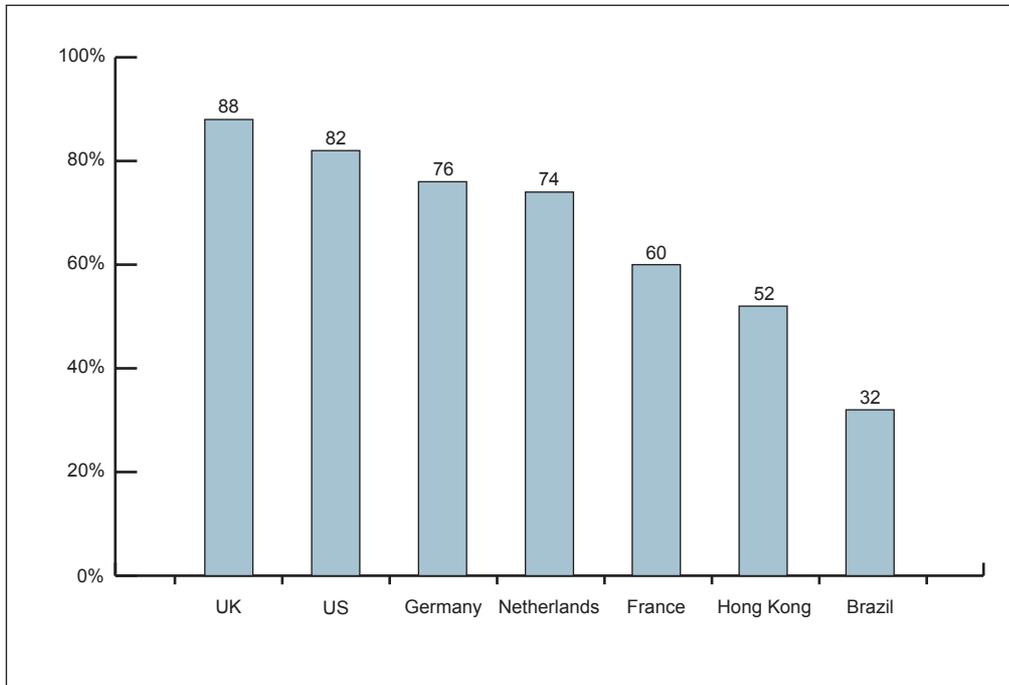
Best practice

Leading international companies are still divided between those that forbid such payments outright, and those that accept that their employees may find it necessary to make facilitation payments, subject to certain conditions. The *International business attitudes to corruption* survey showed that a clear majority of international companies based in the UK and – despite

the FCPA exclusion clause – the US are now instituting outright bans. For example, BP's policy states unequivocally:

BP policy does not permit so-called 'facilitation' or 'grease' payments to be made to government officials, even if such payments are nominal in amount (*Our commitment to integrity. BP code of conduct: www.bp.com*).

Percentage of companies with codes forbidding facilitation payments. By country.



However, putting this policy into practice remains a major challenge. Companies that choose to ban facilitation payments need to ensure that a supporting management framework is in place. In particular:

- Before instituting the ban they need to assess the extent of the problem, and the potential costs of implementing the ban. For example, will it lead to short-term delays in importing goods? If so, they need to plan accordingly.
- They need to train their employees (see chapter four). Particularly in the early stages, any problems arising as the result of a ban should be carefully monitored.
- If the company has been accustomed to making payments as a regular part of its activities, senior management will need to explain the change of policy to the officials concerned. In such cases, local management can use decisions made by head office as an 'alibi': they have no choice.
- Employees should be permitted to make payments in cases where their safety is clearly at risk, for example when held up by a soldier at a checkpoint during a period of political instability. In such cases, they should report the incident to senior management as soon as they can.

In many countries the practice of making facilitation payments is a systemic problem. Individual companies should do what they can to avoid reinforcing the problem, but it is unrealistic to expect them to be able to change the situation single-handedly. Collective initiatives, for example through business associations, may have a greater impact. Ultimately, it is the responsibility of governments to introduce the reforms needed to clamp down on facilitation payments.

Partly for this reason, many international companies still permit gratuities and facilitation payments, subject to certain conditions. An example is the French company Alcatel whose *Statement of Business Practices* (www.alcatel.com) says:

Employees may offer tips, gratuity or hospitality of a customary amount or value for routine services or courtesies received to which the payee is entitled. A tip, gratuity or hospitality may be offered to a government employee only if such act is customary and is not illegal under applicable law. All such expenditures must be reported and recorded in the Company's book of accounts.

Similarly, the Coca-Cola *Code of Business Conduct* states that 'all facilitating payments must be approved in advance by Company legal counsel and recorded appropriately'. It illustrates the principle with a series of real life examples (www2.coca-cola.com) such as:

A finance manager paid \$20 to an employee of a government-owned telephone company to ensure a telephone line was installed at a Company office on time. Even for that small amount, she sought approval from a Company legal counsel and recorded the transaction as a 'facilitating payment'.

In such guidelines, references to 'small amounts' need to be treated with some care. Amounts considered small in Europe or North America may seem quite substantial in developing countries. Judgements on what is and is not acceptable should be guided by legal principles rather than financial estimates.

BHP Billiton's *Business Conduct Guide* (dated October 2004) says that the company is opposed to making facilitation payments as a matter of policy, but recognises that in some cases it may not be possible to find an acceptable alternative. Minor facilitating payments may only be approved subject to certain conditions, including: the purpose of the payment is to expedite a service to which BHP Billiton is legally entitled; there is no reasonable alternative; management is informed; and the payment is recorded accurately (www.bhpbilliton.com).

If companies accept the need for facilitation payments, they should do so only as a temporary measure, maintaining the long-term goal – in accordance with the ICC guidelines – of abolishing them altogether.

Gifts, business entertainment and expenses

Bribes clearly are unacceptable, but what about gifts? Aren't these a normal part of business in some countries? How about business entertainment? If I have an important client, surely I should be able to take him out to dinner? He won't expect to pay for his own cigars. And I'd like to pay for his opera ticket out of company expenses...

The problem

In many cultures it is common to give gifts in return for specific favours, at certain times of the year or as a general expression of goodwill. The practice of entertaining a business partner at a restaurant, for example when planning an important new project, is almost universal. Such practices strengthen personal and business relationships, and are generally beneficial to both parties.

Problems arise when the gifts or entertainment are considered to be disproportionate, either in size or expense, and particularly when they impose an actual or implicit obligation on the part of the recipient. In such cases, the boundary between a 'gift' and a 'bribe' may be narrow or non-existent. It is therefore essential for companies to define what kinds of gifts are and are not acceptable, and to make their policies clear both to employees and to business partners.

Similar issues occur with regard to the payment of expenses, for example if a company invites a customer or an official on an overseas trip to gain first hand experience of a new product or process. It would be natural to provide hospitality, but what level of hospitality is truly appropriate?

Legal issues

The legal principles concerning gifts in kind are the same as for gifts of money. Bribes have been offered in a variety of forms: gifts of land, greyhounds, handbags, children's education and sexual favours. The gift is a bribe if – to use the wording of the OECD anti-bribery convention – it amounts to 'undue pecuniary or other advantage... to obtain or retain business or other improper advantage'.

Best practice

The overriding principle is transparency. Employees may not offer or receive gifts, rewards, benefits or other incentives that appear to create an obligation, affect their impartiality, or influence a business decision.

Gifts should be of a level that would cause no embarrassment to either party if made public. Each company will want to define for itself what this level should be:

- Companies often set a financial limit: employees may accept gifts worth, say, £50 or less. They should declare gifts of a higher value to their managers, and may be required to return them if they are deemed inappropriate. Most organisations allow employees to give and receive small gifts inscribed with corporate logos. Examples include pens, pen-knives or a computer mouse. Such gifts are understood to have limited financial value: a pair of diamond earrings or gold cufflinks inscribed with the company logo might raise problems.
- Organisations differ in their policies on entertainment at restaurants. Most are happy to give and receive entertainment in the course of a legitimate business relationship. Some organisations – particularly government departments – insist on paying their share of any expenses or have an outright ban on corporate entertainment.
- Companies should avoid cash payments. Some companies give gifts 'in kind', often as part of their wider social or community programmes. A drinks company might offer to provide the wine or beer at a public function for a charitable organisation.
- Similar principles apply to travel expenses and hospitality. Any hospitality and travel expenses should be for a legitimate business purpose. Family members of the recipient are not entitled to expenses.

It is good practice to distribute a copy of the company's policy on gifts and other integrity issues to suppliers and key business partners. Some companies go so far as to send formal letters requesting suppliers not to embarrass employees by offering business gifts because they would have to be returned. As with other aspects of integrity, it is easier for employees to resist questionable practices if they can point to a written company policy.

Seasonal gift-giving may be an opportunity to build goodwill. For officials, festivals may in the worst case be an opportunity for extortion backed by implicit or explicit threats of poor service in the year ahead. Even at festival times, the principles are the same: gifts should be proportionate, and they should pass the 'newspaper test'. It may be acceptable to build good relations with, say, a customs office with a seasonal present as a goodwill gesture. However, it is best if the gift is presented in public to the institution rather than to an individual. In this case, a gift in kind – say food and drinks for a seasonal celebration – is less likely to be misconstrued than a present in cash form.

Gifts and 'culture'

International business people sometimes comment that gift-giving is part of their host country's culture, and that it is hard to distinguish between gifts, obligations and outright bribes. In practice, dividing lines almost always exist and it should not be too difficult to discern them.

Japan is an example of a gift-giving culture. People exchange gifts at the end of the year (*Seibo*) and at the time of the Chugen festival in July. There is also a tradition of giving money in specially designed envelopes to mark rites of passage such as births, a child's first day at school, a couple's engagement, weddings, house moves, visits to hospitals and funerals. The

type and the size of the gift are determined by custom, and by the two parties' relative status. There are clearly defined reciprocal obligations.

Japanese generally appreciate it when foreign friends give presents on appropriate occasions, but they do not necessarily expect them to do so. Gifts of disproportionate value will cause embarrassment, whether offered by a Japanese or a foreigner.

Many Japanese acknowledge that the gift-giving 'system' is open to abuse, but the examples they cite are similar to those that would cause concern in other countries. Pharmaceutical companies have been criticised for offering excessive presents to doctors who might order their products. Japan has its own corruption debate, and there is no doubt that there are abuses in both the commercial and the political arenas, but most Japanese know the difference between a gift and a bribe. The same is true in other gift-giving cultures in Africa or elsewhere in the world.

Eskom policy on gifts

Offering business courtesies

Any employee or representative who offers, or approves the offer of a business courtesy must ensure that it is ethical and proper in all respects and that it cannot reasonably be interpreted as an attempt to gain unfair business advantage and will not reflect badly on Eskom's reputation.

Accepting business courtesies

Employees who award or can influence the allocation of business, create specifications that result in the placement of business, or participate in the negotiation of contracts or concessions are particularly vulnerable to criticism relating to business courtesies. If you are such an employee, do not take any action that could create the appearance of favouritism in allocating Eskom's business or that could adversely affect Eskom's reputation for impartiality and fair dealing. This constraint applies to employees and to the members of their immediate families.

Source: *Business conduct policy and guidelines*. Eskom. www.eskom.com.

Nike policy on gifts

We want to avoid the appearance of making business decisions based on improper factors. Therefore, Nike employees may not accept or offer gifts, gratuities, entertainment, or favors unless they are of nominal value and are normal and customary given the business circumstance. Employees may not accept or offer cash at any time and should never accept or offer any gift, favor or entertainment if there is any expectation of a return favor implied. Any employee who receives a gift that falls outside of the acceptable guidelines must report it to their manager, who will decide whether the employee may keep the gift or turn it over to Nike.

Source: *Inside the lines. The Nike code of ethics*. www.nike.com.

Political donations

The provincial governor was very helpful to us when we set up business here. Now he is seeking a return favour. Elections are coming and he wants us to contribute to his election funds. It's all perfectly legal and, after all, our company recently made a political donation in the US. Can I go ahead?

The problem

At a minimum, companies need the acquiescence – if not the overt support – of the political leaders of the regions where they operate. The challenge is to maintain a professional

relationship without being seen as partisan. The company will be in a stronger position if it declares its policy in advance.

Legal issues

In most countries political donations by domestic companies are legally permissible. However, there are varying rules on whether donations should be made public, and whether international companies should be allowed to give donations to domestic political parties. Donations to parties – as distinct from individual politicians – are not currently covered in the OECD convention, and some regard this as a potential 'loophole', making it possible to offer a bribe in another form.

Best practice

Despite this apparent loophole, many large international companies refuse to give donations to political parties. This is a wise policy. Party funding is already a controversial topic – especially where funding sources come from abroad – and it is likely to become even more controversial, both in developed and developing countries. There is a long-running debate in the US on election-funding rules. Similar controversies are taking place in much of the developing world, and this will ensure continuing public and media interest.

Regardless of the precise legal position, donations to parties will incur significant political risks and it is therefore questionable whether they are really in the company's interests:

- If the company is regarded as partisan, it will lose out when its favoured party falls from power.
- The company may wish its donation to be kept secret in the hope of avoiding charges of party political favouritism. However, it will be difficult to secure a plausible guarantee of confidentiality in an era of heightened media interest in party funding. If the donation is initially secret, but news then leaks out, the damage to the company will be even greater.
- The company cannot afford to attach any conditions to its donation, or it will be accused of political interference. Whatever it does, it will still be accused of seeking to purchase influence.

Sample policy statements

Shell companies do not make payments to political parties, organisations or their representatives. Shell companies do not take part in party politics. However, when dealing with governments, Shell companies have the right and the responsibility to make our position known on any matters which affect us, our employees, our customers, our shareholders or local communities in a manner which is in accordance with our values and the Business Principles.

Royal Dutch Shell, *Statement of General Business Principles, 2005*. www.shell.com.

Rio Tinto does not directly or indirectly participate in party politics nor make payments to political parties or individual politicians.

Rio Tinto represents views to government and others on matters affecting its business interests and those of shareholders, employees and others involved in our activities. By fostering such public dialogue we contribute to the development of sound legislation and regulation that is relevant and appropriate to our business interests.

Nothing in Rio Tinto's policy seeks to restrict individuals acting in their personal capacity as citizens from participating in the political process.

Rio Tinto. *The way we work. Our statement of business practice*. 2005. www.riotinto.com.

The company should of course reserve the right to engage with government authorities on a non-partisan basis on matters affecting its core commercial interests. Equally, company employees should in their personal capacity retain their rights as citizens to engage in the political process.

Conflict of interest

In this culture everyone knows each other, and almost everyone is related. Our local manager wants to source supplies from his cousin. He says that this amounts to a family duty, and it is in any case in the company's interest. His cousin is reliable and offers the best deal. Should I allow him to go ahead?

The problem

Conflicts of interest may arise in any country or region, but employees are particularly vulnerable in cultures where there is a strong sense of social obligation to assist relatives, or in countries that are dominated by a narrow social elite whose members are in any case interrelated. If executives are seen to be biased in favour of particular groups or individuals, the company's reputation will suffer, and it will be less likely to obtain or the best service at the best price.

Best practice

Conflicts of interest are unacceptable in all areas of business and the company should say so. No company employee should have decision-making power over the award of business to a relative or a close associate. In particular, the selection of suppliers and contractors must be based on an evaluation of professional merit, and not on personal recommendations.

It is important to make sure that employees are aware of the need to avoid even the appearance of conflicts, and to ensure that they consult senior staff members in case of doubt.

Unilever Code of Ethics for Senior Financial Officers (extract)

All Unilever employees are expected to avoid personal activities and financial interests which could conflict with their responsibilities to the company. Unilever employees must not seek gain for themselves or others through misuse of their positions.

A conflict of interest between a member of staff and Unilever may be financial, but is not necessarily so. As a general principle we are all required to avoid personal activities and financial or other business interests which could conflict with our commitment to our jobs. Even the appearance of a conflict of interest is to be avoided because this can reflect unfavourable on one's own or Unilever's integrity and good name.

Similarly, we must avoid any conflict of interest as a result of a position or other benefit being offered to or taken by family members or any other connected persons.

All such potential conflicts must be raised with local management and express authority obtained. In the event of doubt the Joint Secretaries will advise.

Source: www.unilever.com

Novartis policy on conflicts of interest

Business transactions must be conducted with the best interests of Novartis in mind.

Nobody, whether an individual, a commercial entity, or a company with a relationship to a Novartis employee, may improperly benefit from Novartis through his or her relationship with the employee or as a result of the employee's position in the company. Furthermore, no employee may personally benefit in an improper way.

Situations which may cause conflict between an employee's responsibilities towards Novartis and his or her personal interests should be avoided. Nevertheless, a conflict of interest, or the appearance thereof, may occasionally arise. Should such a situation occur, communication between employer and employee is of utmost importance, and the parties concerned shall attempt to resolve the matter in good faith.

Source: *Novartis Code of Conduct* (www.novartis.com)

Resources

Business Anti-corruption Portal – www.business-anti-corruption.com. This is a new Danish initiative designed for small and medium-sized enterprises operating in developing countries.

Ethical Investment Research Services (EIRIS) – www.eiris.org. EIRIS' research publications include *Corporate codes of business ethics. An international survey of bribery and ethical standards in companies* (September 2005). This summarises research on codes adopted by 2,400 companies in 23 countries.

International Chamber of Commerce. *Rules of conduct and recommendations on combating bribery and extortion*. A set of principles that can be used as a model for individual company codes. www.iccwbo.org.

TRACE International. www.traceinternational.org. TRACE is a US-based membership organisation, originally set up to vet and validate commercial agents and other intermediaries. Most of its resources are restricted to members, but a number of 'articles and publications' are still available for public access. Together with F&C, the UK-based fund management company published a pamphlet on companies' experience of resisting facilitation payments. www.fandc.com.

Transparency International. 2002. *Business Principles for Countering Bribery*. www.transparency.org/global_priorities/private_sector/business_principles. The principles include a guidance document and a six-step implementation process.

UN Global Compact – *Business against bribery* (2005). This is a book-length report with examples of best practice on the design and implementation of anti-corruption strategies. Available on www.unglobalcompact.org.

World Economic Forum – *Partnering against corruption – principles for countering bribery* ('PACI Principles'). www.weforum.org. A set of principles drawing on both the TI and the ICC models.

Chapter four: Implementing an anti-corruption policy

An anti-corruption culture has both tangible and intangible elements, but it does not simply 'happen'. No anti-corruption policy will be effective unless it has enthusiastic endorsement from the chief executive, and a clear management structure governing all aspects of the company's operations. This chapter presents the lessons learnt by leading international companies.

Leadership

Responsibility for implementing anti-corruption policies ultimately lies with the chief executive. When discussing corporate and institutional corruption, eastern Europeans frequently point out that 'a fish rots from the top'. If the top leaders are dishonest or hypocritical, they will set the tone for the rest of the company. Equally, a strong personal commitment to high standards of integrity on the part of the CEO will have a significant impact down the line of command.

Company and institutional leaders take a personal risk when they make public statements on integrity issues. They will look naïve or ineffective if individuals in their organisations are subsequently found to have been involved in corruption. They therefore have a personal interest in ensuring that statements of principle are backed up by concrete implementation measures – and that requires delegation.

Allocation of responsibilities

The specific allocation of responsibilities at board level varies from company to company. The two key principles are regular reporting to the chief executive and the chairman, and collaboration between different management disciplines.

Legal and compliance officers have an obvious role in ensuring that the company operates within the law. However, it is important to achieve a balance between ensuring compliance and positive promotion of high ethical standards. Legal compliance is an important reason for developing an anti-corruption policy, but not the only one. Others include an adherence to high ethical standards, the need to maintain the trust of customers and clients, and a concern for the long-term reputation of the company. Company policies and implementation procedures will need to reflect all these concerns.

In practice, leaders from a variety of different functions will need to meet at the highest level to co-ordinate policy. In addition to the legal department, these will certainly include the head of the finance department, because of its responsibility for audit. Marketing directors will need to take account of integrity issues when drawing up plans for promoting business in difficult environments (see chapter five). Human resources directors are in charge of recruitment, training and company communications. Security advisers may be involved in investigations of suspected malpractice. In the US, large companies now commonly employ specialist ethics officers. The company chairman will need to retain an important overall oversight role.

The involvement of a number of different management disciplines means that it is all the more important to establish clear reporting lines either to the board or – in some cases – to a business ethics committee. BP has established eight Regional Ethics Committees: these report to the Ethics and Environmental Assurance Committee, which in turn reports to the board.

Overcoming cynicism

Often the biggest leadership challenge is to demonstrate that the company's anti-corruption agenda is real. The key principles are:

- *Consultation.* Employees at all levels are more likely to accept anti-corruption policies if they are consulted in advance.
- *Back-up.* If employees have a problem, they should know where to turn.

- **Assurance.** Employees will need to be confident that their careers will not suffer if they fail to win business as a result of refusing to pay bribes (Unilever’s code of conduct contains a specific undertaking to this effect). In some cases, they may need assurance on account of concerns about their physical safety if they resist pressure to engage in corrupt practices.

Building up this kind of assurance takes time, consistent application and a willingness to learn from mistakes. Company leaders will need to be able to make the case that resisting corruption is not only the right thing to do: it is also good business.

Risk assessment

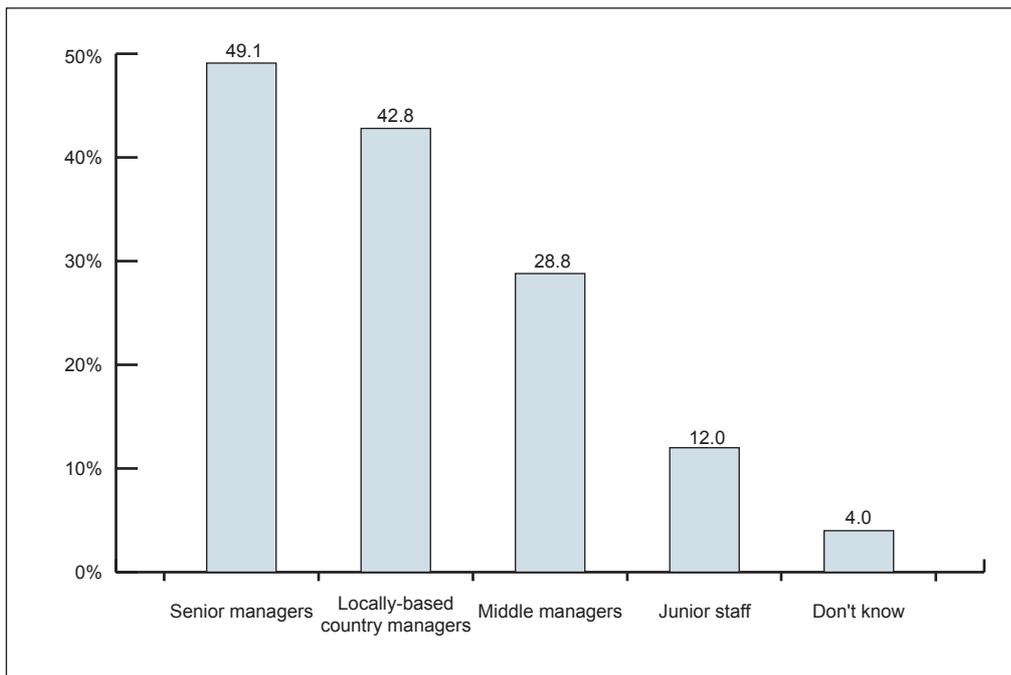
As discussed above, business integrity codes need to be tailored to the specific circumstances of individual companies: the same point applies to implementation strategies. When devising plans of action, company leaders will need to address the specific risks that apply to their particular industry, to the countries where they operate and to different management functions.

Risk assessment should include a detailed review of decision-making processes, for example in procurement procedures, to identify the areas that are most vulnerable to corruption.

Involving middle-management

In the *International business attitudes to corruption* survey, respondents were asked to judge which sections of a company were most likely to be involved if corruption occurred. Overall, nearly half said senior management, and 42.8% and 28.8% respectively pointed to either locally-based country managers or middle managers.

Sections of a company most likely to be involved if corruption occurred.



There are several reasons why country managers may be particularly exposed to corruption. They are on the frontline of national business dealings, they are often keenly aware of the competition and they are typically under pressure to deliver quick results. Working a long way from home in difficult conditions, they can feel that strictures from head office – be they about environmental standards or corruption – are unrealistic when applied to local circumstances.

The toughest critics of a company’s integrity policies are often its own employees. Control Risks interviewed middle managers in one international company shortly after the chief executive had made a series of high-profile public speeches on integrity. Their reaction was deeply cynical:

- First, they did not believe that the chief executive was fully committed to the policies he espoused. He disliked corruption, but they believed that this was secondary to his desire for better international sales. Their own promotion prospects depended more than anything else on their capacity to make those sales.
- Secondly, they were conscious that they would face significant personal security risks if they took a stand against corruption, and they doubted the organisation's capacity or willingness to protect them. The company had recently introduced a hotline for would-be 'whistleblowers', and they did not believe that any messages sent by this route would remain confidential. If expatriates ran into trouble, the company might transfer them. However, local employees, and particularly their families, would remain at risk.

Such responses point to the challenge that international companies face in ensuring that all parts of their international network understand and agree with their anti-corruption strategies. Consensus is unlikely if the authors of the codes are specialists sitting in head office who do not consult their colleagues abroad. It is essential to take the time and trouble to achieve a shared international view before introducing new policies or procedures. Equally, company policy documents should make clear that employees' career prospects will not suffer if they fail to meet commercial targets because of a refusal to engage in corrupt practices.

The case study below is an example of a constructive – albeit sometimes difficult – debate between the European headquarters of a leading international company and a regional director. The eventual outcome was a policy and an implementation procedure that was both tighter than before and realistic.

Case study: Banning facilitation payments

This case study outlines the experience of a European company instituting a worldwide ban for the first time. It is based on an interview with the recently retired senior executive of the company, which has operations all over the world. The interviewee was speaking off the record. His account is a particularly revealing illustration both of the pressures that led to the adoption of a policy explicitly banning facilitation payments, and of the challenges of implementing it.

The company has a justified reputation for high standards of integrity. It has never paid bribes to secure business and believes that on several occasions it has missed commercial opportunities as a result. However, until recently it authorised employees to make facilitation payments in exceptional circumstances with defined procedures for monitoring, recording and auditing.

The change was prompted by an occasion when a senior company executive testified as an expert witness to a parliamentary committee that was conducting an enquiry on the topic of corruption and international development. As a small part of a wider enquiry, the committee wished to interview senior company executives. In the course of his testimony, the executive acknowledged that his company had a policy on facilitation payments that was completely different from commercial bribes. The following day, the press reported this as a statement that his company paid 'bribes'.

This incident triggered an internal debate within the company. Board members were affronted at the suggestion that they paid 'bribes': they believed that there was a clear distinction between 'bribes' and 'facilitation payments' and felt strongly that the press had misrepresented their position. However, they wished to remove any doubt, and therefore decided to change company policy and to end facilitation payments.

The head of one of the company's regional operations responded by sending a strongly worded memorandum to the board stating that its decision was impractical and would put the company in an impossible situation. He gave a list of 14 examples where failure to pay would have serious consequences: he wanted to know whether the board was prepared to take those consequences. One example concerned the drivers of food distribution trucks who were regularly stopped at military checkpoints in remote areas. If they did not make facilitation payments, they might be beaten up.

The board responded by ordering a comprehensive review of company practice throughout the world. Their message to regional and national offices was that they should report honestly on their current difficulties so that the company could devise solutions with a view to eliminating facilitation payments by a set date. If it subsequently emerged that the regional offices had concealed problems, they could face disciplinary action. From now on, demands for facilitation payments should be reported to a committee of the board responsible for managing business ethics and code issues.

The regional offices brought up a number of problems similar to those raised earlier. The company worked through them systematically, which was a 'huge challenge'. The solutions – and the scale of the commercial consequences – varied. In some cases, the company was able simply to stop making payments. In others, the cost might take the form of extra delays or a change of supply routes that had to be planned for. And in yet other cases, the company had to decide to curtail certain kinds of business because the risks were unacceptable.

The company board took a clear view that it was unacceptable to institute a company policy that was not implemented or audited properly. Equally, they believed that it was unacceptable simply to 'subcontract' the problem, for example by distributing goods via another company that might itself make facilitation payments at military checkpoints. The process of reviewing facilitation payment practices throughout the company was therefore difficult, painful and in some cases costly. However, the board felt that – from a reputational point of view – they now had no choice. Having been through the process, they believe that they now have a policy that is both viable and auditable.

Recruitment, awareness-raising and training

Recruitment

A company is as good as the people it employs, and it is therefore essential to recruit the right people. This means checking the background and integrity of new recruits, particularly when making senior appointments. Control Risks' research shows that as many as 25% of job applicants in the UK stretch the truth to embellish their CVs in some way. If new recruits do not tell the truth about themselves, this raises doubts about their probity in future employment.

It is particularly important to take special care when recruiting local employees in countries with high levels of corruption (see chapter five). Well motivated local employees who understand both the national culture and the standards of their employer may be able to help find legitimate means of avoiding bureaucratic and other obstacles. Poorly trained local employees may expose the company to unintended risks by following local rather than international practice.

If the company has a reputation for integrity, this in itself should help it recruit good quality candidates. This principle applies even in high-risk countries.

Spreading the message

A company's policy guidelines need to be communicated, preferably in different formats and languages, to all its employees and business partners.

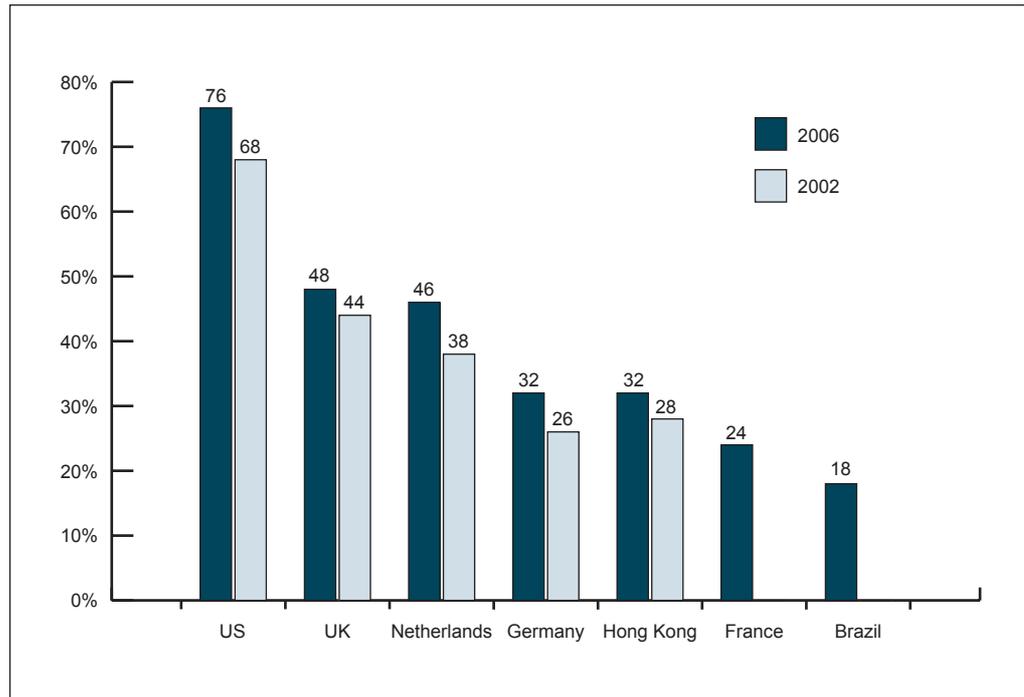
Current best practice is to draw a concise overall code of business principles on the lines discussed in the previous chapter, typically small enough to form a small pamphlet. The code should be written in a simple, clear style. Its purpose is to articulate principles rather than to provide for every eventuality. The code should be translated into all the major languages of the countries where the company operates and it should be made available on the company website.

The code may be supported by a more detailed booklet. Often this is set out in Q&A format: 'what do I do if...?'. Royal Dutch Shell has produced a 56-page management primer, *Dealing with bribery and corruption* (see: www.shell.com) that includes an analysis of the kinds of bribery that employees may encounter. Recognising that there may not be a straightforward answer to all questions, it includes a section on dilemmas as well as a series of case studies.

Training

In practice, there is often a mismatch between companies' declarations of principle, and their willingness to provide anti-corruption training. Most leading Western companies now have codes of conduct barring bribery, but our survey showed that anti-corruption training programmes are far from universal.

Companies with programmes to train executives in ways of avoiding corruption. By country.



The US' lead reflects the importance that companies there attach to compliance with the FCPA. Many US companies, such as Lockheed Martin, produce in-house company videos explaining how the FCPA works and how to comply with it. Others use internet-based learning tools, articles in company newsletters and even board games. As in other areas, there is a significant discrepancy between larger and smaller companies: 45% of companies with more than 1,000 employees have training programmes, compared with only 20% of companies with fewer than 250 employees.

Training should be tailored to specific audiences: internet training can be used to create a basic awareness among a wide audience in companies with large numbers of employees. However, face-to-face training may be more appropriate for decision-makers who are more likely to be exposed to integrity dilemmas – for example sales and marketing executives in high-risk countries. Shell supplements its anti-corruption 'primer' with another document, *Dealing with dilemmas – a training supplement*. This includes a series of problems with no right or wrong answer. Such case studies are particularly useful in training workshops as means of engaging participants and encouraging them to think creatively about potential problems, rather than passively absorbing – or not absorbing – PowerPoint presentations.

Companies that work extensively with agents and other intermediaries should consider including them in their training programmes.

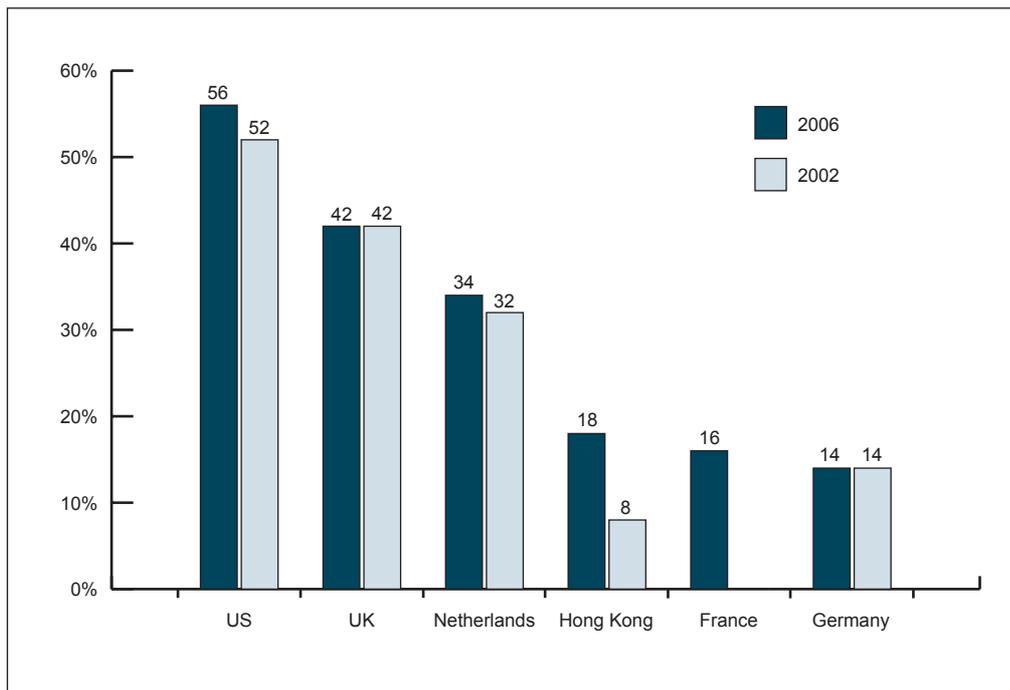
Management strategies

Annual appraisals, compliance statements and reporting

Integrity needs to be 'embedded' into company management, including annual appraisals. It needs to be made clear that it is not simply an 'add-on' to be considered if you have achieved your sales targets.

US lawyers advise companies to require employees to sign annual statements of compliance saying that they have read and complied with the company's code, and that they are not aware of any violation in the year under review. This practice is now becoming more common in the US, the UK and, to a lesser extent, the Netherlands.

Percentage of companies where senior managers make annual compliance statements that they have abided by their anti-bribery code. By country.



Of the different sectors, oil, gas and mining companies are most likely to follow the practice of making annual statements. Size also makes a difference: companies with more than 1,000 employees are more likely to follow this practice: 38% do so, compared with only 31% of companies with fewer than 250 employees.

Typically, employees are required to confirm that they have read and understood the company's business principles in the last 12 months, that they have not been in violation of the policy (or, if they have, they should give details) and that they have participated in the company's training programme. A sample wording runs as follows:

I have not authorised or offered any payment or anything of value, directly or indirectly, to any official employee, agency or instrumentality of the government for the purpose of illegally or improperly influencing any act or decision in any such person's official capacity or inducing any such person to use his influence with the government so that the company has obtained or retained business or gained an improper advantage.

The wording of such statements is legalistic, but it serves as a reminder of company policy. However, better practice is to include positive as well as negative objectives in annual appraisals: What have you done to promote the company's business principles in the last 12 months? What will you do? Rather than simply citing problems to avoid, companies should include positive, measurable objectives for promoting the company's ethical standards.

Financial records and auditing

Both the FCPA and the OECD conventions lay down a requirement that companies should maintain accurate books and records, and in particular that they should not keep alternative 'official' and 'unofficial' sets of accounts. Many of the FCPA prosecutions have been launched by the SEC, rather than the DoJ, on the basis of accounting irregularities.

Good practice includes at a minimum a 'separation of powers' between those making recommendations on the disbursement of funds, financial controllers and auditing. Standard commercial audits should be able to identify weaknesses in the company's system that render it vulnerable to corruption. However, it is not realistic to expect audits to reveal all cases, and it would be unwise to rely on them completely. Auditors do not see themselves as forensic investigators.

Controversy over the role of Arthur Andersen in the Enron case in the US showed how accountants may come under pressure to gloss over irregularities to retain the custom of important clients. Such tensions can be even more acute in emerging and transition economies where there will be pressure to adapt to less rigorous standards in line with local practice.

In addition to conventional audits, it may be valuable to undertake more rigorous tests, where investigators imagine what they would do to defraud the company and test to find out whether it is possible. Control Risks' experience is that such investigations regularly uncover anomalies, for example where suppliers turn out to have undisclosed personal and financial links with employees.

Similarly, benchmarking reviews may bring up unexpected problems, as the following example indicates:

A European clothing store conducted a benchmarking survey of its international supply operations to see whether it could cut costs. It emerged that a buyer in South-east Asia was consistently paying more than the competition for similar goods. The man was trusted and had been working for the company for more than a decade. However, investigations showed that he had been receiving kickbacks from local factory owners. The suppliers had passed on the price of these extra 'commissions' in the form of higher prices.

The buyer had apparently been performing successfully, so no one thought that it might be necessary to take a closer look at his business practices. That proved to be a mistake.

Experience shows that it is particularly important to conduct a thorough review when taking over an existing commercial operation from another company with a different corporate culture. There may be hidden lapses that are unacceptable to the new owners. Many of the recent FCPA cases in the US – for example the cases involving ABB's Vetco Gray group of companies – came to light in the course of management reviews in connection with proposed takeovers.

Hotlines

Communication works both ways. Employees should be encouraged to report ethical problems, or seek help, when needed. In the first instance, whistleblowers – employees concerned about possible ethical violations – should report problems to their managers, but they will naturally hesitate if they believe that their manager's own integrity is open to question.

Best practice is therefore to offer alternative lines of communication to designated individuals outside normal line-management structure. These may be in the human resources, legal or ethics departments. An alternative is to create a company ombudsman or equivalent, or to outsource the hotline to external service providers (Control Risks provides a compliance line service).

Employees should be encouraged to identify themselves when they raise a concern but, if necessary, should have the right to remain anonymous. There should be different means of

communication – such as telephones (typically a free number), emails or letters to a PO Box. The Canadian petroleum company Nexen advertises its toll-free ‘integrity hotline’ in the top right-hand corner of every page on its website (www.nexeninc.com).

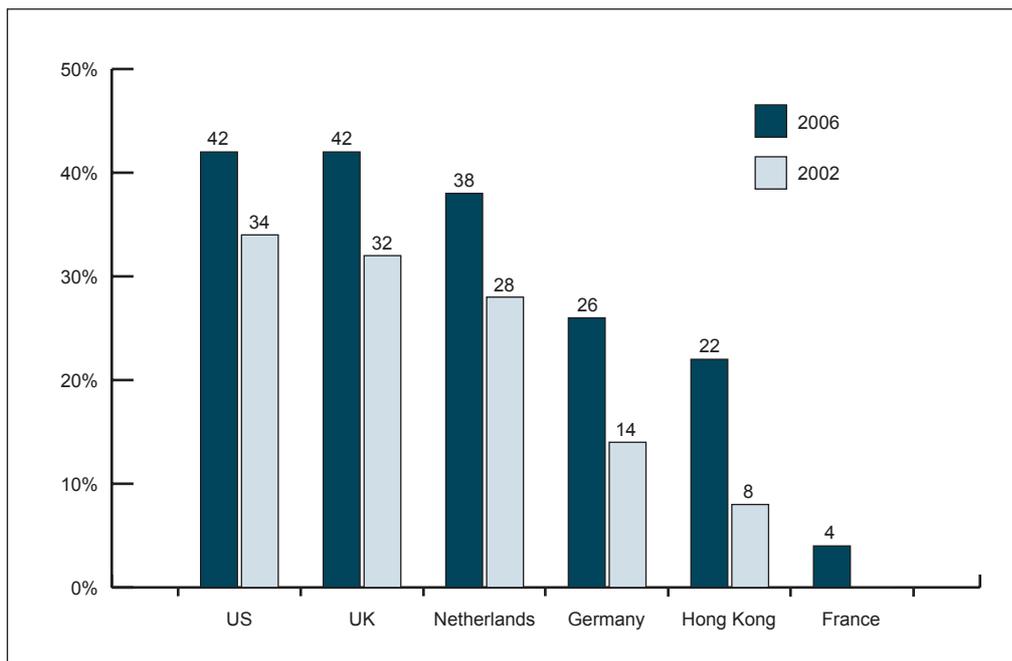
When considering introducing a hotline, many senior managers express concern that malicious employees will use it to denounce colleagues whom they happen to dislike. This does happen, but relatively infrequently. Companies with hotlines report that the advantages greatly outweigh the disadvantages: information from the hotline often makes it possible to address problems that they might not hear about by other means until it is too late.

The most important challenge is to win the confidence of employees. Best practice guidelines include the following:

- **Confidentiality.** All calls must be confidential. Companies differ on whether they accept anonymous calls or enquiries. Most do, and they give callers code words to allow them to ring and find out how their concerns have been addressed.
- **Take all calls seriously.** The company guarantees that it will follow up all calls, even on the most sensitive – or apparently improbable – complaints.
- **Use outsiders where possible.** The people manning the hotlines should stand outside the main management structure. Many companies now use external organisations to run their hotlines.
- **Take prompt action.** If you do not respond quickly and appropriately, callers with legitimate concerns may be tempted to try different approaches – such as contacting the press.
- **No penalties for honest callers.** Companies guarantee that there will be no penalties against employees who report genuine concerns that turn out to be mistaken.
- **Internal reporting.** Under Sarbanes-Oxley law covering companies listed in the US, any hotline complaints involving financial issues must be reported to the chair of the audit committee.

The *International business attitudes to corruption* survey shows that since 2002 there has been an increase in the proportion of companies that have introduced hotlines. The practice is most widespread in the US and the UK, followed by the Netherlands, though it is still much less common in other parts of continental Europe.

Companies with confidential hotlines to report suspected cases of corruption to senior management. By country.



The requirements of the US Sarbanes-Oxley Act on corporate governance, which – like the FCPA – apply to all companies listed on US stock exchanges, have been among the main factors contributing to the spread of hotlines. However, international companies need to take account of local laws and cultural sensitivities when introducing hotlines. In Germany, it is important to consult the company's Works Council (*Betriebsrat*) before doing so.

In France, international companies wishing to introduce ethics hotlines need to ensure that their plans are acceptable to the Commission Nationale de l'Informatique et des Libertés (CNIL), which is responsible for applying France's data protection rules. In November 2005, the CNIL issued guidelines stating that it did not 'in principle' oppose whistleblowing policies, but emphasising that these should be limited to information concerning accounting, auditing and financial matters, and corrupt practices. Whistleblowing policies should not encourage anonymous calls and employees should be aware of their right to access information concerning themselves. French reservations about the ethics of whistleblowing account for the low number of French companies with hotlines in the survey.

The treatment of whistleblowers remains a sensitive topic, though more and more countries are introducing legislation to give them legal protection. Many employees remain reluctant to report malpractice in their work places, partly because they are reluctant to 'betray' their colleagues, but also because they fear that their careers will suffer. In the UK, the Public Interest Disclosure Act 1998 gives statutory protection to genuine whistleblowers. In practice, many find that their careers suffer and a charity, Public Concern at Work (www.pcaw.co.uk), has been set up to look after the interests of such people. Among other services, the organisation provides free and confidential legal help to employees and others concerned about serious malpractice and public dangers in the workplace. The Government Accountability Project (www.whistleblower.org) provides similar services in relation to both government and the private sector in the US.

Responding to problems

The test of a good company is not whether it has problems, but how it responds to them. Statistically, a major company, however strong its ethics culture, is unlikely to escape corruption-related problems indefinitely. Companies will be better able to respond if they plan in advance. The key principles are:

- Follow up all rumours. You cannot afford to ignore any leads.
- Start keeping a detailed record of events as soon as you hear of any allegation.
- Consider whether and when to tell the authorities. The US DoJ and the SEC expect companies to report suspected FCPA violations at an early stage. In recent years there has been an increase in the number of companies who have taken the initiative to report actual or suspected violations: many of the most recent FCPA cases have come to light in this way rather than because the authorities have discovered them independently. There may also be an obligation to report suspected cases under anti-money-laundering rules. However, depending on the specific rules of the jurisdiction concerned, it may not be necessary to inform the authorities immediately if an internal investigation is still under way. Legal advice is essential.
- Consider what to make public and when.

When a suspected corruption case comes to light, a core management team working with internal or external counsel should conduct the initial investigation and draw up a strategy. It is important to limit the number of people involved to reduce the risk of tipping off the offender. The investigating team should give consideration to the following issues:

- The critical need to preserve evidence, e.g. by suspending the company's document destruction policy and securing the computers of individuals who are suspected of involvement in corruption.
- The possible desirability of suspending those employees.
- The risk of third-party claims, e.g. by competitors.

- The ability to maintain confidentiality of documents created during the investigation through legal professional privilege.
- The potential to protect the company's assets by means of court orders freezing corrupt payments.

Since integrity problems can affect share price, it is important to inform the company chairman as soon as a case comes to light. If the case involves significant financial losses or legal penalties, it will also be necessary to disclose it in the company's regular financial reporting.

Policies differ on whether it is essential to inform the chairman of all cases, or only those that involve transactions above a certain financial limit. Because of the particular sensitivities of corruption, it is best to err on the side of giving the chairman more rather than less information, and sooner rather than later.

If an employee has been found guilty of corruption, the company will need to take appropriate sanctions. In most cases this means dismissal.

Reporting

Until recently, companies rarely issued public reports on the management of their anti-corruption compliance programmes, but this is beginning to change. Transparency is now considered to be a key component of the wider corporate responsibility agenda, and leading international companies are including reports on anti-corruption measures in their regular corporate responsibility reports.

The Global Reporting Initiative (GRI) promotes reporting on economic, environmental and social performance with the long-term aspiration of making this as routine as financial reporting. Approximately 1,000 organisations from 60 countries have signed up to the GRI guidelines. The current 'third generation' (G3) of the GRI's Sustainability Reporting Framework includes recommended reporting disclosures on the percentage and total number of business units analysed for business risks related to corruption; the percentage of employees trained in the organisation's anti-corruption policies and procedures; and actions taken in response to incidents of corruption.

Many companies are reluctant to publicise details of corruption incidents in which they are involved for fear of damaging their reputation. This is understandable, but probably mistaken. It is more impressive to learn that a company has faced up to a problem and dealt with it. Royal Dutch Shell has for several years published details of the number of people that it has dismissed for corruption-related offences in its annual reports.

The GRI and the UN Global Compact have recently published a booklet called *Making the connection*, which links the GRI's reporting guidelines with the principles of the UN Global Compact, including transparency.

Regular review

The international anti-corruption agenda is still evolving, and companies are constantly learning new lessons about what works and what does not work. As with other aspects of good management practice, anti-corruption strategies should be reviewed regularly with a view to further improvement.

Case study: Business integrity management in Novozymes

In 2004 the Danish company Novozymes, which is the biotech-based world leader in enzymes and micro-organisms, began a year-long process to devise a revised set of business integrity measures. The company's Sustainable Development Strategy Group led the process, but from the outset worked with a cross-functional working group including employees from legal affairs, finance, and marketing and business development. The team began with a benchmark study of existing business integrity

measures of key customers and competitors, and held a series of hearings seeking feedback from functional management groups across the company.

Novozymes' new business integrity management system is based on three pillars that provide employees with means of seeking guidance on business integrity; anonymously raising concerns about potential breaches of the company's integrity principles; and reporting facilitation payments paid and excessive gifts given and received. The Committee on Business Integrity, consisting of the vice-president of finance, the vice-president of marketing and business development, and the general counsel, supervise the system.

Before launching the business integrity measures, the company published news articles in its annual report, its shareholder magazine and its external website (www.novozymes.com). It has also established a particular intranet site on business integrity with easy-to-read information for all employees. At the end of 2005, the company planned a further series of initiatives including informing business partners about Novozymes' integrity measures, and encouraging them to adopt similar measures; developing a booklet to be handed out to all employees; integrating business integrity into internal training courses; and carrying out specific training on business integrity for selected employee groups in particular regions. It regards all these initiatives as 'work in progress'.

Source: Michael Hougaard Pedersen. 2006. 'Translating global values into local practice: Business integrity management in Novozymes' in *Business Against Corruption*, pp. 51-60 (New York: UN Global Compact. www.unglobalcompact.org).

Broadening the agenda: collective anti-corruption initiatives

One of the constant refrains of the anti-corruption debate is fear of competition. If individual companies accept and implement higher standards, surely they will lose out to unscrupulous rivals.

A partial solution is the promotion of collective initiatives whereby leading companies in the same industry draw up common standards. Voluntary initiatives arguably have less force than legal regulation, but once a company has signed it will face considerable peer pressure to conform. The process of drawing up a collective standard is valuable in itself because it provides a useful forum for the sharing of best practice. The following are examples of current initiatives: all are subject to review and further improvement.

Anti-corruption Forum

The Anti-corruption Forum (ACF) is a UK-based alliance of companies and membership organisations concerned with construction and engineering. Associated groups include the Association for Consultancy and Engineering (ACE), British Expertise, the Institution of Civil Engineers, the Institution of Structural Engineers, the Chartered Institute of Building and Transparency International (UK). The ACF was launched in 2005 with a view to creating a broad alliance of companies, professional associations, project owners and government agencies.

China Business Leaders Forum (CBLF)

The China Business Leaders Forum was initiated in 2004 by the London-based International Business Leaders Forum (IBLF) in association with Beijing's Renmin University. It provides a meeting place where Chinese business leaders and representatives of international companies can exchange ideas and recommendations for best practice on issues such as governance, transparency, tendering and procurement and improving joint-venture relationships.

Convention on Business Integrity – Nigeria

The Convention on Business Integrity (CBI – www.theconvention.org) was set up in 1997 by business leaders in Nigeria. Signatories are invited to commit themselves to a set of principles and practical standards to combat corruption. CBI members include a range of local and international companies.

Defense Industry Initiative on Business Ethics and Conduct (DII)

The DII was founded in the US in 1986 following a critical assessment of industry practices by the Presidential Blue Ribbon Commission on Procurement. The DII is a voluntary initiative run by a steering committee of senior defence industry executives. Its 70 members include all the leading contractors working with the US Department of Defense and together account for the bulk of the prime contracts awarded by the department.

DII signatories undertake to adopt integrity measures including: a written code of conduct; a regular training programme; the provision of a hotline/helpline; procedures for voluntary disclosure of federal procurement laws; and participation in best practice forums. The DII's annual report, which is available on its website (www.dii.org), includes a survey of integrity practices adopted by its members.

Extractive Industries Transparency Initiative (EITI)

The Extractive Industries Transparency Initiative (EITI – www.eitransparency.org) is a multi-stakeholder initiative involving governments, companies, civil society organisations and investment companies. Its mandate is to promote public reporting – and thus greater levels of accountability – of government revenues from the petroleum and mining industries. The principle is that companies should 'publish what they pay' to governments, thus making it easier for citizens to hold their own administrations accountable for what happens to the revenue. Some 20 countries have signed up to the EITI.

International Federation of Consulting Engineers (FIDIC)

FIDIC is based in Lausanne (Switzerland). It was founded in 1913 and has members in 60 countries. FIDIC promotes high ethical and professional standards through meetings, conferences and publications. All members are expected to abide by FIDIC's code of ethics, which is published on the organisation's website (www.fidic.org) and includes anti-bribery statements.

FIDIC has developed a set of guidelines for a Business Integrity Management System (BIMS) for consulting engineers. They draw on emerging best practice, including the need for a code of conduct, the involvement of middle management, auditing and monitoring. BIMS emphasises the importance of evaluating company systems and processes. Its products include a Model Representative Agreement for the appointment of agents.

Wolfsberg Principles

In 2000 an initial group of 11 – now 12 – international banks met in Wolfsberg (Switzerland) to sign an agreement on best practice to prevent money-laundering. The meeting was facilitated by TI, which worked with two international experts, Stanley Morris and Professor Mark Pieth of Basle University.

The principles cover issues such as client acceptance, the need to 'know your customer', due diligence and high-risk countries. Signatory banks agreed on procedures for identifying suspicious activities and reporting them to the authorities. None of these procedures is revolutionary, but the fact that leading banks are working together on money-laundering sends a powerful signal of their commitment.

UK Defence Industry Anti-corruption Forum

The UK Defence Industry Anti-corruption Forum includes representatives from the UK's leading defence companies and defence-sector trade associations. It was set up in May 2006 to promote the prevention of bribery and corruption in the international defence market.

Resources

Business for Social Responsibility – www.bsr.org. US-based membership-based organisation providing advice on all aspects of corporate social responsibility, business ethics. 'Issue briefs' available online include one on best practice in combating corruption and bribery.

China Business Leaders Forum – www.cblf.org.cn.

Convention on Business Integrity (CBI) – www.theconvention.org

Ethics Resource Center – www.ethics.org. US-based not-for-profit. Regular publications include a biennial National Business Ethics Survey.

Government Accountability Project – www.whistleblower.org. A US-based not-for-profit promoting government and corporate accountability with a particular focus on whistleblowing.

Global Reporting Initiative – www.globalreporting.org. Promotes a Sustainability Reporting Framework, the latest version of which includes reporting procedure on transparency/anti-corruption practices.

International Business Leaders' Forum. 2005. *Business against Corruption. A Framework for Action*. This is a 31-page summary document on commercial best practice, co-published with the UN Global Compact and Transparency International. Available on: www.iblf.org.

International Chamber of Commerce – www.iccwbo.org. The ICC's publications include: Vincke, François & Heimann, Fritz (eds) 2003. *Fighting corruption. A corporate practices manual* (2nd ed). Available for purchase online.

International Federation of Consulting Engineers (FIDIC) – www.fidic.com

Royal Dutch Shell – www.shell.com

Public Concern at Work (PCAW) – www.pcaw.co.uk. PCAW is a UK-based not-for-profit organisation specialising in policy advice to individuals, companies and governments.

Transparency International 2005. *Business principles for countering bribery*: TI six step process. A practical guide for companies implementing anti-bribery policies and programmes. Available on: www.transparency.org

UN Global Compact. 2006. *Business against corruption*. Case studies and examples. New York.. Includes chapters giving practical examples of both policy development and implementation. Available on www.unglobalcompact.org

Wolfsberg Principles – www.wolfsberg-principles.com

Chapter five: Honest competition in difficult environments

On the final day of negotiations, the minister took our representative for a drive round the national capital. While pointing out the sights, he congratulated our colleague on winning the contract – and asked what benefits he (the minister) and his family would receive. Our negotiator was unable to give a ‘satisfactory’ reply. Our competitors won the contract instead of us, and we can only assume that they paid. What should we have done?
Unsuccessful competitor in Central Asia.

The anti-corruption policies and programmes outlined in chapters three and four are essential, but they are not sufficient to win business on their own. Companies need to develop proactive strategies to win contracts honestly, even in environments where corrupt ministers and officials are commonplace. By the time the minister makes his demand – as in the story above – it may be too late.

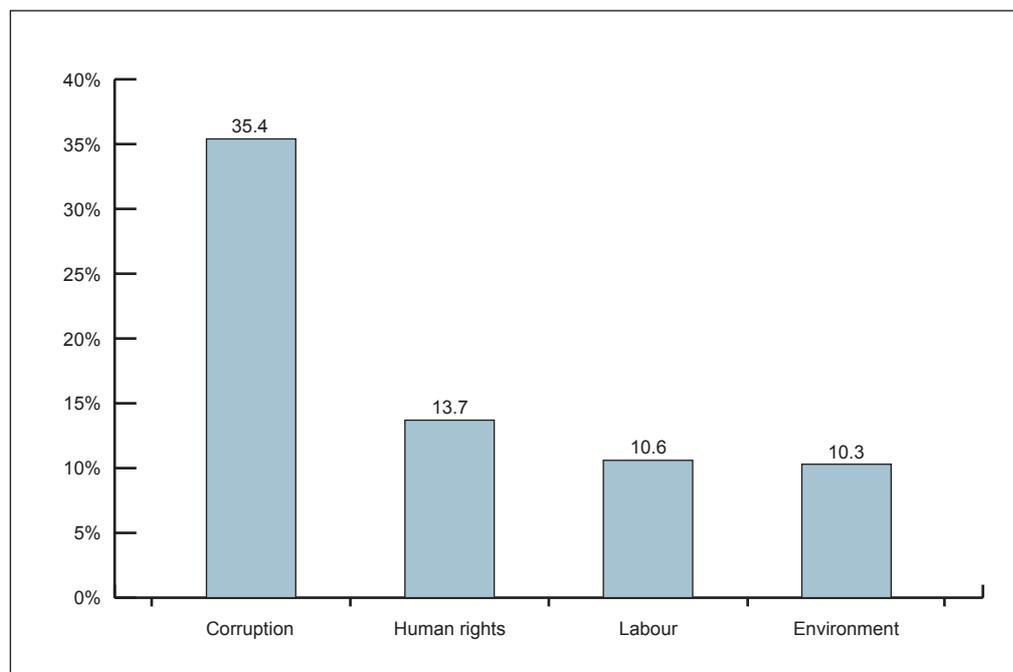
This chapter outlines proven strategies for resisting corruption in difficult environments, but there are no foolproof formulae. Every honest move has at least one dishonest countermove, and good intentions are all too easily subverted. Success demands determination, knowledge and a certain well-intentioned cunning.

Anticipating risks

The investment decision

The first question is whether to go ahead with the investment at all. More than 35% of companies in the *International business attitudes to corruption survey* had been deterred from an otherwise attractive investment because of the host country’s reputation for corruption. By contrast, less than half as many had been deterred by the potential for controversy over each of the other issues cited in the survey – human rights, labour and the environment. This may be because it is easier to address those concerns through good management practices, and because corruption is more likely to have a direct financial impact.

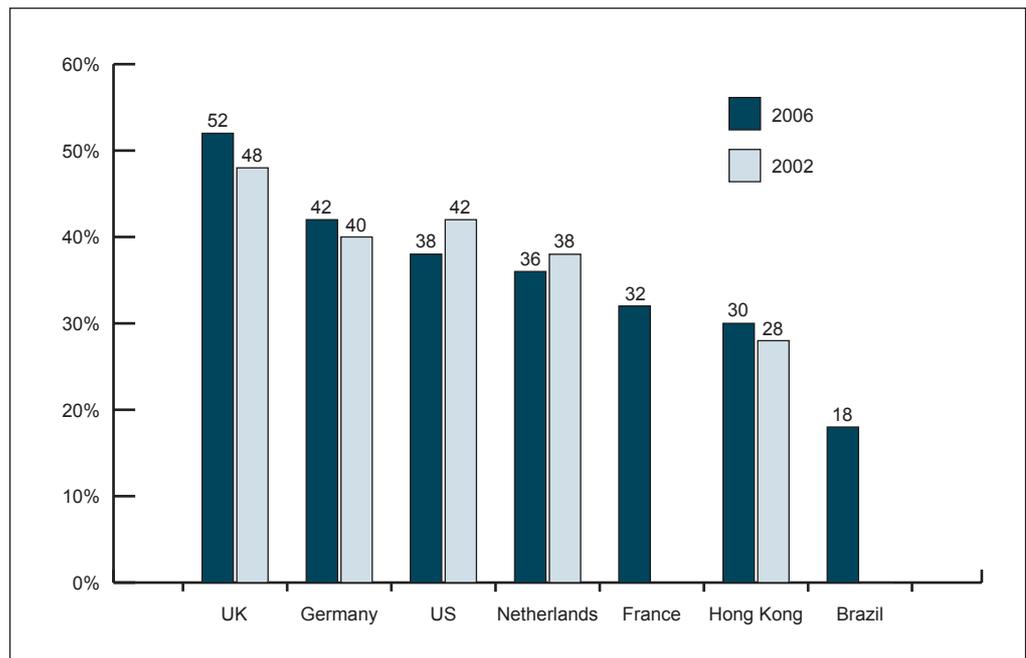
Companies deterred from an otherwise attractive business opportunity because of a country’s reputation for controversy. By issue.



Both the 2006 and 2002 surveys showed a clear hierarchy in the nationalities of companies likely to be deterred. In both years, approximately half of the British companies interviewed had been put off otherwise attractive investments because of concerns about corruption, followed by Germany, the US and the Netherlands. French companies are significantly less likely to be put off by corruption risks. Hong Kong and Brazilian companies are the least likely

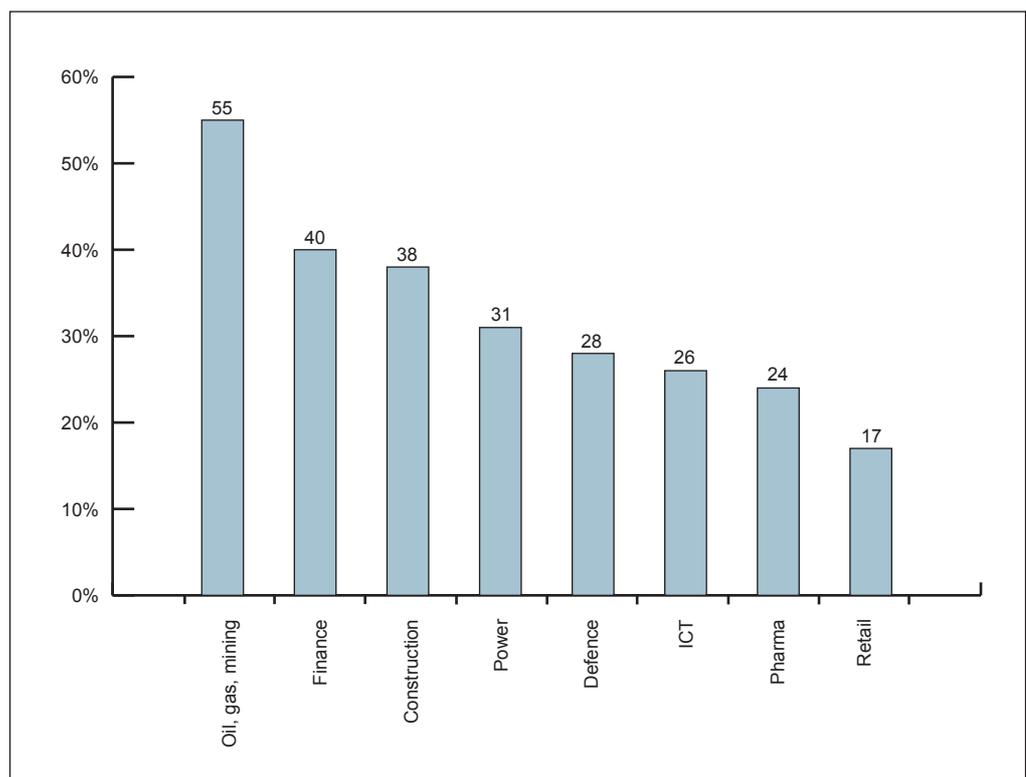
to be deterred, perhaps in part because they have a narrower range of choices in their geographical regions.

Companies deterred from an otherwise attractive business opportunity because of a country's reputation for corruption. By country.



A similar hierarchy applies in the responses of the different sectors. Oil, gas and mining and construction are in the top three because – as noted above – the risks are highest in those sectors. Finance's high ranking may derive in part from strict anti-money-laundering regulations. The sector breakdown was similar in 2002, with the same three industries ranking high in both years.

Companies deterred by high levels of corruption. By sector.



If good companies avoid investing because of concerns about corruption, host countries also lose out: the investors that they attract are likely to have lower standards, both of integrity and of professional competence. Reputation matters in another respect. When companies from emerging economies enter the international market, they find it harder to win the trust of partner companies.

As one Brazilian company put it:

An increasing risk to our business is that every time we try to meet and work with a partner, they think we are criminals. We are a high quality pharmaceutical business but still this very poor image exists.

Another Brazilian company reported difficulties in raising international finance:

...we tried to get finance from a non-Brazilian bank for a project last year. It proved impossible to do it because no one would trust us. They said all the time 'you have no record'. In the end we had to go through the normal process of using a Brazilian bank and they wanted the 'usual consideration' to process the finance.

This report argues that it is possible to operate honestly and successfully even in some of the most difficult environments. However, for this to happen, companies need to make a significant investment in management time in assessing risks, and in managing and responding to problems.

Assessing power and influence

If you do decide to invest, the next step is to begin mapping out the specific risks to your operation. Regardless of the size of your company, it is important to be prepared for local conditions, and many of the central questions are political: Who has decision-making power over your project? Who will influence their decisions? What criteria will they take into account?

In well regulated countries, the criteria are clear and transparent, and there is an efficient procedure for deciding who gets what business and why. At the opposite extreme are societies where decision-making is capricious and largely dependent on the personal whims of individuals and their relationships with the main power centres.

Most developing and transition economies lie somewhere between these two extremes. There are laws, regulations and procedures, but these are not always followed and arbitrary personal influence may be decisive. Companies will need to find out in advance how the system really works, who decides and whether it is possible to influence them honestly.

Preparing your people

The third question is who to choose to lead your local business and how to prepare them. One obvious possibility is to employ local nationals. In that case it is essential to ensure that they understand your company's culture and the integrity standards it expects (see chapters three and four).

If you are employing expatriates, you will need to select the best and most motivated people, not the ones who are most easily spared. In addition to standard anti-corruption training, they will need to be briefed on local conditions. This includes training in cultural expectations and – preferably – language. They must also understand what they may and may not do, and where to turn for help.

When arriving for the first time in unfamiliar and potentially threatening surroundings, novice expatriates may make inappropriate decisions, such as paying a bribe to the first junior official who demands one. A Central Asian geologist, who used to work for an international mining company, gives his view of such people:

Many foreigners come to our country expecting it to be corrupt. As a result they readily pay bribes, even if this is in fact unnecessary. We think that they are stupid.

He added that an expatriate employer had once asked him to carry a bribe to an official. He resented being put in this position and, since he was about to leave for foreign study, decided to resign early. Even in the most difficult environments, it is both wrong and counterproductive to assume that everyone is dishonest.

Routine transactions with officials

The need for advance preparation is as important in minor transactions as it is in high-level negotiations. If a company establishes a reputation for integrity in its day-to-day behaviour, it will find it easier to resist bribery demands in major deals. The basic principles are:

- Find out in advance what the rules are.
- Treat officials with politeness and respect, even if they are apparently breaking the rules.
- Exercise patient determination.

Many international companies still tolerate 'sweeteners' or 'facilitation payments' to speed up routine transactions (see chapter three). Whether this is company policy or not, it is still better to resist demands for illicit payments wherever possible. At the same time, it is important to recognise that, even at a petty level, some demands may amount to a form of extortion. In that case, companies will need to find ways of working round the problem or, in the worst case, taking remedial action after the event.

One-off transactions

An example of a one-off transaction might be an isolated visit to a country or a region where your company does not yet operate. You have not previously encountered the official you meet, and you are not likely to see him again.

At a minimum, you should research any special requirements and make sure that your papers are genuinely in order. Are you travelling on a tourist visa for business purposes? Are there any special regulations about carrying computers into the country? Are there any particular health regulations? Do local officials have a reputation for obstruction? Are there any special tips on how to behave? In Mexico, it is common practice to carry photocopies of your papers for fear of loss or theft. There have been cases where officials take the originals into their offices and refuse to return them.

Many demands are opportunistic. The official thinks that you look vulnerable and inexperienced. He decides to try a little pressure, perhaps by falsely claiming that your papers are not in order. Often such approaches can be shrugged off by polite assertiveness, perhaps tempered with a certain, carefully judged humour. An international consultant working in South-east Asia gives an example from her own experience:

I had a three-day visa to a neighbouring country, and the flight was delayed by five hours. By the time I got to the gate, I had been in the country for three days and three hours. Apparently choosing a figure at random, the official suggested that I needed to pay \$100 for the 'overstay'. I just said in a loud voice, 'So I need to pay you \$100 direct?' Embarrassed, the official promptly changed his mind. In such circumstances it is best to stick to your guns without being combative or nervous.

In parts of East Africa, immigration officials are said to deliberately fail to stamp passports when visitors enter the country so that they or their colleagues have an excuse to create trouble – and demand a 'fine' – when the time comes to leave. The lesson is obvious: check your passport and avoid putting yourself at risk.

Regular transactions

It is all the more important to establish the 'rules of the game' when conducting transactions that are likely to be repeated frequently. Examples include importing goods through customs or dealing with tax officials. You should expect your resolve to be tested the first time. If you compromise once, it will be much harder to resist on subsequent occasions.

An expatriate manager in Russia cites an example of potential problems, and the investment in time needed to deal them:

I needed a visa for a visiting colleague. My secretary explained that it would of course be necessary to make an additional payment in addition to the prescribed fee, otherwise, the visa could be delayed for weeks. I refused to pay, and it did indeed take a couple of weeks to obtain the visa. The next time I made a similar application, the papers were processed much more quickly. On subsequent occasions, they were processed straightaway, without extra charge. If I had paid the first time, I would have had to go on paying indefinitely.

Also in Russia, company managers emphasise the importance of finding out in advance what the official needs to do his job. Tax regulations are complex and obscure, but however unreasonable they may be, the tax inspector will need certain information to do his job. You can minimise problems by seeking out this information before he asks for it. It helps to treat him with respect by ensuring that he has a comfortable office to sit in during his inspection, and providing him with coffee or tea.

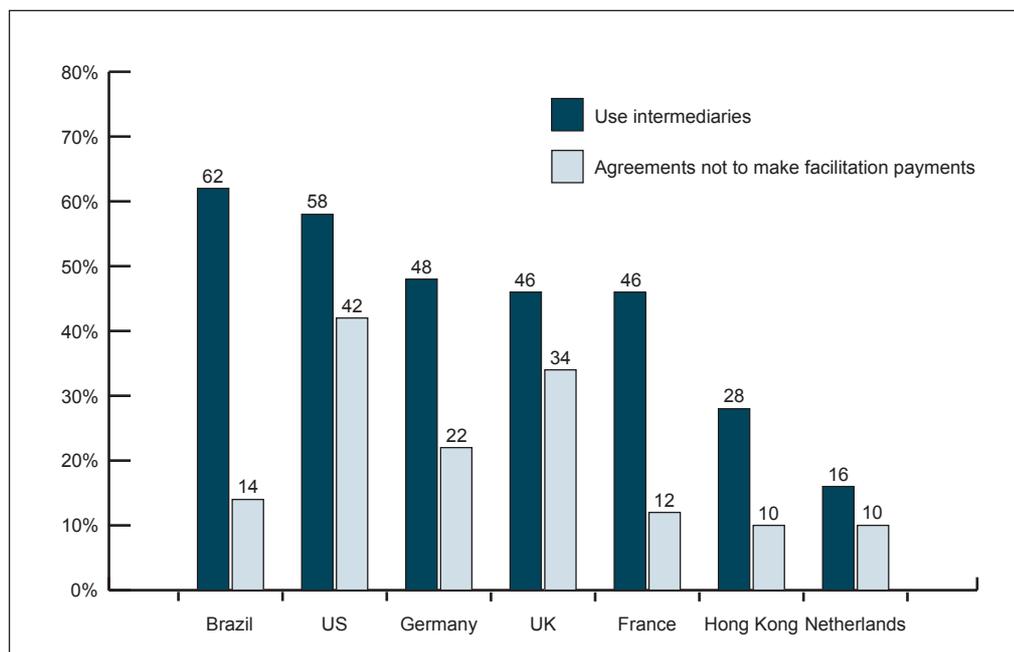
Where possible, it is useful to take the initiative to establish a personal – but professional – relationship with senior officials as a matter of routine. In India or Pakistan, it is good manners to make a courtesy call on the superintendent of police or the development commissioner when launching a significant commercial operation in a new area. It is tactful to invite such officials to opening ceremonies and other company functions. If you have established contact with them in advance, it is easier to call on their help when needed.

A Japanese expatriate with long experience of working in China has adopted a similar approach:

It is unnecessary to pay bribes or facilitation payments. Over the years I have conducted a number of negotiations, for example for licences or building permits. A lot depends on one's personal behaviour. I make a point of treating officials with respect, and getting to know them personally. Sometimes it is necessary to be persistent, and over the years I have spent a substantial proportion of my time dealing with officials, but I always get what I want eventually.

In many parts of the world it is common to employ intermediaries who, for a set fee, will help to speed up bureaucratic transactions, for example customs clearances and visa applications.

Companies that employ specialist firms to help process routine transactions (such as visas and customs clearances) and have formal agreements that they will not make facilitation payments on the employer's behalf. By country.



Our survey showed that such practices were particularly common among Brazilian companies. In Brazil, *despachantes* often help to arrange visas and customs clearances. They advertise their services openly and, in principle, their services are entirely legal.

Such fixers are often efficient, and they enable the company to distance itself from transactions that might lead to demands for bribes or facilitation payments. However, as with other varieties of middleman (see below and chapter three), it is important to ensure that you pay an appropriate fee for professional services rather than an extra-large amount that might be construed as a slush-fund for bribes. The survey showed that US and, to a lesser extent, British companies often had formal agreements that these kinds of intermediaries would not pay bribes on their behalf.

New technology may remove at least some of the occasions for bribery demands. In many countries, it has been notoriously difficult to have a phone line connected without paying an extra fee. Now the solution is becoming much simpler: you buy a mobile phone. A similar point applies to customs. New technology makes it possible to automate many routine transactions, thus removing the discretionary power of individual officers. However, introducing and applying such technology requires political will. Officials resent interference with what they regard as their privileges by right.

Extortion

Even apparently routine transactions may be accompanied by demands for extra payments that amount to a form of extortion.

One regular business traveller tells of arriving at a West African airport to be told that all foreigners needed to take an AIDS test. The white-coated official produced a syringe with a rusty needle to take a blood sample. The alternative was to pay a fee of \$10. Putting aside his principles, the traveller paid.

Also in West Africa, a local businessman was importing a car from the UK. By the time he had completed all the formalities, the gates to the customs compound had closed for the night. He was told that he was welcome to leave the car where it was, but the following morning it might not have any wheels or windscreen wipers. He decided to pay the guards, adding that he might have made a different choice if the car had belonged to his company, which has a strong anti-bribery policy.

In East Africa, an expatriate tells of her experience during an emergency visit to a rural hospital. The doctor told her husband that he would have to pay for certain medicines, and even to find a free bed, even though these services were supposed to be provided by the government. The nurses behaved in the same way. The husband believed that his wife was in serious danger; he was angry, but he paid whatever he had to.

Individuals often have to make this kind of decision on the spot, without any chance of outside consultation, and there may be limited room for manoeuvre. From the company's point of view, the most important thing is to know that such extortion is taking place, and to take steps to avoid it in future, even on small-scale transactions. Even if the company formally forbids facilitation payments, employees should be encouraged to report cases where they have had to pay under duress without fear of retribution from the company.

The opportunities for remedial action will vary from case to case. Larger companies may be in a position to complain to more senior officials. Smaller companies may be able to raise their concerns through chambers of commerce or via their embassies. In the case of a local hospital whose services might be needed in future, one approach might be for a company to contribute to a charitable fund for new equipment. However, it should only do so if it is confident that the money will actually be spent on the equipment and not on the senior surgeon's holiday fund (see below).

Influencing with integrity

Skilful negotiators do not need to resort to bribery as a bargaining tool. The key principles of honest negotiations are:

- *Establish your own integrity standards in advance.* The other side should know what to expect: attempts to solicit a bribe will be rejected.
- *Research.* Find out who you are dealing with, what motivates them and what they really need.
- *Build alliances.* Avoid depending on a single source of political or official support. If you come under pressure, it is easier to defend projects that satisfy a variety of different interests.

The objective is a 'win-win' solution that is publicly accepted and can stand up to independent scrutiny. Many of the 'alternatives' to bribery raise ethical problems of their own and will backfire on companies that resort to them.

Communicating your position

Companies are judged by what they say, what they do and what they have to offer. 'What they say' includes company codes, which should be translated into the local language; US companies sometimes go a step further by distributing local-language renderings of the FCPA in addition to their codes. 'What they do' includes their employees' reactions to petty demands, which is why it is desirable to reject facilitation payments from the outset. 'What they have to offer' is the business case.

The business case is central. If your company has a worthwhile project, then people should know about it. This will require an effective communications strategy at every stage. This may include advertisements, press interviews and, depending on the nature of the project, meetings to brief key officials and community leaders.

Business partners and intermediaries

Companies operating in unfamiliar environments need advice on potential bureaucratic and cultural obstacles. They may not know how to contact key decision-makers, and they want to know what to do when there are difficulties.

Among the sources of such advice are agents, consultants and joint-venture partners. Well-chosen, honest advice will help companies avoid corruption, but – as discussed in chapter three – intermediaries can also be part of the problem. In practice, it is relatively unusual for a minister to seek direct payment, but not at all unusual for him to seek some arrangement via a middleman. The key principles when employing intermediaries are:

- Find out about their personal backgrounds, reputation and connections. Do they have the connections and knowledge that they claim? Do they have connections with organised crime or other unsavoury bodies?
- Ensure that they are aware of your integrity standards and abide by them when acting on your behalf.
- Manage the relationship so that you control people and organisations acting on your behalf, not the other way around.

Both the FCPA and the OECD make clear that companies are responsible both for direct bribes and payments made by intermediaries. US legal practice insists that ignorance of the middleman's behaviour is no defence, and prosecutors in other jurisdictions are increasingly likely to take a similar view.

Informal connections

The use of contacts is legitimate and even essential in a world where social and commercial success is said to be linked to the weight of one's address book, or the number of gigabytes in one's personal organiser. It is much easier to make the first phone call to an important official or potential business partner if you can draw on an introduction from a mutual friend.

Such contacts are both useful and acceptable as long as they do not lead to infringements of laws or official regulations. Also, favours may incur reciprocal obligations. If you use this route, you need to make clear what you will and will not do in return.

Agents and consultants

As discussed in chapter three, the employment of agents and consultants is a particularly sensitive issue because of the possibility – and all too frequent reality – that they may be used as conduits for bribes. It is therefore all the more important to ensure that your company employs the right agents. This requires appropriate vetting procedures, legal agreements to make clear that the agents are not entitled to pay bribes on behalf of their clients, and a commitment on both sides to manage the relationship in accordance with integrity principles.

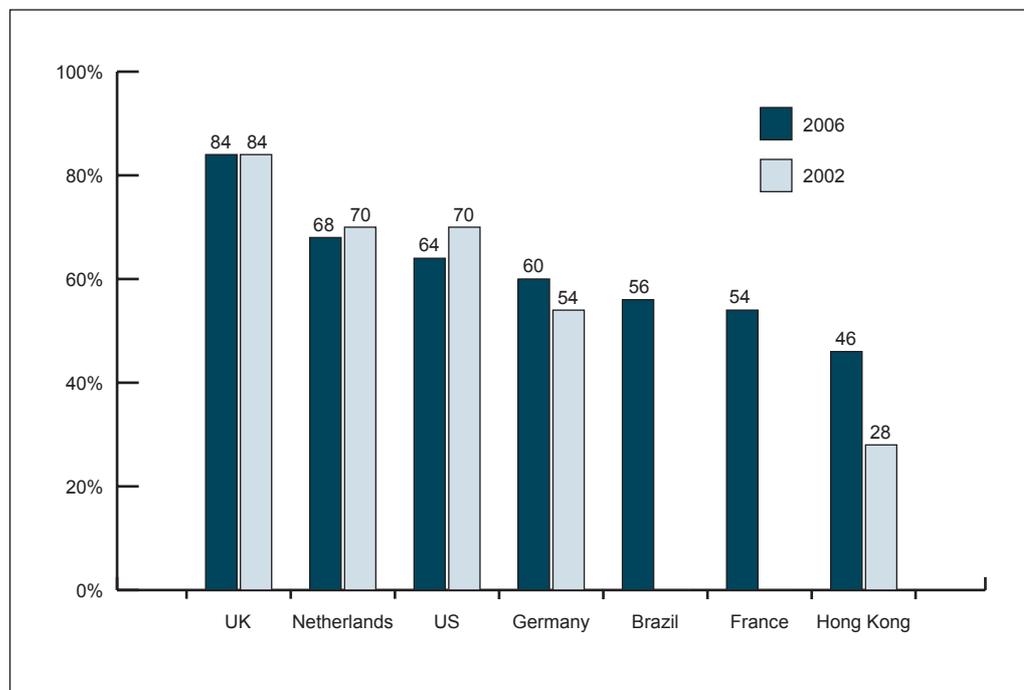
Underlying all these management practices, the basic principle is ‘know your agent’. The following example illustrates the potential hazards of not doing so:

A defence services company operating in the Middle East was approached by a would-be intermediary who claimed to be a close relative of a local ruler. He promised to use his connections to help win a large contract. The company made due diligence enquiries. It established that the would-be agent was indeed a relative of the ruler, but had fallen out with him some years previously. His services would have been useless.

Joint ventures

Similar issues arise when choosing joint-venture partners: are you looking solely at their connections or do they have a technical and commercial track record? What do you know about their past? Might they have links with organised crime? Do they have personal or family links with government officials? The International business attitudes to corruption survey shows that many international companies have instituted formal procedures to vet the integrity of joint venture partners before entering business relationships with them.

Companies with a specific procedure to vet integrity of joint-venture partners before entering a relationship with them. By country.



If the international company chooses a local partner solely on the basis of its political connections, this strategy is likely to backfire. In the short term, the partner may use its connections to assist the company. In the longer term, it may use them to take control over the joint venture altogether and the foreign partner may have little recourse. The following case study from Central Africa provides an example:

A Western company was looking for a joint-venture partner in a project to make and sell office machinery. It selected a prominent local businessman who had no technical expertise but was closely associated with the president. The local partner had the necessary connections and would ensure that the venture was a success. The project was indeed a commercial success, but the original investors did not benefit as they had expected. The local partner used his presidential connections to help him gain majority control over the venture. The foreign investors threatened to go to court, but this was an empty threat in a country where legal disputes last for years, and underpaid judges are notoriously susceptible to financial inducements from people in power.

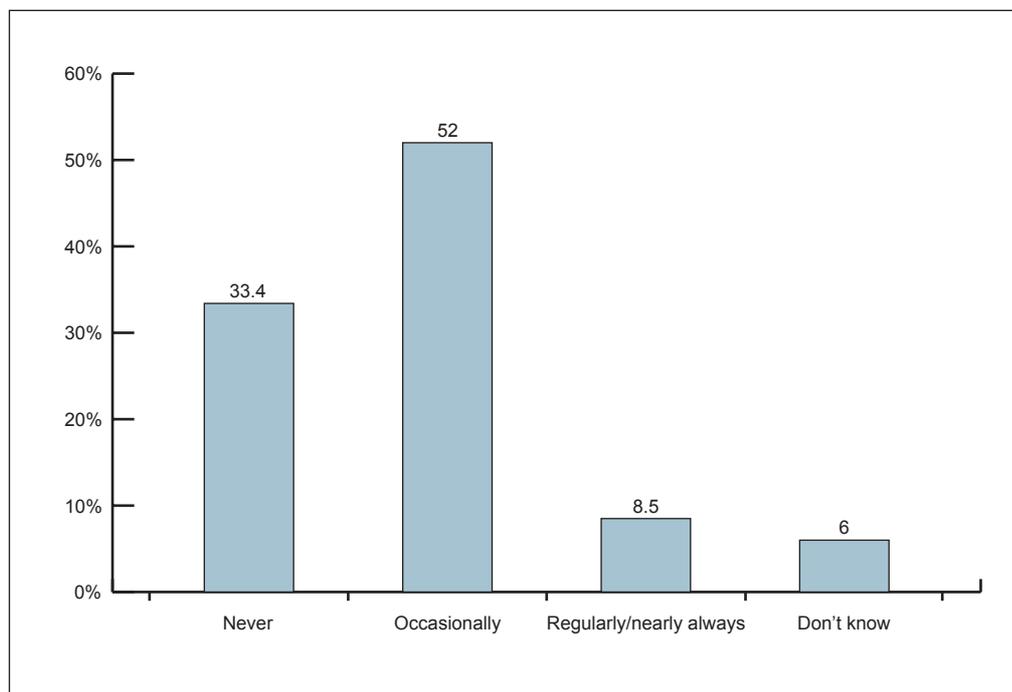
A local partner with less political prominence might have proved a safer ally in the long run.

If the international partner has majority control, it should be in a position to ensure that its own business integrity policies are applied in the joint venture. Partners with minority shares obviously exercise less influence. In such cases it may be difficult to influence integrity policies. Senior management will need to decide whether the joint venture should go ahead.

Suppliers and subcontractors

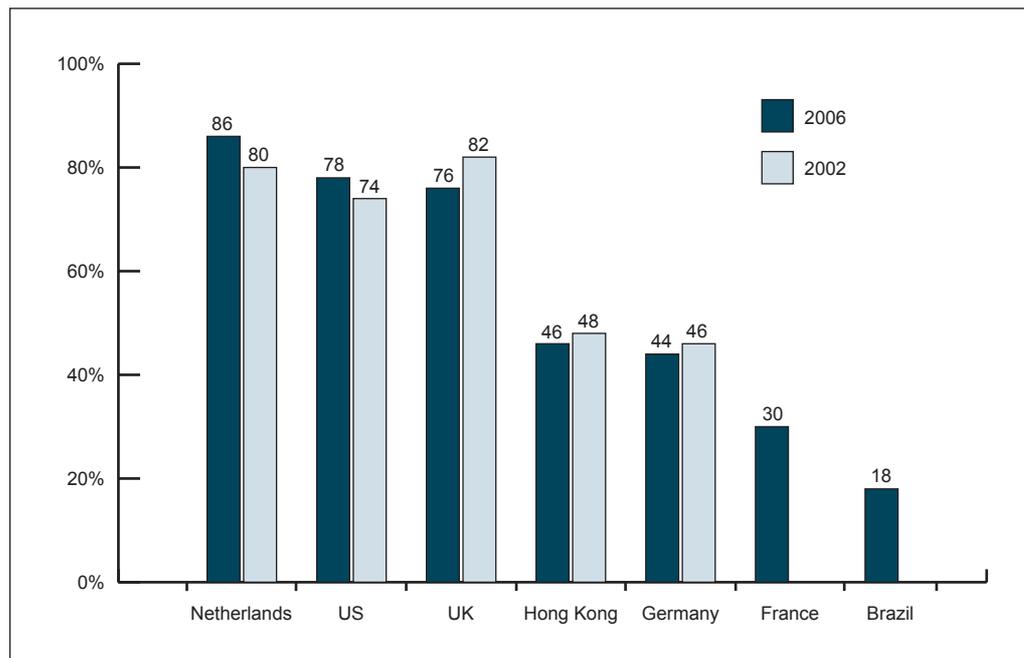
In some cases there may be a temptation to offer contracts to subcontractors and suppliers on the basis of their connections rather than the quality of their service. More than half of the respondents to the International business attitudes to corruption survey thought that companies from their own country employed subcontractors who were related to decision-makers as a means to gain business advantage.

Respondents believing that companies from their country employed sub-contractors connected to decision-makers as a means of gaining business advantage. Average responses from total sample.



Such practices imply a double hazard – the relationship with the company may be seen as a proxy form of bribery, and the suppliers may not deliver the goods. A further potential risk is that suppliers might offer kickbacks to company employees in return for contracts. For all these reasons, it is essential to check the background of potential suppliers before employing them, and to monitor the company's relationship with them as it develops. The survey showed that the majority of Dutch, US and British companies did have procedures to vet the integrity of suppliers, but that such procedures were less common in other jurisdictions.

Companies with a specific procedure to vet integrity of suppliers before entering a relationship with them. By country.



Dealing with politicians and officials

Preparation

Advance research is essential. You will need to know where individuals fit into the political or bureaucratic hierarchy; how much influence they have (are they decision-makers or mere bearers of messages?); and what motivates them. Does your project answer a need that they recognise – for employment, new technology or other benefits? Or is it more likely to be regarded as something optional?

Protocol also is important. If you want to bring people on to your side, you will need to treat them with the respect they think they deserve. That may mean sending a senior director instead of a local representative to conduct the most sensitive negotiations. It is better to avoid meeting officials on your own; it is harder for them to solicit bribes if other witnesses are present.

You will need to be briefed on cultural issues. When the other side nods in apparent agreement, does this indicate genuine assent or simply a polite acknowledgement of what you are saying (in Bulgaria, it means 'no')? If there are lengthy silences, do you need to be alarmed? Are you quite sure that the *karaoke* session is compulsory? Will you cause offence if you politely refuse the tenth glass of whisky? *Karaoke*, with or without whisky, may be a valuable means of establishing personal rapport. Mutual intoxication is often an effective means of building up solidarity, but is rarely considered compulsory.

Appealing to wider interests

The wider public interest is an important part of the business case, even when dealing with individuals who are primarily motivated by personal ambition. Your project may not bring them a direct financial return, but there is often some legitimate way in which they can benefit. The following incident recounted by a businessman in the Philippines illustrates the point:

Soon after our factory got under way, the time came for city elections. The mayor, who had so far been quite helpful, asked us to contribute to his campaign expenses. Such payments are against company policy, but we feared that he might make life difficult if we refused. In the end, we pointed out that our company was bringing employment to his city and that he could claim the credit for attracting investment: this in itself would help his campaign. We didn't pay; he was re-elected, and we are still friends.

Depending on how it was expressed, the mayor's request could have come close to extortion. In this case the company was able to side-step it by pointing to other interests. The fact that the factory provides employment, and no doubt benefits other local business interests, could give the company with useful allies if it ever comes under pressure again.

Foreign companies operating in China and elsewhere in Asia report similar strategies there. Corruption cases involving regional officials remain commonplace. However, companies that make significant investments, and are likely to make a major contribution to tax revenue, are in a strong negotiating position and therefore well placed to resist demands for illicit payments.

Jobs for family members

One way of pleasing your negotiating counterpart is to provide jobs for their relatives or for friends to whom they owe a favour. A European IT specialist working in Central Asia points to the dangers of this approach:

Our company offers jobs to officials' family members, and I can see how dangerous it is. Part of my job is to create internal firewalls so that junior employees do not have access to confidential information. I've had several cases where these people have tried to break through. The company is behaving cynically; it typically expects to get rid of the relatives once the most sensitive negotiations are over, and it is exposing itself to unnecessary risks in the meantime.

The relatives have in effect become a 'Trojan horse' within the company.

It may not be practical or desirable to impose a blanket ban on employees with 'connections', particularly in countries with small educated elites, but the same principles apply to them as to anyone else. They should only be employed on merit and their performance should be tightly managed.

Jobs for subcontractors and suppliers

A variation on the same theme occurs when an official hints that he is prepared to award a contract on the condition that the successful applicant employs a specific subcontractor, perhaps to carry out the construction work for a new factory. The subcontractor just happens to be owned by the official's friends or relatives.

The hazards of giving in to such requests are both practical and legal. If subcontractors are appointed on the basis of connections rather than competence, there is no guarantee that they will perform competently. If there is a dispute they may use their official contacts to defend themselves against their employers and there will be little chance of redress. The legal issue is that employment of the subcontractor may be seen as a proxy bribe to the official, particularly if performance is sub-standard or non-existent.

In practice, the foreign company may not have a wide choice of sub-contractors. At the very least, the employer should make sure that the specifications for the work to be carried out are clearly defined and that the contract is put out to open tender.

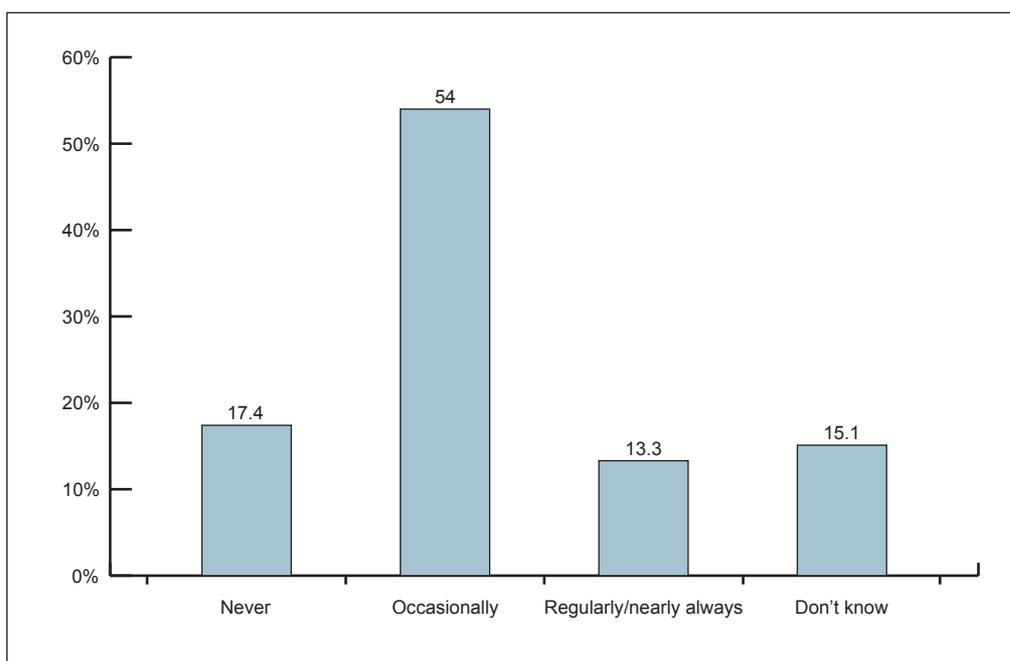
Charities and community relations

The *International business attitudes to corruption* survey suggests that companies frequently use charitable donations as a means of gaining influence.

Experience shows that well-chosen charitable donations can be a useful means of building up popular support and making friends who may be useful in time of need. Donations to hospitals or schools make particular sense if they are likely to be used by company employees. If a company has a good local reputation, it is less likely to receive demands for bribes and may find it easier to negotiate with local officials. However, charitable donations should not be seen as an alternative to bribery. The key principles of good practice are:

- the donation should be public;

Respondents believing that companies from their own country used legal donations to charities favoured by decision-makers to gain business advantage. Average responses from total sample.



- it should fulfil a genuine local need; and
- the organisation that administers it should be well-managed with proper accounts.

A donation to a private charity that is run by the president's wife but that does not keep proper accounts would rightly be seen as a bribe by another name. Two companies' experiences in Pakistan and Colombia illustrate the benefits and potential hazards:

A Western company was drilling for oil in rural Pakistan. Powerful families of landowners still dominate the social hierarchy in that particular region and tend to expect some form of 'tribute'. They have the capacity to create significant obstacles for any company that does not seek their approval. The company found that the landowners appreciated cash, but they also attached considerable importance to status and prestige.

The company appointed selected landowners to the boards of its charitable ventures, such as schools and hospitals, thus responding to their desire for status. It took care to ensure that they were not in a position to exercise financial control over the projects, or to allocate funds to favoured recipients. This approach has helped the company to make friends at different social levels, and to pre-empt demands for bribes or other pressures.

In this case, the company did its research and, by imposing financial and administrative control, helped to ensure that its projects were not open to abuse. In the second example, another Western company – this time operating in Colombia – was less successful:

Company managers tried to pre-empt extortion demands from rural guerrillas in Colombia by building a school for local villagers. The idea was that the villagers would be pleased with the school, and would use their influence with the guerrillas to dissuade them from attacking the company.

The plan backfired because the company found itself dealing with a construction firm that was, in effect, a front for the guerrillas. The construction firm's representatives took the money and the school still has not been built. No one dares complain.

Whatever its intentions, the company's donation has turned into another extortion payment, and there are likely to be further demands.

Finally, it should be noted that a charitable donation that apparently has been made for the sole purpose of gaining political advantage could lead to legal hazards. One example comes from the US, where Schering-Plough Corporation agreed in June 2004 to pay a civil penalty of \$500,000 to the SEC for violating FCPA books-and-record provisions. Schering-Plough had made donations to a *bona fide* charity specialising in the restoration of historic sites in Poland. However, it wrongly recorded these payments as 'medical donations' in its books and records, and the SEC argued that they were intended to influence the director of a Polish health authority who had founded the charity.

Legitimate expenses

The FCPA excludes 'legitimate business expenses' from its definition of bribery. Legitimate expenses could include paying for an official to visit a power station or a mine abroad to give him a better idea of how such a facility would function in his own country. The official may well enjoy a foreign trip, and such visits have a legitimate function. However, as discussed above (see chapter three), companies need to have clear guidelines on the kinds of expenses that are considered acceptable.

The practice of paying expenses is open to abuse when – for example – the official is invited to bring family members with him and they are hosted with extra lavishness. In such cases the trip may be seen as a bribe paid in kind. The company thereby incurs two kinds of risks. First, as with other kinds of bribery, the fact that the company has shown itself willing to bend the rules means that it is likely to face further demands for other favours, licit or illicit. It may also face unwelcome publicity when its generosity comes to the attention of the press. Secondly, at least in the US, the company may face legal action. The Metcalfe & Eddy case (see box) is a test case brought by the US Department of Justice in 1999. The ABB case (see case study in chapter two above), which was settled in 2004, also involved payments to officials visiting the US that were considered to be exorbitant.

The Metcalfe & Eddy case: unacceptable expenses

In December 1999, US company Metcalfe & Eddy agreed to pay a civil penalty of \$400,000 and \$50,000 costs incurred by US government investigators in connection with its activities in Egypt.¹ It also agreed to institute remedial actions, including modifications to its FCPA compliance programme.

Metcalfe & Eddy obtained two contracts, worth a total of \$36m, in connection with the US-funded modernisation of Alexandria's sewage and wastewater facilities between 1994 and 1996. Before the first contract was awarded, the company invited the chairman of the Alexandria General Organisation for Sanitary Drainage (AGOSD) to the US, together with his wife and two children. On the first occasion the chairman was invited to a water conference in Chicago. He also visited Boston, Washington and Orlando, Florida. On the second trip, which was linked to the award of the second contract, the chairman and his family visited Paris (France), Boston and San Diego.

On both occasions the company paid almost all of the family's expenses, and paid to upgrade their air tickets from coach to first class. The US Department of Justice argued that these benefits were meant to persuade the chairman to exert his influence on the company's behalf.

By prosecuting this case, the US authorities wanted to make clear that the FCPA's 'legitimate expenses' exclusion was not intended to be used as an alternative to more conventional forms of bribery.

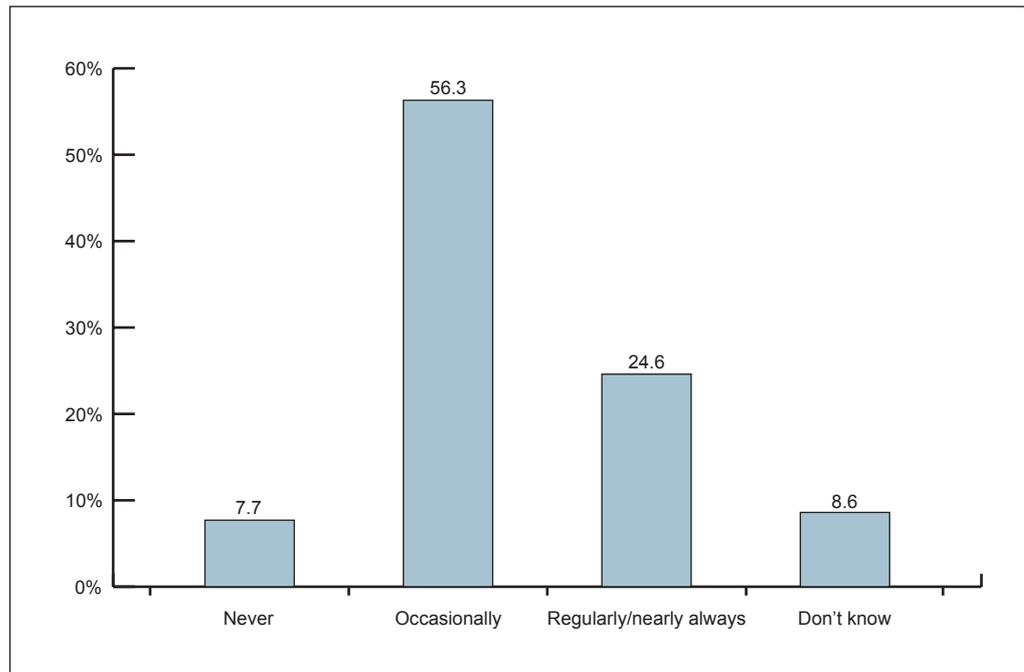
1. 'USAID contractors agrees to pay \$450,000 to resolve Foreign Corrupt Practices Act Allegations', *PR Newswire*, 21 December 1999; *United States of America v. Metcalf & Eddy Inc.* Massachusetts District Court.

Diplomatic support

Embassies

Embassies play a valuable role in helping companies to identify openings in new markets. In many cases, they can help to make introductions both to officials and business partners. They can also warn of potential obstacles, including high levels of bribery. If a company encounters corruption-related problems, the embassy may be able to intercede with senior officials on its behalf. A clear majority of respondents in the International business attitudes to corruption survey thought that companies from their own countries resorted to diplomatic pressure to gain business advantage either 'regularly' or 'occasionally'.

Respondents believing that companies from their own country used diplomatic pressure from home governments to gain business advantage. Average responses from total sample.



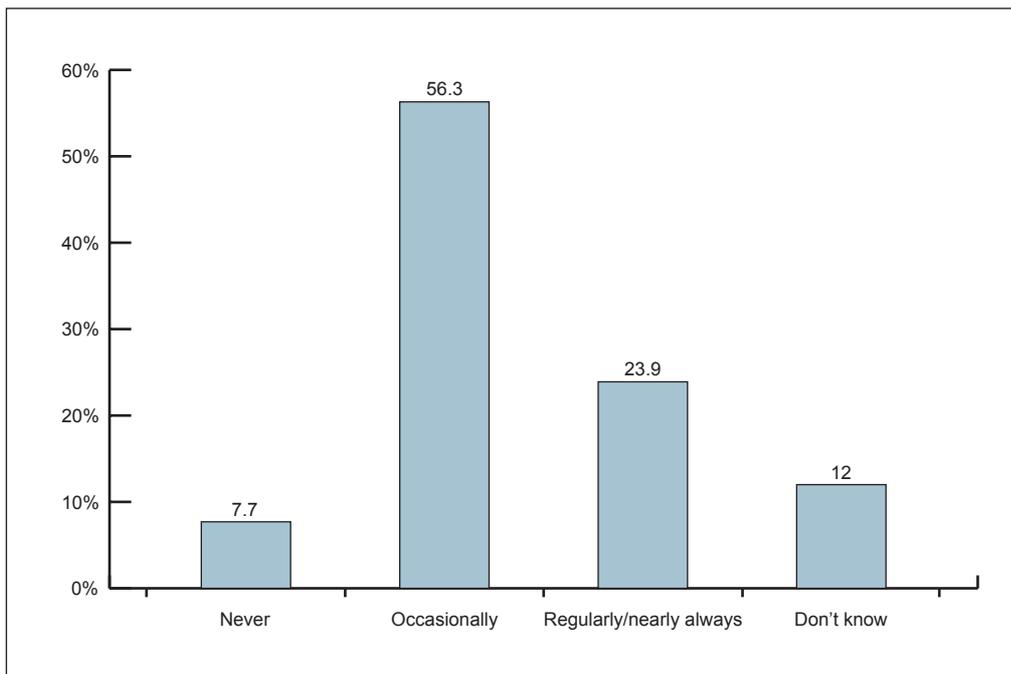
However, like other kinds of influence, diplomatic intercessions need to be carefully judged. One area that has proved controversial is the link between business development and aid. Both Western and Japanese governments have in the past linked development aid to commercial opportunities for their companies. They may do so by offering 'tied aid', where development funds are specifically designated for companies and experts from the donor country. Alternatively, they may offer the prospect of substantial aid grants in return for contracts in another sector.

Such practices have helped companies to win business, and they do not count as corruption in the formal FCPA/OECD sense, but they are controversial. They raise doubts about whether the host country is getting the development assistance that it really needs. From a political risk point of view, inappropriate diplomatic pressure may lay up problems for the future. If a company or project is seen to be 'imposed' on the host country, it will eventually face a backlash.

Multilateral agencies

As noted above, the World Bank and other international agencies have in recent years taken a strong public stance against corruption. Among other measures, the World Bank and its regional counterparts have taken steps to tighten their procurement procedures and threatened to blacklist companies that try to abuse them. Companies that have financing from the World Bank's International Finance Corporation (IFC) or a political risk guarantee from the Multilateral Investment Guarantee Agency (MIGA) will be fully justified in arguing that they simply cannot afford to pay bribes for fear of incurring World Bank penalties. By the same

Respondents believing that companies from their own country used 'tied aid' from home governments to gain business advantage. Average responses from total sample.



token, if abuses take place – for example when a host government official puts pressure on the company to make illicit payments – the banks may be able to use their influence to address any problems.

Procurement

International business people are most likely to encounter large-scale corruption demands when bidding for government contracts to deliver goods or services. There are various ways in which corrupt government officials can rig the procurement process in favour of their beneficiaries.

- They can narrow the technical specifications of the contract to favour one particular company, even though this is not actually necessary.
- They can leak information about competitor bids so that the favoured company is better placed to undercut them.
- They can argue that the goods or services in question are needed urgently, so there is no time for competitive bidding.

At the same time, suppliers may take the initiative by forming 'rings' to fix prices, and this practice has occurred in industrialised countries as well as developing nations.

Counter-measures

The first set of counter-measures is pre-emptive, and involves reviewing past patterns of procurement in the relevant country and sector. Are there any patterns that give rise to suspicion: Do the majority of contracts tend to go to one particular set of companies? Is there a repeated history of companies apparently winning on price, then seeking extra injections of cash once the project is awarded? Is there a history of companies failing to complete projects altogether?

The outcome may influence whether you decide to go ahead with the bid. If there are too many warning signs, it may not be worth the trouble. If you do go ahead, and there is a history of suspected malpractice, you will need to be all the more careful to ensure that your own tendering documents are in order; corrupt officials may be looking for minor irregularities

as an excuse to disqualify you. Similarly, regular marketing and research initiatives become even more important than they would otherwise. Who is ultimately responsible for decision-making? Does the proposed project command wide government and popular support or is it the pet project of an individual?

Many countries are working hard to tighten procurement procedures, often in response to pressure from local NGOs or from development banks. One approach, which has helped increase transparency, is to publish details of the tender, procedures and the outcome on the internet. Such procedures have had positive results in countries as diverse as South Korea and Argentina.

Meanwhile, TI is promoting the idea of 'integrity pacts', whereby all the bidders for a particular project commit themselves to common standards. In principle, the bidders are doing no more than committing themselves to procedures they should be following in any case. Nevertheless, public commitments of this kind can play a useful role.

Facing up to a corrupt competitor

You are hoping to supply technical equipment for a series of projects sponsored by a government ministry. However, you never get past the tender stage. The specifications are written so narrowly that they exclude your product, while favouring a competitor. You suspect that the competitor has paid a bribe to the official who drew up the specifications. And you are losing money all the time.

Few respondents to the *International business attitudes to corruption* survey thought that they could take effective action in cases where a competitor had paid a bribe. By far the largest number of respondents – 41.7% – said that they 'would avoid working again with the same customer and simply look elsewhere in future'. A second common response – 24% in the case of the UK – was 'to make no public complaint, hoping to be more successful next time'.

Several respondents said that they would make informal enquiries to find out what had happened, and some would seek the help of their embassy. A minority said that they would take action as a matter of principle: 8% said that they would seek an explanation from the tendering authority, 4.5% would lodge an appeal and 6.5% would go to law-enforcement authorities. The Dutch (18%) were more likely to go to the authorities, and the French (10%) were more likely to lodge an appeal.

A German respondent commented that there was little point in reporting bribery in high-risk environments where the authorities themselves are corrupt. A Hong Kong respondent spoke for many when he commented that bribery by competitors was just 'part of business'. A US businessman suggested that it was 'best to just accept it [business lost because of bribery] and move on'. Bribery allegations are often based on rumour rather than hard evidence: the perception is that there is little chance of redress.

In practice, quiet diplomacy may be the most effective approach. You are unlikely to reverse an existing contract but may have a better chance next time if you make sure that your concerns are heard at a senior government level, possibly with the backing of your embassy.

Responding to pressure

Companies often complain that large- as well as small-scale corruption functions as a form of extortion, and that they have little option but to pay when they operate in certain markets. As has been seen, this is only partly true. The best-prepared companies are less likely to find themselves in difficulties. Businesses are most vulnerable to pressure if:

- They are inexperienced and poorly prepared.
- They are in a hurry to meet a commercial deadline.
- They are already infringing official regulations in some way.
- Their company has no friends or allies either in high places or in the wider community.

However, no one is immune. The risks typically will be greater for smaller companies than larger ones. Large international companies are likely to have greater influence at the national level and, if corruption is a problem, they can afford to pull out. Smaller companies will be more dependent on individual contracts. Equally, they have more to lose – for example if they choose the wrong joint-venture partner – and may take greater care in the first place.

Many of the management principles are the same as with other kinds of crisis. Good internal and external communications are vitally important. Companies will be better placed to respond if they have rehearsed potential problems in advance.

Demands for bribes

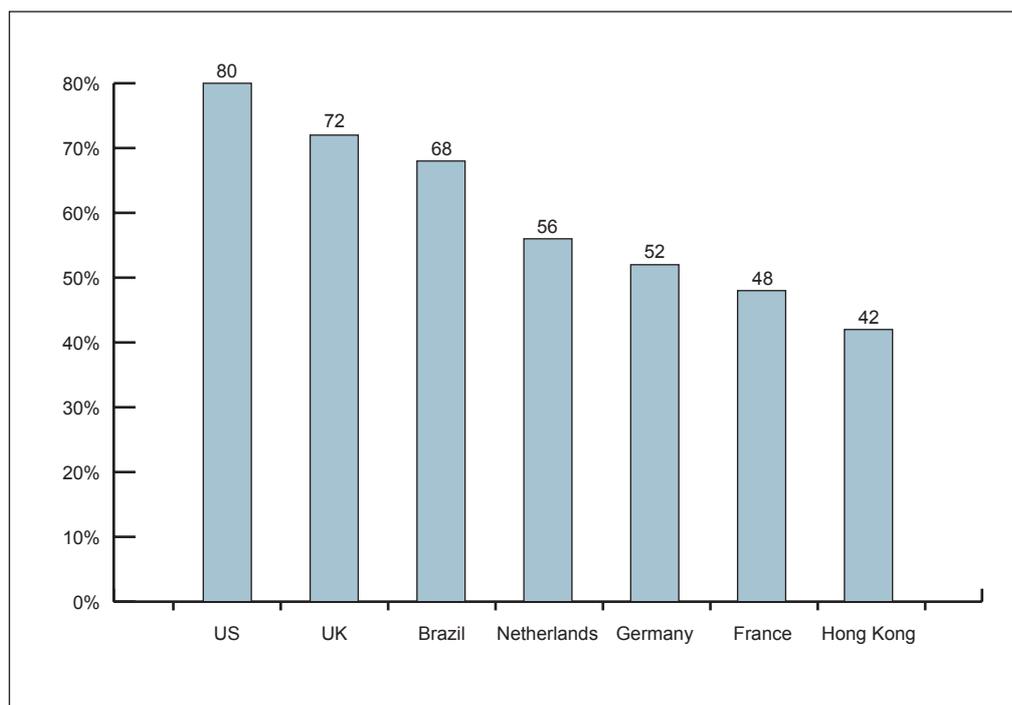
If your company faces pressure to pay a bribe, there are three main principles:

- Play for time, as long as your employees are not under physical threat.
- Gather as much information as possible.
- Draw up an alternative strategy, possibly drawing on the assistance of your 'allies'.

If you have honest friends in high places, they may be able to intercede on your behalf to ensure that the individual demanding the bribe backs off. If you are working on a World Bank-sponsored project, you may be able to appeal to the bank's anti-corruption procedures, while your embassy may also be able to assist. The US Department of Commerce offers US companies a toll-free number that they can call if they face corruption-related problems.² Depending on the circumstances, the department may offer advice or call on the assistance of colleagues in the State Department.

The fact that the FCPA and similar legislation in OECD countries specifically prohibits bribery can be a useful weapon. In the *International business attitudes to corruption* survey a clear majority of US respondents agreed with the view that it was possible to use the FCPA as a 'shield' to avoid corrupt situations.

Respondents believing that the FCPA and similar legislation passed by other OECD countries is an effective tool in helping corporations avoid corrupt situations. By country.



2. US Department of Commerce Trade Compliance Center. <http://tcc.export.gov/>.

Case study: successful resistance in West Africa

This case study is an example showing how the FCPA can make it easier to resist demands.

An international petroleum company was negotiating for a pipeline project and needed a signed agreement from a minister. The country general manager arranged a meeting with the minister, who requested a personal fee to be paid into a foreign bank account.

The general manager politely refused. He pointed to his company's code of ethics. His company was listed on the New York Stock Exchange and therefore came within the remit of the FCPA. If he paid, he personally ran the risk of a prison sentence. Moreover, if the pipeline failed to go ahead on time, this would lead to delays in phase two of the project, leading to a fall in profits. His company would need to issue an official report to shareholders explaining what had happened.

The minister exploded with rage and threw the general manager out, but the threat of public disclosure evidently gave him pause for thought. Some hours later, the minister summoned the manager back and gave him the signed document that he needed.

Bureaucratic extortion

Your regional director has only been in the country for four months and has no experience of dealing with the tax police. Then they make their first visit. The tax official has an impressive demeanour, well-dressed and with a tone of authority. He solemnly announces that the company has made a mistake in its accounts and will have to pay an enormous bill, effectively wiping out the last two year's profits. With a somewhat kindly smile, he adds that – as a personal favour – he could help to sort things out. He would only need a small fee, but the director has to decide at once.

The director will be in a difficult position if he is unfamiliar with local practices. It will be worse if it turns out that his predecessor has established a precedent by paying off the tax officials without telling head office.

In the first instance, he should resist pressure to make an immediate decision: he does not have the authority to do so without consulting head office. He should use the time to check the precise position. If the company has made a genuine error in its accounts, it may have to pay the full fine, regardless of the impact on its profits, but it cannot afford to pay the bribe. On the other hand, if the company's accounts are in order, it should resist the tax official's demands, if necessary appealing to higher authorities in the tax office, however time-consuming this may prove to be.

Case study: resisting tax extortion in Brazil

This case study is an example of successful delaying tactics.

The US expatriate director of an international company in Brazil dismissed a local employee for incompetence. The former employee happened to have an uncle in the tax department. Soon afterwards, a tax official turned up at the office. He made a quick diagnosis: the company owed thousands of dollars in tax and it would need to pay immediately. The official appeared to have two motives: he was evidently looking for a bribe, but he was also seeking revenge on behalf of his nephew.

The director kept his nerve. Under Brazilian tax law, he was entitled to ask for time to produce evidence in the company's defence. He closed down the office for several days, so that staff could concentrate on finding every last receipt. Meanwhile, the director made a point of treating the official with elaborate courtesy, producing coffee and sweets every time he came into the office. Whenever the official asked to see him,

the director called in his secretary – using the excuse that he did not speak Portuguese and therefore needed a translator. The official was too inhibited to ask for a bribe in the presence of a witness.

Eventually, the office staff gathered a pile of receipts several feet high to substantiate the company's claim that it had paid all its dues. With a friendly Portuguese greeting, the director presented the receipts to the official who now had a choice: he could spend days and weeks going through the papers or he could go elsewhere to find an easier victim. He went.

The company had lost several days' business but, if the director had paid the initial bribe, the consequences could have been much worse. He suspects that the implied bribe request was a 'sting operation' to have him thrown out of the country for breaking the law. At the very least, the initial demand would certainly have been followed by others.

Last-minute demand

You have been negotiating for an important government project for more than a year, but success is at hand, and you expect to sign the contract in a few days. You are already looking forward to a large bonus and some well-earned leave with your family. Then the minister asks for a personal favour. Of course you understand that his ministerial salary is low, and he has to pay for his son's education in Harvard. He's a good lad...

This is a common scenario, with several variations. The company has been negotiating for some time. It believes that it has a high chance of success and it does not want to jeopardise those chances because of some minor problem. There is therefore considerable temptation to overlook what may look like a relatively minor issue.

At first sight, the request looks relatively innocuous. The problem is that even a relatively small gift sets a precedent and it will be followed by demands for larger and more substantial payments. You could point the minister and his son in the direction of a scholarship fund, but the principles of the fund should be the same as the contract you are seeking: open, competitive bidding. If you make your case politely and respectfully, you may be able to save the project.

You will be in a stronger position to resist – and are more likely to be taken seriously – if your company has a clear policy: it should come as no surprise to the minister that you simply cannot pay.

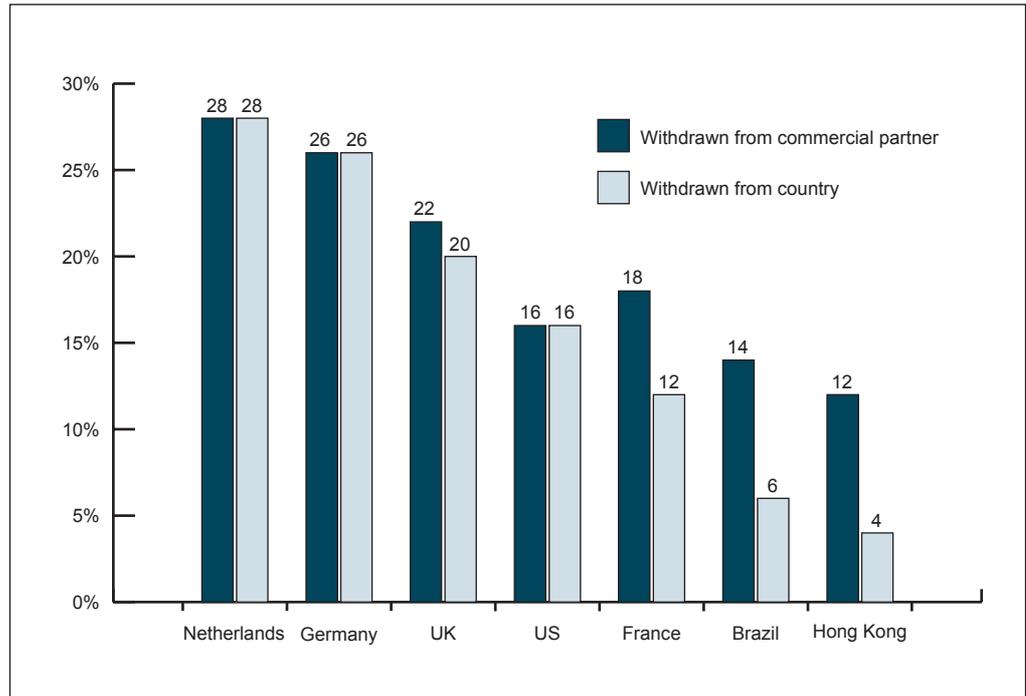
Walking away...

It is easier – and less costly – to avoid making an investment than to pull out of an existing relationship either with an individual commercial partner or with an entire country. Nevertheless, the *International business attitudes to corruption* survey showed that a significant proportion of companies had done both. Such withdrawals are rarely announced publicly, presumably for fear of jeopardising future relationships if the situation improves.

As with other aspects of integrity management, there is a hierarchy of the most sensitive companies, both by country and by sector. The Dutch are the most likely to pull out of an existing commercial relationship or investment, possibly because they are particularly sensitive to reputational concerns. Companies from the oil, gas and mining and the finance sectors were the most likely to have pulled out of existing relationships.

'Walking away' has to remain an option, but of course it will never be the most desirable one either for the company or for the host country. A more desirable outcome will be for well-managed companies – acting individually and collectively – to contribute to improved standards across the board. The final chapter discusses how companies can assist the wider international reform process.

Companies that had withdrawn from a relationship with a specific partner or a country because of concerns about corruption. By country.



Resources

The following resources provide indices or sources of information that can be used to help evaluate integrity risks when deciding whether or not to invest in a country for a first time. Most of them refer to country-level risks, whereas in practice the risks to individual companies are specific to their sectors and projects. Country ratings are useful as an initial screening device but more focused due diligence enquiries are essential once the decision has been made in principle to invest in a high risk area.

Anti-corruption Gateway for Europe and Eurasia – www.nobribes.org. This contains a somewhat uneven collection of information on the former socialist transition economies.

Corruption Online Research and Information System – www.corisweb.org/. This is a database managed by TI. It contains news cuttings, which are gathered daily, as well as a selection of longer articles and papers.

Danish Institute for Human Rights. 2001. *Deciding whether to do business in states with bad governments*. Copenhagen. www.humanrightsbusiness.org. A guide to help decide whether to invest in countries with human rights problems: many of the questions are equally applicable to countries with high levels of corruption.

Global Integrity. 2006 Global Integrity Report – www.globalintegrity.org. An assessment of anti-corruption mechanisms in 43 states produced by a Washington-based think-tank.

OECD 2006. *OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones*. www.oecd.org/dataoecd/26/21/36885821.pdf. Argues that companies need 'heightened management care' when operating in 'weak governance zones', and outlines the issues that they need to consider.

TI 2006. Bribe Payers' Index (BPI) – www.transparency.org/policy_research/surveys_indices/bpi. The BPI assesses the 'supply side' of corruption. It is based on a survey of 11,000 business people giving their perceptions of the standards of companies from 30 exporting countries.

TI 2006 Global Corruption Barometer – www.transparency.org/policy_research/surveys_indices/gcb. This is based on a Gallup poll of 55,000 respondents in 69 countries. It gives the perspective of ordinary citizens rather than business.

TI Corruption Perception Index (CPI) 2006 – www.transparency.org/policy_research/surveys_indices/cpi. The CPI is a composite of different ratings. As its title suggests, it is an index of perceptions with no claim to be a precise measure.

World Bank/International Finance Corporation. 'Doing Business' Indicators – www.doingbusiness.org/. The 'Doing Business' country surveys give an indication of the speed and efficiency of national bureaucracies, by asking questions such as how long it takes to start a new business or resolve a commercial dispute. Some of these may be regarded as 'proxy' indicators for corruption. If procedures are slow, it is likely that bureaucrats will be willing to speed things up for a fee.

World Bank Institute. Governance Indicators – www.worldbank.org/wbi/governance. This is another composite set of indicators, somewhat similar to the CPI. 'Control of corruption' is one of six indicators: the others are Voice and Accountability; Political Stability and Absence of Violence; Government Effectiveness; Regulatory Quality; Rule of Law.

Chapter six: Challenges for the future

This report has argued that there is a clear trend towards tighter enforcement of international anti-corruption regimes. However, for all the progress made in recent years, there are still many uncertainties:

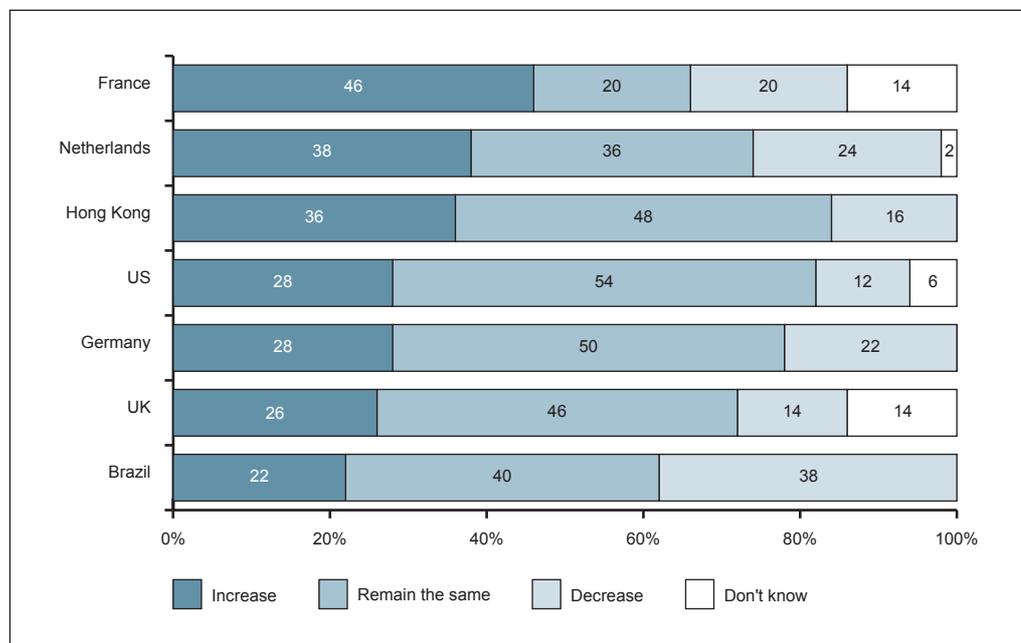
- How far will it be possible to sustain the momentum of reform?
- Will legal reforms lead to real change of behaviour in business and governmental circles?
- And is it really possible for international companies to apply global rules and still operate effectively in areas with weak governance?

This final chapter outlines the prospects for continuing anti-corruption reform and the part that companies can play in bringing them to fruition. One of the main themes is the need for effective implementation by governments and companies of the anti-corruption principles that are now widely repeated in both national and international circles.

Business expectations

Business leaders tend to take a pragmatic, even dour view of the international outlook. When asked about their expectations for the future, respondents to the *International business attitudes to corruption* survey were pessimistic: 42% expected the scale of corruption to remain the same in the next five years; 32% thought that it would increase; and only 23% thought that it would decrease. The French were the most pessimistic, with nearly half expecting the scale of corruption to increase. Despite existing high levels of corruption in Brazil, 38% expected the situation to improve in that country. However, one Brazilian respondent suggested that it could take a generation before there is substantive change in his country.

Percentage of companies expecting corruption to increase, remain the same or decrease over the next five years. By country.



Despite these rather pessimistic views it would be wrong to dismiss the prospects for continuing – and possibly accelerating – reform. Faster and more effective communications, along with combined initiatives by governments and intergovernmental organisations, will ensure that there is a continued international focus on corruption both in the media and at the political level. The questions are how far this attention will lead to concrete results, and how far business can assist the process.

The outlook for international reform

International initiatives

The UNCAC establishes an important point of global principle. However, even in the most optimistic scenario it will take many years before it is truly effective. On the international scene, the most important medium-term indicator will be the effectiveness with which the OECD convention is implemented. As discussed in chapter two, the signing of the convention was one stage in a long-term social and political process. It will take time for its principles to be embedded in national political and commercial regimes, and it will lack credibility unless it is enforced effectively.

US experience has shown that a relatively small number of successful prosecutions may have a disproportionate impact on business attitudes. If US experience is to be replicated elsewhere, other governments will need to give investigating authorities the resources they need. Some progress has been made since our 2002 report: in particular there is evidence of stronger enforcement in France and Germany. However, corruption remains a difficult and sensitive subject, and enforcement in other key OECD countries – notably Japan and the UK – appears to be lagging behind. Corruption will slip down the reform agenda, both nationally and internationally, unless political leaders take a strong lead.

Government responsibilities

At the national level, the most important task is to strengthen political and judicial institutions. In some cases, legal reform may be necessary. This is particularly true of former socialist countries, where tax laws often remain confusing and ill-suited to a market economy. However, in most cases – including in western Europe and Japan – the main challenge is not so much the creation of new laws as the effective implementation of existing ones. Again, this will require political will.

International agencies will play an important role advising on measures to strengthen institutions in developing countries. The multilateral development banks have been helping governments diagnose weaknesses that lead to corruption. Similarly, the UK's Department for International Development (DFID) emphasises the importance of good governance in its aid programmes. Nevertheless, as in the industrialised world, the main burden of reform will fall on national governments.

Success at the national level typically demands a combination of strong personal leadership and institutional reform. The World Bank's *Anticorruption in Transition* report points to both progress and setbacks in the post-socialist economies of Central and Eastern Europe and the former Soviet Union.¹ Georgia and Slovakia have made the most dramatic improvements, and Romania and Bulgaria have also seen significant successes. The external environment – notably the aspiration to join the EU in the case of Romania and Bulgaria – has been a particularly important driver for change. Internal political and institutional reforms have resulted in greater public accountability.

The role of civil society

Meanwhile, civil society movements, such as the various anti-corruption NGOs, will continue to play an important role in strengthening their governments' commitment to reform. Georgia is a significant example in this respect: many of the new leaders who came to power following the 2003 'Rose Revolution' had civil society backgrounds. Locally-based civil society movements such as the Georgia Young Lawyers' Association (GYLA) continue to monitor the activities of the new government, and to press for further reforms where necessary.

Building popular trust

At a popular and personal level, it is easier to justify paying bribes when this is seen as the usual way of circumventing oppressive regulations imposed by an illegitimate and unloved regime. It will take time to break entrenched habits in societies where the state has historically been seen as a source of oppression.

1. James Anderson & Cheryl Gray. *Anticorruption in Transition 3. Who is succeeding... and why?* Washington DC: World Bank, 2006.

Again, the key issue is institutional effectiveness rather than fundamental cultural values. Hong Kong offers a positive example of a government that has effectively challenged corruption since the late 1970s, even though graft was said to be customary in Chinese society. It will remain a major challenge to replicate Hong Kong's experience in larger and even more complex jurisdictions.

Weak governance zones

While the *Anticorruption in Transition* report points to encouraging signs of progress, it also emphasises that this trend is not universal and adds that, even where progress has been made, it can still be reversed. Kyrgyzstan has introduced a series of legal and institutional reforms, but has made limited progress in implementation and capacity-building. According to the World Bank's survey of local companies, bribery levels in the country increased between 2002 and 2005. It remains to be seen how far the new Kyrgyz government, which came to power following the 2005 revolution in the republic, will be more successful than its predecessor in combating corruption. The outcome will be one of the key factors influencing its future patterns of economic development.

Inevitably, the pace of change will be uneven in different countries and industries. In the more optimistic scenario, globalisation will continue to have a positive impact. The more far-sighted national governments will recognise the need to implement international integrity standards, partly because domestic opinion demands them, but also because of the need to attract foreign investment.

However, for the foreseeable future, there will still be countries and regions where, for a variety of economic and geopolitical reasons, standards of governance lag behind the emerging global norms. Often they will have anti-corruption legislation, plans and commissions, but implementation will be imperfect or non-existent. All too often, plum commercial projects will be allocated at the discretion of the president and his cronies. The black market and – in some cases – the drugs trade will provide illicit sources of funds that can be used to buy off political opponents. Such countries may still attract foreign investment, but it will come in smaller quantities and from less reputable companies.

What can business do?

These enduring local, national and international complexities will create major challenges for international companies that are committed to high standards of legal and commercial integrity. They will continue to face competition from competitors with less-than-rigorous standards and in many countries they will have limited recourse if business rivals bend the rules. However, both in their own self-interest and as a point of principle, mainstream companies have no choice but to abide by the anti-corruption standards defined by both national and international law. Moreover, companies themselves – far from being passive bystanders – have an important role to play in ensuring that anti-corruption standards are applied effectively.

Internal measures

This report has argued that companies' first task is to implement high standards in their own operations. As has been seen, this means both adopting the right policy and implementing it effectively. If companies are to carry out their work effectively in difficult environments where corruption is commonplace, they will need both diplomacy and skill.

A business commitment to integrity will carry short-term costs: in some cases it may be necessary to stay clear of otherwise attractive projects to avoid unacceptable compromise. However, the long-term rewards include a greater sense of security and a higher chance of sustained commercial success. In future, companies that cannot demonstrate high standards will be prevented from competing for key projects, such as those sponsored by the World Bank. Contracts that have been won through fair competition will be more secure as well as more cost-effective. Companies with a reputation for honesty are more likely to win repeat business. A strong anti-corruption stance is justified by enlightened self-interest.

Advocacy

Secondly, companies can play an important role by calling on governments to implement anti-corruption procedures more effectively. Companies may do this in their individual capacity, but they will carry greater weight – and have a more obvious claim to legitimacy – if they work collectively, for example through chambers of commerce and industry associations.

The ICC and the WEF has taken a strong lead in promoting higher anti-corruption standards. Even so the collective voice of business has all too often been muted. This needs to change. The OECD convention helps good companies by giving them more powerful legal grounds to resist corruption demands. At the same time, it offers the best hope of enforcing common standards, so that companies from industrialised nations operate according to the same rules. Business associations need to be more outspoken in welcoming the new laws and pressing their governments to implement them effectively.

Business associations also have an important role to play in sharing expertise, both nationally and internationally. Again, the ICC has taken an important lead. As seen in chapter four, specialist organisations such as the Defense Industries Initiative (DII) and the International Federation of Consulting Engineers (FIDIC) are helping promote integrity standards in their sectors. The Makati Business Club in the Philippines (www.abc.com.ph) is a good example of a business association working with other organisations to share anti-corruption expertise at the national level.

Engagement

The final area where companies have an important role to play is in commercial engagement with 'difficult' countries. Individual companies must base their investment decisions on their own commercial self-interest. However, the wider public interest will be best served by more rather than less engagement. As the 11 September 2001 terrorist attacks showed, failed states may be a source of insecurity far beyond their borders. Companies that work in difficult environments, overcoming corruption and other associated problems, may help to prevent weak states from becoming failed states.

In such regions they will certainly need to apply 'heightened management care', to use a phrase from a recent OECD report.² The extra management time required will in itself amount to a significant investment, but by helping open up new areas to commercial development it could bring significant rewards. Celtel, the Netherlands-based mobile phone operator, is an example of a company that combines strict anti-bribery standards, entrepreneurial initiative and commercial success. It now operates profitably in 14 African countries, including states such as Sierra Leone and Congo (DRC) that have only recently emerged from conflict.

No one seriously expects to eliminate corruption completely. There will always be loopholes and there will always be individuals with the imagination, determination and greed to exploit them. However, it is possible to imagine a world in which business corruption is seen as exceptional rather than commonplace. Well-managed companies can play a part in bringing this positive scenario closer to reality.

2. OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones. Paris: OECD, 2006.

Appendix: Methodology of the 2006 and 2002 surveys

IRB Ltd conducted the survey on behalf of Control Risks and Simmons & Simmons in May, June and July 2006. IRB conducted a total of 350 telephone interviews with 50 companies in each of Brazil, France, Germany, Hong Kong, the Netherlands, the UK and the US. France and Brazil had not been included in the previous survey. All respondents were senior decision-makers at or near board level, and all the companies operate internationally.

The respondents represented eight different commercial sectors: banking and finance (26.3%), public works & construction (20.8%), telecoms and IT (12%), arms and defence (10.9%), oil, gas and mining (10.9%), pharmaceuticals and health care (7.2%), retail (5.6%) and power generation (5.4%).

Control Risks' previous survey took place in August and September 2002. IRB conducted a total of 250 telephone interviews with 50 companies each in the UK, the US, Germany and the Netherlands, and 25 companies each in Hong Kong and Singapore (Singapore is not included in the present analysis).

The respondents represented the same eight commercial sectors in broadly comparable proportions: banking and finance (31.6%), public works & construction (20.8%), telecoms and IT (8.8%), arms and defence (12%), oil, gas and mining (9.2%), pharmaceuticals and health care (5.6%), retail (5.6%) and power generation (6.4%).

Control Risks

Control Risks is an independent, specialist risk consultancy with 18 offices on five continents. We provide advice and services that enable companies, governments and international organisations to accelerate opportunities and manage strategic and operational risks.

Since 1975, Control Risks has helped hundreds of clients to manage risk and deliver opportunity. In an interconnected world where regulation, risk and complexity may appear to present a daunting impediment to success, we help clients look after their people, their interests and their reputation. They regularly call on us to help them resolve some of their most sensitive issues, and this is when they appreciate our independence, honesty and a commitment to act ethically at all times. It is also then that they most value our discretion.

Control Risks' people will always work to the highest professional standards, bring a depth of expertise and experience and be informed about what is happening in the world. Our staff are drawn from a range of backgrounds and professions, whether it be government service, the law, journalism, commerce or academia.

We offer a diverse range of risk consultancy services to assist with finding the solution to a multitude of issues for a wide variety of clients in every region of the world. We provide insight, talent and a practical focus to break down complexity and deliver clarity. Our clients rely on our resolve, dedication and integrity to deal with uncertainty and to take the right decisions.

Political and security risk analysis

Supported by a worldwide network of retained correspondents, Control Risks' analysts provide tailored assessments, briefings and workshops on political, business or security risk issues that could affect investments or operations in a country. We provide tailored research analysis and consultancy for your specific company, project or business trip. We also provide a comprehensive online service with constantly updated objective analysis and forecasts of political, operational, security and travel developments and their implications for business and employees across a range of sectors.

Business intelligence and investigations

Control Risks' business intelligence consultants work with mergers and acquisitions teams to carry out detailed due diligence into the personalities, backgrounds and reputations of target companies. Our anti-fraud team carries out fraud vulnerability studies, investigate fraud and trace and recover assets. Where the problem is intricate, multi-jurisdictional or just sensitive, Control Risks can draw together an international, multi-disciplinary team to help senior management solve it.

Forensics

Control Risks Network Forensics is the largest private, technical forensic laboratory in Europe and provides a range of supporting forensics services for both law-enforcement and corporate clients, including audio/visual, computer, fingerprinting and handwriting analysis. We also have a specialist IT security and investigations team.

Security consultancy

Control Risks develops comprehensive security strategies for clients and manages their implementation. In particular, we advise clients on reducing risks to their people, information and physical assets. When the threat to business is particularly acute, Control Risks provides specialist security co-ordinators to operations. Services we provide in this area include consultancy and behavioural threat investigations, customised security awareness and travel security training, executive protection, special event security and high-risk environment asset protection. We review existing security arrangements and, for new projects, our engineers work with architects to include security measures at the design stage.

Crisis management planning and training

Our consultants provide customised crisis management planning and training, which enable our clients to anticipate events and retain the initiative in handling crises, such as extortion, kidnap, product contamination and emergencies requiring evacuation.

Crisis response

Control Risks provides incident management consulting for clients facing kidnaps, extortions, short-term hostage situations and illegal detention of employees, product tampering, and other unique business crises. If a client falls victim to such an incident Control Risks will deploy a consultant to advise on negotiation strategies and liaise with law enforcement, families and the media. Control Risks has handled more than 1,100 such crises.

Travel security

We offer a broad range of services to assist clients with designing, implementing, reviewing and enhancing a travel security programme. Our online services provide updated information vital for travellers, and detailed security briefings and learning programmes are also available. We have a dedicated team of consultants providing retained clients with immediate support and security, crisis management and related advice on demand – 24 hours a day, 365 days a year – from our state-of-the-art operations centre (CR24). Control Risks' travel-tracking service (CRTravelTracker) automatically collates all employees' travel details into a single, user-friendly interface, allowing clients to control where employees can travel and locate them at a moment's notice.

Screening services

Control Risks Screening's skilled research staff provide a variety of screening services to support a comprehensive risk management programme. Our flexible and cost-effective screening packages can be tailored to varying requirements across a range of industries and countries, and include pre-employment screening to suit different levels of appointments, vendor screening and drugs and alcohol screening.

Governance and development

Control Risks' dedicated specialist team provides governments, donors, NGOs and the private sector with a range of consultancy services to assist with the design and implementation of stabilisation programmes, national threat and risk assessment strategies, and defence and emergency response reviews. We also provide advice on protecting against reputational issues such as human rights abuses, corruption and fraud.

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