Role of the Private Sector in Ethics
and Corporate Governance in the Fight Against Corruption
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PROCEEDINGS REPORT

"To make a difference in the fight against corruption, we need transparency related reforms with spine, not rhetorical ones."
Daniel Kaufmann
Director of Global Programs, World Bank Institute

This proceedings report of the FORUM/CIPE international consultation on business ethics, anti-corruption, and corporate governance summarizes major issues that participants discussed and indentified as key considerations for anti-corruption initiatives for the private sector. The following are key points that are elaborated in greater detail in the main body of the report:

- The public, private, and civil society sectors all share a responsibility to strengthen the institutional framework of transparency, accountability, and good governance, particularly in the context of developing countries. Effective rule of law is an area deserving priority attention and support.
- The standards of this institutional framework are codified through international conventions by the OECD and the United Nations, and are also continually supported, improved and innovated through numerous voluntary initiatives at national, regional and international levels.
- The effects stemming from globalization and a growing global population are directly impacting the way that companies do business, namely introducing new issues and considerations into a company's balance sheet that in the past were not considered central to the bottom line. The challenge is growing pressure to balance profitability and sustainability concerns.
- There are collective action solutions to state capture and the tragedy of the commons, but it takes foresight and leadership to leverage their potential in mitigating the corrosive effects of corruption. The voice of institutional investors and the role of media against corruption are examples of powerful levers for change. Also, strategies must be tailored to the appropriate scale, context, and resources that exist between large corporations, Small and Medium-Sized Enterprises, and other business structures.
- Due and equal consideration to the duty of care, the duty of loyalty, and the business judgment rule is central to managing business risks, and the tradeoffs that arise between the private goals of companies and the public interests of society.
- Ethics and economic efficiency are two sides of the same coin in making the business case against corruption. Also from a broader perspective, corporate governance is a framework of rules and values to "do the right thing" as defined by markets, economic efficiency, ethics, sustainability, shareholders, or any other stakeholder.
- A focus on "disclosure, disclosure, disclosure" and a rigorous application of an "incentives-driven" framework to anti-corruption and good corporate governance is fundamental to the collective responsibility of corporate boards and to the individual responsibility of managers and directors in building ethical business organizations.
- Business ethics is not a moral argument nor is it about imposing Western principles from developed economies and global corporations. It is about creating organizations that abide and act upon a set of ethical principles within their appropriate context, and which also form part of internationally accepted values and norms.

Background

The Global Corporate Governance Forum (Forum) and the Center for International Private Enterprise (CIPE) hosted an international consultation on March 3, 2008, at the World Bank Paris Office, to examine the role of the private sector in levering ethics and corporate governance to counter corruption. Participants included: (1) CEOs and senior executives from companies in Africa, Asia, Latin America, Europe, the Middle East, and North America; (2) investment managers from Hermes Equity Ownership Services (US$120 billion fund), California State Teachers' Retirement System (US$165 billion fund), and Norges Bank Investment Management (US$370 billion fund); and (3) representatives from regional and international bodies such as the UN Global Compact, the Global Reporting Initiative, the International Chamber of Commerce, the Ethics Institute of South Africa, the Russian Institute of Directors, Transparency International, and the Corporate Executive Board. The agenda and list of participants are attached as Annex 1 and Annex 2, respectively.

Discussions took place around three thematic sessions: (1) private sector perspectives from operational and practical experience; (2) effective corporate governance tools to counter corruption—the "why" and "how"; and (3) the role of and lessons from international initiatives. All three sessions were informed by a draft background paper entitled, *The Moral Compass of Corporations: Business Ethics and Corporate Governance as Anti-Corruption Tools*, which examines the interrelationship among ethics, corporate governance, and anti-corruption, and current best practice by boards and directors in building ethical business organizations. This background paper will be revised based on the issues raised through the international consultation and will be released in the second half of 2008 by the Forum under its FOCUS publication series.

This proceedings report is a summary of major issues that participants discussed and identified as key considerations for anti-corruption initiatives by the private sector. As such, this report is not meant to present policy prescriptions, consensus positions, or definitive conclusions on the issues that are summarized. Rather, the report reflects the substantive dialogue that took place among participants, encompassing the range and diversity of opinions from different business sectors and regions of the world. At times the points summarized in this report were made in the spirit of generating debate, and should not be taken to represent the individual views or collective opinion of participants, nor the policy of their organizations. Even when opposing views were stated, these were put forward within the spirit of strong collective and individual commitment to fight corruption.

Anti-Corruption Progress in Context

Key Points of Discussion:

The past few decades have led to significant progress in building the institutional framework for transparency, accountability, and good governance in both the public and private sectors. As a result, the fight against corruption is now buttressed by legally-binding conventions from the OECD and the United Nations, as well as by numerous voluntary initiatives that continue to advocate for improved standards and increased application of such standards. Transparency International, the Global Reporting Initiative, the UN Global Compact, the International Chamber of Commerce, and the World Economic Forum are only a few examples of organizations that have launched important voluntary initiatives that did not exist a decade ago. Building the institutional framework for better companies and better societies is a learning process, where the public, private, and civil society sectors share mutual responsibility to ensure that the "rules of the game" are written and applied for the benefit of all society and not for the private gain of the few. Exposing and breaking relationships of state capture are key to fighting corruption, as well as helping to strengthen effective rule of law in both developing and developed countries.

Discussions and comments took place against the backdrop recognition that both the public and private sectors have made great inroads in building the institutional framework of transparency, accountability, and good governance. But though we have learned much about corporate governance and fighting corruption in the past few decades, the foundations need reinforcement in order to continue to bring to bear practical lessons of experience on ongoing and future reform initiatives. The private, public, and civil society sectors all share a responsibility to strengthen good governance, particularly in the context of developing countries.

In the private sector, corporate governance has led to major transformations within the last decade in how companies are managed and controlled. The OECD Convention on Combating Bribery and the UN Convention Against Corruption entered into force in 1999 and 2003, respectively. Today we see the sustainability agenda and business ethics at the forefront of good corporate governance, and the sensitive topics of bribery and corruption are no longer taboo in corporate board discussions. Participants were reminded that just ten years ago in Germany it was not only perfectly legal to pay bribes but they were even considered tax deductions. This loophole has been closed in Germany, but the scale of annual bribery is estimated at US$1 trillion worldwide.

The OECD and UN Conventions represent a codification of standards that have gained acceptance by business, society, and national political leaders. Voluntary initiatives represent the other side of the coin, and complement existing binding legislation through advocacy for improved standards and increased application of such standards. Transparency International (TI), the Global Reporting Initiative, the UN Global Compact, and the World Economic Forum's Partnership Against Corruption (PACI) are only a few examples of prominent initiatives that did not exist a decade ago. The advantages and disadvantages of mandatory versus voluntary

initiatives generated lively debate, leading to a recognition that these initiatives should not be merely seen as a set of new guidelines. Rather the organizations behind these initiatives should be recognized for shepherding a process that generates new knowledge and helps to further the process of change.

Many of the voluntary initiatives can be best understood from the perspective of helping to facilitate a massive process of adaptive change. Ronald Heifitz from the Harvard Business School has characterized adaptive change as change where we need to reset our values and learn new paths to finding solutions where there are no easy answers. Such are the challenges being tackled by voluntary initiatives committed to improving good governance and eliminating corruption. These voluntary initiatives recognize that the solutions cannot be provided by technicians and experts. Only with the collective effort of stakeholders representing different facets of society and of an economy—engaged in dialogue and learning how to advance the practice of new principles and standards (e.g. ethics, sustainability, collective action, anti-corruption, disclosure, etc.)—can true progress be made.

Participants pointed to GRI as a case with important insights that could help inform different types or scale of anti-corruption and corporate governance reform initiatives. GRI was founded in 1997 with the vision that sooner or later there would be a demand for comparative and robust information on the sustainability impact of companies in terms of social, economic and environmental impacts. In addition to the known changes brought upon by globalization, the world is also undergoing a fundamental transformation stemming from the tripling of population in the last 4 decades. This process, which continues to increase, is beginning to change the way we consume, the way we transport ourselves, and generally the way in which we think about how we use and share the world in terms of its public resources. Carbon trading is but one manifestation of the changing world.

The challenges of our changing world described above are giving rise to a series of serious problems that we will have to contend with, and they will have a direct effect in particular on how we do business. Therefore, issues that in the past were not considered central to the single bottom line are now forming part of a company's balance sheet. This new learning process—of building a framework to measure and disclose sustainability impacts —can too easily be manipulated to frame it as a negative condition. However, if we are to work collectively to find solutions to the sustainability challenge, a more constructive and positive formulation is equally possible: to what extent are a company's products and operations helping to foster a more sustainable world? Solutions require metrics in order to be able to assign value and to analyze impacts, as well as to frame the discussion from the perspective of the bottom line. However, even more important, in light of the massive adaptive change that is required, is the fundamental recognition that finding solutions and writing the new rules requires an on-going global dialogue among multiple stakeholders, and that we learn and contribute most by being present at the table of debate. Lastly, experience seems to suggest that standards of a voluntary nature—such as GRI, TI, UN Global Compact, PACI, etc.—

seem to have a quicker market acceptance than those of a regulatory regime. Also their voluntary status was seen as an advantage because the moment you make the standards compulsory and obligatory, you short circuit the learning process and the dialogue that is required to advance the practice and perfect the standards.

The concept and research on "state capture" by Daniel Kaufmann and his team at the World Bank Institute is central to understanding corruption and the feasibility of designing and implementing anti-corruption initiatives. State capture refers to what is possible for development and economic growth when the rule making power of the State is captured by vested interests—whether individual, corporate, familial, or any other form—resulting in rules that are written and applied for the benefit of the few. At a national scale, it is tantamount to having the leadership of a country and a handful of individuals forming a joint venture to run the country at the expense of the larger society. Whether state capture happens at the national level, in certain segments, or in varying degrees of penetration—signaled by such terms as crony capitalism or corporatism—its effect is nonetheless corrosive. The issue is not at all trivial and it occurs in both developing and developed countries, at times becoming very difficult to detect elaborate networks and sophisticated mechanism by which the country's leadership and special interests form corrupt partnerships. As Daniel Kaufmann and his team have calculated, there is a "400% governance dividend" derived from reforms that achieve good governance and control corruption: over the long run, countries that implement such reforms can achieve a four-fold increase in per capita income.

A key reflection was that corruption is an intrinsic part of state capture, and that to fight corruption it is key to introduce reforms that expose and help break the relationships of state capture. Fighting corruption should not be a choice between whether a country has state capture or none at all. The key is to introduce reforms that expose and help brake the relationships of state capture. Thus corporate governance becomes a tool towards this objective. At the same time, however, we cannot forget that ending the cycle of corruption requires action beyond the corporate sector.

In the context of fighting corruption in developing countries, whether through leveraging corporate governance, business ethics, or other tools, it was pointed out that special consideration must be given to other factors that may be taken for granted in other settings. One special focus should be continued support to strengthen the effective development and functioning of the institutional framework that is a prerequisite for good governance, such as the judiciary, the civil service, police, etc. Another is that training on corporate governance—which seems to mostly target private sector actors—should also be extended to members of parliament and other senior public servants who must possess a solid understanding of corporate governance principles and how such a framework affects private sector development and national competitiveness.

The Three Rules of Business Enterprise

"We must keep in mind that firms have to take risks. If they are not taking risks, they are probably not innovating and not generating profits for their shareholders"

John D. Sullivan
Executive Director, CIPE

Key Points of Discussion:

Risk is inherent to doing business, innovation, and the entrepreneurial spirit. The duty of care, the duty of loyalty, and the business judgment rule are three key principles to help business executives manage risk while advancing the private goals of a company and the collective interests of society, particularly with respect to fighting the corrosive effects of corruption. Business ethics and values are increasingly recognized as foundational elements of good corporate governance: creating an organization that acts and functions on the basis of certain values and standards, whether stemming from obligatory regulations or the culture of the organization. This is not a moral argument. It is about properly diagnosing business risks, understanding the ethical standards that in turn guide actions, institutionalizing the application of such standards in business operations, and reporting in a transparent manner corporate performance against established standards. The business case against corruption, therefore, is fundamental to having an efficient economic system, which in turn depends on what Adam Smith conveyed through his book, *The Moral Sentiments*, namely that the interaction among individuals (i.e., the free market) is based on a series of ethical premises.

Whether we discuss corporate governance reforms or anti-corruption initiatives, all too often we forget to focus on three basic principles of private enterprise governance: the duty of care, the duty of loyalty and the business judgment rule. It is important to reflect on how these three principles intersect and how their interplay affects the types of reforms or initiatives that will prove effective. If we go too far with the duty of care and duty of loyalty, we jeopardize business judgment, and vice versa. These three principles exist because risk is an inherent element of doing business. It cannot be eliminated or wished away, but can be managed to serve both the interests of companies and society. But just as society should recognize that risk is a constant feature of private enterprise, companies too must take the time and effort to fully understand the risks that they take on through their activities. If boards and managers fail in their collective and individual responsibility implicit through the three rules, as is often the case in corruption scandals, the company, the shareholders, and ultimately society bear the costs and consequences.

The three rules also point to the important topic of values and ethics in doing business. At a conceptual level, the interrelationship between ethics, corporate governance, and anti-corruption can be viewed from two angles. One angle is the ethics of governance, which is to ask what is the purpose of governance (whether we speak of corporate governance or the governance of any institution)? It is acting on the basis of certain values and of creating an organization that functions on those

values. It is values that help manage the balance between private and public goals. From this perspective, corporate governance is about ethics and values. This is not a moral argument, but rather that if organizations are not clear about their value systems or do not provide sufficient guidance on them, we will continue to face the same corruption risks that currently preoccupy us.

The second angle—the governance of ethics—points to learning and to the practical process of governing ethics in business. There are many lessons to share but four best practices stand out: (1) we need to undertake proper risk assessments because if we do not understand or properly diagnose the risks we face, we cannot manage them; (2) we need to clearly define the ethical standards that guide our actions, whether they are regulatory standards or values that define the culture of an organization; (3) we need to institutionalize such standards through various steps, such as communication strategies, training, awards, etc.; and (4) we must be transparent and report our ethical and corporate governance performance, certainly through independent auditors and ideally with external verification.

The dialogue on values and ethics in business generated the liveliest debate and the most diametrically opposing views among participants. At one end, caution was urged to not pose the need to fight corruption from a moral philosophy argument, and certainly to avoid making or giving the false notion that companies need to be ethical before they can address corruption. The danger of such positions is that we will alienate important segments of the business community, who are more likely to be persuaded by the simpler argument that eliminating corruption is fundamental to having an efficient economic system. At the other end of the spectrum, views were expressed that it is no longer possible nor desirable to separate ethics and economic efficiency arguments when making the business case against corruption. As was pointed out, many believe that the most important book in economics is Adam Smith's first book, *The Moral Sentiments*, which posits that the interaction among individuals is based on a series of ethical premises. Similarly, Jean-Baptiste Say, a French economist at the beginning of the 19th century, was quoted: "We are told to make virtue admirable; I dare add that it should also be made profitable."

In the end there was agreement among the opposing views that business ethics and fighting corruption should never be conceived as a sequential issue—it is never about causality from one to the other—but rather that the key distinction to be made is that they contribute to and are part of the solution for good corporate governance. From a broader perspective, corporate governance is therefore a framework of values and rules to do the right thing as defined by markets, economic efficiency, sustainability, ethics, shareholders, or any other stakeholder.

Fundamentally the challenge is to maintain a balance between the three rules and with incentives that help company decision makers and board members fulfill their basic duties while protecting the business judgment of profit maximization. Transparency is one such incentive, which is discussed further below, but first we turn to the issue of the bottom line.

Balancing Profitability and Sustainability

"The abuse of entrusted power for private gain is always fine for the one person doing it, but it becomes catastrophic if everybody starts doing it."
David Pitt-Watson
Chairman, Hermes Equity Ownership Services; and co-author of "*The New Capitalists: How Citizen Investors are Reshaping the Corporate Agenda*" (2006)

Key Points of Discussion:

If the bottom line—i.e., a company's financial performance—is the basic principle driving entrepreneurial behavior and decisions, then the issue of incentives becomes central to how a company will weight costs and benefits in choosing whether to reject or engage in corrupt acts. The nature, design, costs, and effectiveness of the regulatory framework, transparency standards, anti-corruption legislation, rule of law, ethical principles—just to name a few elements—all play a major role in altering the basic equation of costs and benefits. Currently, the performance of companies is increasingly attuned to the welfare of society, having regard however to the primary objective of companies to be profitable in a socially responsible manner. We may not be able to completely eliminate abuses of entrusted power for private gain, or curb the behavior of individuals who consciously abuse risk, but we can employ "anxious vigilance" (in the words of Adam Smith) through existing mechanisms of corporate governance, and of collective action to make the risks of corruption as high as possible so that companies will have no incentive to participate in it. As a practical illustration, institutional investors can make a big difference against corruption simply by raising it as an issue within the companies they are invested in. It is about making companies forcefully aware that institutional investors attach significant value to combating corruption when making investment decisions.

Over the past few years the profit-based framework for business decision-making has seen a growing expansion to broader strategic considerations that concern environmental, social, and governance issues. This process—commonly referred to as the expansion from single to double, triple and higher bottom lines—is an important development that can not and should not be ignored in how we look at anti-corruption initiatives. The discussion did not intend to rank which bottom line is more important, nor did it see this as a productive or necessary discussion. The important point to remember, however, is that in the final analysis companies are accountable to shareholders and owners based on the principle of the single bottom line.

If we accept that the single bottom line is a basic principle that drives entrepreneurial behavior and decisions, then we have to give due consideration to the issue of incentives, namely, which incentives matter or do not matter in terms of affecting the basic equation of costs and benefits by which a company chooses to reject or engage in corrupt acts. For example, the scope and depth of a regulatory framework (see section below for more detail) plays a major role in altering this basic equation of costs and benefits.

The incentives prism was suggested as a valuable tool to consider the merits of anti-corruption initiatives. By no means was it suggested as the only or most important tool. Simply it was put forward as a useful method to shine new light on how we consider or evaluate effective anti-corruption solutions. Thus, as we examine lessons and reflect on what works and what does not work, the suggestion was to apply rigorous analysis from the perspective of incentives.

The dilemma of corruption is that though companies may recognize that it is wrong to engage in corrupt acts, there will always be a short-term advantage to those individual companies that opt to do it. Thus, what are the incentives that can curb corruption? Which type of incentives can foster collective action by the private sector to combat corruption? More specifically, what incentives can make the pursuit of short-term advantages so risky that companies will choose not to engage in corrupt acts? There will always be individuals that misperceive or consciously abuse risk, so the key challenge is to work at a systemic level to change the balance to where the risks of corruption are so high that companies will have no incentive to participate in it.

The role of institutional investors was highlighted as central to helping reduce corruption. As influential owners of shares in companies worldwide, investors can exercise a strong impact on good governance by committing to include an anti-corruption focus in their duty of making sure that the companies that they own are run in the best interest of their clients. A strong analogy was drawn between corruption and people taking drugs in sports: taking drugs destroys the person and the sport, yet it happens all the time. In business, by distorting the purpose of providing people with goods and services that they want in open and free markets, and the profits that result from such enterprise to the shareholders, corruption destroys the company and the very integrity of the business institutions that as a society we are all invested in. When the core competence of companies becomes passing around brown envelopes stuffed with money, the whole function of private markets begins sliding down a slippery slope.

The tragedy of the commons—a concept that states that if all businesses agreed that there should be no corruption, all would be better off; but if one business cheats, it will benefit and consequently everyone else will begin cheating—points to the fact that we cannot eliminate the abuses stemming from corruption, but we can commit to remain vigilant to stamp out abuses wherever they emerge. If we embrace the "anxious vigilance" of the owner, as Adam Smith called it, we can make a difference in reducing the degree to which entrusted power is used for private gain. The mechanism that we have as owners for this "anxious vigilance" is corporate governance. On this point, participants forcefully pointed out that corporate governance is not just formal structures and systems of a board of directors, and of directors individually, but also the broader issues brought forth by the basic duties of care and loyalty. The system will never be perfect, but if we are serious about attacking corruption, then we must think how our broader understanding of

corporate governance can make business institutions work against the tragedy of the commons.

Therefore investor responsibility in remaining anxiously vigilant makes a huge difference in pushing back corruption. An investor referred to his recent visit with the CEO of a French company that had been involved in very public issues of corruption in different parts of the world. The investor had prepared for a very difficult meeting but instead discovered a group of executives that were passionate about their desire to eliminate the roots of corruption. The CEO specifically thanked the investor for being the first one to ask about corruption and for raising the issue directly with him. Extrapolating this experience against the numerous pension funds around the world that invest in hundreds of companies worldwide—and whom the investor knows to be as concerned with corruption as he is—it is surprising that they do not exercise their voice against corruption. Investor responsibility in raising questions of corruption with company managers is a simple and practical step that can make a big difference. For this reason, participants felt that it was fair to ask whether the UN and World Bank pension funds were exercising these measures, making sure that their investments in the companies that they invest in weigh in against corruption.

Although the general view was that institutional investors can be powerful agents of change simply because of the nature of their role in business, an argument was raised that "activist" institutional investors were necessary to realize the potential leverage of their influence. The need for such activism was raised in the context of weak governance where market institutions and corporate governance mechanisms have limitations as levers of change. Activism, therefore, was seen as a way to make companies forcefully aware that institutional investors attach significant value to combating corruption when making investment decisions.

The Regulatory Framework

Key Points of Discussion:

In the aftermath of major corruption scandals, the automatic response should not be a call for more and broader regulation. Determining the right balance of regulatory oversight will vary across sectors and countries, but should be a measured and reasoned evaluation of costs, benefits, and the incentives and disincentives it can generate for private sector development. In the context of countries with weak rule of law, a whole set of basic governance and development challenges arise before one can begin to address the right balance of regulatory oversight.

Two distinct but equally important issues were identified in relation to the regulatory framework affecting the private sector: one was the balance between too much or not enough regulation, and the second was on the degree of enforcement. The latter issue takes on an even greater importance when viewed from its

considerable variance across countries. In many developing countries, even among the top ranks of emerging markets, if the rule of law is weak or ineffective, it introduces a whole set of basic governance and development challenges before one can begin to address the right balance of regulatory oversight.

However, assuming that regulations are enforced, the balance of regulatory oversight can become either a powerful incentive or disincentive for reform. Particularly in the aftermath of major corruption scandals and especially at levels that shock our notions of fairness, it can become convenient and very easy to suggest a further set of regulations to protect against future repetitions. The important point is to avoid such automatic reactions, and instead to take a measured and reasoned approach in evaluating the costs and benefits of any new proposed regulations, including the costs to enforce such reforms. The current debate in the U.S. on the benefits of the Sarbanes-Oxley Act of 2002, for example, centers on an issue that many countries are struggling with, namely the balance between costs and benefits of corporate governance reforms—especially as they differ between larger and smaller companies. These debates, to be productive and useful, must examine at what threshold do corporate governance reforms inhibit innovation and risk to the point that they undermine private enterprise and capital markets, and the fundamentals of the very system that they aim to protect.

In situations where underdeveloped market institutions or weak regulatory frameworks may seem to present insurmountable challenges, it is still possible to achieve meaningful progress towards good corporate governance. Recent research in Nigeria, for example, revealed that despite the challenges posed by weak governance institutions, effective corporate control mechanisms were achieved through the combination of three practical interventions: leveraging price incentives, giving recognition to legitimate independent authority, and committing to a shared value system. Also a rating system was tested that tracked company behavior in five areas: internal controls, basic regulatory compliance, accountability practices, value system, and track record with these issues. Regular application of this five-star system produces time-series rankings where declining positions raise concerns to the level of boards for appropriate response. The system was seen as both practical and useful, leading the Nigerian Economic and Financial Crimes Committee to adopt it as part of its oversight of the financial industry.

Similarly, Lebanon's legal framework has provisions that are counter to best practice standards of corporate governance. For example, under Lebanese law a member of a board must be a shareholder, which raises obvious difficulties in achieving representation of independent directors on a board. In finding practical solutions to this dilemma, Lebanese companies have opted for transparent steps that allow them to comply with the law and add independent directors to their boards. Only one share is sold to independent directors as a way to maintain their independence, which they must sell back when they step down from their board. Other examples similar to Nigeria and Lebanon exist, but the important point is that there are ways to find practical solutions to overcome the challenges, while at the

same time promoting the application of best practice standards. Of course, changing ineffective legislation should be a long-term focus on the private sector side rather than simply devising short-term solutions to sidestep regulations, even if it is done transparently.

Transparency Reforms

Key Points of Discussion:

Transparency-related reforms are fundamental to recognizing the risks of corruption, particularly as tools for preventive and early-warning systems. Disclosure is an important company strategy, particularly when it is designed to engage a broad community of stakeholders in finding solutions to identified risks, and not as a public relations exercise to gain legitimacy. Transparency and disclosure mechanisms also act as an alternative to more or excessive regulation. To some degree they are information regulations, allowing for better informed market players and, in turn, better informed decisions within the marketplace. Effective board accountability, independent monitoring, relevant measures of performance accountability and assurance, media freedoms, practical global accounting standards, and collective blacklists of corrupt companies were just a few of the transparency-related reforms that were mentioned as effective means to combat corruption. All such efforts may represent small steps by themselves, but every single step is a contribution to the learning and innovation process that leads to better and more effective transparency and disclosure systems.

For too long transparency related reforms were the black sheep option to fighting corruption, but now have taken a more prominent role and are meriting worldwide the attention they deserve. Transparency is an indispensable tool in recognizing the risks of corruption, particularly as preventive and early-warning systems. Though it is useful to correct the weaknesses of corporate governance controls exposed by breaches of corruption, it is even more productive and efficient to identify and manage risks before they lead to a crisis. The private sector is often the subject of low credibility, particularly in the aftermath of grand corruption scandals. Business can help reverse this trend by being more open about the impact of its operations (ranging from the duty to shareholders to the commitment to a sustainability agenda). But disclosure that is conceived as a public relations exercise only serves to further discredit the private sector. A better option is disclosure strategies meant to engage a broad community of stakeholders in framing the issues and solutions that are communicated through company reports. Mechanisms that foster greater transparency and disclosure, buttressed by independent review, also represent alternatives to more or excessive regulation. Transparency reforms are in some degree information regulations: they lead to better informed market players—whether these are analysts, investors, customers, or any other type of stakeholder—who can then start to make better informed decisions and avoid the tragedy of the commons.

Effective board accountability is a critical element to fight off corruption. Mr. Mo Ibrahim, the billionaire Sudanese-born mobile telecommunications entrepreneur,

once explained to a participant how he managed to set up his mobile phone companies throughout Africa without ever having to pay a bribe. He worked in some of the most difficult situations of corrupt environments, yet he managed to succeed doing business without resorting to bribery. Mr. Ibrahim explained that though he was the sole owner of his company, he set up a board of directors and instructed them to treat the company as if it were a publicly traded company. He asked that the board demand to know about every payment made by the company and to ensure that such payments sat within a framework of ethics. So when he was asked for veiled requests of bribery or legitimate contributions to community projects where the company wanted to install a mobile mast, he simply answered that he would be happy to do so but first he had to obtain the approval of the board. Mr. Ibrahim ended up presenting proposals to the board of every scale, such as requests by politicians to open primary schools in their districts, but Mr. Ibrahim's objective was to ensure that payments were made in an open and transparent manner.

Third-party favors to politicians, such as honoring requests for new schools, were challenged as constituting a sophisticated form of corruption, and therefore not too different from bribes passed through brown envelopes. The debate on these opposing views led to three significant clarifications. First, with straight bribes in cash, the basic problem is that once the money is stuffed into a brown envelope we have no idea where the money goes because it is not being accounted for in any manner. Second, there is a big difference between anonymous payments of cash and completely open payments that provide a societal benefit. Thus as we think about and address issues of corruption, particularly across countries with very different historical and cultural traditions, we should remain open minded about companies that are able to make this second type of distinction. Ultimately anonymous payments that go into off-shore bank accounts are absolutely not acceptable. Third, and perhaps the critically important issue, an orthodox position against the concept of transparent contributions to communities and stakeholders puts into question the whole world of corporate social responsibility. Where governments are inefficient providers of public services, we should recognize the role that companies—both domestic and multinational, large and SMEs—can play in education, health, and other social development services.

Independent monitoring was another element deemed critical to fend off corruption in any corporate governance situation. Whether one is a shareholder, investor, or another type of stakeholder, we place considerable trust in the companies we invest in. It follows, therefore, that we need an independent reviewer that is allowed access into a company, examines all situations, and then provides assurance that the company speaks with absolute truthfulness when it claims what it states. The Enhanced Analytics Initiative, launched in 2004, was mentioned as a practical mechanism by which we could start promoting and getting traction on the principle of independent monitoring. This principle, however, is also dependent on relevant measures that can provide *bona fide* assurances that monitoring is indeed independent. Currently the U.S. Foreign Corrupt Practices Act, the OECD Convention

on Combating Bribery, and similar legislative frameworks, constitute important references for this assurance, as well as the fundamental contributions being made in this area by other voluntary initiatives, such as the Global Reporting Initiative.

Transparency also touches upon international accounting standards, which are the subject of heated controversy as to what the standards should be and how they should be written. From the perspective of practical measures to combat corruption, it was pointed out that little value can be gained from arcane questions, such as how to mark to market different financial instruments. Instead, what would have an enormous effect on changing existing incentives would be to establish a much more basic standard: when auditors sign off on a set of accounts, (1) they are confirming that appropriate controls are in place to manage corruption risks and, (2) that the board was alerted of cases where corrupt practices took place. The addition of this basic standard to global accounting standards would lead to significant transformations in how the corporate world would operate.

Recommendations were also made to help realize the contributions that multilateral organizations can make to strengthen transparency and promote transparency related reforms. The World Bank currently discloses through its website the full name of hundreds of companies and individuals who the World Bank has publicly sanctioned for being involved in inappropriate or corrupt practices. This disclosure initiative has been adopted by the EBRD, but it could also be replicated by other similar bodies and even NGOs. Further, the idea was raised that Transparency International (TI) could become a repository of all the companies that are delisted and publically sanctioned through these various initiatives, and could also contemplate devising a corruption index for companies, as it currently does for countries. The net effect sought from all these recommendations and initiatives is to increase the reputational costs of engaging in corruption, which by itself is the type of incentive that can make a big difference in the fight against corruption.

Also the role of the media emerged as central to strengthening transparency in both the public and private sectors. For example, over 4,000 companies have signed up to the principles of the UN Global Compact, and fund managers responsible for some US$12 trillion have committed to abide by the UN Principles on Responsible Investment. The media is a powerful mechanism to ensure that companies that sign up to these voluntary initiatives in fact do keep up with their promises. More generally, the media's watchful eye and its investigative journalism reporting around the principles of anti-corruption, ethics, and good corporate governance has the power to put these issues on the radar screen of society and companies, thereby illustrating how important these issues are to our private and public interests. As an example, Russian researchers recently counted the number of press mentions of particular companies with respect to corporate governance abuses. The researchers found a strong correlation between the number of press mentions and a greater protection of minority shareholders in terms of corporate governance, as compared to competitors that had not been mentioned or investigated by the press. Support

to media, and the protection of media freedoms, is therefore a key step in advancing the interests of transparency and disclosure.

Although no one would argue with the merits of transparency and disclosure, it is important to recognize that there are limits even when efforts are faithful attempts to be open and transparent. Thus, how can one trust that accurate information is being disclosed, or how does one set up reporting systems that ensure that a board is receiving the information that it needs to see and within the time frame that it needs to see it? These subtle but important nuances point to the difficult challenges of implementing transparency reforms. Nevertheless, as with the case of the oil and gas drilling company case discussed below, it is by concrete actions and steps towards the goal of transparency that one discovers gaps and weaknesses, leading to learning and innovation that help achieve better and more effective transparency and disclosure systems.

Building Ethical Organizations in the Real World

"If you want to succeed in building a sustainable business at any point in time, you need to have good people to act as the cornerstone of your growth. The fact is that you cannot attract or retain top talent if you engage in corrupt practices."

Tawfik Diab

Managing Director, PICO Petroleum, Egypt

Key Points of Discussion:

Two company case studies were examined, one from the U.S. and one from Brazil, which illustrate the operational challenges and the process of change in building ethical organizations:

- Ownership: the first step is to clearly establish who owns and who is accountable for the ethics agenda within a given company;
- Policy: a company should establish clear standards, which are generally reflected in a code of ethics. All employees should be able to fully understand the behavior and actions that are Co
- Communication: ethical organizations spend a lot of time communicating their standards to employees, using every opportunity for interaction to reinforce the values that define the company's culture;
- Measurement: ethical organizations measure their level of compliance in order to understand the degree to which they are abiding by the standards that they set for themselves;
- Enforcement: this is the hardest step to undertake, but holding employees accountable on a consistent basis is key to building the credibility of a company's ethical standards;
- Balance: even when the paramount objective is to turnaround a company from a faltering to a profitable state, the parallel application of "control-based" and "commitment-based" strategies is necessary to ensure that financial recovery goes hand in hand with employee empowerment that builds a unified vision of the company's new ethical standards, and helps protect against future risks of corruption.

Participants discussed two company cases (one from the U.S. and one from Brazil) that vividly illustrate not only the degree to which corruption can occur but also how committed action and leadership can turn corrupt-prone environments into best practice models of ethical business organizations. The U.S. case involved an oil and gas off-shore drilling corporation with approximately 7,000 employees and operations in 20 different countries. In 2005, the company discovered that improper payments were being made to government officials in one country. During its investigations, it soon discovered that some form of improper payment existed in every country that it looked into, at times going back to 2001. The company self-reported to the US Department of Justice as its actions were violations of the U.S. Foreign Corrupt Practices Act (FCPA). This launched an arduous and costly process of corporate governance reforms that today place the company among the industry leaders in compliance, reporting, transparency, and accountability systems. So far the costs of the investigations and reforms amount to US$40-45 million. For a company with annual revenues of $2 billion, the resources devoted to building a corrupt-free environment and an ethical culture represent a very high percentage of revenues. The reform process has not been easy, but it has positioned the company with a solid foundation for long-term competitiveness and sustainability. With all the scrutiny, advice, and consultations that it received, the company has probably done more thinking about effective corporate governance and combating bribery than many of its competitors or most U.S. corporations.

Reflecting on its reform experience and in comparison to the other 60 corporations that are under investigation for potential FCPA violations, the U.S. company case offers five key lessons that are powerfully relevant to solutions aimed at reducing corruption and building ethical business organizations. Each lesson is increasingly harder to implement than the previous one, but as the U.S. company demonstrated, the results can be achieved through committed leadership. The categories of these five lessons are as follows:

(1) Ownership: the first step is to be clear that the internal structures of a company reflect who owns and who is accountable for the ethics agenda. Within U.S. corporations, this responsibility should reside with the board of directors. The key point is that it must rest at the highest level of a company, where "setting the tone at the top" reflects a high degree of care and concern about complying with laws and with the principles of ethics espoused by the company. It may not always be easy to get the attention of the board on these issues, and its various committees may have different levels of concern for transparency, but the board must clarify who manages the various risks inherent to operations (e.g., anti-trust, anti-bribery, intellectual property, human resources, etc.). Regardless of how risk responsibilities are assigned within a particular corporation, the board must provide clear direction as to who manages, who advises, and who is accountable to the board for the compliance function.

(2) Policy: an ethical organization has clear standards, which are generally reflected in a code of ethics. There are two very important issues to bear in mind when dealing with ethical standards: it must be clear that the standards are based on internationally accepted norms, and not the standards of a particular country or culture. Second, care must be taken to write codes in language that is understood by all employees and not as if it were a legal treaty. Employees should be able to fully understand in simple terms what is expected of them, otherwise the codes lose their effectiveness.

(3) Communication: ethical organizations spend a lot of time communicating their standards to employees. This is partly accomplished through training, both face-to-face classroom settings and on-line modules that can be customized for different languages, categories of employees, or other criteria. However, what is important is to use every opportunity for interaction with employees—such as emails, newsletters, retreats, award ceremonies, milestone celebrations, etc.—as a way to reinforce the company's ethical standards.

(4) Measurement: ethical organizations measure their level of compliance in order to understand the degree to which they are abiding by the standards that they set for themselves. This is hard to do but a necessary step if one is serious about transparency and accountability. Both internal and external assessments—informal and formal—can be employed at all times to remain aware that employees at all levels are complying with policies and programs.

(5) Enforcement: the hardest step to undertake is enforcing a company's ethical standards. High level examples of employee discipline, such as the termination or forced resignation of senior executives, is among the most powerful statements that a company can make to demonstrate its conviction and gain credibility on its ethical culture, particularly with average employees who act under the directives of superiors. The key is to hold people accountable on a consistent basis at all levels of the organization.

The case of the Brazilian company involved a state-owned steel company that was privatized in 1992. At that point the company initiated a long and complex turnaround process. The beginning was marked by obsolete facilities, conflicts of interests among shareholders, and pervasive corruption. As an illustration, it was pointed out that distributors paid in advance for the company to produce steel, helping to create a vast network of employees that siphoned off the resources of the company. Today, the turnaround process has produced impressive results. The company's share price increased 150% in 2007, the highest return in the Brazilian stock market. It now has a market value of US$20 billion and the second lowest cost in steel production worldwide. Its results are buttressed by strong corporate governance and a strict ban on corrupt practices.

The Brazilian case helps illustrate lessons as powerful as those of the U.S. company above. The leadership was able to turn around the company by engaging in what

was referred to as a shock therapy of controls to regain the confidence of shareholders and the market. The tight controls, in turn, unleashed a series of side effects that resulted in an unhealthy internal environment: an atmosphere of fear, an excess of bureaucracy, low self-esteem, and a poor sense of achievement, all of which made it difficult to foster and develop company leaders. At times, however, the company was fighting for survival, as happened in 1997 when the Brazilian currency crisis almost bankrupt the company. The need for survival partly explained the aggressive controls that led to the negative side effects, which paradoxically threatened anew the long-term survival of the company. The leadership recognized this risk and instituted a new "commitment-based" strategy to balance the "control-based" strategy that helped turn around the company.

The commitment-based strategy—based on introducing purpose to individual and team achievements and a practice program that promoted dialogue and volunteer work—was designed to balance the former rules-based approach with a values-based approach. The purpose was to integrate ethics, values, and sustainability standards as an integral part of the company's operations, and to change the mindset of employees and managers towards a unified vision of the company's new ethical standards. The Brazilian company illustrates the value of focusing on a three-pronged strategy: financial results, a balance between control and commitment, and to do both simultaneously. The key lesson is to work simultaneously on all three fronts, as too often when we fight corruption we tend to focus too much on negative corrections (e.g., sanctions, terminations, etc.) at the expense of empowering employees. This lesson seems paradoxical, but proved to be the winning strategy for the Brazilian company's success: even when you are fighting bankruptcy, a values-based strategy is necessary for the goal of financial performance and for building a culture of ethics that helps protect against the risks of corruption.

The Small and Medium Enterprise (SME) Sector

Key Points of Discussion:

Anti-Corruption strategies and initiatives—whether pursued through legally-binding or voluntary standards, domestically or internationally—should be tailored to the appropriate needs and resources of different business structures, such as global corporations, state-owned enterprises, family-owned businesses, small and medium-sized enterprises (SMEs), and co-operatives. Because of their large number in most economies and the implications that they have for national growth and development, SMEs should not be afterthoughts in the design of major policies and reforms that are done with large public corporations in mind.

It was recognized that much of the anti-corruption debate and many of the initiatives proposed often take place from the perspective of large publicly traded corporations. Although corporate governance principles, such as transparency and

accountability, apply equally to other business forms—such as family-owned firms, SMEs, cooperatives, and state-owned enterprises (SOEs)—participants recommended that more attention and work should be done that is tailored to the specific needs and context of these other business forms. The call was to take into account the constraints faced by smaller entities—particularly as most do not have the deep pockets of global corporations—and to not simply add on these business structures to the reforms that tend to be designed for large public corporations. For example, South Africa has only about 400 listed companies but 88,000 registered SMEs. So at a scale of 1:150, corporate governance and business ethics tools to fight corruption are an altogether different type of challenge between SMEs and large corporations.

Corruption in supply chains directly leads to a consideration of corporate governance in SMEs and family-owned businesses. These are the major players in global supply chains and in very large numbers, which makes it even harder to control against all types of inappropriate practices. Global corporations face increasing difficulties in controlling corruption the further down the supply chain they go. Examples were cited of corporations that cancelled contracts from suppliers due to inappropriate business practices, yet the same suppliers would simply move and open in a new location under a new name. The more flagrant offenders would even establish mirror factories, so if auditors paid a visit they would be taken to a model facility. So as one designs disclosure systems, for example, a goal should be to prevent SMEs from becoming corruption conduits for higher levels in the supply chain, in addition to keeping reporting requirements for SMEs as simple as possible.

Conclusion

Collectively the group of participants represented a unique vantage point from all regions of the world and from different industries, offering a diversity of perspectives of how to understand and practically address the challenges of corruption. As business executives, investors, and advocates of good corporate governance, many participants underscored the real-world dilemmas that companies face in dealing with the tradeoffs between financial and social goals, especially when operating under the premise of "doing the right thing."

A call for practical and pragmatic initiatives was the leitmotif of all meeting sessions. Proposals and initiatives should strive for tools that can be used directly and easily be made operational, otherwise it will prove difficult to adhere to standards and we run the danger of falling back on lofty and rhetorical pronouncements that—in the words of Daniel Kaufmann quoted on the first page—have no spine.

If political and business leaders are not committed to anti-corruption or do not have the will to institute reforms, it does not matter what mechanisms or systems we come up with—whether these are legally biding or voluntary in nature. We can

promote and implement practical and gradual steps, such as codes of ethics and media training, but it is incumbent upon us to ensure that the broader reforms that generate the enabling environment also take place, such as judicial reform, media freedoms, and the transparency related reforms described throughout the proceedings report. Without the broader reforms, gradual but necessary steps will have limited impact.

The overall aim is to support, not undermine, private sector development, particularly in developing countries and for SMES that are so critical to national development and to poverty reduction. Excessive regulation, as one side of the coin, or lack of transparency on the other, are fertile ground for bribery and corruption. Strategies, solutions, and initiatives will differ across countries. What is important to recognize is not that value lies in "beauty contests" about which country has the best mechanisms for board accountability. Rather, the key is to identify and share the elements that constitute best practices in order to adapt them to a different context in pursuit of equally effective results. Fighting corruption effectively requires global dialogue and a learning process among stakeholders committed to good governance. We must expose ourselves to the practices of other countries, and foster different avenues to share best practices, innovations, lessons, and experiments, or again we fall into the trap of lofty pronouncements or of reinventing the wheel.

The business ethics and good corporate governance debate is not about imposing Western principles from developed economies and global corporations. It is about internationally accepted values and norms, and how an organization that is seeking finance—domestically or from anywhere in the world—can be trusted to use those funds in the best interests of those that are providing the capital. At one level, protecting the abuse of this entrusted capital involves monitoring and control systems that are typically understood to comprise corporate governance. At another level, and perhaps the most important one, good corporate governance rests upon a framework of ethics and values. This is not a morality argument, nor should it be viewed as a serial issue, i.e., whether business ethics or fighting corruption precede each other. From a purely corporate governance dimension, business ethics and a focus on anti-corruption are fundamentally complementary efforts to the larger framework of identifying and managing risks, and of balancing individual and communal goals from doing business in free and open markets. A common refrain emerged from the dialogue (attributed to Ira Millstein) that a large part of the solution in creating the incentives for decision makers to honor the three rules of business enterprise—the duty of care, the duty of loyalty, and the business judgment rule—could be distilled to: disclosure, disclosure, and more disclosure.