Policy Position

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Building Corporate Integrity Systems to Address Corruption Risks

Corporate integrity is often perceived to be the product of ethical leadership, strong compliance and effective regulations that prevent and sanction wrong-doing. While these elements are essential, each on their own is not sufficient to comprehensively and sustainably tackle the broad range of interrelated corruption risks that face companies.

For companies and policy-makers to work effectively against corporate corruption, they must integrate these components within a 'corporate integrity system'. Various stakeholders from the broader market and policy environment are part of building a corporate integrity system and provide complementary checks, balances and incentives. Implementing a policy agenda on corporate integrity must involve strengthening the system's components and working with stakeholders to realise their role in the system. The greed, recklessness and failing risk-management that characterised the financial crisis have heightened the importance for companies to have such an all encompassing corporate integrity system in place.

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"I firmly believe that a company that cheats on overtime and on the age of its labour, that dumps its scraps and chemicals in our rivers, that does not pay its taxes or honour its contracts will ultimately cheat on the quality of its products. And cheating on the quality of products is the same as cheating on customers".

- Wal-Mart CEO Lee Scott, October 2008

Among Fortune Global 200 companies, 86 per cent have business codes in place, a 50 per cent increase from 2000.[2]

Ethics Codes: On Paper vs. in Practise

As Neville Cooper, founder of London's Institute of Business Ethics, has stated "a code of ethics cannot make people or companies ethical. But nor can hammers and saws produce furniture. In both cases they are necessary tools, which need intelligent design and use."

Indeed, the proliferation of codes of conduct among companies has been exponential. Among Fortune 200 companies, the share of corporations having such codes has quadrupled in less than 15 years. Yet not all codes are equal. Some are only one page while others reach up to 80 pages. The areas they cover vary greatly, with about 63 per cent of the business codes in place at Fortune Global 200 companies addressing corruption and bribery.

The effectiveness of having codes has also been put into question. About half of a recent series of empirical studies found that codes of conduct are effective while one-third noted that they are not effective at all.

These patchy results reflect the importance and challenges of embedding a code within company and employee practises. Experts have noted that how a code is introduced, implemented, internalised and institutionalised can mean much more than what it actually covers.

1. What is a corporate integrity system?

The concept of integrity in companies refers to a holistic approach of doing business that involves the management, employees and shareholders in adopting actions and standards that provide for an effective defence against corruption and abuses. When a company has 'high integrity', conduct on the part of directors, management and employees is characterised by adherence to globally-recognised ethical standards, compliance with both the spirit and letter of the law and regulations, and promotion of responsible core values (e.g. honesty, fairness and trustworthiness).

Ethical leadership, anti-corruption compliance systems and regulatory oversight are the principal ingredients for corporate integrity. But additional incentives, checks, and balances are necessary to make these elements more effective, assess their performance, plug loopholes and provide a second line of defence against corrupt behaviour.

Only a comprehensive corporate integrity system can achieve these aims by building an inter-linking framework around four interdependent elements:

- Norms and cultures (e.g. codes of conduct, ethics and corporate citizenship);
- Governance (e.g. compliance systems, corporate governance and whistleblowing);
- Public rules and regulations (e.g. regulatory oversight and law enforcement); and
- Broader checks and balances (e.g. rating agencies, investors, employees, media and civil society watchdogs).

The first component relies on companies adopting and enforcing global ethical standards that bind businesses and employees to shared principles (values, policies and attitudes) and practices (norms, systems and processes). However, their voluntary nature and their frequent lack of independent verification makes it difficult to assess whether related measures are working (see side bar).

Governance frameworks, the second component, go a step further by establishing internal structures, processes and control mechanisms to prevent management or staff misusing their positions and power within the company for personal gain. A company's top staff — the directors, chief financial and executive officers, general counsel and human resources head — must set the tone and lead the way in behaving with integrity and encouraging standards in the company, including on executive remuneration, levels of board oversight, financial transparency and whistleblower protection.

Regulation and oversight by governments, the third component, helps to formalise and enforce such policies and practices. Yet effective regulation requires resources and political will, and these can vary considerably by country. In the case of public enforcement of securities regulations, South Africa spends four times the amount as France relative to its gross domestic product (GDP).[1]

Checks and balances on the system, the fourth component, are provided by a mix of players, including employees and larger shareholders, auditors, legal service providers, rating agencies and investment analysts, as well as investigative journalists and civil society organisations (CSOs). The effective engagement of each of these actors comes with its own challenges and depends on a wide range of policies. The media, for example, take on an essential role in disclosing high profile cases, but interference from owners or advertisers can compromise independence. For their part, auditors, accountants and rating agencies help to verify essential information on company performance and risk management, but conflicts of interest can undermine their effectiveness.

2. Gaining the 'integrity dividend' and stopping bad practices

Corporate integrity systems encourage better performance and reduce the cost of doing business. Companies with anti-corruption programmes and ethical guidelines are less likely to fall victim to corruption and lose business.

Strong corporate integrity systems pay 'integrity dividends' by preventing corruption that can lead to lost business opportunities, corporate crime, higher costs, a damaged reputation and low staff morale. Positive impacts of corporate integrity systems are associated with higher economic growth, greater productivity and higher investment to GDP ratios. In one of several such studies, an analysis of more than 1.500 companies found that an investment portfolio focusing on the best-governed companies would have outperformed the market by more than eight per cent.

When corporate integrity systems are not in place or properly functioning, bad practises can be easily spread across companies and countries by global trade, investment and supply chains. The track record of emerging economic powers such as Brazil, Russia, India and China (BRICs) is mixed on supporting the different components of a corporate integrity system (see side bar).

Just as breakdowns can spill across businesses and boundaries, bad behaviour from a company's top leadership can create a trickle-down effect. Among instances of corporate fraud, 25 per cent involve senior managers, whose actions severely damage staff morale in one out of every three cases.[3] Yet consistent ethical leadership from the top can produce the opposite effect and can turn integrity into the standard operating procedure for how business is done.

3. Responses

While business executives and regulators must lead in the building of corporate integrity systems, many more stakeholders need to join them to tackle corruption.

Business must:

Strengthen, adequately fund and assess compliance and reporting efforts.

- Report on all elements of corporate citizenship and provide information on compliance systems, public policy engagement, and company revenues and taxes (by-country)

Ensure due diligence.

- Develop strong processes for selecting reliable partners with particular emphasis on establishing company-led anti-corruption safeguards, where local institutions are weak.
- Implement effective business codes to ensure compliance. Codes must be comprehensive, morally justifiable, tailored to a company's particularities and embedded in its operations. Anonymous hotlines to report abuses, whistleblower procedures and ethics committees are tools that provide the impetus for applying codes in practice.

Monitor compliance with a company's internal policies.

- Set up and support mechanisms for the independent monitoring and verification of compliance with company codes and commitments.

According to TI's 2008 Bribe Payers Survey, one-quarter of the more than 2.700 business executives surveyed blamed private sector corruption for impeding the operations and growth of their businesses. Such findings discredit the notion that corrupt acts give businesses a competitive advantage and benefit the bottom-line.

BRICs, Bribery and Conventions

According to TI's 2008 Bribe Payers Index, a ranking of twenty-two countries, when individuals were surveyed on likelihood of their firms to bribe overseas, Chinese and Russian companies come in at the bottom (21 and 22, respectively), with those from Brazil and India performing only slightly better (17 and 19, respectively).

BRICs have also been slow in adopting regulations in line with international frameworks such as the Organisation for Economic Co-operation and Development Anti-Bribery Convention (1997) and the UN Convention against Corruption (2003). Brazil has ratified both, China and Russia have ratified only the UN convention and India has failed to adopt either.

Company employees exposed nearly a fifth of all publicly-reported cases of corporate fraud in large US firms between 1996 and 2004 — more than regulators, auditors, the media and any other actor.

This policy position draws on the TI Global Corruption Report 2009: Corruption and the Private Sector. It is one of four papers based on the Report. The others cover regulatory policies, corporate lobbying and cartels. All facts and figures, unless otherwise stated, are cited from the Report.

The GCR 2009 brings together more than 80 leading experts and practitioners to explore a wide range of corruption risks in and solutions for the private sector. To learn more, see: www.transparency.org/publications/gcr.

To purchase this and other GCRs in the series, visit Cambridge University Press at www.cup.cam.ac.uk.

Organise broader stakeholder action and collaboration.

- Support employee training and orientation programmes that emphasise an individual employee's integral role in corporate integrity.
- Adopt, support and actively engage in the development of related standards for transparency, accountability and integrity.
- Collaborate with other companies in environments where corruption is endemic to develop common approaches to address corrupt practices.
- Serve as a model when operating outside a company's home country by supporting local businesses and chambers of commerce in related work.

Governments must:

Close loopholes.

- Bridge the enforcement gaps by cooperating across borders among anti-corruption agencies, competition and tax authorities and financial regulators. Information sharing is the first step, working jointly on cases is the next.

Enforce rules and measure performance.

- Make enforcement more efficient and effective, and the process of regulation more transparent and accountable, by providing adequate funding and staff and setting disclosure guidelines for inputs to and performance of agencies.
- Strengthen oversight and controls over rating agencies, auditors and other actors to reduce potential conflicts of interest that these gatekeepers face.

Uphold international and regional commitments.

- Adopt and enforce UNCAC and OECD convention measures to provide a common policy baseline for addressing corruption and bribery.

Civil Society must:

Monitor companies' anti-corruption efforts.

- Extend civil society's watchdog functions that are used to assess a company's environmental performance, sustainability and responsible corporate citizenship to the area of anti-corruption.

Advocate adoption of complaints systems and whistleblower protections.

- Business watchdog groups and labour unions should encourage companies and legislators to create an enabling environment to internally report abuses.

Forge coalitions to monitor and advocate for corporate integrity systems.

- Various actors have an overlap of common concerns about corporate integrity and can draw on this strength to ensure that citizen interests are given due weight in related policy decisions.

References:
[1] Based on US dollar amounts per billion of GDP for a country. H. Jackson and M. Roe, Public and Private Enforcement of Securities Laws: Resource-based Evidence, Working Paper no. 08-28 (Boston: Harvard Law School, 2008).
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[3] PricewaterhouseCoopers, Economic crime: people, culture and controls. The 4th biennial Global Economic Survey (London: PwC, 2007).

Transparency International (TI) is the civil society organisation leading the global fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, Germany, TI raises awareness of the damaging effects of corruption, and works with partners in government, business and civil society to develop and implement effective measures to tackle it. For more information go to: www.transparency.org

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