

Reduced risk, enhanced reputation? – An analysis of corporate responses to bribery

Introduction

This report summarises recent findings of EIRIS research in relation to its criteria on countering bribery. It also provides recommendations to investors for future engagement with companies to improve their management response to bribery.

Key findings:

- Bribery poses significant risks to any company (and its shareholders) which has operation across multiple territories and markets
- Most FTSE All World listed companies do not adequately address bribery – leaving them exposed to risks of unlimited fines, reputational damage, restricted access to markets and difficulties in raising capital
- Oil and gas sector displays the most advanced response to bribery
- National regulations and stock market listing requirements are encouraging more companies to counter bribery
- Companies with a high level of exposure to have better policies and systems for countering bribery than their peers with lower risk exposure - possibly a result of the close scrutiny this sector has faced from civil society groups, investors, regulators and other stakeholders
- Companies which are more highly exposed to bribery are more aware of the risks they face and are doing more to address these risks than those that are less exposed.
- Investors have a crucial role to play in shaping the anti-bribery agenda

1) Why is bribery an issue?

Recent bribery cases involving large corporations have highlighted the significant impact and adverse effects that such scandals can have on individual companies' performance - as well as on the wider economy. It is therefore crucial for both companies and investors to recognise risks in relation to bribery and corruption and develop measures to counter bribery effectively.

Impacts on Society and Markets

Bribery and corruption can have various negative impacts. Bribery is known to distort markets and the allocation of resources by manipulating prices of products and services. Bribery can also adversely affect the economic and social development of countries by deterring long-term foreign and domestic investments, enhancing inflation and thereby depreciating national currencies and reducing expenditure on education and health.¹

Impacts on companies and investors

Large, off-the-book payments to public officials or intermediaries may prove to be a significant financial burden for a company and call into question the performance of its duties to its stakeholders. Adverse publicity can significantly damage the company's reputation, which may in turn result in restricted access to markets or difficulties in raising capital. Recent scandals have brought these challenges into sharp relief. Bribery scandals cost Siemens EUR 2 billion, including the USD 1.6 billion fines paid to the US and German authorities. News of a federal investigation in the United States into allegations of bribery was linked to an overnight 10% fall in BAE's share price on the New York Stock Exchange.² Overall, companies may benefit

with short-term gains but at the possible cost of long-term profitability.

These elements have significant implications for the shareholders of companies and the risk profile of investment portfolios.

Company risks

- Large expenditures affecting financial performance
- Negative publicity and reputational damage
- Impaired access to finance and capital markets

International Conventions

Governments and international organisations have sought to eliminate corrupt practices from business activities and introduced several codes to address the issue. The OECD Anti-Bribery Convention was adopted in 1997 to establish laws to criminalise bribery of foreign public officials in international business transactions. It has been adopted by 38 countries including 22 members of the EU.³

In June 2004 the UN Global Compact Summit expanded its key principles on good corporate practices that cover human rights, labour and the environment, to include a 10th measure focusing on corruption. The new principle calls on companies to put effective management systems in place to combat bribery.

The United Nations Convention against Corruption is the first global, legally-binding anti-corruption instrument bringing together key anti-bribery principles. It entered into force in December 2005 and has been signed by 140 states as of January 2010.

Additionally, signatories to the UNPRI pledge to seek "information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)"

UK Context

It was announced in 2009 that the UK government would introduce legislation to criminalise companies or individuals who offer, promise or give a financial or other advantage to another person, or who request, agree to receive or accept a financial or other advantage. A breach of the new law may result in up to 10 years imprisonment.

2) How does EIRIS research bribery?

EIRIS has developed bribery assessment criteria in co-operation with Transparency International, a global civil society organisation with a focus on corruption, to evaluate how companies are addressing this complex and difficult issue. The criteria identify a company's risk exposure to bribery and corruption and provide a comprehensive analysis of the company's anti-bribery policy, management systems and reporting that are in the public domain. The research allows investors to engage with companies on the issue of bribery by comparing results within and across sectors.

The level of exposure to risks related to bribery is determined by business sectors and countries of operation, as well as business activity, including whether the company requires government contracts or licensing for its operations.

After identifying the exposure level, EIRIS assesses the company's anti-bribery policy, management systems and public reporting using five grade levels:

No evidence - a review of company literature has revealed no evidence of any policy / system / reporting mechanisms in place to address the issue of bribery
Limited - there is some evidence that the company is aware of the issue of bribery
Intermediate - there is evidence of a company policy / system / reporting mechanism addressing the issue of bribery
Good - the company's countering bribery policy / system / reporting are considered adequate to manage risk by EIRIS

Advanced - this category is intended to identify leading practice companies

3) Research findings

Below are recent results from EIRIS research on companies in the FTSE All World Developed Index.⁴ All figures are based on information extracted from EIRIS databases as of January 2010.

Risk Exposure and Response to Bribery

As figure 1 indicates, of the nearly 2000 companies that constitute the FTSE All World Developed Index examined for this report, 32% have been classified to have a high level of exposure to bribery, 52% medium and 16% low exposure.

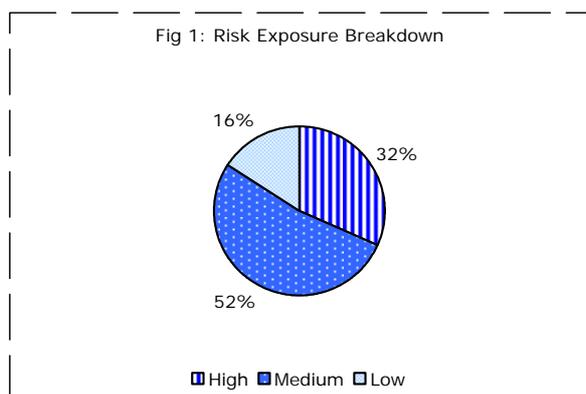
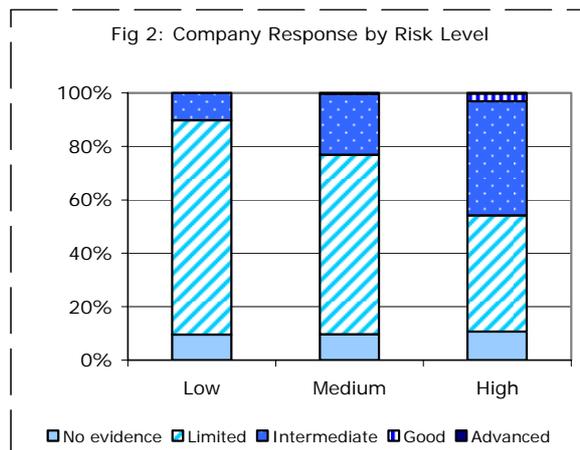


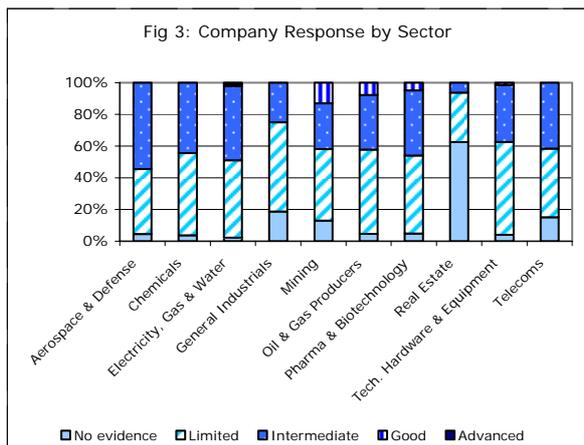
Figure 2 shows how companies with different risk levels have responded to bribery and corruption. A company's *overall* bribery assessment is determined by the combined scores derived from a company's anti-bribery policy, system and reporting assessment. It is noticeable that far more high risk companies have achieved an *advanced, good or intermediate* overall grading than medium or low risk companies. Whilst 46% of bribery high risk companies have been assessed as having at least an *intermediate* level of response to risks from bribery, only 24% of medium risk companies and 10% for low risk companies have achieved this level.



The above result indicates that companies with a high level of exposure to bribery responded to their heightened risk by implementing more comprehensive policies and systems for countering bribery and making these transparent through more detailed reporting mechanisms than their peers with lower risk exposure. High risk companies are more likely to have faced pressure from civil society groups, investors, regulators and other stakeholders to address the issues of bribery within their operations. Despite this, however, only one company achieved an overall *advanced* assessment amongst all the companies analysed.

Business Sectors and Response to Bribery

Companies in different sectors have demonstrated varying performance, as illustrated in Figure 3. In the Mining sector, 13% of companies and in the Oil and Gas sector, 8% of companies, have been assessed as *good*. This can be attributed to the valuable work of sector initiatives and civil society pressure. For example, the sector initiative by the International Council on Mining and Metals (ICMM) in 2001 and in 2002 the Extractive Industry Transparency Initiative (EITI) were established to highlight certain controversial issues within these sectors and transparency and bribery in particular. Bribery scandals have often affected whole sectors and this has made some sectors more aware of the issue than others.



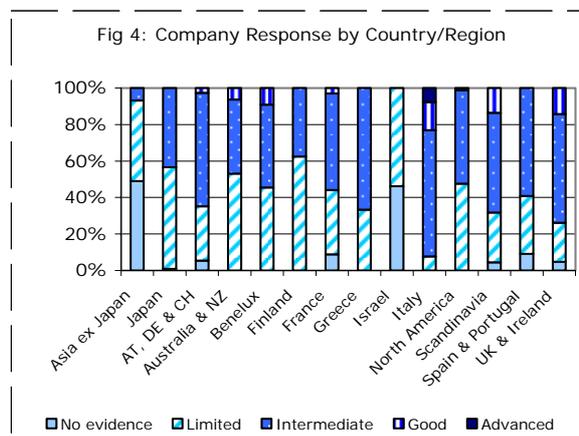
Other sectors which are showing positive developments in the area of countering corruption are the Electricity, Gas and Water sectors as well as the Technology Hardware and Equipment sectors. Real estate is the high risk sector with most scope for improvements. In this sector, only 6% of companies have been assessed by EIRIS as having an *intermediate* overall assessment and no companies as having a *good* or *advanced* assessment. This sector disparity may be linked to disclosure trends in different countries. For instance, a significant number of Real Estate companies are listed in Hong Kong and Singapore where legal regulations and Stock Exchange requirements in relation to bribery are limited.

Response to Bribery by Country and Region

Specific country regulation or stock market requirements has a positive impact on the development of company policies and systems to counter risks related to bribery. As shown in Figure 4, 92% of all high risk companies in Italy have been awarded at least an *intermediate* assessment, with none assessed as demonstrating *no evidence*. This is due to the implementation of the compulsory Legislative Decree 231.⁵

A similar trend can be observed for US listed companies. In the US companies are required to implement a Code of Ethics for relevant staff and whistle blowing procedures by the Sarbanes Oxley Act (SOX).⁶ Additionally the Foreign Corrupt Practices Act (FCPA) has raised awareness

of bribery issues amongst companies. This has contributed to 52% of North American companies having been credited with an *intermediate* assessment for countering bribery risks. No high risk North American company has been assessed as having *no evidence*.



AT = Austria, DE = Germany, CH = Switzerland, NZ = New Zealand

On the other hand, companies in countries without relevant legislation, demonstrate poorer performance. In Asia excluding Japan (i.e. Hong Kong, Singapore and South Korea), nearly half of companies, 49%, have not produced evidence of taking any significant steps to counter bribery.

4) Conclusions and recommendations for investors

Bribery and corruption is a key issue for investors. It has been addressed by some companies but many are yet to develop effective ways to deal with the issue. Approximately a third of all companies in the FTSE All World Developed Index are classified as facing a high exposure to risks linked to bribery and corruption. However, under half of the high risk companies have demonstrated even an intermediate level of management response, with only one company achieving an *advanced* assessment.

This represents an important area of risk for investors but is also an important opportunity for them to play a key role in

promoting good practice. Investors can engage with and reward companies with innovative anti-bribery tools, express their concerns in relation to bribery and help companies find new possibilities to integrate anti-bribery practices into their day-to-day business. Investors should be encouraged to engage with companies on a broad scale, since it is not only companies with a high risk exposure that are facing bribery issues.

Shareholder pressure can be of vital importance in the successful implementation of the UN Global Compact. Where a financial institution has signed the UN Global Compact, investors in that institution also have a responsibility to sign the Global Compact. Furthermore, the Principles for Responsible Investment (PRI), which have been signed by 198 asset owners and 362 investment managers, also focus on the implementation of the 10 principles of the UN Global Compact.⁷

The need for investors to engage with companies can be seen in particular with regard to the public disclosure of companies' anti-bribery efforts. Many companies still hesitate to talk about bribery. EIRIS research has found that reporting mechanisms lag significantly behind policy development and the implementation of systems within companies. Only 0.3% of companies facing high risk exposure to bribery demonstrate *good* reporting and none have been assessed as *advanced*.

Public disclosure can help to open the anti-bribery debate amongst companies, investors and civil society.

EIRIS research on bribery and corruption provides a tool for investors to comprehensively monitor a company's countering bribery policy and systems as well as monitor whether a company makes quantitative and comprehensive qualitative data available in the public domain. This enables investors to invest in companies with a strong awareness of issues in relation to bribery, engage with companies on issues that are not sufficiently included in a company's risk management or ultimately consider divestment from companies that have not incorporated

adequate measures to counter bribery in their company culture. EIRIS research provides investors with a tool to identify best practice examples and thereby help them engage more effectively with companies.

Recommendations for investors:

- Integrate anti-bribery responses in investment process
- Engage with companies, in particular focusing on transparency and reporting
- Reward good performance and highlight areas of concern
- Identify best practice examples

How we can help – EIRIS Convention Watch Service

EIRIS is a leading global provider of independent research into the social, environmental governance and ethical performance of companies. We offer a range of products for responsible investors.

EIRIS Convention Watch explores claims that companies have broken international principles on human rights, labour standards, the environment, health and safety, or bribery.

Convention Watch provides a clear understanding of the many serious negative allegations made against companies in press articles and through NGO campaigns. It reviews and assesses allegations of company breaches of the spirit of major international conventions on human rights, labour standards, the environment, corruption, anti-personnel landmines and cluster munitions. Full reports on companies' performance are provided.

For further information on EIRIS' products and services for responsible investors please email clients@eiris.org, visit www.eiris.org or call:

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Author: Sachi Suzuki with thanks to Stephanie Maier, Franziska Jahn-Madell and David Tozer

¹ MAURO, Paul: Why worry about corruption. IMF Economic issues No. 6, 1997

² Aerospace Daily & Defense Report, Volume 222, Issue 62, 27 June 2007

³ http://www.oecd.org/document/20/0,3343,en_2649_34859_2017813_1_1_1_1,00.html

⁴ The index rules are available at www.ftse.com/Indices/FTSE_All_World_Index_Series/index.jsp

⁵ Prior to the enactment of *Legislative Decree number 231 of June 8, 2001* the Italian legal system did not provide for corporate administrative responsibility for the criminal conduct of employees. Employees were liable individually for their criminal actions; however, corporate entities as a whole were not responsible, except for the reparation of the civil damages caused by the illegal conduct. This new law is inspired by the compliance models that are adopted in the United States, and it has forced Italian corporations to adopt similar models.

⁶ The *Sarbanes-Oxley Act* was passed largely in response to the Enron and Worldcom scandals; it was passed by the U.S. Congress in July 2002 and signed by President Bush on July 30, 2002. The legislation requires the CEOs and CFOs of listed companies in the United States to certify the accuracy of their companies' accounts and annual reports (Form 20-F for foreign companies) submitted to the U.S. Securities and Exchange Commission, the U.S. financial market supervisory body.

⁷ <http://www.unpri.org/>