

QUESTIONS FOR A MULTI-STAKEHOLDER DIALOGUE ON RESPONSIBLE INVESTMENT IN WEAK GOVERNANCE ZONES

Looking through the Lens of the OECD Integrity Instruments

Comments from

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Investor roles and home and host government responsibilities

1. Do companies have a role in helping to support reform of economic and political institutions in host societies?
2. If companies have such a role,
 - Is this role different in weak governance zones than it would be elsewhere?

Answer: Multinational Companies do have a role to support the reform process of the developing countries. This role assumes even greater significance in the weak governance zones characterized by weak political, economic and civic institutions since they face a trade off. If they invest with the high amount of risk in these weak governance zones, they might run into deep financial trouble. On the other hand, risk averse attitude might encourage some other companies sans international standards to invest in these zones and become part of the decay rather the reform and endanger the long term sustainable not only of that society but also of the world. It is important that the multinational enterprises, which are more conscious of the observance of the rules and standards, should take up this challenge, encourage the reform process by being partners and contribute toward long term prosperity of the society.

- How are they to tell the difference between positive contributions to the reform process and inappropriate involvement in local politics (which Recommendation II.11 of the Guidelines asks them to avoid)?
- How are they to distinguish between their own roles and those of host governments, international organisations and home governments (e.g. their diplomatic services, ODA programmes, etc.)?

Answer: It is important that the multinational enterprises should distinguish between their own roles and other key stakeholders like the host governments, international donor and financial organizations. The best way could be by joining hands with the governments undertaking reform programs as partners for the socio economic uplift of the society. Their efforts for the socio economic uplift should not overlap with those of the government and other international organizations. What is required is a concerted effort in coordination with all other involved in the development process for the economic well being. This will not only check duplication of activities but also ensure even greater transparency and accountability both in the allocation and utilization of funds.

Investor roles in weak governance host societies

3. Investors in the DRC responded to threatened or actual abuse of political power by cultivating political ties so as to establish a kind of “home made” investment protection. How do efforts of this type affect the development of the rule of law in weak governance host societies?

Answer: It depends on the intentions and motives of the investors to go for investment in the countries known for political abuse of power and violation of human rights. What is important for the investors is that they should be able to distinguish between the pro reform governments and anti reform governments. South Africa perhaps offers the best example of how to move to this transition. In the closing years of liquidating apartheid, it encouraged investors with its pro reform agenda and investors responded to their call. Cultivating with the governments which are not responding to international calls for reform runs the risk of becoming an accomplice and ultimately deteriorating not only political fabric of the society but also the financial fabric of the company.

4. The DRC case study suggests that investors in weak governance host countries have to be well informed about the local political situation and about each other’s activities.
 - What should a company do if obtains information about wrongdoing by private actors or public officials? Should companies be encouraged to bear witness to wrongdoing? Under what circumstances should companies consider that they have whistle-blowing responsibilities?

Answer: A responsible company needs to highlight the wrongdoing or misdemeanour in good faith without giving the impression it is interfering in the internal affairs of the country. If they work as partners and are able to inculcate in people a feeling of trust and confidence, they will live up to the expectations of the people, which is perhaps more important than protecting the illegal acts of the government officials, and at the same time fulfilling their whistle blowing responsibilities in letter and spirit.

- Should their responses be different in weak governance zones than they would be in other investment environments? If so, how?

Answer: Their responsibility in weak governance zones is certainly more delicate. They should never give the impression of cultivating political ties with the government for the sake of their business interests. What is important is how they can contribute toward reforming these governments for the benefit of the society. This could be possible only if they hold themselves up as transparent and accountable by following the guidelines outlined in the instruments of integrity of OECD.

- If companies have a responsibility to make their knowledge about wrongdoing public, how can they protect themselves against retaliation by host country actors?

Answer: One way to protect themselves in the degree of involvement of the local population in the operational activities of the company. If the involvement of the local population is constructive and meaningful, it will hold back the detractors from taking any retaliatory action against them. The local population raise hue and cry because they believe they the foreign companies are engaged in the local politics of the country. The companies need to dispel with this impression and they can do so, if they work in tandem with the local stakeholders.

5. The DRC case study shows that oil and mining companies provided “monetisation” services that converted the DRC’s natural resource assets into (mainly) financial assets that accrued to state-owned enterprises or to the Treasury at a time when few financial and fiscal controls were in place.
 - Does companies’ provision of these services influence the nature of their responsibilities in weak governance host countries? If so, how?

Answer: Yes. The company should have considered the financial and fiscal controls that were in place at time before committing themselves to any amount of money. It not only adversely affected the sustainable development cause but at the same time resulted in the wastage of resources by a fiscally irresponsible government. It is suggested to monitor the provision of such services in the light of the integrity instruments to save both the material and sustainable resources.

- How can these companies avoid giving the appearance that they are aiding and abetting people who might be in a position to take advantage of the weak financial and fiscal controls in the host country?

Answer: Multinational enterprises observe certain international standards and norms reflected in the integrity instruments of the OECD as well. They need to distinguish between the activities which are environment friendly, transparent and accountable and which are not. There should be a mechanism of assessing that whatever step the company has taken in the host country by virtue of its investment operation have added more to the costs or the benefits. This mechanism should be developed in the light of the cost benefit analysis taking into accounts the concerns of all the stakeholders of the host country from the common people to the government. If the benefits outsmart the costs, in terms of socio economic uplift then the company should go for an activity, otherwise decides against it.

6. Is there any special role that financial companies can play (besides their important and often legally required contribution to helping combat money laundering) in improving the institutional framework in weak governance host countries?

Answer: Yes. The financial companies can play a very important role in promoting a culture of transparency and accountability in the host country. They should not help check money laundering but also try to equip the local financial institutions with all the necessary tools and techniques required for the good, smooth, efficient and transparent of these institutions. This can be done by enhancing the capacity of the local institutions in fulfilling international financial standards.

Corporate governance – creating shareholder value with integrity

7. The Disclosure Chapter of the Guidelines encourages companies to apply high standards of financial and non-financial disclosure. Do companies have an extra duty of transparency when investing in non-transparent host countries or are their responsibilities in this area the same in all host countries?

Answer: They have an extra duty in the sense that at times they will be faced with stiff resistance. They can overcome it by building the capacity of the local institutions and train them in all the important fields of financial and prudential regulation. Financial propriety is the key toward promoting good corporate governance. It is one aspect on which there is no room for flexibility. The greater the transparency and accountability, the more well entrenched and sound the financial system of the country and less the chances of misuse of public money for illegal profits. The constant emphasis to comply with the international financial reporting standards should go a long toward changing the culture of the societies in weak governance zones making both the business and government responsible.

8. OECD societies have valid reasons – grounded in the public interest -- for holding large, publicly-listed companies to higher transparency standards than smaller and/or unlisted companies. The case study of publicly-listed junior mining companies with DRC investments suggests that the juniors have smaller, less open boards than large companies; are less likely to report on company policies, management practices and performance in non-financial areas. The small unlisted mining companies in the case study are found to be less transparent than both large and small publicly listed companies in the financial and non-financial areas.
- Should junior and small unlisted companies be encouraged to use their boards to assign high strategic priority to the ethical management of their investments in weak governance zones? If so, how could this be done (e.g. add board members, create a special committee with access to relevant expertise)?

Answer: Yes, the instruments of integrity should be applicable to all irrespective of the size and scope of the company. The small unlisted companies should reconstitute their board to include more board members having independence, and who can at the same time check on the illegal tendencies of the executive and management. Inclusion or expansion of the board only is not sufficient what is required is the provision of an effective say of these members in the activities to have regular monitoring. The small unlisted companies should also undergo regular auditing procedures since the principles of corporate governance are meant to create responsible business and responsible business means socially responsible business.

- Recommendation II.8 of the Guidelines asks companies “to develop and apply ... management systems that foster a relationship of confidence...” with the societies in which they operate. The Disclosure chapter encourages them to communicate information on “systems for managing risks and complying with laws, an on statements or codes of business conduct”. How do these recommendations apply to small unlisted companies and to junior companies in weak governance zones? Should they be encouraged to adopt internal compliance and external non-financial reporting practices that the case study shows to be common among larger extractive industry companies?

Answer: The small listed companies should not adopt practices that are not compatible with the good corporate governance mechanisms. They should adopt the same practices of ensuring internal compliance and external financial reporting practices as the standards suggest. In no way, these companies should exploit the leverage being small, responsibility creates no difference between small and big, when it comes to rule of law, it should be observed across the board.

- Chapter I of the Guidelines acknowledges that small- and medium-sized companies may not have the same capacity to observe the Guidelines as larger enterprises. Is asking the juniors and the small unlisted companies to open up their boards, adopt advanced compliance programmes and engage in extensive non-financial reporting equivalent to asking these companies to act like large publicly listed companies? If so, is this reasonable?

Answer: The point is it is not a matter of small and big. It is a way of going about in business. The only pretext on which these small companies escape is the excuse of the lack of resources? More often than not, it is regarded as a genuine reason. But the fact of the matter remain, that they cannot deny the utility of observing the principles and codes laid down for large business enterprises. Steps should be taken to equip them with the same skill set, and tools required for good corporate governance. Capacity building, sound management practices, honest corporate and financial reporting mechanisms are some of the inputs that go into the process of establishing good corporate governance. The sooner these small companies should adopt these standards, the better for them.

Doing business with weak governance state-owned enterprises (SOEs)

9. The case study shows that many OECD-based companies had joint ventures and other business relations with SOEs in the DRC and suggests that these SOEs' governance rules were weak. OECD and non-OECD experience shows that weak governance SOEs can be a mechanism for lowering public wealth through waste or questionable business practices. Through their joint venture arrangements, OECD based companies provide services and revenues to SOEs.
- Are companies' responsibilities the same when they enter into joint ventures with weak governance SOEs as their responsibilities with stronger governance SOEs?

Answer: Yes they need to abide by the same rules and regulations otherwise they will not only let the corrupt and the unfair escape the responsibility but run the risk of spoiling their own management practices.

- What SOE characteristics should an investor look at when considering whether or not to enter into partnerships with weak governance SOEs and when deciding how such partnerships should be managed?

Answer: Effective and efficient management, financial health of the company, and accountability and transparency are absent more frequently in SOEs exceptions apart. Most of the SOEs are undergoing reform in recent years. An investor entering into an arrangement with the SOEs needs to look at the commitment of reform by the SOE, if it is fully committed to reform it self, it should enter into partnership with the SOE. The commitment to reform however should be demonstrable in a tangible manner and one such way could be the degree of adoption of the OECD integrity instruments for the multinational enterprises.

- Guidelines Chapter X asks companies to conform “transfer pricing practices to the arm’s length principle.” Should companies be encouraged to apply this principle when structuring transactions with SOEs, even when it is not required by law or is not a common business practice in the host country?

Answer: No. Since transfer pricing is one factor which makes SOE less prone toward transparent documentation. For the companies entering into arrangement with the SOE, they should be encouraged to apply these practices of arm’s length principle.

- Does Annex Table 1 – drawn from the OECD Corporate Governance Principles and the Guidelines for Managing Conflict of Interest in the Public Sector -- provide a useful list of considerations for identifying weak governance SOEs?

Answer: Yes. It is a useful check list for identifying weak governance zones. However it needs to make a distinction between the zones currently undergoing transition and make themselves ready for these principles and the ones which are not yet observing these principles at all.

10. Many of the larger multinational enterprises in the DRC mining sector tend to be non-operating shareholders in mixed public/private companies. In this respect their positions and interests are similar to those of the DRC citizens. In addition, large publicly listed companies tend to have significant expertise in corporate governance, involving elaborate and transparent governance practices. The current DRC government has identified SOE reform as a policy priority.

- Should such companies be encouraged to seek to protect the interests of host country citizens (as shareholders in these partially state-owned companies) or are their responsibilities limited to protecting the interests of their own shareholders?

Answer: Yes they should seek to protect the interest of the host country citizens as it will not only pave the way for the smooth and speedy reform but would only ensure the sustainability of this reform process which is of utmost importance given the track record of the weak governance zones, where most of the reform program fail because of lack of consistency and coherence in policies.

- Recommendation II.6 of the Guidelines asks companies to “uphold good corporate governance principles”, while Recommendation II.3 asks them to “encourage local capacity building through close cooperation with the local community, including business interests”. Should large companies be encouraged to share their governance expertise with their SOE partners?

Answer: Yes since this is one potent way of promoting good corporate governance practices in weak governance zones.

Corporate tax payments into weak governance fiscal systems

11. Do companies that make large tax and royalty payments to weak governance fiscal systems have a role in supporting reform of these systems?

Answer: Yes

12. If it is agreed that companies have such roles, then:

- how do these relate to those of other actors, notably host governments and international financial institutions (whose mission is *inter alia* to promote public sector reform)?

Answer: These companies should work in partnership with the hosts governments and international financial institutions to promote public sector reform. Industry education partnership could be one policy step. The establishment of this partnership will not only produce pragmatic solutions based on sound research based evidence but would also identify the priority areas for further research in the field of public sector reform hitherto unaddressed paving the way for a win win situation.

- how can companies most effectively go about supporting reform? Should companies refrain from signing contracts with governments that prohibit them from publishing their payments to host country treasuries? Are there countervailing concerns about business confidentiality that cannot be met through appropriate contracting?

Answer: Companies can support the reform process by providing financial resources for specific purposes. Before committing any amount of money, they need to ascertain the viability of the projects. The priority areas could be the social sector like health, education, and other priorities outlined in the Millennium Development Goals aimed at eliminating poverty. But the process of financing should be transparent and the companies should avoid entering into contract with the governments disallowing them to make their contribution public as this goes against the very spirit of reform process and raises doubts and apprehensions in the minds of people. New Economic Plan for Africa's Development (NEPAD) could serve as guideline for them.

13. Do the questions set forth in Annex Table 2 – which are based on the OECD Best Practices for Budget Transparency -- provide a good basis for identifying weak fiscal systems and areas where reform is needed?

Answer: It provides a good basis for identifying weak fiscal systems. It could be further strengthened by including questions like what proportion of budget is allocated as discretionary funds of important personalities at the helm and what is the mechanism of audit of these funds. Secondly in many countries defence budgetary allocation is exempted from audit. The interpretation of the word audit needs to be expanded as some auditing practices currently in place do not fulfil standard auditing definitions.

Eradicating bribery of public officials

14. Chapter VI of the Guidelines asks companies to promote employee awareness of and compliance with company policies against bribery and extortion and to adopt management control systems that discourage bribery and corrupt practices. Do participants agree that these recommendations are particularly relevant for investors in weak governance zones, where bribery and corruption is common?

Answer: Yes. Companies should refrain from indulging in local politics as this is one factor which has come in for criticism in recent years as some companies back up their respective political constituencies and reap the reward after their success. The point to make is it is the task of the men at the helm in the home country as well to bring this company to task if it takes such steps of indulging in local politics. It will pose dual fear from the host and home country to hold this company back from indulging in such practices.

15. Recommendation VI.2 of the Guidelines asks companies to “ensure that remuneration of agents is appropriate and for legitimate services only”. When a company’s agent or other business partner is found to have bribed public officials, is it sufficient for the company to sever its relationship with the agent or should it be encouraged to take additional remedial actions? If so, what kinds of actions would be appropriate?

Answer: In the first the company place the company should sever its relationship with the agent guilty of such practices. The remedial measure should follow after this action. Possible remedial measure should include

- **Activity based payment by the finance department and the finance officer needs to verify the nature of the payment to be made and should be held responsible for any irregularity in this regard.**
- **Reduction in the discretionary powers of the agents to get such payments released**
- **Strong internal auditing procedures to ensure transparency in its financial operations.**