



Business and Industry Advisory Committee to the OECD

Comité Consultatif Economique et Industriel Auprès de l'OCDE

Paris, 10 December 2004

BIAC Statement

On

**'CONDUCTING BUSINESS WITH INTEGRITY IN WEAK GOVERNANCE ZONES: ISSUES
FOR DISCUSSION AND A CASE STUDY OF THE DRC'
DAF/INV/WP(2004)1**

BIAC Committee on International Investment and Multinational Enterprises

1. BIAC is looking forward to the OECD Experts Consultations on Business Integrity in Weak Governance Zones on 15 December and its consultation with the OECD Investment Committee on the 16 December. The following should provide some input into the discussions while complementing our submission on the issue from mid-September this year.

I. General Points

2. In order to input more substantially into the process, BIAC asked its members for their views on the issues of security, governance, whistle-blowing, partnerships with SOEs, host country and company responsibilities, public budget integrity and home country government assistance. From the feedback we got, we would like to highlight the following:

3. The primary responsibility of companies doing business in weak governance zones is to obey the law, meet their responsibility to their shareholders, and do the job they were invited in to do. Thus, any outcomes of an OECD project on Weak Governance Zones should be practical for companies, i.e. provide concrete proposals for company action and thereby create real value added for the host country and business alike. Since it is very difficult to generalise on situations in a multitude of weak governance zones, everything depends very much on the situation, roles and responsibilities in each individual case. Thus, general guiding principles beyond or supplementing the OECD's Guidelines for Multinational enterprises should not be promulgated. However, BIAC has supported effective implementation of the Guidelines and continues to do so. In this sense, the Guidelines offer a useful point of reference when companies operate in difficult environments.

4. Certainly, companies' responsibilities include obeying national and international law and meeting the responsibilities to their shareholders and employees. They may also see a benefit from participating in CSR-Instruments. It is sadly a very valid description of investor's situation in weak governance countries that they are also victims of rights violations (para.32 of the Secretariat's paper). This is why in our survey, respondents tended to place a lot of weight on the security issue. It is probably fair to say that since the end of the cold war the security situation for the international expatriate community has deteriorated critically in many countries, whether we are talking about political and economic security or property and work environment security. The security of its employees is a core concern of companies nowadays investing in weak governance countries.

5. This shows already – and we find it very positive that the Secretariat paper acknowledges this – that the answer to the question of how business can make sure that they are not “part of the problem”, but part of the solution in these countries is not obvious. In reality companies are facing difficult ethical questions (para. 67, 68), most of them are in fact outright ethical-- if not impossible-- dilemmas.

6. One of the major points made by members concerned the nature of investments arrangements in the extractive industry (oil, gas, minerals other natural resources) in the host country:

- Investments in the extractive industry are very long term and very costly. Energy projects are usually more capital-intensive than projects in most other industries, involving large initial investment before production or supply can begin. The more capital-intensive an industry, the more exposed it is to risks. While investors can reduce economic risks, political and legal risks are often outside their control. Host governments may change the regulatory and economic framework at any time in a

way that substantially affects a project's financial viability. Therefore companies investing need very strong long-term agreements with the host government which include guarantees (arbitration) for the economic viability of their investments.

- After larger companies have made their investment, they are viewed by the host country government as influential because of the size and potential value of their investments (even if their negotiation position vis-à-vis the host government weakens considerably after the pre-entry stage). This means that they are under a spot light and have to be very careful not to assume the role of government. But this creates the first dilemma for the larger, MNE investors: if they interfere with the host countries affairs, the host government may see its sovereignty challenged and could threaten the investment. If they do not interfere, the international community might criticise them for not following international "CSR standards" with the consequence that grants might be renounced, investment credit guarantees issued by the home country put into questions, etc.

7. There is indeed no obvious answer to this situation or similar situations in which a company may be asked to assist in providing governmental functions Any thoughts that the OECD may wish to share with BIAC must acknowledge that the starting point must remain that the major role of companies is to produce, distribute, market, etc. which is the basis for host countries' invitation to OECD companies to invest in their country (para.5). Business can not be a surrogate of governments.

8. On the other hand, **companies do have an opportunity to assist where governments seek reform and commit to reform on a sustained basis.** There is always a strong business interest in good governance and given a serious commitment of the host country, companies should always support governance reform. BIAC members are already involved in much of the outreach work done by the OECD Investment and Governance Committee which has exactly this goal, but would need to be extended to Weak Governance Zones.

9. **The important condition is that host country governments must lead and own the effort.** There have to be clear lines of responsibility between host and home governments, international organisations and companies in place. **We would argue for a co-operative approach involving all these actors and business would look at such an effort with great interest. If the current project leads to help clarifying these respective roles and setting up a kind of Public-Private Partnership for host countries governance reform, it is to be welcomed.**

10. **In order to do this, as a first step, more information needs to be collected on the experience of other international institutions, other IFIs and national aid institutions who have worked in this area.** This would be an opportunity for OECD governments, BIAC, TUAC and other international organisations to co-operate and provide some value added to the effort. The positive outcome that should emerge from this exercise should be the identification of limited but very concrete initiatives that business could entertain and consider with governments and other stakeholders, rather than delegating to business tasks which governments were unable to fulfil.

II. Some Preliminary Comments on the Secretariat's paper

11. BIAC would like to compliment the Secretariat for further developing this difficult project. We would like to highlight some positive points made in the 26 November version of the Secretariat's paper on "Conducting Business with Integrity in Weak Governance Zones":

12. The paper recognises already in para. 1 "the primary roles of public policy in host countries and of the international community in improving institutions". This is an important point for the business community. It is more and more shared by the civil society who has become equally critical of the notion that companies should "substitute" governments in pursuing public goods in countries with governance failures. As stated before, this does not mean that companies have no role to play in supporting positive public governance, but that public competences should predominately rest with public institutions which should be – at least in theory – accountable to their people.

13. The paper goes on to highlight that "economic history attests to the power of business sectors to raise general welfare and living standards when they operate within effective systems of public and private governance" (para.23). This reassures us that business' continuous involvement in weak governance zones is not only to be seen as not damaging but even supported by the OECD Investment Committee. We also welcome the finding that "in most countries, the asset conversion services provided by extractive and financial industries contribute to general welfare in important ways" (para. 32).

14. Again, we find it very reassuring that BIAC's old hypothesis: exit of the OECD investor does not result necessarily in an improvement of the situation in the host country, is taken into account in the paper when it states that the "findings tend to support the contention of major mining and petroleum companies that, if they are prevented from investing in 'difficult environments', then other investors are available to take their place" (para.28).

BIAC stands ready to explore with governments and international organisation ideas on improving the governance environment in weak governance zones, acknowledging business' potential for concrete improvements in its sphere of influence if co-operation and definition of roles and responsibilities with governments and other stakeholders is achieved.

ANSWERS TO CONSULTATION QUESTIONS PROVIDED BY BIAC (LETTER OF 16 SEPTEMBER 2004) TO AN EARLIER VERSION OF THE CONSULTATION QUESTION (IN A DOCUMENT MADE AVAILABLE TO THE INVESTMENT COMMITTEE AT ITS SEPTEMBER 2004 MEETING).

Investor responsibilities and home and host government responsibilities

1. Do companies have a role in helping to supporting reform of economic and political institutions in host societies?

Of course, as a basic rule, all companies have a duty to respect universally accepted human rights and other internationally accepted standards, regardless of the country in which they are operating. BIAC does not see its role in defending unlawful or corrupt behaviour of any company engaged in weak governance zones.

However, the difference in business environment in countries with weak governance (so-called 'failed states') as opposed to that in OECD countries must be acknowledged. We regard the duty of care to its employees and also of its assets as the first and foremost responsibility of a foreign investor in such a host country environment. As the *Economist* recently stated, the protection of its employees is more and more a major challenge for companies operating in weak governance countries. This alone, constitutes a major operational difference in the investment environment companies are faced with in weak governance zones as opposed to an OECD investment environment. Apart from that, companies should strive to improve economic and political institutions if they have the means and opportunities to do so, although the opportunities to influence the latter can be limited and balanced against the risk of being accused of political interference.

The major point is that the assumption of any 'general obligation' to get engaged in the politics of the host country must be rejected. It is up to the company, which may differ considerably in size, influence, skills, contacts etc., to decide what further positive contributions it can make. Demanding too much can result in discouraging business in these countries.

2. If companies have such a role,

Is this role different in weak governance zones than it would be elsewhere?

- 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)?

As the report highlights, the majority of companies operating in this region are small, junior companies operating in a challenging environment. From such a perspective, the differentiation between positive contributions to the political process and improper involvement in local politics is a difficult one. The weaker the governments are in these countries the bigger the rhetoric tends to be on 'sovereignty' and non-intervention by foreigners. Having to deal with different fractions of insurgents/troops etc. throughout the country add to these difficulties.

- How are companies to distinguish between their own roles and those of host governments, international organisations and home governments (e.g. their diplomatic services, ODA programmes, etc.)?

Investor roles in weak governance host societies

3. 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.

Rules-based systems such as Bilateral Investment Treaties are good instruments for the protection and promotion of foreign investments, and hence should lower the incentive for business to seek protection from the government by creating 'home made' investment protection schemes.

- If a company were to become aware of wrongdoing by private actors or public officials should it speak out publicly about it? Do companies have a responsibility to bear witness about wrongdoing or questionable practices?

We do not want to encourage unfair practices and therefore tend to agree that any company should be obliged to report any criminal offence committed by public officials or private actors. However, we believe that excessive finger-pointing and whistle-blowing is unproductive because it impedes the free and efficient operation of independent companies and creates and conveys an image of, an unstable and suspicious environment. We believe that the environment in weak governance zones is already sufficiently conducive to whistle-blowing. We do not want to induce it further by turning it into a legal requirement. In these countries wars start over spurious claims and erroneous information.

- If they do have such responsibilities, are these different in weak governance zones than they would be in other investment environments? If so, how?

The corporate responsibility to report criminal offences remains the same in all circumstances, but we do not want governments to provide incentives to competitors to make false claims in an environment which is already prone to whistle-blowing.

- If companies have a responsibility to make their knowledge about wrongdoing public, how can they protect themselves against retaliation by host country actors? Is there a role for concerted action via business associations? Can home governments assist companies?

In the case of criminal offences, business associations could help avoid retaliation by host country actors by being the mediator between companies and government for the disclosure of wrongdoings. By keeping anonymity and avoiding direct accusations from one party to another, business associations could reduce the escalation of tension between and within parties and the incentive to retaliate.

4. 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?

The process of asset conversion in developing countries is a normal one. In a risky environment with an in-existent legal framework, it is common for companies to provide related services to the government in exchange for protection and guarantees of government support. However, the perceived power of 'asset conversion' is a fragile one. Because of the political instability and the prevalence of bribery and corruption, companies are never fully protected against the threat of expropriation or nationalisation of company assets by the government.

- 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?
5. Financial companies can also provide asset conversion and other services that might be of assistance to people seeking to take advantage of host countries' weak financial and fiscal controls. Does their provision of these services influence the nature of financial companies' responsibilities in weak governance host countries? If so, how?

In providing financing in emerging countries, financial institutions have significant opportunities to promote environmentally and socially responsible development and therefore can help improve the institutional framework in weak governance countries. This is commonly done by creating a set of Principles for good investments with a list of minimum criteria the borrowing party must fulfil to receive the investment. Public financial institutions such as the World Bank and regional development bank have their own set of guidelines, but now approximately 20 private financial institutions have adopted the Equator Principles as their guideline to better project finance practices.

However, the development of a plethora of guidelines for private investments in developing countries can actually lead to the undesired result of a slowdown in private investment due to the setting of unrealistic and overly detailed requirements and to restrictions on private investors' freedom of decision and action.

Corporate governance – creating shareholder value with integrity

6. 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?

No, a company's duty of transparency should be the same regardless of the country it is operating in. However, the laws enacted for supporting this duty to transparency should in no circumstance infringe on a company's duty of care of its employees, and of its assets.

7. OECD societies have valid reasons – grounded in the public interest -- for holding large, publicly-quoted companies to higher transparency standards than smaller and/or private 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 privately held mining companies in the case study are found to be less transparent than both large and small publicly quoted companies in the financial and non-financial areas.

In general about the relationship of responsibilities of small and large companies. Realistically speaking, small companies face different pressures and incentives from their larger counterparts. Larger companies are more exposed to an international public and press, thus safeguarding their reputation is crucial for survival. Moreover, they face a variety of internal and external pressures, such as capital market pressure, employee pressure and legal constraints that can be less restrictive in the case of smaller companies. However, one also has to see that smaller private companies are more vulnerable, can more easily be manipulated and hence are less able to protect themselves against threats, blackmailing and other corrupt practices by the host country. They may face less incentive for conduct, but they also face more exposure to threats/loss of business. The protection of SME investors and their employees might be the more relevant problem in weak governance zones than pondering about how they can improve public institutions.

Therefore, in weak governance zones, small and large companies face different pressures and have different incentives for responsible management. Yet, in a similar tone to the answer to question 1, of course companies should face the same responsibilities regardless of their size and status, notably in terms of abidance to internationally-recognised human rights protocols.

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

8. 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.
9. Are companies' responsibilities the same when they enter into joint ventures with weak governance SOEs as their responsibilities with stronger governance SOEs?
 - 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?
 - 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?
10. Most of the larger multinational enterprises in the DRC mining sector tend to be 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.

- 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?
- Recommendation II.6 of the Guidelines asks companies to “uphold good corporate governance principles”. Should large companies be encouraged to share their governance expertise with their SOE partners?

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 responsibility to promote reform of these systems?

The EITI is part of a greater initiative to improve the investment climate in developing countries by increasing transparency over payments by companies to governments and government-linked entities, as well as transparency over revenues by those host country governments. Indeed, revenues from the extractive sectors are an important engine for economic growth and social development and the lack of accountability and transparency in these revenues can exacerbate poor governance and lead to corruption, conflict and poverty, especially in the Tropical African context where rent-seeking practices, patron-client relations and capital flight are common.

However, we firmly believe that how revenues are allocated by the government is a decision of the host country’s government only, and companies have no right to interfere in such decisions. As much as citizens have the right to complain about how revenues are allocated by their government, companies should not be used as a tool to influence the government. Moreover the feasibility of such an initiative is questionable. As Bhagwati points out, “If multinationals started interfering in decisions of this kind, that would be political intrusion that would be rejected by every government that values the independence they fought for prior to their independence from colonial powers” (Bhagwati, 2004 , 169). Lastly, the EITI model is specific to the extractive industry sector and is not always easily applicable to other sectors.

12. If it is agreed that companies have such responsibilities, 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)?
- how can companies most effectively go about meeting these responsibilities? 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?