QUESTIONS FOR A MULTI-STAKEHOLDER DIALOGUE
ON CONDUCTING BUSINESS WITH INTEGRITY IN WEAK GOVERNANCE ZONES

Response from
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We are concerned that the questions only deal with a narrow subset of issues contained in OECD instruments. We are particularly struck by the absence of any question about how companies should interpret the human rights provision of the OECD Guidelines for Multinational Enterprises when operating in weak governance or conflict zones. Also it is not clear how the different OECD instruments relate to one another – while opportunities for linkages exist they have not been developed – nor is it clear how they might relate to and complement non OECD instruments e.g. Global Compact, Universal Declaration of Human Rights etc. Another general point is that the answers to the questions would vary enormously depending on whether a company was investing in a country with weak institutions or one in the midst of a civil war or a country with a repressive or authoritarian government.

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?

Companies exercise a great deal of influence over economic policies in developing countries either directly in their negotiations with host governments or indirectly through their home governments or international financial institutions such as the World Bank. Inevitably companies look for short-term reforms that favour their own commercial and financial interests, which are not usually compatible with meeting the host country's sustainable development goals. In conflict zones the companies need to extract the maximum in the shortest period possible exacerbates such problems. Inevitably this results in greater environmental damage, little added value as most of the minerals are shipped out of the country as quickly as possible for processing elsewhere, and in the worst cases it consolidates economic power among a small elite. This type of 'investment' acts as a break on genuine political, economic and social development.

2. If companies have such a role,

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

The scope for having a positive reforming influence will differ depending on whether a company is present in a country with weak institutions or a country whose institutions have been undermined or fragmented because of conflict. In the latter case, the opportunities for having a positive influence are minimal.

In weak governance zones, a key lesson to emerge from the DRC study is that it is a mistake to pursue rapid reforms for the benefit of foreign investors and the private sector if reforms to improve respect for civil and political rights and the overall administration of justice are not pursued with equal vigour. Companies demand 'investor protection' but are silent when it comes to broader issue of freedom of expression.

It should be obvious that in weak governance or conflict zones, companies' behaviour will be judged not only on whether they "obey the law, meet their responsibility to their shareholders, and do the job they were invited in to do" but also on whether they have conformed to the OECD Guidelines and other human rights standards.

Given the complexity and distinctive nature of weak governance and conflict situations it would be dangerous to generalise. It should not be taken as a given that the continuous involvement of business in weak governance zones is "not only to be seen as not damaging but even supported by the OECD's Investment Committee".

- 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)?

Companies that promote transparency and try to work constructively with civil society organisations are more likely to make a positive contribution to the reform process. But of course in weak governance and conflict zones civil society may also be weak and subject to ethnic or political allegiances. In such cases companies have to tread carefully not to exploit or inflame such differences. Working through international development NGOs is one way of approaching this problem.

Companies should declare what contributions they have made to political candidates. They should not, for example, pay local journalists to attend press conferences and should do all they can to promote freedom of expression and information to the wider community.

- 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.)?

Companies are only expected to act in their 'sphere of influence'. Companies will be assessed on the way in which they negotiate deals; the transparency of their transactions; their relations with local communities not merely in providing 'services' but whether they disclose relevant information about their activities, the composition of their board, their ultimate beneficial owners, and the scale and duration of their investment.

It is worth noting that many of the DRC-based companies make large claims about the role they have been forced to play in the absence of a State to justify their presence in conflict zones. There are few opportunities to verify the amounts of money that are spent nor to assess their value in terms of sustainable development. Roads may be built and maintained but they are for the companies' convenience and needs and do not necessarily meet the needs of local communities to reach markets. Companies often negotiate with local chiefs to provide certain goods and services (such as schools) bypassing emerging progressive and democratic structures. For companies in remote locations their security arrangements with local police or military leave them vulnerable to demands to give practical assistance in repressing real or imaginary rebellions thereby risking being complicit in human rights abuses or even war crimes.

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?

Investors in the DRC needed a local political sponsor in order to obtain mining concessions or licences to operate which meant that they paid their political allies special 'fees' or bonuses, or offered *them shares in the enterprises or paid outright bribes usually through agents in order to get established and to maintain control of their assets. In the Eastern part of the country the different rebel administrations and their military backers made clear that such payments were necessary to purchase weapons and prosecute the war. All such activities undermine the development or re-establishment of the rule of law.*

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?

In the DRC companies were and continue to be remarkably reticent about wrongdoing by other private actors perhaps because they fear some sort of retaliation. They are more outspoken about public officials but again they often seem to prefer to deal with these issues 'informally' with the assistance of their political allies. Companies have an obligation to report cases of war crimes, crimes against humanity and serious human rights violations that they have knowledge of to an appropriate international body if it is not possible to report such crimes to the host country's law enforcement officials because they may be complicit.

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

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

There should be a simple test for a company deciding whether to invest in a weak governance or conflict zone. Would it be possible for company representatives to report serious wrong-doing to an international body and/or a host country institution without suffering negative consequences? If the answer is no then it should not proceed.

Companies that decide to report to appropriate international bodies wrong-doing by others should benefit from some kind of 'witness protection scheme' provided that they are not acting out of anti competitive motives.

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?

Companies that offer directly or through agents financial incentives to politically exposed persons are clearly in violation of different aspects of the OECD’s ‘integrity package’. Offering bonus payments, shares or regular payments to political intermediaries still seems to be routine in weak governance and conflict zones.

The only protection for companies obliged to operate in such circumstances is to maintain a complete and public record of all payments. Payments to help purchase weapons or which might facilitate human rights abuses are clearly never acceptable. If companies suspect that funds destined for the Treasury are being funnelled into private accounts they can file suspicious transactions reports to the relevant Financial Intelligence Units.

- 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?

Companies should not operate in places where there is no revenue transparency mechanism in force and where payments to the Central Bank are either not made or are not properly recorded and tracked. Ad hoc arrangements that depart from best banking principles should never be regarded as acceptable.

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?

Improved implementation of anti money laundering regulations is essential, particularly in the area of correspondent banking. The intermediary financial sector should also espouse the OECD Guidelines to inform and guide investment practice in weak governance and conflict zones.

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?

Of course. Companies choosing to invest in weak governance or conflict zones need to demonstrate that they are reputable and this means adhering to even higher standards of disclosure and accountability than usual.

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)?

Even small companies could have access to ethical guidance if they wanted. More should be done to ensure that all companies are given coherent advice from different branches of government (foreign office and investment departments) and from international bodies like the World Bank.

The DRC study makes clear that very little ethical advice was sought or given to these companies during the war. Indeed many government officials have suggested that practices that are contrary to the OECD's integrity practice are necessary in weak governance and conflict zones. Unless there is a unified stance in support of human rights, transparency and the full OECD package companies won't feel the need to conform.

- 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?

- 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?

Yes, it should be accepted as the 'price' they have to pay to operate in these environments. They are taking risks in the hope of acquiring future large profits. Non adherence to ethical standards is not an option.

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.

There are many reasons why SOEs are weak. Gecamines' decline can be traced back to the early 1990s when there was a violent expulsion of Kasaians from Katanga, which deprived the SOE of its most experienced managers. Gecamines is much worse off post Mobutu than it was even at the end of his regime. Powerful political elites have been able and are still able to interfere in the management of Gecamines and undermine solid plans for its restructuring. Many contracts have been subject to gross political interference and internal objections by Gecamines' officials have been overruled. In what the draft DRC study infers is the 'reform period' i.e. after the drafting of the New Mining Code there is little sign of any significant change in behaviour. As a result, the lucrative cobalt deposits are being squandered and degraded. Artisanal miners many of whom are children, are being subjected to appalling working conditions. Only members of the political elite and international companies that are buying the ore through third parties are benefiting.

Individual strategies for coping with state collapse, by transforming the state into a private resource, contribute to its maintenance and prevent collective institutional adjustments. In Congo's climate of great scarcity, the economic returns to the preservation of weak and dysfunctional institutions are sufficient to stifle institutional entrepreneurship and innovation.

What we see with Gecamines is its de facto privatisation at the hands of political elites.

- Are companies' responsibilities the same when they enter into joint ventures with weak governance SOEs as their responsibilities with stronger governance SOEs?

Many companies – even large, reputable ones – believe that it is sound and acceptable business practice to obtain concessions on the most favourable terms irrespective of the longer term costs to the SOE or the developing country. This was apparent in Zambia with the sale of ZCCM and it also true with Gecamines. In conflict zones where there are strategic resources the 'invisible' costs may be higher as 'political protection' poses a significant, unregulated and unpredictable burden on the unwary companies. Many small companies talk about these costs in terms of 'taxation' when in reality they could more accurately be described as bribes.

- 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?

If an SOE does not have a management structure capable of withstanding predatory pressure from political elites then entering into any partnership agreement would be highly problematic. A positive signal may be the existence of an independent advisory committee (e.g. the role of a leading merchant bank in Zambia when ZCCM was privatised) or an international management committee (planned for Gecamines but stalled for over a year).

- 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?

As mentioned earlier, it behoves companies choosing to operate in such environments to conform to the highest possible standards of conduct, including those on transfer pricing. The whole point of the OECD Guidelines is that companies are expected by home governments do much more than adopt local practices that fall far short of acceptable international norms or comply with inadequate or outdated host country legislation.

- 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. 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?

Multinational companies in such positions usually disclaim any power to prevent misconduct and deny any responsibility for misuse of the mixed companies. If that is the case then it is clear that their interests are not the same as host country citizens and that without some clear recommendation from home governments they would not willingly undertake to play such a role.

- 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?

Yes. But doing it through example.

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?

They normally see their role as reducing the levels of tax and royalty payments they pay. If they gave as much attention to the fiscal systems and transparent revenue management schemes it would be beneficial.

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)?

The role of IFIs and host governments is to balance the demands of investors with the needs of the population when promoting reform. It is unrealistic to expect that companies could do that.

- 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?

Governments opposed to publishing payments made by companies are sending a strong signal that they may be engaged in dubious practices. A company that enters into agreements with such governments should face both reputational and market penalties.

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?

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?

Yes, absolutely. In issuing guidance to companies that are considering investing in weak governance or conflict zones the OECD should make explicit that it is not advisable for companies to enter a country where bribes or other illicit forms of payment are routine, particularly when the risk of such funds fuelling conflict or human rights abuses is high.

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 severe its relationship with the agent or should it be encouraged to take additional remedial actions? If so, what kinds of actions would be appropriate?

No it is not sufficient. A company should be required by its home government (i) to demonstrate that the practice was not a deliberate company policy to avoid responsibility under anti bribery laws; and (b) to show that such payments have ceased.