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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS

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

Response from Philip Armstrong, Head of Corporate Governance, Edward Nathan Corporate Law Advisers, South Africa

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?

Broadly speaking there is probably an expectation for companies operating in weak governance zones to play a role in this process. However, arguably the reform of economic institutions should be distinguished from any reform of the political framework. While it would clearly be in the interests of companies to see that the economic institutions are appropriately reformed in a way that will generate consistency and predictability, any involvement within the political framework is fraught with considerable difficulty and companies involving themselves in this area will potentially fall into the trap of possibly being accused of rent seeking practices to accommodate their interests in such an environment (possibly in an anti-competitive manner that not only impacts foreign competitors, but also could impede local businesses).

It is accepted that the political system in these environments is often closely intermingled with the economic framework. One of the challenges for multinational companies operating in these zones is to undertake transactions with the governing (political) authorities where significant emphasis is placed on rent seeking extraction, with little regard for economic imperatives or development, against the potential that a less principled competitor that does not enjoy the same measure of international public prominence will secure the transaction by accommodating these practices as it is less likely to be challenged or embarrassed. Given the competition for natural resources in these regions, of course a purely principled approach which would see a prominent international company walk away from such opportunities later translates into its own economic performance. In other words, companies operating in these regions are operating on an "uneven playing field" and have to balance the risks of doing business in these regions against the significant economic opportunities it potentially offers.

While recognising the primary focus of companies is, therefore, on achieving good returns on its investments for their shareholders it must also be accepted that companies no longer act in isolation or independently from the societies and the environment in which they operate. This brings to the fore, the concept of their "licence to operate" and this obligation no doubt includes supporting the communities in which the company operates and any national development initiatives that affect their ability to operate in a responsible way. Certainly, companies out of self-interest might well support economic reform initiatives, given their access to skills and resources that might not be immediately available in the weak governance zone, but this should be carefully considered against any steps that would be tantamount to engaging in distinctively political issues for the reasons already outlined. Not only is adherence to international accords and conventions sufficient, but clear internal guidelines and support should be given to management and staff deployed in such zones in providing guidance on acceptable conduct and unacceptable behaviour.

2. If companies have such a role,

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

  While companies call for consistency and predictability from the authorities, whatever region they operate in, it is essential for companies to ensure that their own standards of operation and conduct are emphatically consistent – whatever the state of governance or otherwise in the regions in which they conduct business. This calls for a strong value system in companies that requires regular reiteration consistently across all its operations but recognising that in some areas management will be under considerable duress to adhere to these standards, and appropriate support systems need to be put in place not only for the benefit of the management team and its staff but also as it forms an inherent risk to the business that requires observation and supervision.

  It is in the company's own interest to maintain consistency of its standards of conduct universally. It is about the company managing its business risks effectively, with integrity and without exception. This is a longer-term process in practice.

  Companies in weak governance zones (both as a corporate citizenship imperative and risk mitigation tool) have to constructively foster reform in the following areas:

  - Supporting the creation of "a level playing field" through better participatory processes and levels of transparency and disclosure in policy making and enforcement;

  - The promotion of a competitive market environment;

  - Strengthening reputational agents, such as: self-regulatory bodies (e.g. accounting, auditing and legal professionals), the media, business associations, local financing agencies, the civil society movement (e.g. consumer and environmental activists) and shareholder movements (e.g. institutional investors and venture capitalists);

  - Promoting an active integrity based business community (e.g. business associations and chambers of commerce etc.) that will promote good business practices by developing local codes of conduct and ethics based on fairness, transparency, accountability and responsibility.

- 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)?

  Positive contributions to the reform process would involve companies participating in developmental initiatives or constructively engaging or supporting both the public and civil society sectors, whether through dialogue with particular sectors or within multi-stakeholder platforms. This excludes a company attempting to impose its own “will”, manipulating the local landscape for its own selfish motive, taking advantage of gaps in the system or context to unethically benefit itself, or even to create or encourage factors or fertile grounds that would usher in gaps in the system or unethical opportunities for the company.

According to [one company’s business principles] the company maintains a position of impartiality with respect to party politics and rather contribute to debates on public policy issues that affect the company in countries where it operates which might involve discussions with government officials or provision of written advice about the likely impact of proposed policies on the company and the industry. Attendance at events hosted by political parties are essentially discouraged, except where it may be required for briefing purposes and careful guidance would be sought from the head office before embarking on such an activity to ensure that its *bona fides* will remain intact in the process. Considerable guidelines are offered by this company on this issue, as would be the case for a number of major international companies operating in similar territories such as [company names]. This is one of the measures that provides the necessary guidelines for local management and puts in place an accountable value system that applies consistently across all countries of operation to ensure that the highest standards of objectivity and impartiality are achieved and monitored.

In differentiating between positive contributions to the reform process and inappropriate involvement in local politics, a company should apply the test of *good faith*. This test involves a company ensuring that its intention in the particular context is candid, *bona fide* and for the best interest of the host community and country (noting complexities that sometimes exist between national interests and sectional interests) in the long term. Also, the company should ensure that the process through which it contributes to the reform process is sensitive to the socio-economic and political dynamics within the host community and indeed country. This is by no means an easy task and the test involves both subjective and objective considerations. However, the following steps are suggested as a guide:

- To what extent does the company understand the economic, environmental, social and political circumstance and landscape in the country? (e.g. prevailing level of education and enlightenment, risks and opportunities to the long term sustainability of the host community/country, ethnic polarisation, dominant interest groups, minority interests and rights, dynamics between the groups, such as national versus sectional prerogatives and interests, etc.)

- What is the nature of the reform proposed, with an emphasis on the economic aspects relevant to the proposal preferably?

- What sort of intervention is required from the company?

- Has the company got a guideline or policy relating to issues around the reform in question?

- Will the company be required to do anything unethical or find itself potentially being called upon, or even perceived, to be taking a position among political players or their preferences?

- What will be the long term effect/impact of the company’s intervention on the environmental, economic, social and political landscape in the host community, region and country?

- To what extent will the company’s intervention favour the long term sustainability of the host community as well as in relation to the host country, and vice versa?

- What will be the benefit(s) accruing to the company by virtue of taking such action or omitting to act as the case may be? In other words, the test should be on the economic issues facing the company, industry and national interests and not any ulterior motives or sectoral preferences particularly of a political nature.

- 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.)?

  This is becoming more blurred with companies acquiring more relevance and strength. This is also being reinforced by the ongoing privatisation exercise in many parts of Africa, which have fostered within proponents of corporate social responsibility the notion that the business sector has an "obligation" in raising the general welfare and living standards within their spheres of operation. On the other hand, businesses are usually of the view that their paramount duty is to make profits and not to "substitute" governments in pursuing public goods in countries with government failure. However, as a guide:

S/n	**Actor**	**Roles**
1	Multinational Corporations	With large international companies becoming more powerful, it presents a number of significant challenges both for the company in the way it operates across a broad range of market environments and for regulators and governments in ensuring their appropriate and responsible conduct often beyond the boundaries of their home territories. This highlights their involvement in issues of sustainable development, whether through: ▪ Philanthropy or charitable giving in support of Millennium Development Goals (MDGs) being pursued by host countries ▪ Incorporating good corporate citizenship principles as part of the core business conduct and strategies of the company in these environments. This is often facilitated through an enhanced approach to the recognition of environmental and social issues as material operating risks, with focus on management systems, reporting and appropriate internal assurance processes and validation, etc ▪ Involvement in sector based action, highlighting risks and opportunities ▪ Collective multi-stakeholder action, linking sustainability to city, regional or country competitiveness ▪ Lobby for adoption of transparency initiatives ▪ Supporting reforms and efforts to improve institutions

2	Host Governments	▪ Providing enabling and regulatory framework that is consistent and predictable and conducive for business to thrive, including setting the tone for acceptable governance standards and leading by example usually through an independent judiciary, objective and unfettered regulatory oversight and through the operation of their own State-controlled organs and commercial operations predominant in these environments ▪ Improving institutions and initiating reforms, both at the regulatory level and in SOE's ▪ Facilitating multi-stakeholder partnerships and collaborations through public/private partnerships among other similar initiatives which have the benefit of securing public policy objectives and utilising the commercial resources of the private sector to pursue market enhancements and developmental objectives ▪ Provision of economic infrastructure and appropriate public finance accountability measures ▪ Collective multi-stakeholder action, linking sustainability to city, regional or country competitiveness
3	International Organisations	▪ Providing benchmarks for best practices ▪ Lobby, advocacy and research ▪ Promoting and contributing to reforms and efforts to improve institutions ▪ Donor funding and facilitating aid that is designed and facilitated in collaboration with the host government and directed towards its key economic priorities, that is sustainable in the longer term and does not pursue "hobby horses" or "flavours of the month" ▪ Collective multi-stakeholder action, linking sustainability to city, regional or country competitiveness
4	Home Governments (Diplomatic services, ODA programmes)	▪ Negotiating relationships with host government ▪ Providing advice and insight to MNCs ▪ Donor funding and facilitating aid ensuring that it is appropriately directed towards long-term sustainable economic development

		▪ Supporting lobby, advocacy and research initiatives ▪ Collective multi-stakeholder action, linking sustainability to city, regional or country competitiveness ▪ Supporting reforms and efforts to improve institutions

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?

   Political connections are sought by companies in all countries to ensure some level of "home made" investment protection, particularly, considering where the company's ability to conduct business may be directly affected by government decision making or intervention. Worthy of note is that this is more common in sectors characterised by capital intensive and long term investments (e.g. the extractive sector). This is also common in jurisdictions where the "property rights" regime/institution are not of a sufficient high standard for the establishment of a democratic and market based economy as well as where there is the absence of fair and competitive commercial environments in which the tenets of corporate governance thrives.

   Lobbying of this sort may be seen as normal or OK in countries with concretised democracies, infrastructure and capacity for law enforcement and proper parliamentary safeguards. However, in weak governance host societies, there is a tendency for this type of set-up to be abused in a manner that distorts the rule of law, creates an uneven playing field, monopoly or unfair competition as well as unethical business practices. In Africa, such "home made" investment protection practices have been alleged to be used as conduits for impositions on the country (which at times could be disruptive on an entire country) through the influence of powerful companies and their networks – hence the saying that "it takes a big corporation and an ambitious General to topple a government".

   Companies should maintain honest, open and constructive relations with government and their agencies, officials and personnel. Also agents, third parties and employees who lobby on behalf of a company or who represent companies in government matters must comply with all applicable laws and regulations relating to corporate participation in public affairs generally guided by its home territory standards at least. It is important for companies to have clear policy instruments in place, which should be appropriately communicated to all of its stakeholders as a means of communicating the basis on which company officials are bound by company strictures that dictate their behaviour and authority in a properly objective and commercial way.

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?

As discussed in § 2 above, it is important for companies operating in weak governance zones to be well informed about the political environment and any issues which impede on the business and/or economic environment in a way that will challenge the company's standards of operation and conduct and will inform appropriate risk measures and controls to manage and monitor these appropriately in support of local management.

This is an extraordinarily difficult dilemma for companies and has implications that go well beyond the implications of its response to such matters in any particular territory of operation. There are legal and business consequences that at times would be challenged by the more subjective nature of some of the nefarious activities taking place, and possibly a better approach would be to "neutralise" its engagement in such issues by privately drawing attention to this conduct with the home country government that can pursue diplomatic channels or through any international fora where such practices could be challenged as a matter of international convention, e.g. OECD Guidelines, UN Global Compact, World Business Council for Sustainable Development, World Economic Forum, etc.

If relevant legislation exists in the weak governance zone, the question is whether any reporting called for under whistle-blowing legislation would be honestly and confidentially dealt with, or whether it would still be better to revert to a more discrete and subtle process as described above for example. Some countries have attempted to render the officer or company liable to prosecution, whether a local resident or foreign official of a company operating in the host country. Such an example would be § 515 of the Nigerian Criminal Code (Chapter 77, Laws of the Federation of Nigeria 1990), which requires that:

> "Every person who, knowing that a person designs to commit or is committing a felony, fails to use all reasonable means to prevent the commission or completion thereof, is guilty of a misdemeanour, and is liable to imprisonment for two years"

In South Africa, steps have been taken with the introduction of the Prevention and Combating of Corrupt Activities Act of 2004 to provide for the strengthening of measures to prevent and combat corruption and corrupt activities in both the private and public sectors and various institutional structures such as the judiciary. This legislation gives wide interpretation to the manner in which corrupt activities and transactions can take place, providing for extraterritorial jurisdiction and extends beyond directors and officers of companies to include employees and others acting in an authorised capacity on behalf of the company. It is extensive in application and carries significant penalties that apply not only to local residents in South Africa but to any person construed to be conducting corrupt activities in South Africa or on behalf of South African companies in foreign jurisdictions. It is a rigorous application of the *United Nations Convention against Corruption*.

Companies should be encouraged to bear witness to acts and omissions in breach of the law, or international conventions, although this may be mitigated by the absence of a strong political will in the host country to prosecute reported cases of corrupt activities and sometimes the expedient nature of political relations between countries. Without unequivocal commitment to the application and enforcement of various international conventions regulating corrupt practices at the international level, it is almost unrealistic to expect certain large international corporations to assume this responsibility alone. The episode around the issue of "publish what you pay" in Angola in relation to a stated insistence on this by a global petroleum group is a case in point and the potential political retaliation to its economic interests in that country. Similarly, the lack of international commitment initially to the steps taken by the Lesotho government to prosecute a number of well known international companies allegedly complicit in certain corrupt activities involving the Lesotho Water Highlands Project also illustrates the need for a commitment at the international as well as local level.

Companies may consider that they have whistle-blowing responsibilities in the manner prescribed within the regulatory environment of the countries in which they operate. This buttresses the need for companies to establish their legal compliance obligations within their spheres of operation, and to have a clear policy document (also containing sanctions against employees, agents and contractors for non compliance) on this, which is appropriately, communicated to all stakeholders. In South Africa, the Protected Disclosures Act of 2000 provides procedures in terms of which employees in both the private and public sectors may disclose information regarding unlawful or irregular conduct by their employers/colleagues without fear of reprisal.

However, what would the position be in a situation where a country's laws are suspended and a draconian one substituted instead (by a junta or military administration in furtherance of a coup, or in a state of emergency, as the case may be), which does not provide for whistle-blowing responsibilities? Possibly, the company may act in furtherance of an international convention or declaration (which may only be of persuasive and not authoritative effect in the particular country), depending on the will of the relevant authorities to so act and the willingness of the company to engage in this process to the potential detriment of its economic interests. The well publicised difficulties of [a company] in Nigeria in connection with the execution of Saro Wiwa is a case in point, as has been the difficulties experienced by petroleum companies operating in the Aceh province of Indonesia and many similar examples.

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

See above. A less restrictive environment should not be used as an excuse for breaching the company's policy on whistle blowing matters. This is enshrined within [a company's code of conduct], in which the company states that for example, it adheres to its standards of environment care even in countries with less stringent legal requirements. In fact, the measure for any global company is to adhere to the highest standard of conduct that applies in any area of its global operations, not just in its home territory.

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

The approach described earlier to look at "neutral" sources through which valid concerns could be articulated discretely is probably the more realistic response to this dilemma. Companies taking an open, public position will find themselves in a difficult position not only in the weak governance zone but possibly with contemporaries and other governments in other areas of operation concerned that the company will use its public platform to embarrass competitors and government officials and thus might be reluctant to encourage their economic participation and investment. This ultimately will translate into longer term consequences for the company and potentially its own economic demise, so it has to be an issue that is delicately and discretely handled through the powerful platforms that the major international company is likely to have access to without appearing to pursue its own private agenda.

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?

  According to T. Palley[1], many of the poorest developing countries have significant natural resources, and the income from these resources should be used to support growth and development. But all too often, corrupt officials misappropriate this income with the complicity of companies seeking to harness access to those resources either through outright bribery and corruption to induce preferred allocation or the possibly less publicised (but probably more common) practice of facilitating payments that will expedite favourable execution of contracts and tenders without the accompanying bureaucratic delays through incompetence or inefficiencies. Moreover, corruption often fuels internal grievances that cause conflict and civil war.

  The natural resource curse is vividly illustrated by events in Angola, where an International Monetary Fund fiscal audit has been unable to account for hundreds of millions of dollars of oil revenues. In Nigeria, Cameroon, and Congo-Brazzaville, oil wealth has failed to generate development. Sudan is marked by strife over oil. And in Aceh, Indonesia, secrecy about oil payments and public misunderstanding about the scale of those payments have fanned regional separatism.

  The nature of the services provided by companies within the extractive sector (which involves the conversion of natural resource minerals into vast amounts of revenue) is such that warrants practice of a high standard of the tenets of good governance, especially transparency, which (according to King II in South Africa) is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This obligation is incumbent to a larger degree on companies operating in weak governance zones, so as to avoid generating the perception that they are aiding and abetting unscrupulous government officials who might be in a position to exploit the weak financial and fiscal controls in the host country.

  Adherence to the *Publish What You Pay Initiative* (in which OECD-based regulators require private sector companies to disclose all payments to host states) and the *Extractive Industries Transparency Initiative* (whereby host states are required to disclose all revenues, and require private companies to disclose payments to help check revenue data) are important initiatives aimed at promoting greater degrees of transparency for the above stated reasons.

  The Publish What You Pay coalition of over 250 NGOs worldwide (including a number of Angolan NGOs e.g. CARE, Acção para o desenvolvimento, Pesquisa e Cooperação Internacional and Agência Ecuménica para o Desenvolvimento Social em Angola) call for the mandatory disclosure of the payments made by oil, gas and mining companies to all governments for the extraction of natural resources. According to this coalition, this is a necessary first step towards a more accountable system for the management of revenues in resource-rich developing countries.

- 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?

[1] www.soros.org/initiatives/washington/articles_publications/articles/publishpay_20030304

In the more developed environments, extensive financial disclosure is called for increasingly and with detailed breakdown of the source of revenue and allocation of significant expenditure and payments. Companies are also increasingly required to outline with some considerable detail their internal controls and risk assurance processes, thereby providing an opportunity to openly and transparently address this issue constructively within their home territory reporting and disclosure requirements. Vigilant institutions and others monitoring issues in the governance zones would thereby have access to requisite information that it can suitably reconcile and take up the issue through their own means of engaging on the public conduct of governments in weak governance zones.

While stressing the importance of transparency and disclosure on the part of corporations in developing countries, R. Khoza and M. Adam (The Power of Governance, 2005:211) point out that "where disclosure of information is limited, stakeholders may naturally be circumspect about the practices in an organisation."

International agencies that are often engaged in some way or other in these territories also have the ability to set strictures or covenants on governments and their agencies in weak governance zones that would serve as a further measure of enforcement or monitoring. In fact, often they have the ability to identify obvious breaches or inappropriate activities and would be better advised to also engage in these processes in support of companies genuinely seeking to conduct themselves honestly and with integrity. The Lesotho case again comes to mind, and while legally contentious a more rigorous process to "black listing" should be brought to the fore and again the contentious issue of "conditionalities" for development assistance that protects the allocation of revenues into the fiscus should be investigated with more commitment.

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?

A healthy banking system is very essential for a well-functioning stock market and corporate sector. Good governance within the financial system is particularly necessary in developing countries, where banks provide most of the finance, although financial market liberalisation has exposed banks to more fluctuations and to new credit risks. In fostering better governance within the private sector, a framework that enhances or promotes a flexible yet safe and sound financial system is crucial based on the following elements[2]:

- Minimum capital requirements that provide banks and their supervisors with a range of tools to accurately measure different types of risks, so that the bank has an adequate amount of capital to cover those risks.

- Supervisory review of an institution's internal assessment process and of its capital adequacy. In this regard, financial companies in these zones will need to have a set of policies and procedures to ensure adequate capital requirements and sound management. Such measures include undertaking credit risks, monitoring and disciplining large borrowers effectively, and adhering to stringent auditing procedures. However, the results of these internal processes will depend on (a) the effective corporate governance of borrowers (usually firms), which makes it incumbent on banks to gather accurate information about a firm's condition in order to access risk appropriately; and (b) effective monitoring mechanisms that ensure compliance.

- Effective use of disclosure to strengthen market discipline as a complement to supervisory efforts. This third pillar strengthens the preceding ones by bolstering the disclosure requirements and thereby enhancing market discipline. For example:

  - Disclosing bank' risk assessments and company risk rankings provide an important resource regarding information about a corporation's financial viability, which shareholders and investors respectively can use to press management for changes or to shift their investment elsewhere. A good example here is [an OECD-based bank's] research project, in which the bank quantified 50 corporate governance risk factors in conjunction with financial analysis to establish (in terms of top 46 companies in South Africa) whether the risks are properly priced by the equity market;

  - Disclosing information about bank's ownership structures and relationships with other firms or the public sector promotes good governance of banks and companies, and helps prevent moral hazard and financial meltdowns. This relates also to the increasing discussion about whether or not developing countries should require that commercial and investment banking activities be separated[3].

Apart from anti-money laundering measures, financial institutions can play a crucial role in improving the institutional framework in weak governance zones. Through their financing activities, financial institutions could make it incumbent on their clients to practice a high standard of governance by having in place requisite systems and processes that enhance the principles of governance. However, in countries where financial institutions do not have significant lending

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2 See the BIS's website: www.bis.org

3 See H. Blommenstein and M. Spencer, "The Role of Financial Institutions in the Transformation to a Market Economy," IMF Working Paper WP/93/75, 1993.

capacity or where the economy is dominated by SMEs that are not accessing financial services, the effect of financial institutions in this regard may be considerably minimised.

International finance institutions also have opportunities for promoting environmental and socially responsible development through their project financing activities and thus are able to impact on institutional frameworks in weak governance 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?

Transparency, information disclosure and the quality of a company's accounting standards and auditing relations are incumbent on all companies interested in fostering investor confidence and ensuring long term economic growth and competitiveness. However, while companies across different jurisdictions may practice the principles of good governance to varying degrees, companies that are investing in non-transparent host countries, appear to have the extra duty of ensuring the ease with which outsiders are able to make meaningful analysis of the company's actions, its economic fundamentals and the non financial aspects pertinent to that business. This is imperative if the company is to enhance its reputation or at least keep it intact as well as to avoid generating the perception that they are complicit in the non-transparent complexities that may exist.

Corporate governance has evolved to focus not only on financial performance, but also on economic, social and environmental performance – the so-called "triple bottom line, which is known as sustainability reporting. However, reporting effectively on economic, social and environmental performance is more complicated than traditional reporting (on only financial issues), as there is no standard reporting mechanism and no universally agreed criteria that can be applied. Among instruments developed to encourage best practice in this regard are the Global Reporting Initiative (GRI) and in South Africa, the King II Report. Noteworthy is that according to a SustainAbility survey, based on an analysis of reports from all over the world (2002), priorities that need to be reinvigorated in terms of sustainability reporting are materiality (identifying relevant issues to be reported by particular organisations) and integration (starting from boards setting performance objectives for triple bottom line and integrated sustainability reporting, then emerges through integrated triple bottom line performance) in addition to verification (both in terms of available skills needed for such processes and the audit process itself). This would be essential for companies operating in weak governance zones.

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)?

The tenets of good corporate governance, corporate citizenship and social responsibility needs to be given equal impetus in relation to junior and small-unlisted companies, particularly those that are operating in weak governance zones. Further, this is particularly imperative for companies operating in risk prone sectors (unethical practices), e.g. the commodities market and the extractive sector because of the large amounts of money involved in these sectors, the temptation for unethical and opportunistic practices as well as the preponderance of small players operating outside the radar of public scrutiny who may do greater cumulative damage than a big corporate player that is more likely to be under public scrutiny from a number of quarters. However, while junior companies are often attributed with poor or selective business practices, caution should be exercised not to stigmatise all players in this sector similarly. It is more about ensuring a level playing field that requires the intervention, supervision and monitoring of a number of reputational and other similar agencies of influence – particularly those financing these activities or facilitating such activities through development assistance where their authority could be brought to bear on activities considered undesirable or inappropriate. This requires not only a measure of political will within the host country, but also among the governments in the OECD countries that have ascribed to the various OECD conventions and standards as a measure of good governance and business practice. This is absolutely critical!

Promoting compliance in this regard has to be innovatively structured, as the additional cost burden and the creation of further market barriers by such requirements, may present challenges for junior and small companies, who do not have the same capacity as their bigger counterparts.

Better performance on the part of junior/small unlisted companies could innovatively be promoted through supply-chain compliance channels, or as condition precedents for accessing finance and being part of large project financing initiatives. Another option could be to incorporate these requirements into licensing and accreditation processes.

- 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?

  As above.

- 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?

  As above, without consistent practices at least in the areas of core principles and standards to be followed by all players operating in weak governance zones, there will always be the potential for opportunistic and arbitraged transactions that will not serve the long-term, sustainable economic benefits that should otherwise accrue to the host country in a responsible way and for the benefit of its citizens.

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?

  As with many of the other issues, given the conventions that have been adopted by the OECD, surely this requires to be monitored with a measure of political commitment at the OECD level with the same measure of vigilance that weak governance countries are criticised. The nature of the joint venture transactions should ensure that the standards of good governance and business practice are a *sine qua non* for all arrangements reached with SOE's in weak governance zones, in other words consistency of business practices and standards should apply regardless of the quality of governance in the territory concerned. The emphasis would be on the risks attendant in such an environment and the extra levels of vigilance that would be adopted by OECD country companies to ensure that these commercial ventures are conducted with a measure of integrity and responsible business conduct. It should be deployed against a measure of skills transfer and management development within the host country SOE as a contribution to the economic development of the host country technical and management skills, while also seeking to remediate any potential or inherent risks in the nature of the business relationship.

- 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?

  See below.

- 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?

  Again, the principle is quite simple. OECD country companies should be deploying, at a minimum, the same standards by which they are expected to conduct themselves in their home jurisdiction. The mere fact that this is not required by law or a common business practice in the host country in a weak governance zone is simply not an excuse – frankly, a point that underlies nearly every other response given in this survey. However, as emphasised throughout, the OECD will have to look at how its own measures and standards can be more effectively supervised within the OECD countries so that there is no accusation of selective practices where this might be politically difficult back in the OECD. It is the inconsistency of the application of these standards and practices that is creating the measure of arbitrage that tends to arise in weak governance zones, with little fear of retribution or sanction back home regardless of the knowledge that this is in fact taking place.

- 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?

Annex Table 1 provides a useful list of considerations for identifying weak governance SOEs. Additional criteria could include:

- The enabling framework establishing SOE's should be carefully analysed to understand the extent to which government has significant discretion over its activities and authority, which should also be compared to the record of involvement and inclination to intervene on the part of government especially in relation to board and management appointments and the award of contracts and tenders. Another important indicator is the measure of transparency attendant with the affairs of these companies and whether any recent, reliable financial statements are available and the extent to which the operations are largely subsidised by the national fiscus as an indicator of financial accountability and responsibility.

- To what extent is there any public or agreed statement or contract of objectives stipulating certain agreed principles of performance, objectives and strategic intent between the SOE and government.

- How is the financial management of the SOE regulated and supervised? In South Africa, this is provided for in the Public Finance Management Act of 1999, (PFMA) which sets out the regulation of financial management of State, Provincial and Constitutional enterprises, agencies, institutions and other forms of publicly accountable bodies. The administrative requirements of the PFMA are elaborated by National Treasury Regulations that are read in conjunction with the PFMA and set onerous obligations on directors, managers and auditors of these organisations with significant criminal penalties and/or personal liability. As significant as the provisions of the PFMA might be, it is the public policy intent behind the legislation that gives a clear message locally and internationally of the South African government's commitment to good corporate governance in its publicly accountable institutions.

- To what extent has the SOE effective financial, risk management and internal controls, a procurement system which is fair, equitable, transparent, competitive and cost-effective, and a system for evaluating major capital projects?

- Are there mechanisms for the SOE to prevent irregular expenditure, fruitless and wasteful expenditures, losses resulting from criminal conduct, and expenditure not complying with the operational policies of the enterprise?

- Is the running of the SOE along sound business lines? Who are the principal actors? What is their track record? What is the track record of the SOE regarding previous JVs?

- Under what circumstances may the SOE be investigated by the Attorney-General or Auditor-General or their equivalent regarding its financial statements in the public interest or upon the receipt of a complaint?

- What are the compliance obligations and procedures that the SOE needs to adhere to and what is the general record of competence of board members serving on these companies?

- Are there mechanisms for protecting and enforcing minority shareholder rights?

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?

  Both of these categories (citizens of the host country on the one hand and the company's shareholders on the second part) are both important stakeholders that should be taken into account simultaneously for the sustainability of the enterprise. Surely these are mutually interdependent, while in the more developed markets there is no obligation on a dominant or significant shareholder to be concerned with the interests of its fellow shareholders, in an environment of the nature described it will prove to be mutually reinforcing to ensure that host country citizens see a common nexus and could become another monitor on behalf of the foreign multinational over and above its own supervisory activities of the affairs of the SOE, as shareholders.

- 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. This should be a major part of any JV agreement as it should become mutually reinforcing to the benefit of all parties. Capacity building through skills transfer and sharing of experiences is not only material to uplifting host country standards in line with international practices, but is a risk mitigating measure and does not entail significant financial investment but has the potential to generate more reliable and improved operational conduct that enhances the foreign investment proposition.

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?

    A company that makes large tax and royalty payments to weak governments and fiscal systems would probably be best served out of its own self-interest, with the reciprocal benefits to national economic development and society generally, to engage in measures that would improve the reform of these systems. This would be through facilitating open discussion on better measures of fiscal management and supervision, through to more appropriate systems of taxation and allocation or support of resources that would contribute to an appropriate improvement that serves the interests of the country and government and not just the company itself.

    Companies within the extractive sector, for instance, should promote and lobby government to adopt transparency initiatives towards improving disclosure and accountability regarding payments to governments and utilisation of revenues drawn from taxation and other levies on the operations of major investments like the extractive sector among others. As has been demonstrated in Nigeria's Niger-Delta area, companies can themselves be targets of extreme communal violence as a result of perceptions that they were either complicit in the Federal government's misappropriation of revenues or were simply not doing enough in ensuring service delivery to the masses in expectation of the revenues drawn from their activities.

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)?

  See above.

  Government's adoption of systems that promote good governance can go a long way in setting the tone for zero tolerance for unethical conventions and practices. On their own part, international organisations can promote public sector reform by making such processes imperative as a *sine qua non* for project financing in those zones.

- 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?

  See above.

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?

    The questions set out in Annex Table 2 provide a good basis for identifying weak fiscal systems. However, additional criteria could include:

    - To what extent is the country's fiscal/macro economic policy framework supportive of sustainable development considerations?
    - Who are the principal actors in producing the budget?
    - How predictable and consistent are the country's economic/fiscal policies?
    - What is the standard of the country's public finance management?
    - Does the regulatory framework promote economic activities and corporate integrity?

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?

    Individual companies need to establish the legal regime regarding corruption in their spheres of operation as well as sensitising their stakeholders on the issue via their policy documents.

    However, anti-bribery and corruption measures by individual companies need to show absolute zero tolerance in spirit, principle and substance, with absolute buy in from the top brass in the company more importantly. For instance, it makes no sense to spend so much time and efforts in getting management and staff to be above board, when the company's leadership is complicit (implicitly or actively) in unethical practices beyond operational levels, in conjunction with high ranking public officials and other third parties, as the case may be. Of concern is the notion that *"anything goes"* in zones with weak governance standards, with expatriate corporations and their personnel sometimes going into those zones having the mindset of *"taking advantage of the jungle that exists"*. A typical example would be a recent observed experience when boarding a plane at the International airport in Lagos (Nigeria). To my dismay, all the people paying runners to jump a queue were expatriates, while the local people maintained a good standard of decorum.

Companies need to weave into their mindsets that they cannot offer business or courtesy gifts including facilitating payments, particularly in circumstances that might create the appearance of impropriety. Bribes, kick-backs, secret commissions and similar payments should be prohibited by companies in spirit, truth and honesty even to the point of losing business opportunities.

Companies should also exercise care in engaging third parties or agents to represent the company's interest as well as monitoring their performance. In sensitive circumstances, the company's policy and expectations in this regard should be clearly communicated and accepted by the agent or third party as a condition precedent to such party acting on behalf of the company.

Very commendable in this regard is [Company name's] action in pulling out of a very lucrative deal with [Nigerian company name] (in Nigeria, 2004) once they became uncomfortable with an atmosphere of underhand commissions and payments. Apart from dropping the deal, they went to the extent of dismissing senior personnel that had not kept the [company name] board sufficiently informed of the on goings, and went public with their position as a demonstration that this is not accepted conduct when doing business with [company name]. It is interesting that in this framework, the holding company of [the company] is listed on the New York Stock Exchange and along with a major US shareholder [of the company] was particularly concerned with US sanctions against involvement in corrupt 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 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?

Options open to the affected company include penalising defaulters, severing such relationships and timeous communication with relevant stakeholders. Possibly, if the circumstances are very serious, the company may pursue legal redress, although, usually the organisation's paramount interest is to handle matters in a way that would do the least damage as per public relations.

Table 1. Doing business with state-owned enterprises: Considerations for evaluating integrity risks

Transparency

- Does the SOE disclose financial and non financial information according to international best practices? (CGP)
- Does the SOE provide information on all material matters of significant concern for the State as an owner and the general public? (CGP) In the case of extractive industry SOEs – material financial matters would include how successful the company is safeguarding the country's financial interests in its extractive industry wealth. Protection of the interests of people in the vicinity of the extractive industry operations is also of major concern for extractive industries and the SOE might be expected to report on these matters as well.
- Does the SOE have efficient internal audit procedures, under the control of and reporting to the audit committee, if this exists, or to the Board itself? (CGP)
- Is the SOE subject to an annual independent external audit under the conditions prescribed by the IOSCO Principles for Auditing? (CGP)

Nomination and role of the board of directors

- Has the government established a structured and transparent nomination process for SOE boards? (CGP)
- Do SOE board members act in the best interests of the company and treat all shareholders equally? (CGP)
- Are SOE boards independent from management and any direct political interference? (CGP)

Conflict of interest:

- Do members of the SOE board and key executives make decisions and provide advice on the basis of the relevant law and policy and the merits of each case, without regard for personal gain? Are they "disinterested"? (COI)
- Have members of the SOE board and key executives disposed of, or restrict the operation of, private interests that could compromise official decisions in which they participate? (COI)
- Are members of the board and key executives required to disclose to the board whether they, directly or indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation? (CGP)
- Is abusive self dealing by the officers of the SOE prohibited? (CGP)
- Have non-executive members been named to the Board who are capable of exercising independent judgement to tasks where there is a potential for conflict of interest? (CGP)

Table 2. Evaluating host country budget systems

- Are the accounting policies that underpin the budget (including any deviations from these policies) publicly available?
- Has the government put in place a system of internal financial controls, including internal audit, in order to assure the integrity of information provided in the reports?
- Do the finance minister and senior officials responsible for producing budget reports effectively assume their responsibilities?
- Is the budget report audited by a "Supreme Audit Institution" in accordance with generally accepted auditing practices?
- Are the audit reports scrutinised by Parliament?
- Does Parliament have the opportunity and the resources to effectively examine any fiscal report that it deems necessary?
- Are all fiscal reports made publicly available (including the availability of all reports, free of charge, on the Internet)?
- Does the finance ministry actively promote understanding of the budget process by individual citizens and non-governmental organisations?

Source: Questions derived from the OECD Best Practices for Budget Transparency.