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CONDUCTING BUSINESS WITH INTEGRITY IN WEAK GOVERNANCE ZONES: ISSUES FOR DISCUSSION AND A CASE STUDY OF THE DEMOCRATIC REPUBLIC OF CONGO

This note by the OECD Secretariat provides background analysis and proposes issues for discussion of the Investment Committee's project on conducting business with integrity in weak governance zones. Within the framework of this project, the Committee has engaged in consultation with stakeholders to provide answers to a list of questions that are derived from this document (see pages 36 to 39). Responses to the questions have been solicited through the OECD website. The conference in Addis Ababa will provide a further opportunity for consultation.

Any written answers can be sent by email to Kathryn Gordon (kathryn.gordon@oecd.org). Answers will also be posted on the OECD website and considered by delegates at the next meeting of the Investment Committee in April 2005. Please note that answers should not contain the names of privately-held companies or other private organisations, including self-citation.

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Executive summary

1. This project on conducting business with integrity in weak governance zones furthers the Investment Committee's goal of promoting policy environments that attract investment flows and that promote growth and development. The project is also part of the Committee's work programme on implementation of the OECD Guidelines and follows up on issues raised by the United Nations Expert Panel Report on illegal exploitation of natural resources in the Democratic Republic of Congo (DRC). In its earlier work on corporate responsibility, the Committee has stressed the importance of an appropriate allocation of roles between the public and business sectors. In some investment environments, public authorities are unwilling or unable to protect rights (including property rights) and to provide basic public services (e.g. social programmes, infrastructure development and prudential surveillance). These "government failures" lead to broader failures in political, economic and civic institutions that the project refers to as "weak governance". While recognising the primary roles of public policy in host countries and of the international community in improving institutions, the Committee aims, through this project, to answer the following central question: do companies have different roles when operating in weak governance zones than those they have in OECD and other healthier investment climates? This paper provides background analysis and proposes issues for discussion of various aspects of this question.

2. Investment in weak governance zones raises a broad range of ethical issues – management of corruption, protection of human rights and labour and environmental management. While earlier Investment Committee consideration of investment in weak governance zones looked at this broad range of issues, the current paper focuses on those issues about which the OECD "integrity instruments" can shed light. These instruments include the OECD Guidelines for Multinational Enterprises, the Corporate Governance Principles, the Guidelines for Managing Conflict of Interest in the Public Sector, the Convention on Combating Bribery of Foreign Public Officials and the Revised Recommendation on Combating Bribery in International Business Practices.

3. The paper proposes the list of main issues, based on the analysis presented here and summarised in a list of questions at the end of this paper, be used in the context of a dialogue with stakeholders. This dialogue would provide inputs that may lead to the subsequent development of a list of considerations for companies that are thinking about investing in weak governance countries or that are currently managing such investments. The list would also be a resource for officials from home and host governments as well as for trade unions and NGOs when they deal with the business ethics issues.

4. The list draws on the OECD integrity instruments and on a case study of foreign investment in the DRC. The case study is presented in a series of boxes that parallels the analysis. A list of questions drawn from the case study and analysis appears at the end of the paper. The list is designed to serve as a basis for multi-stakeholder dialogue on investment in weak governance zones.

5. The issues identified here fall into three categories.

- *Corporate and government roles*. The Investment Committee defines corporate responsibility as the actions taken by companies to nurture and enhance their relationship with surrounding societies. The core responsibility of business in society is to provide competitive returns to suppliers of capital while also complying with law and with widely accepted practices that might not be written down in law books. In addition, the Investment Committee's previous work has stressed the need for appropriate allocation of roles and responsibilities between the private and public sectors. The paper looks at how this definition of corporate responsibility applies to investment activity in weak governance zones and in particular, at how it applies when governments are unable or unwilling to assume their responsibilities. Although the case study deals mainly with extractive industry companies, the issues it covers are relevant for any company that operates in sectors where public/private interactions are particularly important (e.g. public utilities, construction and armaments).

- *Doing business in weak governance zones*. Weak governance zones, such as the DRC, present extreme investment environments that pose serious risks of various types. The paper reviews the population of OECD-based companies with investments in the DRC during the pre-reform period. Based on this case study, questions are raised concerning the nature of corporate responsibility for this distinctive and diverse population of firms and on the role of home and host governments.

- *Using the OECD integrity instruments*. The OECD integrity instruments summarise a body of thought, gleaned from years of policy analysis and peer reviews, about how to design and implement good public policy and, in some cases, on the business sector relates to the overall governance framework. Some of the questions look at how the OECD integrity instruments might be used as a tool by companies analysing investments in weak governance zones. In particular, issues are identified in the areas of corporate governance, managing business relations with weak governance state-owned enterprises, supporting institutional reform of host country budget systems and eradicating bribery of public officials.

Introduction and background

6. The mission of the OECD Investment Committee is to enhance the contribution of investment to growth and sustainable development by advancing investment policy reform and international co-operation. Investment in most developing countries falls short of their development needs – greater investment flows will be needed if the ambitious goals set forth in the Millennium Development Declaration are to be met. This paper is part of an Investment Committee project on investment in weak governance zones. Through this project, the Investment Committee hopes to contribute to improving the development prospects of countries that, because of serious institutional shortcomings, are largely excluded from the benefits of broader participation in the global economy. These countries are beset by violent conflict that has welfare costs of the most grievous sort – loss of life, serious injury, and widespread destruction of personal property and of public infrastructure.

7. Underpinning this situation are economic, political and civic institutions that do not work well. Institutions shape individual behaviour and give rise to group behaviours. They determine how individual human motivations and ways of doing things (e.g. selfishness or altruism, competition or cooperation, honesty or guile) play out in group situations. Almost by definition, countries beset by violent conflict have serious institutional shortcomings – they are unable to shape the behaviour of individuals so that peace and prosperity can be achieved. These institutional shortcomings are referred to as "weak governance".

8. The central questions posed in this paper are – do companies have different roles when interacting with host government institutions in weak governance zones than they would in the OECD and other healthier investment climates? Institutions include informal habits and practices as well as formal rules and procedures. The current paper focuses on the latter. Formal institutions are influenced by the millions of individuals that interact with them and often involve built-in processes for reform and adaptation (e.g. through legislative, judicial and administrative processes). Institutions are often subject to international influences of various sorts (e.g. from international investors, international financial institutions and donors, inter-governmental processes, UN peace keeping activities and sanctions). Thus, many different actors -- mostly domestic but also international – play roles in shaping institutions.

9. Although politicians and civil servants are one among the many actors that influence institutions, their role is important because they are (or should be) the guardians of much of the formal institutional structure. Ideally, governments protect rights of all sorts – e.g. the right to basic security; economic rights (including property rights); the right to engage in political dialogue; and freedom of association in the workplace or in other contexts. Not only do these rights have a direct impact on welfare, they also determine the degree to which people from different walks of life can participate in changing institutions and holding them accountable. Government actors also provide the public services that support successful societies and economies (e.g. through appropriate law making and enforcement). In addition, other public services – e.g. education, income supports, medical services, regional and cultural programmes – provide a means for society to meet its collective needs and to deal with tensions through political channels. In weak governance zones for a variety of reasons, the government is unwilling or unable to play its role in protecting basic rights and in identifying and meeting collective needs.

10. Thus, government actors play a central role in caring for the basic institutional infrastructure that underpins effective governance. Their failure to do so is one of the defining characteristics of weak governance. However, while "government failures" are an essential part of the backdrop to the issues raised in this paper, they are not its focus. In keeping with its aim of supporting the Investment Committee's follow-up on the OECD Guidelines for Multinational Enterprises -- a government-backed, voluntary code of conduct for international business -- the paper identifies main issues in relation to companies' responsibilities as they conduct business in weak governance zones.

11. The importance of an appropriate allocation of roles between the public and private sectors has been a recurrent theme in the Investment Committee's work on the OECD Guidelines – it is easier for companies act responsibly when they operate in effective policy environments. Over the years, the Committee has explored the relationship between successful economic development and effective policy. The Committee's work covers the many policy areas that influence a country's ability to attract and benefit from international investment. Much of this is summarised in "Foreign Direct Investment for Development" (OECD 2002), which explains that such benefits are demonstrable and large, but that "policy matters" – that is, a healthy policy environment is needed if these benefits are to be fully realised. The Committee continues to accumulate knowledge in this area via its dialogue with non-Members under the "Investment for Development" Initiative[1].

12. Other OECD bodies have contributed essential elements to this body of knowledge. In the area of conflict prevention, the work of the Development Assistance Committee is particularly noteworthy. The *DAC Guidelines on Helping Prevent Violent Conflict* (OECD 2001) and *Security System Reform and Governance: policy and good practice* (OECD 2004) provide blue-prints for action in many areas (governance, security systems, regional cooperation, justice and reconciliation, and building partnerships) and for many actors (home and host governments, international organisations, overseas development agencies and business, trade unions and NGOs). This DAC publication also provides detailed concepts and principles for understanding 'home country responsibilities' and stresses the need for OECD-based donors and other officials (e.g. in diplomatic services) to cooperate to promote institutional development in weak governance societies.

13. Other organisations have also looked at the issues raised by business operations in weak governance and conflict zones. Business and conflict was the subject of the first Policy Dialogue held under the United Nations Global Compact. In addition, many OECD member governments have explored various facets of the issue of business and conflict (e.g. Belgium[2], Canada, Netherlands, Norway, Sweden, Switzerland, United Kingdom and the United States).

14. Some initiatives in this area have focused on the linkages among natural resource dependence, weak governance and conflict. Indeed, in weak institutional environments, natural resource rents can create problems because they may bring out the more negative human motivations and behaviours – greed, guile and aggression. Earlier Investment Committee work on this issue found that natural resource rents can create the means and the motives for conflict and for irresponsible actions by both government and private actors. The World Bank has sponsored statistical studies that show that conflict risk is positively related to natural resource endowments[3]. Likewise, the Extractive Industry Transparency Initiative (EITI) focuses on the transparency of revenue payments made to host governments by extractive industry companies – this initiative seeks to promote transparency on the revenue side of host country budget systems so as to facilitate accountability in host country use of natural resource revenues. The Investment Committee associated itself with the EITI through a Chair's statement in June 2003 (Annex 2). The current work supports EITI by addressing other important transparency issues – host country state-owned enterprises in oil and mining; problems that might exist on both the revenue and expenditure sides of host

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1 See www.oecd.org/daf/investment for more information about this initiative.

2 The government of Belgium sponsored part of the current work through a voluntary contribution.

3 The World Bank sponsored research exploring the statistical relationship between conflict and variables that might predispose countries to conflict. The research finds that: 1. ethnic and religious fragmentation have not statistically significant effect on conflict risk, once economic variables are accounted for. The level, growth and structure of income are significant risk factors and dependence on primary commodities is a "particularly powerful risk factor". This research is published as "Greed and Grievance in Civil War" and can be found at: http://www.worldbank.org/research/conflict/ paper/greedandgrievance.htm

country budget systems; and eradication of bribery of public officials. In the diamond production sector, the United Nations-backed Kimberly Process Certification Scheme – a multilateral trade regime for rough diamonds established to combat the trade in conflict diamonds – has had a significant impact on overall governance in the sector.

15. The project undertaken by the Investment Committee complements these and other initiatives by drawing on the OECD "integrity" instruments to improve understanding of the business sector's role in conflict and other weak governance zones. In addition to the OECD Guidelines for Multinational Enterprises, the instruments include: the OECD Corporate Governance Principles, the Guidelines for Managing Conflict of Interest in the Public Sector, the Convention on Combating Bribery of Foreign Public Officials and the Revised Recommendation on Combating Bribery in International Business Practices. The content, purpose and legal status of these instruments are reviewed in the Addendum to this paper. Although the legal status of these instruments varies, they all provide guidance on how to evaluate aspects of the institutional environment and, in particular, on how weak governance environments might be improved. Several of these instruments are referred to in the text of the OECD Guidelines.

16. Drawing on the OECD integrity instruments, the present paper poses questions or issues for discussion that aim to support dialogue on the business role in weak governance zones. The Committee aims to use the results of this dialogue process to develop a list of questions that companies might want to consider when deciding whether to invest in weak governance zones or when managing such investments. The list and associated analysis would target several audiences:

- *Companies*. The list could provide companies with a risk management tool, consistent with the OECD Guidelines, on conducting business with integrity in weak governance zones and on enhancing their contributions to host societies and positive public policy development. The benefits for the business sector from an improved investment climate in weak governance environments will be enormous. By unleashing the development potential of these economies, improved governance will open up investment opportunities and allow consumer markets to grow where none had existed before. It will also facilitate compliance with host and home country law. The business case for the investment community as a whole to support efforts to improve governance is compelling.

- *Home governments*. The list might be helpful for home government officials involved with programmes that lie at the intersection between government and corporate responsibility. Home governments influence OECD-based investors in weak governance host societies through various policies and practices. Channels of influence include overseas development assistance, and export credit and investment guarantee programmes. State-owned enterprises are another channel of influence -- two OECD-based state owned enterprises had investments in the pre-reform DRC.

- *Trade unions, NGOs or non-adhering governments* might want to use the list as an input for dialogue with companies with operations in weak governance zones.

With this project, the Investment Committee will also make a distinctive OECD contribution to the international debate on investment in weak governance zones that complements the DAC Guidelines on Conflict Prevention, particularly the ideas set forth in Chapter 7 ('Working with Business').

17. The Committee has considered investment in weak governance zones on a number of earlier occasions (Annex 1). In response to a request to look at investment in Myanmar, it undertook a broad review of the main issues in business ethics raised by this type of investment (management of security forces, relations with local populations, transparency of relations with host governments). This work was later published as "Multinational Enterprises in Situations of Violent Conflict and Widespread Human

Rights Abuses" (Working Papers on International Investment No. 2002/1, May 2002). Most recently the issue arose when a United Nations Expert Panel – in its report to the Security Council on illegal exploitation of natural resources in the Democratic Republic of Congo (DRC) – named 85 companies that it claimed had not observed the Guidelines. The current work follows up on the UN process and complements work with individual companies undertaken by National Contact Points (see Annex 1 for a description of OECD follow up on the UN Expert Panel Process).

18. The current project includes a case study of business operations in the Democratic Republic of Congo. The case study illustrates some of the concrete ethical dilemmas that companies face when conducting business in weak governance zones, particularly those dilemmas that are relevant to the OECD integrity instruments. Despite ongoing problems and continued political fragility, the DRC is currently undergoing reforms designed to put it on a path of successful development. A recent International Monetary Fund (IMF) assessment notes that "remarkable progress has been made concerning peace and reunification"; new investors are showing interest in the country, real GDP growth is picking up and public sector reform is underway[4]. The case study deals mainly with the pre-reform period from 1990 to 2001. This covers the political instability and mounting violence that marked the end of the Mobutu regime (from roughly 1990 to 1997, when Mobutu was deposed) and the period of overt conflict (1997 until 2001). Thus, the case study looks at a policy environment shaped by a declining dictator, the violent wresting of power from him and the ensuing war.

19. While the pre-reform DRC represents an extreme example of "weak governance", its policy framework resembles those of the weak governance countries studied earlier by the Investment Committee (e.g. inadequate protection of human rights of all sorts, weak governance state-owned enterprises that operate through joint ventures with foreign companies and ineffective fiscal controls). Thus, the DRC case study provides an opportunity for the Committee to extend its exploration of the interplay between corporate and government responsibilities.

20. The present document is organised as follows. The first two sections recall the Investment Committee's definition of corporate responsibility and review business roles in weak governance zones. Subsequent sections look at four areas of business ethics about which the OECD integrity instruments shed light: 1) corporate governance practices of companies investing in weak governance zones; 2) managing partnerships with weak-governance state-owned enterprises; 3) paying taxes into weak governance fiscal systems; and 4) eradicating bribery of public officials. Each section ends with a series of issues for discussion – these are designed to elicit inputs from delegates and from partners in Guidelines implementation that will be used in the further development of this project. The final section reviews findings to date and proposes possible next steps. The methodology for the empirical work is presented in Annex 3.

Defining corporate responsibility in weak governance zones

> *The Guidelines aim to ensure that the operations of enterprises are in harmony with government policies, to strengthen the basis of mutual confidence between enterprises and the societies in which they operate, to help improve the foreign investment climate and to enhance the contribution to sustainable development made by multinational enterprises.*
>
> *The OECD Guidelines, first paragraph of the Preface*

[4] IMF Country Report No. 04/97. page 5.

21. Corporate responsibility involves the search for an effective "fit" between businesses and the societies in which they operate[5]. The notion of "fit" recognises the mutual dependence of business and society – a business sector cannot prosper in the long run if the society in which it operates is failing and a failing business sector inevitably detracts from general well-being.

22. "Corporate responsibility" refers to the actions taken by business to nurture and enhance its relationship with society. Of course, other actors – and especially governments – can also nurture this relationship by providing such services as law enforcement, appropriate regulation and investment in public infrastructure used by business and by financing its activities via a well designed and disciplined tax system. Nearly all OECD work helps governments to do this better, but its work on state-owned enterprises, on public sector ethics and managing conflict of interest in the public sector is particularly relevant for weak governance zones. If the efforts of business and society are successful, then the fit between the two helps to foster an atmosphere of mutual trust and predictability that facilitates the conduct of business and enhances economic, social and environmental welfare.

23. The core responsibility of the business sector is the conduct of business itself – its function in society is to earn competitive returns for owners of capital by identifying and developing promising investment opportunities. In the process, businesses provide jobs and produce goods and services that consumers want to buy. The OECD Corporate Governance Principles describe good practices that help companies, governments and others play their roles in the corporate governance system more effectively. 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.

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[5] The definition of corporate responsibility proposed here is drawn from *Corporate Responsibility: Private Initiatives and Public Goals* (OECD 2001) and from C/MIN(2001)4 "Private Initiatives for Corporate Responsibility. Report to Ministers by the Committee on International Investment and Multinational Enterprises".

Box 1. Human Development Indicators, Natural Resources and the Public Sector in the DRC

The DRC's economic and political system has provided low and falling levels of well-being for its people. The DRC places 168 among the 177 countries in the United Nations Development Programme's 2004 human development ranking. The DRC's human development index fell continuously over the period for which index is calculated (19975-2003)[1]. Other welfare indicators reinforce this picture. On average, 73 per cent of the population was undernourished over the 1998-2000 period (compared with an average of 32 per cent over 1990-92). Life expectancy at birth was 40.6 years in 2001 (down from an average of 45.9 years in 1970-75). Real GDP per capita fell by 8 per cent per year from 1990 to 2001. Public health expenditure in 2003 was 1.1 per cent of GDP -- well below the sub-Saharan African average of 2.5 per cent. The infant mortality rate is 129 per 1000 live births (the sub-Saharan African average is 105). The World Bank estimates conflict-related excess mortality since 1997 at 1.5 to 3 million deaths, including about 200,000 persons (mostly civilians) killed in fighting. [2]

Underpinning this low performance in human development terms was a public sector that was not working well. Problems identified in a 2001 IMF report include:

- The government did not control all of its territory. The report identified 5 out of 11 provinces as being "not under control of government".
- Transportation infrastructure[3] and public health and information systems had "collapsed".
- Telecommunications, energy and water utilities were severely deteriorated.
- Public revenue and expenditure management was weak.
- The state owned enterprise sector was pervasive, but had "dismal performance."

Rich natural resource endowments and abject poverty have coexisted in the DRC for many years. The DRC's mineral wealth is not only varied (e.g. cobalt, coltran, copper, diamonds, gold and uranium) but much of it is of exceptionally high quality. In addition, the DRC has oil reserves and supplies of tropical timber and ivory.

The impression left by the DRC is that, in macroeconomic terms, the sums do not add up. The weak policy framework has not allowed the DRC to convert its resource wealth into higher standards of living for its people. Instead this wealth appears to have been dissipated, either through waste or corruption. The 2002 Working Paper considered by the Investment Committee identified common features of weak governance countries (documented for Angola, Myanmar and Nigeria) -- state owned enterprises with weak governance rules, poorly performing fiscal systems and lack of protection of political and civil rights that could allow broader systems of checks and balances to operate. The 2002 Working Paper noted that large sums of money could "disappear" from countries with similar problems – the missing sums amounted to several percentage points of GDP. In particular, it described the Swiss and UK anti-money laundering authorities' discovery of some $1.8 billion that had be "siphoned through" their banks by the Abacha family of Nigeria. Furthermore, it also cited World Bank/IMF estimates that between $500 million and $1.4 billion was missing from the Angolan Treasury. For both Nigeria and Angola, these sums represent several percentage points of GDP. The same institutional problems identified in the earlier report – weak governance SOEs, poor budget control and weak protection of rights -- are also found in pre-reform DRC.

Notes:

1. 2004 Human Development Report. United Nations Development Programme. http://hdr.undp.org/statistics/data/indic/indic_12_1_1.html
2. Statistics on GDP, life expectancy are from United Nations Development Programme's Development Statistics (2003). Statistics on public health expenditure and infant mortality are from World Bank Development Indicators, 2003 (web address). The World Bank estimates of increased mortality can be found at http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/
3. A June 2003 study notes the importance that the development of transportation infrastructure will play in effective regional integration. OECD, Sahel and West Africa Club entitled "The Democratic Republic of Congo and Cross Border Regions: Reconstruction and Integration Projects" by Roland Pourtier.

24. However, corporate responsibility goes beyond the core function of creating value for suppliers of capital. Businesses are expected to obey the various laws that apply to them and, as a practical matter, have to respond to societal expectations that are not written down in law books (e.g. to respect human rights, even if these are not protected by the law of the countries in which they operate). The OECD Guidelines for Multinational Enterprises and the Principles of Corporate Governance help companies to do a better job of balancing these competing pressures.

25. In weak governance zones, this search for an effective "fit" between business and surrounding societies is particularly difficult because the political, civil and economic institutions that help achieve it are not working well. In pre-reform DRC, the 'fit' between business and society reflected mainly a narrow range of interests and pressures – those of high level political and business actors. The rest of the population was largely excluded from political and civic dialogue by poverty, threats of physical violence and suppression of political, civil and labour rights. Indeed, the business sector itself – including both domestic and foreign investors – suffered from violation of property rights, from threats of physical violence and from poor public services. The DRC case study suggests that – at least in the formal economy -- only a narrow range of business interests were able to survive in this environment. While these companies did develop a kind of "fit" with the surrounding society, it was not a successful one. The failure of the DRC economic and political system is evident – Box 1 shows that it has produced some of the lowest human development indicators in the world.

26. While the economic and political system of pre-reform DRC was not successful in raising the welfare of the people of the DRC, it undoubtedly served the needs of high level political actors[6]. It allowed them to protect and to benefit from their privileged positions. These privileges can be very valuable – Box 1 cites examples where losses from budget systems or theft by individual political actors and their entourages amounted to several percentage points of host country GDP. Responsible companies investing in weak governance zones such as the DRC may wish to understand what is wrong with host country institutions in order to avoid being complicit in wrongdoing and to help these countries move onto a more successful development path. The OECD integrity instruments– which contains principles for good practice in such areas as governance of state-owned enterprises, budget integrity, conflict of interest in the public sector -- provides guidance to help companies assess the risks they face in weak governance environments.

Business roles in weak governance zones – the 1990-2001 DRC experience

27. The case study shows that the DRC was largely cut off from mainstream investment processes during the 1990-2001 period. Investors in most sectors have shied away from the DRC (Box 2), leaving mainly extractive industry investors and related service providers (especially financial services). This result is undoubtedly due to the high perceived risk of DRC investments and to the fact that natural resource investments are linked to resource availability and made financially viable by natural resource rents.

28. However, the pre-reform DRC environment was so severe that even extractive industry investors had trouble surviving there. Large multinational enterprises were present in the DRC oil sector, though most exited during the pre-reform period (by selling to smaller OECD-based companies and to an Angolan

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6 The idea that the institutional set-ups in weak governance zones are "functional" in the sense that that they have evolved to serve the interest of certain political and business actors is developed in "Multinational Enterprises in Situations of Violent Conflict and Widespread Human Rights Abuses". This paper shows a pattern in the institutions of weak governance zones: lack of respect of basic rights (e.g. property rights, labour rights, other political and civic rights); weak governance state-owned enterprises and weak budget systems. OECD International Investment Working Papers Number 2002/1. May 2002.

state-owned enterprise). The population of mining investors seems to show the effects of the DRC's extreme investment climate. It is more skewed away from major mining companies and toward second tier investors (publicly listed mining "juniors" and small, unlisted mining companies) than it would have been if the policy climate had been healthier. These case study 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.

29. With its unstable political framework and its almost unmatched natural resource wealth, pre-reform DRC offered a risky investment environment with high potential returns. Investors in such environments need a strong appetite for risk. Junior mining companies are known for their risk-loving business cultures. They bring know-how and entrepreneurship to the mining industry, specialising in the discovery of new mineral deposits and in other initial development activities that are critical to the success of the sector. In the DRC, this role has been somewhat altered – small unlisted companies and publicly listed junior mining companies have been offered a chance to operate "world class" mining properties and the prospect of moving up into the ranks of major mining companies.

30. While some mining investors incurred large losses in the DRC, others have proven to be shrewd investors. They have steered clear of the DRC's numerous hazards and realised handsome returns. For example, the quote below refers a Zambian- and DRC-focused junior mining company that had invested heavily in a DRC property without having secure title to it[7]:

> *Compared to a few years ago, [company name] is now widely held; the share register includes some of the biggest fund managers known out of Wall Street, Toronto, London, Paris and Australia. This is in sharp contrast to just a few years ago, when [company name] had just one material investor; he, not without irony, was a resident of Las Vegas, Nevada, the biggest gambling centre in North America. He made a bundle on his investment when he sold out at around C$3.5 a share*[8].
>
> *Mine Web, September 2003*

31. Set against the high potential returns on DRC investments were significant risks. These included the usual operating and market risks associated with the minerals sector, but risks also stemmed from the unpredictable political environment. These included the risk of expropriation (in several cases, established mining claims were invalidated or transferred by the government), of disruptions caused by conflict (several companies were forced to shut down operations for extended periods) and of physical violence to employees.

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7 This company's title to its property was only secured in March 2003 after the DRC government and the World Bank worked together to strengthen the legal framework in the minerals sector (including adopting a mining code).

8 Mine Web September 22, 2003.

Box 2. OECD Based Companies with Operations in Pre-reform DRC (1990 – 2001)

This box looks at companies active in the DRC over the 1990-2001 "pre-reform" period. This period covers the build-up to the violent wresting of power from Mobutu in 1997, the ensuing war and ends with the assassination of Laurent Kabila in 2001. After taking power, Joseph Kabila ushered in a series of reforms designed to stabilise the country and to enhance its economic and social performance.

The pre-reform investment climate in the DRC was an extreme one and it appears to have influenced the population of companies active there. This box provides a general overview of companies active in the DRC, including investors. The data is based on a sample of companies developed using the methodology described in Annex 3. The Box then focuses on two investor categories: "partly indigenous" conglomerate investors and mining investors. It also looks at the pattern of firm entries and exits in the DRC mining and petroleum sectors over the pre-reform period.

The main findings are:

- Most sectors of the DRC economy are largely cut off from mainstream, OECD-based investment processes. Outside the natural resources and finance sectors, only 4 major multinational enterprises appear in the sample of 58 DRC OECD-based investors.

- Two extremely diversified conglomerates dominate much of the DRC economy. Both have OECD ties (nationality, business operations, place of incorporation), but their business strategies focus on the DRC (in one case) and on Zimbabwe and the DRC (in the other). It is unlikely that this strategy – extreme diversification in a small market – would be viable if these companies were competing in a more normal investment climate.

- Operators in the DRC mining properties tend to be mid-sized or junior publicly listed companies or small unlisted companies. In other environments, rights to operate these properties – many of which involve "world class" mineral deposits -- would probably have gone to better capitalized, major mining companies. The DRC's extreme investment climate appears to have impeded entry by larger, more competitive companies and created strategic opportunities for smaller, more marginal companies.

- Nine OECD based companies had investments in the DRC oil sector during the pre-reform period. Four of these were major multinational companies (three of these exited during the period, having sold out to much smaller OECD based companies and to an Angolan SOE.).

Business information is difficult to obtain for the DRC and the amount of information available about the companies in the sample is high variable. The activities of some companies are well documented (in business data services, Congolese and OECD government reports and on company websites) while little is known about others. This sample provides a unique picture of foreign companies active in the DRC – however, it is a sample, not the total population of for companies. The sample is more likely to omit smaller, less visible companies than larger, publicly quoted companies.

One hundred four OECD-based companies have been identified as having activities in the DRC over the 1990-2001 period. These consist of 67 companies in the minerals sector, 9 in oil and gas, 9 in financial services, 8 in consumer products, 4 in transport and 3 in information and communications technologies (Figure 1). Of these, 58 are investors (Figure 2).

Figure 1. Number of OECD-based Companies with activities in the DRC, by sector

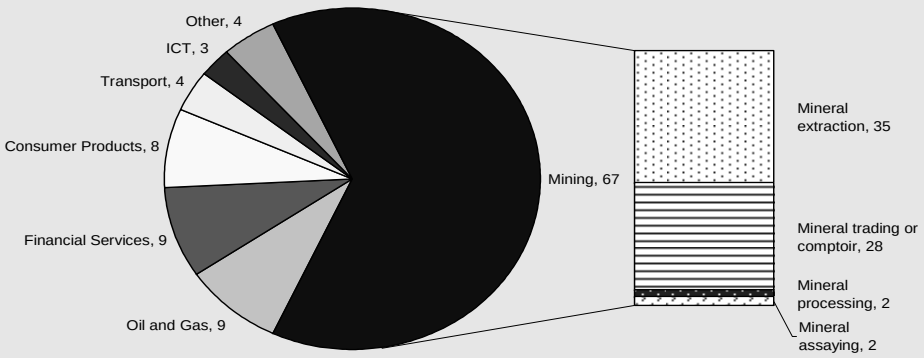
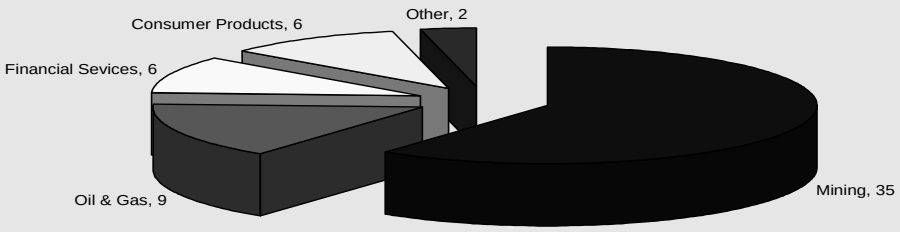


Figure 2. Number of OECD-based investors in the DRC, by sector



Source: OECD; in Figure 2, the two diversified conglomerates discussed in the box are included in mining sector.

The investors' sample contains 35 mining companies, 9 companies in petroleum, 6 in financial service, 6 in consumer products as well as 2 others (in transport and agri-food). An investor is defined as a company that has production facilities, commercial presence and/or rights to exploit natural resources in the DRC. Extractive industries -- with 44 out of 58 investing companies -- dominate the sample. The scarcity of consumer products firms is noteworthy. Indeed, outside of extractive industries and financial services, major multinational enterprises are rare – only 4 major multinational enterprises outside extractive industries and finance appear in the sample. Of the financial services investors, all are either major international institutions or are closely related to one. Of the 9 oil and gas companies with investments in the DRC, four are major multinationals and one is an OECD-based state-owned enterprise.

The *two African focused conglomerates* deserve special attention. One is a family company headquartered in an OECD country but with roots in the DRC dating back to the colonial period. The other, also with mixed OECD-African ties, focuses more broadly on central Africa. Although their business strategies target on DRC or central African markets, both are truly global companies. One is present in Europe, the Middle East and other African countries. The other has group companies incorporated in the OECD and the Virgin Islands with an African base in Zimbabwe. The most striking feature of these conglomerates is their extreme diversification. In addition to their DRC minerals investments, these two companies cover general trade and manufacturing, medical services, aviation, electrical services, construction, building materials, real estate, sports management, leisure and tourism, metal products, food, other consumer products and transport services. In effect, the entire DRC business sector is spanned by these two enterprises.

It is doubtful that these conglomerates' business strategy – extreme diversification in a small market – would be viable if competitive processes were working normally in the DRC. The heads of both companies are noted for their high level political contacts in the DRC and elsewhere. These connections appear to be the companies' chief competitive assets. Their ability to survive suggests that the DRC's difficult investment climate has acted as a barrier to entry for domestic and international competitors and has cut many sectors of the economy off from global investment processes.

The investment climate also appears to have influenced the population of mining companies operating in the DRC. The 35 mining companies in the DRC investor sample consist of:

- 6 major mining companies. From a host country perspective, the advantage of major mining companies is their access to capital, technology and enhanced transparency and accountability arising from their greater visibility. The Mining, Minerals and Sustainable Development (MMSD) Report[2] describes them as "high profile organisations conscious of the need to have a social licence to operate. Many of them have well developed codes of practice and ways of doing business, as well as reporting procedures that take into account a broad range of environmental and social concerns. When [such companies] open a new mine, there is likely to be a substantial effort to assess, minimise and mitigate many of the environmental and social impacts, to develop and effective mine closure plan and to foster constructive and consensual involvement with the local community." Only one of these major companies operated a mine during the conflict period -- the others had non-operating investments in joint ventures or financial investments in partially privatised state-owned companies.

- 18 publicly listed mid-sized and junior mining companies. These companies dominate mine operation in the DRC – they have most of the personnel and equipment on the ground. In other settings, junior companies would specialise in exploration, initial development of properties and in marketing properties to major companies. The DRC has offered juniors an opportunity to operate world class mining properties. In the DRC environment, junior mining companies' traditional taste for risk has been directed at managing political risks and the distinctive security risks associated with operating in a conflict zone. From a host country perspective, these companies present certain drawbacks. The MMSD report[1] states: "Some of the smaller intermediate and junior producing companies are undercapitalised and short of management expertise, while at the same time under intense pressure to succeed and hence likely to take on marginal risks."

- 10 small unlisted mining companies and one state-owned, OECD-based mining company[3]. The positioning of the unlisted companies is similar to that of the juniors – 6 operate mines, 2 have financial investments and little information is available on the activities of the other two companies. While small, these companies

operations are global – several have activities stretching across North America, Europe, North Africa and the Middle East (including in offshore financial centres). Basic information about these companies (ownership, range of business interests, financial performance) is often lacking.

Sixteen entries[2] and 3 exits by OECD-based investors were documented between 1996 and 2001. All 3 exits occurred in the oil industry and all involved the sale by top-10 oil companies to smaller, less visible companies (to two smaller OECD-based companies and to an Angolan state-owned enterprise. Fourteen of the entries were in mining. Mining entrants consisted of 2 major multinational enterprises, 10 juniors and 2 small unlisted companies. The predominance of junior and small unlisted companies in entries suggests that they increasingly dominated the DRC mining scene – they were the principal actors in the partial privatisation of DRC mining assets that occurred over the 1990-2001 period.

Notes:

1. Breaking New Ground, Mining, Minerals and Sustainable Development: The Report of the Mining Minerals and Sustainable Development Project (May 2002, Earthscan Publications Ltd. London). The "major" mining companies identified in the present paper are those that have DRC investments and that appear in the list of top-30 companies (by market capitalisation) in the MMSD study.
2. An entry is defined as a company setting up one or more mining operations in the country – thus, it is based on movement by companies, not on initiation of projects.

32. The OECD-based companies play complex and multifaceted roles in weak governance contexts. The case study suggests the following roles:

- *Victims of rights violations.* In countries with rights violations as widespread and serious as in the DRC (e.g. conscription of child soldiers), violation of investors' rights might seem to be a minor problem. Yet, investment protection – or the lack of it – is part of the backdrop to the DRC's problems. Threatened or actual violation of investors' rights has been a feature of the DRC economy since at least the Mobutu period. During the pre-reform period, these problems included outright expropriation, arbitrary transfers of mining properties from one joint venture to another and changing of corporate control arrangements by presidential decree (Box 4). Unlike most other victims of rights violations in the DRC, foreign investors were in a position to react -- they refused to invest, left the country or learned to manage the risks.

- *Well informed insiders and actors in the political system.* Political risk management was an essential survival skill for DRC investors (Boxes 2 and 4). In the absence of the rule of law, investors sought to protect their investments by cultivating high-level political alliances. However, in order to qualify for this protection, companies had to make themselves useful and not to interfere with the government; it was dangerous for investors to speak out publicly as witnesses of wrongdoing or as whistleblowers. The case study revealed only one instance of OECD-based companies speaking out clearly and publicly against wrongdoing by the pre-reform governments. This and the absence of broader systems for promoting corporate and government accountability created a context ripe for high level political corruption and undue political influence. Companies also had to keep a close eye on each other. Firms competed more in the political arena than in the DRC market place – the case study revealed instances of companies' waging political campaigns against one another. Moreover, the disorderly arrangements within the mining joint ventures created opportunities for one partner to self-deal at the expense of others (Boxes 2 and 4). Companies needed to be vigilant and to keep a close eye on the political situation and on each other.

- *Providing services*. While companies depended on politicians for protection, political actors also depended on them to provide vital services. Mining and oil companies (in addition to operating on their own account) provide a type of financial service – they help host countries convert their mineral assets and oil reserves into other, more liquid assets. Extractive industry firms are aware of this service component to their business. An oil industry executive, speaking in 2002 at an International Energy Agency event[9], described this as "monetising the upstream assets" of host countries (essentially converting their oil reserves into cash) and noted his company's ambition of being a "preferred provider" of this service. Countries can also use financial institutions to generate liquid assets by borrowing against their natural resources. Box 4 shows that many OECD-based companies provide this service via their joint ventures with DRC state-owned enterprises. However, 'monetisation' also takes place via corporate tax and royalty payments made directly into the host country Treasury.

- *Creating stakes*. In most countries, the asset conversion services provided by extractive and financial industries contribute to general welfare in important ways. In weak governance countries, these asset conversion services increase financial liquidity in context of weak financial control – as shown in Boxes 4 and 5, budgetary and SOE governance arrangements do not permit these liquid financial assets to be secured and channelled toward uses that enhance general welfare. Without well-defined and –enforced property rights (for example, the rights of host

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9 *Oil and Natural Gas Scenarios for the Caspian Region* (IEA Workshop, Paris, November 2002).

country citizens to benefit from their natural resource wealth), this can create both the "means and the motive" for conflict.

Corporate governance – creating shareholder value with integrity

While it is acknowledged that small- and medium- sized enterprises may not have the same capacities as larger enterprises, governments adhering to the Guidelines nevertheless encourage them to observe the Guidelines recommendations to the fullest extent possible.

The OECD Guidelines for Multinational Enterprises. Chapter 1. Concepts and Principles.

Enterprises should…

6. Support and uphold good corporate governance principles and develop and apply good corporate governance practices.

7. Develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate.

The OECD Guidelines for Multinational Enterprises. Chapter 2. General Policies.

33. Corporate governance systems determine who has a say in corporate decision making and how decisions are made. They influence companies' success in fulfilling their core mission – earning competitive returns for suppliers of capital while also responding to competing pressures (e.g. for complying with law). Corporate governance practices differ by country,[10] sector, size and organisation of ownership (e.g. unlisted versus publicly-listed). The OECD Principles for Corporate Governance provide principles for good practice in this area. The Guidelines commentary notes that they give further impetus to the OECD Principles of Corporate Governance[11].

34. Transparency is an important element of corporate governance systems. Transparency can be said to exist when there is successful two-way communication between a company and the people it affects (above all shareholders, but also employees, business partners, local communities, creditors, etc.). Such communication requires two-way flows of information. Companies need information – keeping informed about the business environment is central to creating shareholder value and to responding to the needs of stakeholders. They also need to provide reliable information to the other parties in the communication process – this information allows shareholders and stakeholders to evaluate the company and to influence its policies (e.g. through market pressures, participation in shareholder meetings, regulatory enforcement, NGO campaigns, trade union actions).

35. A variety of governance tools are available to help companies ensure that incoming and outgoing information is accurate and available to the people who need it. Boards of directors -- both their membership and their responsibilities -- determine how companies collect and use information at the highest strategic level. External audits, and internal management systems help companies gather, produce and use reliable information. External reporting practices determine who outside the company gets access to what information.

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[10] See *Corporate Governance: A Survey of OECD Countries*, OECD, 2004.

[11] Paragraph 7 of the Commentary on Chapter II notes that the Guidelines give impetus to the OECD Principles of Corporate Governance and also states that: "Although primary responsibility for improving the legal and institutional regulatory framework lies with governments, enterprises also have an interest in good governance."

36. Boxes 3a-c review the transparency and accountability practices of DRC mining investors. These suggest that, in the DRC, weak public and private sector transparency might have intersected with and reinforced each other. While the pre-reform DRC may have been one of the least transparent policy environments in the world, corporate practices did relatively little to shed light on key business dealings. This combination of public and private opacity eliminated any possibility of broad participation in scrutiny of both the public and business sectors. This section reviews some of the generic issues raised by the case study of the governance practices of DRC mining investors.

The Transparency Continuum – Major, junior and small unlisted companies

37. Box 3a shows three broad categories of DRC investors: 1) major multinational enterprises; 2) publicly listed junior and mid-sized mining companies; and 3) small unlisted companies. This movement from large, publicly traded (listed) companies to smaller unlisted companies is also movement across a transparency continuum.

38. The large companies are subject to the full range of transparency requirements and expected practices for major publicly listed companies. These include the extensive financial disclosure required by stock exchanges and by prudential supervisors, scrutiny from the financial community and from shareholders and exposure to union and NGO pressures. Large volumes of financial and non financial information – published by the companies themselves or by other institutions -- are available on these companies' ownership, policies, management systems and performance.

39. The publicly-listed junior and mid-sized mining companies occupy an intermediate position in this continuum. Basic financial and ownership information about these companies is readily available. They are listed on major or second-tier exchanges and, as such, are subject to relatively rigorous financial disclosure regimes (though disclosure regimes for companies with smaller capitalisation are sometimes deliberately set lower for theses companies)[12]. The case study of DRC investors shows that, in several other disclosure areas – reporting on corporate policies, management practices and non-financial performance -- they disclose less information than the large multinationals (Box 3b and c). Lower disclosure in these areas is undoubtedly normal for smaller firms, but also raises the question as to whether or not this lower disclosure (and these companies' importance for the DRC economy) contributes to the overall lack of transparency observed in the DRC.

40. Other characteristics may also mean that the junior companies are somewhat removed from broader processes of accountability. Like their small unlisted counterparts, these companies are fairly small, have little or no public visibility and often operate in remote areas. Since they depend largely on specialist investors, they attract little interest from the wider financial community. Reputation capital is not a major competitive asset for them (outside their reputation in a narrow field of mining specialist investors). They are less likely to be members of business and industry associations[13]. With their lower public profiles, they are also less likely to be subject to the scrutiny that larger companies receive from political actors and civil society, including trade unions.

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[12] Second tier exchanges often have lower listing standards than first-tier exchanges.

[13] This statement is based on a study of membership lists of major mining associations.

Box 3a. The Transparency Continuum – Governance and DRC Mining Investors

Based on information available on company websites as of April 2004, three broad categories of governance can be distinguished among DRC mining investors. Organised from most to least transparent, these categories are:

1. *Large, publicly quoted companies*[1]. These 6 companies are top-30 mining concerns and are listed on major international exchanges. They have governance arrangements – size and structure of the board of director, auditing and disclosure policies and exposure to scrutiny by analysts, institutional investors and other actors -- that go with their status as major, listed companies. Extensive information about them is available from company reports, business and mining information services, stock exchanges and financial analysts, business associations and from reports by trade union and NGOs.

2. *Junior and medium-sized publicly quoted companies*. Occupying a middle position in the transparency continuum are the smaller publicly-quoted companies – 7 (out of the ten for which listing information is available) are quoted on the Toronto exchange[2]. These companies tend to have small boards, relatively extensive financial disclosure and limited disclosure about broader performance and risk management practices (see Boxes 3b and c). This pattern of practices is not unique to DRC junior mining companies (junior mining companies investing in the OECD show the same pattern of behaviour. However, given the significance of these companies for the DRC economy, this case study result raises the question as to whether or not these practices due not reinforce or interact with broader non-transparencies in the DRC economy.

3. *Small unlisted companies*. At the opaque end of the transparency continuum are the unlisted, small and medium-sized companies. In particular, four such companies are major actors in the DRC mining sector and three are partners in joint ventures with state-owned enterprises in mining. These companies are often part of larger business groups. The groups' activities are global – they involve entities located in Europe, the Middle East, other parts of Africa and North America. They include business units incorporated in the DRC itself as well as in the Bermuda, the Cayman Islands and the Virgin Islands. It is not always possible to determine who the owners of these companies are. Since the companies are unlisted (and therefore not subject to as rigorous financial reporting requirements), only limited financial information is available. There is no indication that any of them publish non-financial reports on non-financial policy, management practices and performance.

Notes:

1. The other exchanges where these mining investors are quoted (including secondary listings) are: the Australian Stock Exchange, Berlin Stock Exchange, Frankfurt Stock Exchange (which market?), London Stock Exchange (main plus alternative) and the New York Stock Exchange.

2. The Toronto Stock Exchange (both the main and the "Venture" exchange) attracts many mining companies. The Exchange offers a special version of its listing requirements that is tailored to the mining industry's needs.

Box 3b. Boards of Directors of DRC Investors

Boards of Directors have the ultimate responsibility for corporate policy and performance. Their composition determines which issues are assigned strategic priority and how they are dealt with. This box looks at the composition of the boards of the junior DRC mining investors and compares it with those of larger extractive industry companies. The box focuses on smaller mining companies because of the central role they play in the DRC minerals sector (as mine operators and joint venture partners with state-owned enterprises). The box aims to shed light on how these companies' Boards balance financial pressures with "competing pressures" (e.g. to comply with law and to observe widely shared standards for business conduct such as the OECD Guidelines).

Based on company websites as of April 2004, information is available on the Boards of Directors of 10 of the 18 junior and medium sized mining companies in the DRC sample. These 10 companies have, in total, 68 directors, including 38 executive and 30 non-executive directors (Figure 3a). The Secretariat has compared the board membership of these companies with those of 10 largest mining companies (which have a total of 107 directors) and the ten largest oil companies (which have a total of 146 board members)[1]. This comparison shows that, on average, the DRC junior companies' boards:

- are small relative to large extractive industry companies – they are two thirds the size of the boards of top-10 mining companies and about half the size of the top-10 petroleum companies' boards;

- have fewer non-executive directors relative to executive directors (Figure 3a). The DRC juniors have slightly more than 1 executive director for each non-executive director. For top-10 mining, this ratio is roughly 3 executive to 5 non-executive directors and for top-10 oil 1 executive for 3 non-executives.

- are very focused on mining expertise. DRC junior company boards are dominated by mining experts and by financial, accounting and legal professionals (Figure 3b). Fifteen of the 30 junior mining company non-executive directors are, themselves, from the mining industry. In contrast, 8 of the 69 non-executive directors in the top 10 mining companies are from the mining sector and 13 of the 108 non executive directors of the top 10 oil companies are from the oil sector. Moreover, about 20 per cent of the top-10 mining and oil non executive directors have not followed careers in business (e.g. they are diplomats, university presidents, heads of charitable foundations, etc.) For the DRC junior non-executives, none of the 30 non-executive directors had this background.

- are very focused on African mining. Ten out of 68 junior-company directors are African mining specialists.

The overall impression left by the junior mining companies' Boards is that they are heavily weighted toward mining (and even African mining) expertise. They are focused on the financial, technical and legal requirements of mining. It is normal for companies with smaller capitalisation to have smaller, more focused boards. The case study results suggest, however, that the junior mining companies do not use their boards to bring in influences and information from outside the mining sector that might help them deal with what are undoubtedly difficult questions of business ethics arising from their investments in the DRC.

Notes:

1. The top-10 mining companies are taken from the list of top-30 companies (by market capitalisation). Breaking New Ground, Mining, Minerals and Sustainable Development: The Report of the Mining Minerals and Sustainable Development Project (May 2002, Earthscan Publications Ltd. London).

Figure 3.a. Board Composition - Executive and Non-Executive Directors

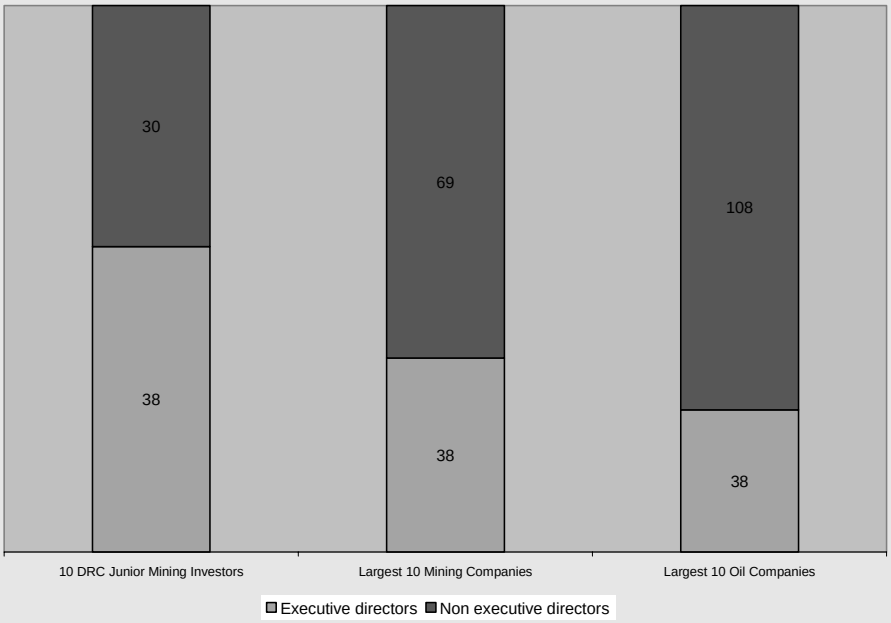
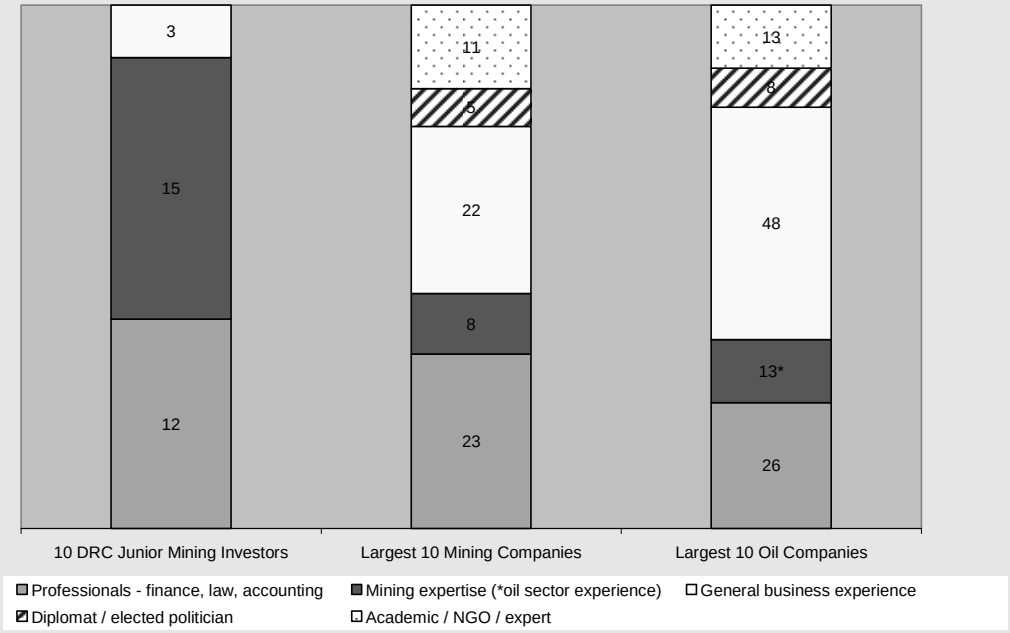


Figure 3.b. Professional background of non-executive directors



Box 3c. Governance Practices – Management, Reporting, Board Involvement

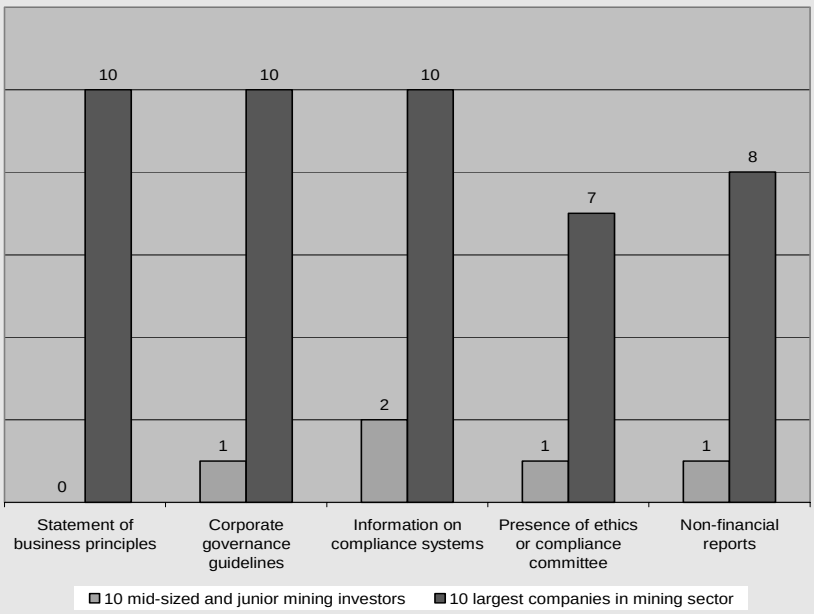
Recommendation II.7 of the Guidelines asks companies to "develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the societies in which they operate." The Concepts and Principles Chapter (Chapter I) of the Guidelines also notes that "small- and medium-sized enterprises may not have the same capacities as larger enterprises", thereby noting that it might not always be possible to have the same expectations of them as of larger companies. This box uses publicly available information to report on the DRC investors' policies and practices in five areas – 1) publication of statements of business principles; 2) publication of corporate governance guidelines; 3 reporting on compliance systems; 4) whether there is a board-level ethics or compliance committee; and 5) publication of social and environmental reports.

Based on company websites as of April 2004, all six major mining companies with DRC investments have produced statements of business principles, corporate governance guidelines, compliance systems and non-financial reports. Three have an ethics/compliance committee. None of the small unlisted DRC mining investors publish any material that would indicate that they engage in any of these practices.

Figure 4 compares the 10 DRC publicly listed junior mining companies' practices with those of the top-10 mining multinational enterprises. The figure shows that the junior mining companies are significantly less transparent than the largest mining companies. None of the juniors has produced a statement of business principles. Only 1 junior has a Board-level compliance or ethics committee, while 7 of the top 10 mining companies do. Only 1 junior regularly produces a non-financial performance report, compared to 8 of the top-10 mining majors.

Overall, this Box suggests that the small unlisted and junior listed companies disclose less information – about their business policies, management practices and non-financial performance reporting – than the major mining companies (top-10 and DRC investors). This finding might reflect the fixed costs of developing and maintaining such practices, which smaller companies (with lower output over which to spread these costs) might find difficult to bear. It might also reflect less need for such practices (top management in smaller companies might be able to communicate company policies through other means such as direct communication and direct observation of employee compliance with the policy).

Figure 4. Selected governance practices: junior versus major mining companies



41. The small unlisted companies are the most opaque in the DRC investor sample – often it is not possible to determine even who owns them. Many consist of complex groups of companies owned by holding companies or trusts. The complexity and global scale of the business groups (which often straddle several continents and, in some cases, off-shore financial centres) to which some of these companies belong contribute significantly to the lack of transparency in the DRC mining sector (at least three of these unlisted companies were joint venture partners with state-owned enterprises in the mining sector). Although it is normal for unlisted companies to produce less information than publicly-listed companies[14], the important role they played in the DRC mining sector – especially as business partners for state-owned enterprises – may have aggravated the lack of transparency that characterised the sector in the pre-reform period.

42. The final issue on transparency relates to commercial and financial transactions among related companies. Some of the companies in the sample have business ties of various kinds with each other or with each other's groups: they are partners in joint ventures; they sell goods and services to one another; they invest in each other and provide other forms of finance; their officers sit on each others' Boards. These complex business groups and related financial and commercial transactions can give rise to valuation and reporting problems that would challenge even highly sophisticated accounting and audit capabilities and the most elaborate systems of ethical "checks and balances" (e.g. committed and well informed financial service professionals, effective whistleblower protection, extensive media scrutiny, etc.). These capabilities were not present in pre-reform DRC.

Board composition – SMEs versus larger companies

43. Chapter VI of the Corporate Governance Principles describes the responsibilities of the board of directors. The commentary to this chapter states:

> *Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving adequate returns for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. In order for boards to effectively fulfil their responsibilities they must be able to exercise objective and independent judgement. The board has a key role in setting the ethical tone of the company, not only by its own actions, but also in appointing and overseeing key executives and consequently the management in general. High ethical standards are in the long term interests of the company as a means to make it credible and trustworthy, not only in day-to-day operations but also with respect to longer term commitments.*

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[14] *Beyond the Corporate Veil*, OECD (2002), describes this as follows:

> In most jurisdictions, corporations are divided into public limited companies (joint stock or share companies) and private limited companies (companies limited by shares or guarantee). The primary distinctions between private and public limited companies are that the shares of a public limited company are freely transferable and there are no limits on the number of shareholders in a public limited company. These two features generally enable a public limited company to issue registered or bearer shares, offer its shares to the public at large and trade its shares on a stock exchange. In exchange for such flexibility, public limited companies submit themselves to rigorous regulation and supervision, such as frequent detailed financial and non-financial disclosure and enhanced accountability at the board level. In contrast, private limited companies may only issue registered shares, must restrict transfers of its shares, must limit the number of shareholders and may not issue shares to the public at large. In turn, private limited companies face a less stringent regulatory and supervisory regime than public limited companies….

44. Most discussions of board composition focus on whether the board is sufficiently independent from management to be able to hold executives accountable for their performance – that is, they focus on the board's role in addressing problems arising from the separation of ownership and control. This section looks at how the boards of investors in DRC mining sector deal with the broader performance question raised in the quote -- how does the board help to set the "ethical tone" of the company and how does it balance "competing pressures" (e.g. to comply with law and to observe international recommendations such as the OECD Guidelines).

45. The study of the composition of the boards of directors of selected extractive industry companies (Box 3b), shows that the DRC junior mining companies' boards are focused on the technical, financial and legal requirements of mining. Compared with the Boards of the top-10 mining and oil companies, they have a lower ratio of non-executive directors to executive directors and their non-executive directors represent a narrower range of interests. The larger companies' boards commonly draw on people with diplomatic, university or political backgrounds, whereas only 3 board members for the DRC junior mining companies have this background. Moreover, many of the junior companies' boards are heavily weighted toward not just mining expertise, but toward African mining expertise. The boards are not used as a means for bringing broader societal perspectives into the strategic management of the junior companies.

46. As the Box points out, this highly focused board composition is undoubtedly a characteristic of all junior mining companies, not just those with DRC investments – smaller companies tend to have smaller, more focused boards. However, the question raised by these case study results is: because of the special ethical challenges raised by doing business in countries like the DRC, should companies be encouraged to use their Boards to show that they attach high strategic priority to dealing with these issues? Because political and civic dialogue and other accountability mechanisms are largely suppressed in countries with weak governance, the narrow board composition of the junior companies might poses more problems in such countries than it would in others. In theory, these companies' boards could be used as a means of enhancing corporate accountability across a wide range of ethics issues.

Compliance systems

47. Recommendation II.7 of the OECD Guidelines – as well as the Corporate Governance Principles and the Revised Recommendation of the Council on Combating Bribery in International Business Transactions -- promote the use of effective internal management systems. They also encourage reporting on these practices (see, for example, recommendation III.5 of the Guidelines). However, Chapter I of the Guidelines acknowledges that "small and medium sized enterprises may not have the same capacities as larger enterprises" and asks them to "observe the Guidelines to the fullest extent possible."

48. Box 3c compares the management systems and non-financial reporting practices of the DRC junior mining company sample with those of the top-10 mining companies (no information is available on the internal management practices of the unlisted companies). Publicly-available information suggests that the legal and ethical compliance systems of the smaller companies are significantly less elaborate than those of the top-10 mining companies. Overall, these companies disclose less information on their management practices and their non-financial performance than large companies do.

49. These differences are, at least in part, due to economic factors. For example, if the costs of developing compliance systems and associated reporting are largely fixed, companies with lower break-even volumes will be less likely to undertake them. Thus, for economic reasons, it is normal for smaller companies to be less active in these areas than larger companies. However, several questions arise in this connection: 1) does this pattern of business practice (combined with central role these smaller companies play in the DRC minerals sector) pose greater problems in the countries with fewer alternative channels for ensuring transparency (like pre-reform DRC) than it would in other investment environments?; 2) does it

make sense to encourage these companies to, when operating in weak governance environments, to make extra efforts to enhance transparency? 3) Alternatively, does the main responsibility lie with host governments, who could act to improve policies so as to be able to attract well capitalised, highly transparent investors?

State owned enterprises – making partnerships work

> *Enterprises should take fully into account established policies in the countries in which they operate … In this regard, enterprises should:*
>
> *1. Contribute to economic, social and environmental progress with a view to achieving sustainable development …*
>
> *3. Encourage local capacity building through close co-operation with the local community, including business interests….*
>
> *6. Support and uphold good corporate governance principles and develop and apply good corporate governance practices.*
>
> *Recommendations 1, 3 and 6, Chapter II of the OECD Guidelines*

50. The Guidelines ask companies to contribute to sustainable development, to encourage capacity building with local partners and to support good corporate governance principles. This section looks at OECD-based companies' partnerships with an important local business interest – state owned enterprises (SOEs). In the DRC, SOEs dominate not only extractive industries, but also public services and other sectors (thus, this section is relevant for companies conducting business with the entire range of SOEs).

51. Although state ownership of companies frequently poses problems for public sector management, it can be used as a policy tool for protecting the public interest. For example, Norway's management of its petroleum wealth involves a mix of private and public enterprises. Both are subject to strict corporate governance rules and both operate in broader systems for ensuring effective accountability. This arrangement appears to have succeeded in safeguarding the Norwegian people's stake in their natural resource wealth. Other OECD countries have opted for fully private solutions and these can also work well.

52. In weak governance contexts, SOEs can become a channel for wasting natural resource wealth or for diverting it for private purposes. Joint venture arrangements between OECD-based companies and SOEs are a prominent feature of the DRC minerals and petroleum sectors. Box 4 shows that 21 OECD-based companies (all small unlisted or mid sized and junior mining companies) have entered into joint ventures with 4 SOEs in extractive industries. In addition, 9 companies had (at some point during the pre-reform period) financial investments in partially privatised SOEs.

53. Although such SOE-private joint ventures are extremely common in extractive industries, they can bring OECD-based companies into close proximity to problems of business integrity when the SOEs in question are subject to weak governance arrangements. Problems with SOE arrangements identified in the case study include:

- The SOEs were not *de facto* subject to strong governance rules. SOE governance during the pre-reform period combined heavy political intervention with neglect of State responsibilities. At least two people were named as Chairs of boards, whose suitability was questionable (both were subject to conflicts of interest; one had political contacts but no business or mining expertise). There was a lack of independent board directors. Accounting, audit and internal controls were weak and there is no indication that financial reporting observed international standards. The lack of effective, rules-

based governance in these SOEs and in associated joint ventures left the people of the DRC[15] (the SOEs' ultimate owners) exposed to risks of abusive self dealing by SOE officials or by SOE business partners.

- Enterprises that posed clear integrity risks were accepted as business partners of SOEs. The small unlisted company groupings (Box 3a) posed particularly serious risks. Their unlisted status, global reach (including controlling entities in offshore financial centres), the complexity of their group structures significantly contributed to the prevailing lack of transparency. The unlisted groups (whose ownership may not be known, whose books are not audited or publicly available) posed the greatest risk of abusive related party transactions. These are financial or commercial transactions between related (jointly controlled companies) that are designed to channel and hide financial flows between the entities. If these transactions do not respect the arms' length principle (that is, if they are not priced as if the entities were engaging in an anonymous market transaction), there is a potential for one shareholder or venture partner to self deal at the expense of other shareholders or venture partners. The most obvious victims of such self-dealing would be the state-owned enterprises because of their lax governance frameworks[16].

54. Strengthening SOE governance and privatisation have been identified by the current DRC government and the International Monetary Fund as priority areas for reform[17]. The Guidelines encourage companies to promote capacity building with local partners and to "support and uphold" good corporate governance principles. In the DRC mining sector (and in the other countries and sectors where companies have partnerships with weak governance SOEs), companies' support of strengthening SOE governance might be one area in which they can make an important contribution to host societies' progress toward sustainable development.

55. Table 1 summarises the principles in several OECD instruments that help companies identify weak governance SOEs and possible areas for promoting better governance practices. These principles are taken from the OECD Corporate Governance Principles (identified as CGP in Table) and the Guidelines on Managing Conflict of Interest in the Public Sector (identified as COI). The Table's application of the corporate governance principles to state owned enterprises also draws on work done to date by the Working Group on Privatisation and Corporate Governance of State-Owned Assets. Table 1 focuses on three areas: transparency, Board of Directors and management of conflict of interest.

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15 Some of the private companies that invested in mixed public private companies also faced risks of abusive self dealings by SOE officials or other business partners.

16 The Corporate Governance Principle's Commentary (IV.D.6) states that "it is an important function of the board to oversee the internal control systems coving financial reporting and the use of corporate assets and to guard against abusive related party transactions."

17 IMF Country Report 04/97 April 2004. page 13.

Box 4. Joint ventures with SOEs in the DRC mining and oil and gas sector 1990 -- 2001

State-owned enterprises (SOEs) are a pervasive feature of the DRC economy. A 2001 list compiled by the IMF shows 51 state-owned companies operating in such sectors as mining, energy, manufacturing, agriculture, transport, communications, finance and other services. The IMF and the current DRC government have identified SOE reform as a major priority for structural reform. Extractive industry SOEs are of particular concern -- the 2001 IMF report on the DRC economy describes their performance as "dismal" and refers to their "huge financial losses". This Box reviews what is known about mining SOE's governance practices, which (during the pre-reform period) seemed to combine direct involvement of the DRC president and a pronounced neglect of basic governance practices (audit, reporting, internal management as asset security arrangements).

Ten companies in the DRC extractive sector - nine in the mining sector and one in oil and gas -- were once fully state-owned enterprises. During the 1990s, the DRC government was successful in attracting foreign investors for partial privatization and joint venture redevelopment of SOE mining operations. As a result, of the nine mining SOEs, one was fully-privatized and three semi-privatised[1] and five remained entirely in state hands. Four (fully state-owned) SOEs had 18 joint ventures with a total of 21 OECD companies during the pre-reform period. In all but one case, the operators of these joint ventures were junior or unlisted companies. The OECD joint venture partner operates through companies incorporated in the DRC (6 cases), the Virgin Islands (1 case) and the Cayman Islands (1 case). Eight OECD companies operate partnerships with the Cohydro, the oil and gas SOE. Six of these are publicly quoted oil majors, one is state-owned and one is private.

The rules for SOE governance in the DRC during the pre-reform period did not conform to international good practice guidelines such as the OECD Corporate Governance Principles or the draft Guidelines on the Governance of State Owned Assets. De facto governance arrangements appeared to tolerate conflict of interest of top officers. They failed to create internal management controls to secure assets and allowed embezzlement and stealing to take place at all levels. Accounting, audit and reporting practices do not appear to have followed international standards. The resulting lack of transparency and accountability was exacerbated by the fact that companies were accepted as joint venture partners with SOEs that (as documented in earlier boxes) were also highly non-transparent.

SOE governance problems observed during the pre-reform period include:

- *Lack of financial disclosure and of related audits and management controls*. There is no evidence that any of the SOEs conform to IOSCO reporting standards (none published annual reports). They did not appear to be subject to external audits during the period studied[2].

- *Conflict of interest on BOD*. The Chairman of the Board of Gecamines (the largest mining SOE) from November 1999 to March 2001appears to had serious conflicts of interest as he was at the same time the owner of an unlisted group with mining investment in the DRC. These opposed his fiduciary duties as a Board member and his ownership interests in one of the African-focused conglomerates described in Box 2. This conglomerate had both joint ventures and commercial relations with the SOE in question. Another person with conflicts of interest (resulting from his private mining holdings in the country and political ties to Zimbabwe) served as a top official of Gecamines from November 1998 to October 2000.

- *Absence of independent directors on SOE boards*. The Secretariat has been able to locate one complete SOE board (for MIBA, the major diamond SOE) corresponding to the conflict period and a partial listing for Gecamines. There is no indication that there were any independent directors.

- *Presidential interference in SOE governance*. In 1999, the DRC President named a high level political figure to head the MIBA "board" (the decree also altered governance arrangements). Major OECD-based shareholders in this mixed public-private company expressed public concerns about the suitability of the person named to head the company.

- *Shifting of properties by presidential decree*. In 1999, President Laurent Kabila transferred two valuable diamond properties from one semi-privatised company (MIBA) to another company (SENGAMINES) by presidential decree.

- *Embezzlement by top SOE officials*. The person named by President Laurent Kabila to the MIBA board is currently under investigation by Belgian financial authorities for having embezzled $80 million. Belgian authorities suspect that as much as one quarter of the embezzled money was used to buy arms. Related money laundering charges have been brought against the officials of an OECD-based bank.

- *Questionable joint venture partners*. Small unlisted mining companies and publicly listed junior mining companies were the SOEs' most common joint venture partners. DRC mining SOEs formed joint ventures with companies that were highly non transparent (including with 3 of the 4 small unlisted companies which are described in Box 3a as being highly non-transparent). As shown in Boxes 4b and 4c, the publicly listed, junior companies that operated most of the joint ventures properties also lacked transparency and accountability in some areas (publishing corporate policies, management practices and reporting on non-financial performance). These partnerships – and the financial and commercial transactions they entailed -- posed risks of abusive self dealing (especially since SOE financial control processes did not appear to be strong enough to ensure that all transactions conformed to the "arms length principle").

- *Organised theft by employees at all levels*. In the late 1990s, theft cost MIBA between 30 and 50 per cent of annual revenue (estimate made by MIBA creditors). A firm hired to improve security found systematic undervaluation and theft of diamonds and an employee-run criminal syndicate that siphoned off high-value gems. In addition, MIBA's security guards reportedly allowed illegal access to diamond fields to certain informal miners at night and opposed access by others. This indicates a lack of internal control – and, more particularly – of effective asset security systems.

Notes:

1. Two of the partial privatisations involved OECD companies. One stake was taken by a joint venture between two well-known OECD companies and the other by a small unlisted company.
2. Under current government plans, MIBA, the mixed ownership SOE in the diamond sector will be subject to an external audit; IMF Country report 04/97.

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)

Promoting Budget Integrity – A Role for Major Corporate Taxpayers?

> *It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with the tax laws and regulations in all countries in which they operate and should exert every effort to act in accordance with both the letter and spirit of those laws and regulations. This would include such measures as providing to the relevant authorities the information necessary for the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing arrangements to the arm's length principle.*
>
> *Chapter X of the OECD Guidelines*

56. Fiscal policy determines who gets what out of government spending and who has to pay for it. Many societies have developed elaborate fiscal systems for meeting their collective needs and implementing their models of social justice. These policies have created their own distinctive rent-seeking activities and have also contributed to fiscal imbalances in the OECD area. However, they are also widely recognised to have been reasonably successful in helping to create prosperous, just and peaceful societies.

57. Chapter X of the OECD Guidelines deals with taxation. The Guidelines are one of the few major corporate responsibility instruments to make recommendations in this area[18]. Companies themselves recognise the importance of their roles as taxpayers -- a OECD survey of 50 extractive industry companies' public statements showed that tax payments were one of the benefits for host societies most frequently cited by these companies[19]. However, in October 2001 (when the survey was conducted) only two of the 50 mining and oil companies (all of which had operations in weak governance zones) cited concerns about the uses these taxes were being put to.

58. As the Extractive Industries Transparency Initiative (EITI) and the "Publish What You Pay" campaign gained prominence, the possibility that major taxpaying companies could or should promote better fiscal transparency and control in weak governance countries this question has been much discussed. Also receiving much scrutiny and criticism is the practice of companies signing contracts with host governments in which they agree not to divulge the amount they pay into the public treasury[20]. International financial institutions are also active in this area[21]. The case study shows that concerns about weak fiscal controls were also relevant in pre-reform DRC. Box 5 shows that budget controls were practically non-existent in the pre-reform period.

59. The EITI and the Publish What You Pay Campaign did much to raise awareness of revenue transparency as issue for international policy makers. Many companies and business associations have spoken out publicly on the issue of revenue transparency – they are willing to work with others to help

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18 Among the major international corporate responsibility instruments discussed in "The OECD Guidelines and Other Corporate Responsibility Instruments: A Comparison" (published in the 2001 Annual Report on the OECD Guidelines) only one other instrument mentioned paying taxes as a corporate responsibility.

19 See Table 2 in Multinational Enterprises in Situations of Violent Conflict and Widespread Human Rights Abuses. Working Papers on International Investment Number 2002/1. May 2002.

20 This practice is not a feature of contractual arrangements in OECD oil-producing countries for example See Table 1 in Multinational Enterprises in Situations of Violent Conflict and Widespread Human Rights Abuses. Working Papers on International Investment Number 2002/1. May 2002

21 For example, in December 2004, the International Monetary Fund released for consultation a "Draft Guide on Resource Revenue Transparency".

make progress, but stress the need to avoid violating existing contracts of to respect the sovereignty of host governments. For example, the International Organisation of Oil and Gas Producers "Position on Transparency" supports the principles of transparency and expresses members' willingness "to work with multilateral institutions, regulatory bodies and other appropriate parties to reduce corruption and maximise transparency"[22].

Box 5. DRC Budget Practices

(Based on IMF Country Report No. 01/123 July 2001)

The IMF noted in 2001 that the DRC already weak fiscal situation deteriorated over the 1990s, as shown by growing deficits and a falling revenue-to-GDP ratio (hitting an average of 5 per cent over the 1996-2000 period). The IMF report identifies a range of problems on both the revenue and expenditure sides of the fiscal system.

On the revenue side problems include:

- Taxation of SOEs did not *conform* to ordinary law -- it was negotiated.
- Revenue was diverted to specific accounts outside the control of the Treasury. In 2000, an amount equivalent to at least 1.2 per cent of GDP was kept outside the treasury account at the central bank.
- Tax collecting *agencies* were generally poorly staffed and poorly equipped. There was no specialised unit to look after large taxpayers.

Problems were especially serious on the expenditure side of the DRC public budget. The IMF report expresses concern about "the total absence of control over expenditure". The report notes that, during the 2000 fiscal year, "only a marginal proportion of expenditure (less than 2 per cent, according to some estimates) was executed through normal procedures. Most expenditure was paid either (i) from diverted revenue sources without any control, or (ii) through direct payment orders to the central bank without any prior knowledge of the treasury or (iii) through fast track procedures. In any event these procedures strongly differ from the county's formal and rather orthodox budget process. .. Overall the proliferation of parallel channels deprived the Ministry of Finance of its capacity to record and control expenditure. "

60. International organisations – including the OECD – have formalised what has been learned about good budget practices. The OECD 'Best Practices for Budget Transparency' propose principles that are based on decades of peer reviews of members' budget experiences. In particular, its section on "Integrity, Control and Accountability" describes practices that are of direct relevance to the issues being considered here. Table 2 is based on these OECD principles and proposes a list of questions that companies might want to consider in evaluating weak budget systems: public sector accounting policies; financial control systems and allocation of responsibilities; audit; and public and parliamentary scrutiny.

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22 For example, the International Association of Oil and Gas Producers issued a statement that supports improved revenue transparency but suggests that approaches to improving transparency should: 1. recognise the sovereignty of host governments; 2. protect proprietary information; 3. create a level playing field among companies and protect competitive bidding processes; and 4. be clear and consistent with respect to the nature and destination of payments.

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.

Eradicating bribery of public officials

Enterprises should…:

11. Abstain from improper political involvement in local political activities.

Recommendation from Chapter II of the Guidelines

1. Not offer, nor give in to demands, to pay public officials or the employees of business partners any portion of a contract payment. They should not use sub-contracts, purchase orders or consulting agreements as means of channelling payments to public officials, to employees of business partners or to their relatives or business associates.

2. Ensure that remuneration of agents is appropriate and for legitimate services only. Where relevant a list of agents…..

6. Not make illegal contributions to candidates for public office or to political parties or to other political organisations. Contributions should fully comply with public disclosure requirements and should be reported to senior management.

Recommendations from Chapter VI of the Guidelines

61. Only one major accusation of bribery of high level public officials can be found in the reports of the UN Expert Panel. The company in question was the proprietor of a mining property which was being operated as a fully private concern (a relatively unusual arrangement in DRC mining). This company responded as follows to the Panel's allegations:

"the Company has demonstrated that the [Panel's] evidence is based on actions by independent consultants appointed by the Company to assist in political lobbying in the DRC in late 1997, acting in breach of their contractual obligations and without the authority of the Company. The Company has also demonstrated to the Panel of Experts that once the problem was recognised, it was dealt with immediately and the relationship with the consultants severed in mid 1998. No payment to government officials, either in the form of cash or public company shares was ever made or promised by the company. [23]"

Bribery, solicitation and extortion are considered endemic problems in most weak governance zones. Business has asked for greater clarity from governments about what is permitted and what is not[24]. On one level, the answer to this question is straightforward. The 35 parties to the OECD Convention on Bribery of Foreign Public Officials in International Business Transactions made their positions clear when they criminalised bribery of foreign public officials. This was reinforced by the United Nations Convention against Corruption, whose 111 signatories have sent a strong message about the need to forego and eradicate a broad range of corrupt practices.

62. The summary of 2003 OECD Corporate Responsibility Roundtable – which dealt the business sector's contribution to the fight against corruption -- reinforces this message:

… Lack of responsibility in the public sector cannot be used as an excuse for corporate irresponsibility.... By criminalising bribery of foreign officials, the OECD Convention implicitly asks companies to forego business that cannot be conducted without bribery. An NCP acknowledged that this is extremely costly [for business], but he also stated that it will strengthen the motivation for companies to call on governments to establish conditions in which business can be conducted with integrity[25].

63. The 2003 Roundtable summary also stressed the need "to clarify the meaning of corrupt business practices in the many grey zones that exist in this area". Several areas were identified as priorities for further work, including use of agents, other business partners and subsidiaries[26]. The questions raised by the use of agents and subsidiaries have been addressed on several occasions by the OECD Working Group on Bribery's and are being addressed in the context of Phase 1 examinations (which look at national legislation that implements the OECD Convention) and Phase 2 examinations (which look at enforcement). While the examinations show considerable diversity in legal and enforcement treatment of these issues, they also send a strong message about legal responsibility for agents and subsidiaries:

- *Agents*. OECD Convention requires signatories to criminalise bribery of foreign officials "whether directly or through intermediaries." Thus, agents are clearly covered. Current good practice suggests that companies should first ascertain if the use of an agent is really required. If its is, then they need to handle their relationship with care by *inter alia* ensuring: 1) due diligence in the selection and appointment of the agent; 2) that the amount paid for services is reasonable

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23 Reaction no. 4, S/2002/1146/ADD1 Addendum to the second Expert Panel Report on the Illegal Exploitation of Natural Resources in the Democratic Republic of Congo. page 13.

24 See, for example, 2004 Annual Report on the OECD Guidelines for Multinational Enterprises for a discussion of one such request by business and for a description of the OECD Investment Committee's and the Working Group on Bribery's initial response to this request.

25 *2003 Annual Report on the OECD Guidelines for Multinational Enterprises,* pages 116-117.

26 The other two areas identified as priorities were political contributions and integrity in private-public transactions.

and that it corresponds to a real service; and 3) that a clear contractual relationship exists with such the agent and that he/she is informed of and accepts the policies of the company.

- *Subsidiaries*. The Convention requires criminal sanctions for "complicity in, including incitement, aiding and abetting or authorisation of an act of bribery." Thus, corporate headquarters is criminally responsible if it authorised bribery. If headquarters knows that a subsidiary has bribed, it is likely to be held liable. If it did not know, but should have, then liability will depend on the facts of the case and the country's rules and practices in a number of areas (e.g. responsibility of legal persons, treatment of negligence, veil piercing jurisprudence).

64. The Guidelines – reflecting a soft law perspective and reinforcing the message of private anti-corruption initiatives such as the ICC Principles and Transparency International's Business Principles – asks the different entities within a business grouping to "co-operate and assist one another to facilitate observance of the Guidelines." Thus, the Guidelines assign clear ethical responsibilities to headquarters to prevent bribery, even if legal liability might not be present.

Conclusions

65. This analysis and case study provided in this paper give the impression that the problems facing weak governance countries are highly intractable. Even this paper's relatively narrow review (dealing only with issues relevant to the OECD integrity instruments) points to broad, interconnected and deep-seated problems. It seems that corporate contributions to supporting institutional reform in weak governance host countries often involve "second best" solutions and approaches that might cast companies in unaccustomed and uncomfortable roles.

66. While weak governance host countries' problems must ultimately be solved by the citizens and the governments of those countries, home country governments, international organisations and multinational enterprises may be able to contribute constructively to the search for solutions. It would seem to be reasonable to ask companies that want to be part of the solution to avoid being part of the problem. Some of the implications of this for investors in weak governance zones are straightforward – for example, the OECD Bribery Convention sends a strong message about the need for companies to forego business that cannot be conducted without recourse to bribery of public officials.

67. However, as this paper has shown, broader consideration of what it means for business to not be "part of the problem" in weak governance zones (where problems are so pervasive) leads to an extensive ethical grey zone that this project will attempt to clarify. For example, what are the ethics of engaging in business partnerships with state-owned companies whose governance rules are weak or non-existent? Should a company sign a contract with a host government in which it agrees not to publish the revenues it pays into the host countries' Treasury when the contract might contribute to depriving the country's citizens of their ability to make their government fiscally accountable? What if refusing to sign this contract means that the company will lose a major contract to a less scrupulous competitor? How should companies' responsibilities to their shareholders – a responsibility that is core to their broader mission in society – be balanced with other considerations? The answers to these questions are not obvious.

68. The current project seeks to provide inputs to companies facing these difficult ethical questions. The Investment Committee aims to develop a list of considerations for companies that have current or prospective investments in weak governance host countries. The list of questions proposed below is designed to serve as basis for multi-stakeholder dialogue that will provide inputs to the Investment Committee's planned development of a risk management tool for investors. At the same time, the Committee recognises that it might not be possible to devise a list that summarises the relevant issues in an

area so fraught with ambiguities – to the extent that no firm conclusions emerge from the dialogue, the output of the project would be a summary of the main positions.

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

Looking through the Lens of the OECD Integrity Instruments

Investor roles and home and host government responsibilities

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

2. If companies have such a role,

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

   - How are they to tell the difference between positive contributions to the reform process and inappropriate involvement in local politics (which Recommendation II.11 of the Guidelines asks them to avoid)?

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

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?

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?

   - 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?

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?

   - 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?

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?

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?

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)?

   - Recommendation II.7 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?

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?

   - 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?

   - 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?

   - 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?

    - 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?

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?

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)?

    - 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?

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?

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?

ANNEX 1. OECD INVESTMENT COMMITTEE AND NCP ACTIVITIES IN RELATION TO INVESTMENTS IN WEAK GOVERNANCE ZONES

The Committee on International Investment and Multinational Enterprises (CIME) has been asked on several occasions to consider multinational enterprises' activities in weak governance zones. In 2001, the Trade Union Advisory Committee to the OECD (TUAC) asked the CIME and the National Contact Points to look at multinational enterprise operations in Myanmar. In response to this request (and in parallel with an International Labour Organisation investigation of accusations of forced labour in that country), the CIME considered a report on the generic issues raised by operations in weak governance zones, with a particular emphasis on extractive industries. The report covered a wide range of issues, such as management of security forces, resettlement of local populations and the fiscal dimensions of MNE investments. This report was published as International Investment Working paper 2002/1 in May 2002 under the title "Multinational Enterprises in Situations of Violent Conflict and Widespread Human Rights Abuses". Its findings include:

- Weak governance zones present particular problems for corporate responsibility because there is so little "government responsibility".

- The frequency of violent, civil conflict has increased significantly and continuously over the last several decades (based on a comparison the 1945-62, the 1963-81 and 1982-99 periods).

- Companies investing in weak governance zones face a wide range of issues without getting much guidance or assistance from host governments: protecting employees and assets; avoiding recourse to forced labour and other human rights violations; resettlement of local populations; environmental and social impact mitigation; making up for the lack of fiscal mechanisms for "buying" local support for investments that create disruptions for local communities.

- Some companies – working with governments, NGOs and international organisations -- have taken steps to redress problems and raise public awareness of them. The paper discusses the UK-US Voluntary Principles on Human Rights, the Chad-Cameroon pipeline initiative and a large petroleum company's attempts to publicize the Angolan government's instance on confidentiality of the size of corporate payments into the Angolan Treasury.

- The paper reports on a survey of 50 extractive industry companies with activities in weak governance zones. The survey shows that larger companies were more likely to publish policy statements, to disclose management practices and to report on performance in relation to their activities in weak governance zones.

- The distinctive follow up institutions of the OECD Guidelines could be used as a forum for exploring ways that the private sector can contribute to the search for solutions to these countries' deeply rooted problems.

Similar issues were brought to the Committee's attention by the United Nations Security Council's Expert Panel on the Illegal Exploitation of Natural Resources and Other Forms of Wealth in the

Democratic Republic of Congo (DRC). Two of the Panel's reports referred prominently to the OECD Guidelines for Multinational Enterprises:

- In its October 2002 report (S/2002/1146), the Expert Panel claimed *inter alia* that 85 companies had not observed the OECD Guidelines for Multinational Enterprises and challenged the governments adhering to the Guidelines to use them to promote responsible business conduct by multinational enterprises with operations in the DRC. Many of the companies named in the report expressed concern about: the damage to their reputations caused by the Panel's accusations; the lack of precision (most companies did not know exactly what they were accused of); and the lack of due process and transparency in the Panel's procedures.

- In October 2003, the Panel reported its efforts to verify, reinforce and update its earlier findings (S/2003/1027). Some NGOs and companies expressed concern about the report's lack of transparency and explanation of how and why companies were placed in the report's five "categories"[27].

The 2003 Annual Report on the OECD Guidelines for Multinational Enterprises contains the following description of NCP activities in relation to follow up on the Panel's reports (page 21):

> …. *Some NCPs reported that they had been in contact with enterprises named in Annex III of the October 2002 report. Others mentioned that they had approached the Panel by various means, asking for information. The good offices of the CIME Chair have also been used for this purpose. However, since no additional information had been received at the time of the [June 2003] meeting, the NCPs felt that they were not in a position to address the question of how the OECD Guidelines should be implemented by individual enterprises in the specific circumstances of the DRC.*

The 2004 Annual Report describes follow up on the Panel reports by NCPs over the June 2003-June 2004 period as follows:

- *Belgium.* The Expert Panel interviews with Belgian companies were followed by the Belgian ambassadors to those countries. The Belgian NCP received 7 dossiers from the Expert Panel. The 7 companies concerned have been interviewed by the Belgian NCP with a view to forming a preliminary evaluation of each case. The Belgian NCP intends to follow the procedural guidance for specific instances as it pursues its examination of these dossiers.

- *Canada.* The Expert Panel's third and final report put seven of the eight Canadian companies in the category – "Resolved – no further action required". The report listed one Canadian company as "Pending Cases with Government" and requested further enquiry by the government. The NCP has accepted the conclusions of the Panel's report and is in the process of following up with the eighth company. A representative of the NGO coalition was informed of the NCPs approach in a February 2004 meeting.

- *France.* The French NCP is currently engaging with a transport company that appeared in category V of the Expert Panel Report ("Parties that did not react to the Panel report").

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[27] The five categories are: 1. Resolved (meaning the Panel and the companies have found a "solution to the issues that led to their being listed in the October 2002 report"); 2. Provisional resolution; 3. Referred for updating or further resolution; 4. Referred for further investigation; and 5. Parties that did not react to the report.

- *Germany*. The German NCP has conducted exploratory talks with the German companies named in the Panel's report. This process of contacting and discussing with companies has led to a considerable increase of awareness of the Guidelines and in the likelihood that they will be taken into account in future operations in the DRC. The Panel report of October 2003 points to only one case that will require further clarification, but the NCP has had difficulty obtaining sufficient information to enable it to determine whether there has been non-compliance with the OECD-Guidelines.

- *Netherlands.* The Dutch NCP looked into an NGO request to consider a case related to the Expert Panel's claim that a Dutch company had "violated" the Guidelines. After several meetings with the company and NGOs, the NCP decided that the instance should be declined due to the lack of an "investment nexus".

- *United Kingdom*. The UK National Contact Points has issued a public statement (Archive document 8) on the Expert Panel's claims regarding DeBeers. The statement says that the claims are "unsubstantiated."

- *United States*. The US NCP has determined that no further involvement is warranted given that all of its companies were included in Category I (Resolved – No further action required) of the Panel's final report.

ANNEX 2. INVESTMENT COMMITTEE CHAIR'S STATEMENT AT THE EXTRACTIVE INDUSTRY TRANSPARENCY INITIATIVE MULTI-STAKEHOLDER CONFERENCE

London, 17 June 2003

As Chair of the OECD Committee on International Investment and Multinational Enterprises, I am pleased that the OECD is participating in today's conference. The general principles of transparency and accountability underpinning the Extractive Industries Transparency Initiative (EITI) are essential to achieving the international community's goal of promoting integrity and sustainable growth in the global economy. The recent G-8 Declaration on Fighting Corruption and Improving Transparency places the fight against corruption and the push for transparency in the context of promoting sustainable development and stronger investment climates in developing countries. The OECD fully subscribes to this goal and the recognition of the important steps governments must take to enhance transparency. It also recognises that multinational enterprises can make an important contribution to the sustainable development of the countries in which they operate and considers that enhanced transparency by multinational enterprises should go hand in hand with improved public sector governance.

OECD's on-going activities in such areas as combating bribery and corruption, promoting improved corporate governance and encouraging corporate responsibility all complement EITI's efforts to enhance transparency:

- The *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* requires each signatory to criminalize the bribery of foreign public officials by companies based in its territory. The Convention, and related OECD Recommendations, provides a broad blueprint for eliminating the pernicious practice of foreign bribery by companies to obtain or retain business in other countries.

- Improving corporate governance is another area where the OECD makes a distinctive contribution. The OECD is currently exploring how the *OECD Principles of Corporate Governance* can be applied to state owned assets. This project is of obvious interest to the many state-owned oil and mining companies, whose governance practices also form important parts of the broader transparency picture in extractive industries.

- Transparency is also one of the themes of the *OECD Guidelines for Multinational Enterprises*. The OECD Guidelines are voluntary recommendations to multinational enterprises which are applicable world-wide. All OECD governments, the European Commission and a growing number of non-OECD governments are committed to their effective implementation. They are supported by follow-up procedures which allow discussion among governments, business, trade unions and NGOs of issues relating to implementation of the Guidelines and clarification where needed of the meaning of the Guidelines in specific circumstances.

- As part of its work under the Guidelines, the CIME concluded a study on the challenges facing extractive industries as they operate in regions characterised by conflict and widespread human rights abuses. The study's findings are consistent with the premises underlying EITI; it also contrasts contracting practices in OECD and non-OECD countries and highlights the importance

of host government observance of fiscal control standards as well as good governance of state-owned enterprises which are partners of extractive industry foreign companies.

I am glad that the OECD has been given opportunity to participate in preparatory meetings for EITI. I believe that co-operation should continue, consistent with our institutions' respective functions, mandates and procedures.

ANNEX 3. METHODOLOGY FOR STUDY OF OECD-BASED COMPANIES WITH ACTIVITIES IN THE DRC

1. The Secretariat compiled a database of 105 "OECD companies" with activities in the DRC from 1990 to 2001 – that is, the period leading up to the conflict (1990-1996) and the period of overt conflict (1997-2001) until the assassination of Laurent Kabila in January 2001. To be included in the sample, companies had to be either incorporated in countries which are OECD members or to have strong links such as head offices based in an OECD country or a Chief Executive of OECD nationality. This database and related archives can be made available to interested NCPs.

2. The UN Report on the Illegal Exploitation of Natural Resources and Other Forms of Wealth in the Democratic Republic of Congo provided the starting point for identifying companies with activities in the DRC. In Annex III of the Report, the Panel lists 85 companies it considers to be in violation of the OECD Guidelines for Multinational Enterprises. The Secretariat calculated 58 of these to be OECD companies on the based of the criteria above. The UN Report was not the sole source for any of the information used in this paper (that is, UN Expert Panel information had to be corroborated by the other sources below, otherwise it was not used).

3. The Secretariat used a number of sources to identify additional OECD companies with activities in the DRC. In particular, the African business web-site Mbendi (www.mbendi.com); the mining web-site Infomine (www.infomine.com); the US Embassy in Kinshasa's Country Commercial Guide 2002; the members' list of the Congolese Chamber of Commerce (www.fec.dc); a DRC mining report by the UK Department of Trade and Investment (www.uktradeinvest.gov.uk/files/congo_mining.doc); and annual reports by George J. Coakley, The Mineral Industry of Congo (Kinshasa) published by the US Geological Survey - Mineral Information (http://minerals.usgs.gov/minerals/pubs/country/africa.html#cg.)

4. The database contains detailed information about the companies and their activities in the DRC. Information on company activities in the DRC was gathered in both English and French from a variety of sources including those listed above; company web-sites; Africa or DRC focused on-line information providers such as DigitalCongo (www.digitalcongo.net), Congo Ned (www.congoned.dds.nl), Congo Independent (www.congoindependant.com), Africa Confidential (www.africa-confidential.com), Africa Intelligence (www.africaintelligence.com) and Africa Time (www.africatime.com); mining and minerals web-sites such as Minesite, Diamonds.Net and ProfessionalJeweler.Com; reports by non-government and research organisations, in particular the International Peace Information Service (IPIS), Pole Institute, Global Witness, Amnesty International and Mining Watch Canada.

5. Company web-sites provided the main source of basic information about the companies themselves:

- Nationality - Place of incorporation and, if different, location of main offices and nationality of owner.
- Ownership – Companies in the extractive sector are major, junior, unlisted or state-owned. A mining major is defined as one that appears in the list of the top-30 companies by market capitalisation in *Breaking New Ground: Mining Minerals and Sustainable Development Project*

(May 2002, Earthscan Publications Ltd. London). Companies in other sectors are either publicly listed or unlisted.

- Stock exchange listings - Major and junior companies are publicly listed on stock exchanges. Care was taken to differentiate between tiered exchanges such as the Toronto Stock Exchange and the Toronto Venture Exchange.
- Contact details – Web-site or address and telephone number.

6. Groups. Many companies in the sample are subsidiaries of larger groups or have subsidiaries and joint ventures with activities in the DRC. Information on parent companies and subsidiaries/joint venture companies with activities in the DRC was recorded in the database. However, companies within the same group are counted as one organisation. Of particular interest are 4 Groups with strong connections to OECD countries, including 2 DRC based conglomerates. All 4 of these Groups have one or more web-sites which provided the main sources of information on their activities in the DRC, together with the UN Panel's 2002 report. The Secretariat had to design complex flow charts to clarify the structures of these Groups, particularly in one case where there are three contradictory accounts of ownership structure.

7. Sector of operations. Company activities in the DRC are categorised into five main sectors, namely "minerals and mining", "oil and gas", "financial services" (banking and accountancy), "consumer products", and "other sectors", including transport, ICT, construction, printing and security. For the minerals and mining sector, activities are sub-categorised in terms of mineral extraction (exploration and/or development), mineral processing, mineral trading and assaying. Very little information was publicly available on companies trading in minerals. The type of mineral mined (gold, diamond, cobalt, copper, zinc and managanese) and name of the property were recorded.

8. Nature of operations. The nature of a company's operations refers to whether it is an investor, service provider or supplier relation. Companies that own facilities, have a commercial presence or, in the case of the mining sector, exploration and/or development rights are defined as investors. Services include banking, consultancy, accountancy, transport and mineral assaying. Suppliers are companies trading in minerals or consumer products to/from/within the DRC but which do not have a commercial presence there. Comptoirs are included in the supply relations category. Comptoirs are companies that have received a license from the DRC government to trade in minerals. The limited amount of information disclosed by most mineral trading companies poses difficulties in terms of determining whether a company is indeed a comptoir or is instead active further down the supply chain. For statistical purposes, companies with investments in the DRC that are also trading goods or services are considered investors.

9. Mining investors. The Secretariat paid particular attention to the activities of investors in the DRC mining sector. Companies with investments in the DRC mining sector either operate mines or have financial investments in companies operating mines. 5 companies with investments in the mining sector also have activities in other sectors. The Secretariat considers 4 of these companies, including 2 conglomerates, to be mining investors. The fifth company invests primarily in the oil and gas sector. Thus from the sources listed above, the Secretariat identified 35 mining investors, including 6 majors, 18 juniors, 10 unlisted and 1 state-owned company. 8 of the 18 juniors with activities in the DRC between 1990 and 2001 are no longer in business due to mergers, acquisitions or bankruptcy and no longer have company web-sites. There is very limited information publicly available for 7 of the 10 unlisted companies.

10. Entries and exits. The Secretariat recorded entries and exits of companies in the extractive sectors from 1990 to 2001, where this information is publicly available. An entry is defined as a company setting up one or more mining operations in the country – thus, it is based on movement of companies in or out of the DRC, not on initiation of projects.

11. Untraceable companies. Information is particularly scarce with regards the activities of 4 US companies with investments in the DRC mining sector - at least two of these are operators of mines in the DRC. One is a joint venture between a Netherlands and a US company.

12. Corporate governance. The Secretariat conducted a comparative study of the corporate governance practices of the 10 (out of 18) publicly quoted small and medium sized mining investors still in business, the 10 largest companies in the mining sector the 10 largest companies in the oil and gas sector. The 10 largest mining companies identified by the Secretariat were based on a list of the top-30 companies in the mining sector by market capitalisation included in the report *Breaking New Ground: Mining, Minerals and Sustainable Development. Report of the Mining Minerals and Sustainable Development Project* (May 2002, Earthscan Publications Ltd. London). The Secretariat replaced two top-ten companies – one state-owned company and one company largely owned by another in the top-10 - with companies further down the list. A list of ten companies which are amongst the largest in the oil and gas sector was compiled using several oil/gas sector web-sites, notably Petroleum Intelligence Weekly. Again, recently state-owned companies were not included.

13. Based on mini-biographies on company web-sites, the Secretariat conducted a study of the composition of the Boards of Directors of the ten small and medium sized DRC mining investors and the ten largest companies in both the mining and the oil/gas sectors. Only one company in the oil and gas sector did not provide director mini-biographies and the Secretariat was able to access this information by conducting an Internet search of each director's name. The number of executive and non-executive directors on each company Board was recorded. As a result of using company web-sites, the figures are recent and include directors appointed after 2001.

14. The professional backgrounds of non-executives directors are characterised according to five categories: "professional experience" in finance, banking, law or accountancy; sector-specific expertise in the mining / oil and gas sectors; "general business experience"; "diplomat / elected politician" including former Ambassadors, Senators and Presidents; and finally, "academic/NGO/expert". The latter category includes University Professors and Presidents, heads of philanthropic organisations and NGOs and people with specialist knowledge, in environmental issues for example, who have served in an advisory capacity to government or others. Most of the non-executives falling into more than one category are financial experts to the mining or oil/gas sector specifically. They specialise, for example, at raising capital or accounting for the extractive sector. In these cases, the Secretariat made a reasoned judgement as to where the director's main experience lies. For the 10 DRC mining juniors only, the Secretariat recorded the total number of directors (both executive and non-executive) who mini-biographies explicitly indicate mining experience in Africa.

15. Again based on company web-sites, the Secretariat recorded for each company whether it had produced a statement of business principles, corporate governance guidelines and non-financial report, and whether it had an ethics/compliance committee or provided information on its compliance systems. Ethics/compliance committees are also referred to as "public issues", "disclosure and procedures", "corporate governance" and "code of conduct" committees. Companies that have established an ethics/compliance committee are considered to have provided information on their compliance systems. Of the companies that provide some written information on their compliance system, the level of detail varies considerably. Companies with ethics/compliance committees tend to provide more detailed information on their compliance system in the form of a Terms of Reference document for the committee. Several majors have set up compliance hot-lines.

16. From the DRC Ministry of Mines and Hydrocarbons 2003 report, the Secretariat identified 10 companies in the DRC extractive sector that were once fully state-owned enterprises – nine in the mining sector and one in the oil/gas sector. Few OECD companies own and operate mining concessions outright,

most have financial investments in or joint ventures with an SOE. The Secretariat recorded how OECD companies carried out their activities in the DRC – through fully owned mining concessions, joint ventures and financial investments – using information from a number of sources listed above. Information on the activities of nine OECD companies in the oil/gas sector was based largely on company web-sites, reflecting the greater degree of transparency of the oil/gas compared to the mining sector.

APPENDIX

THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES AND OTHER OECD INTEGRITY INSTRUMENTS

Integrity is defined as "firm adherence to a code or standard of values".28 International organisations, such as the OECD, have issued many instruments – taking the form of codes, guidelines, declarations, conventions and best practice lists – that address various issues and target a variety of audiences. These instruments cover many areas of public policy and draw on the policy experiences of the public officials that participate in OECD processes and on consultations with other actors. In some cases, these instruments also deal directly with or have implications for other actors in the policy system, including the business sector.

The legal status and uses of these instruments are diverse. Some examples that illustrate this diversity are:

- The Investment Committee's investment incentives checklist. This checklist was published under its authority and which summarises the findings of the Committee's discussion of this policy area and is intended as an evaluation aid for governments.

- OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions requires that signatory governments enact or adapt national legislation in a way that conforms to the principles set forth in the Convention.

- The Best Practices on Budget Transparency and the Council Recommendation serve as the basis for ongoing dialogue and peer reviews of budget procedures and public sector ethics programmes, respectively.

- The OECD Guidelines for Multinational Enterprises – a government-backed, voluntary code of conduct for international business – were adopted by Council at Ministerial Level. Governments undertake to promote these Guidelines, notably by creating National Contact Points and participating in other implementation procedures associated with the Guidelines. The Guidelines are part of the Declaration on International Investment and Multinational Enterprises. Countries are required to sign on to the Declaration when they become members of the OECD.

This addendum provides background information on those OECD instruments that are used in the main paper, "Conducting Business with Integrity in Weak Governance Zones: Issues for Discussion and a Case Study of the DRC". The texts of these instruments can be found at the web addresses appearing in parentheses:

- OECD Guidelines for Multinational Enterprises (www.oecd.org/daf/investment/guidelines)

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28. Webster's II Dictionary.

- Principles of Corporate Governance (www.oecd.org/daf/corporate/principles)
- Recommendation of the Council for Managing Conflict of Interest in the Public Sector (www.oecd.org/gov/ethics)
- OECD Best Practices for Budget Transparency. (www.oecd.org/gov/budget)
- OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. (www.oecd.org/daf/nocorruption)

The addendum looks at 3 broad attributes of these instruments:

- Policy community that developed the instrument
- Aims and audience
- Legal status and follow-up.

OECD Guidelines for Multinational Enterprises

Policy community that developed the MNE Guidelines

The revised text and Council Decision were adopted by the Council Meeting at Ministerial Level in June 2000. The OECD Investment Committee is responsible for the OECD Guidelines. It oversaw the negotiations that led up to the revised text of the Guidelines and the Council Decision in June 2000 (the latter document describes adhering countries' commitments in relation to the Guidelines).

Aims and audiences

The OECD Guidelines for Multinational Enterprises contain voluntary principles and standards for responsible business conduct in such areas as human rights, disclosure of information, anti-corruption, taxation, labour relations, environment, and consumer protection. They aim to promote the positive contributions multinational enterprises can make to economic, environmental and social progress.

The Guidelines express the shared values of the 38 countries that have adhered to them. These are the 30 OECD members and 8 non-member countries (Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania, and Slovenia). The adhering countries are the source of most of the world's foreign direct investment and are home to most major multinational enterprises. Although many business codes of conduct are now publicly available, the Guidelines are the only multilaterally endorsed and comprehensive code that governments are committed to promoting.

Surveys of corporate policy statements suggest that the Guidelines are one of the international corporate responsibility instruments[29] most cited by companies. In addition, business, trade unions and NGOs participate actively in the follow up of the Guidelines.

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29. See, for example, introductory section of the 2004 Report by the Chair of the Annual Meeting of National Contact Points. This section describes the results of a World Bank survey of the international instruments that influence companies' corporate responsibility policies. See www.oecd.org/daf/investment/guidelines.

Legal status and follow-up

The National Contact Point (NCP) is a government office (sometimes tripartite in structure)[30] that is responsible for encouraging observance of the Guidelines and for ensuring that the Guidelines are well known and understood by the national business community and by other interested parties. The NCP promotes the Guidelines; handles enquiries about them; assists in solving problems that may arise; gathers information on national experiences with the Guidelines; and reports annually to the OECD Investment Committee. The Guidelines procedures provide for something called "specific instances," a facility that allows interested parties to call a company's alleged non-observance of the Guidelines' recommendations to the attention of an NCP. As of June 2004, some 80 specific instances had been called to the attention of NCPs since the June 2000 review.

The Investment Committee is the OECD body responsible for overseeing the functioning of the Guidelines. It also issues clarifications on the application of the Guidelines in specific circumstances. The Committee regularly consults with the OECD's business and labour advisory committees -- the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) – and with NGOs on matters relating to the Guidelines.

OECD Principles of Corporate Governance

The revised Principles are the result of a wide-ranging consultation process that involved officials from both OECD and non-OECD countries as well as businesses and professional bodies, trade unions, civil society organisations and international standard-setting bodies. The review was led and concluded by the OECD Steering Group on Corporate Governance, which comprises representatives from all 30 member governments together with observers from the World Bank, the International Monetary Fund, the Bank for International Settlements, the Financial Stability Forum, International Organization for Governmental Securities Commissions (IOSCO) and the Basel Committee. The Business and Trade Union consultative committees to the OECD (BIAC and TUAC) also participated in the Steering Group's meetings. Experts from Asia, Latin America, Eurasia, Southeast Europe and Russia also contributed to the Principles, sharing their experiences from a series of Regional Roundtables in 2002 and 2003.

Aims and audience

The OECD Principles of Corporate Governance are designed to assist governments and regulatory bodies in both OECD countries and elsewhere in drawing up and enforcing effective rules, regulations and codes of corporate governance. In parallel, they provide guidance for stock-exchanges, investors, companies, trade unions and others that have a role in the process of developing good corporate governance. Since the original OECD Principles were issued in 1999, they have become a generally accepted standard in this area. They have been adopted by the World Bank in its work and they have been endorsed by the Financial Stability Forum as one of twelve key standards for financial stability.

Legal status and follow up

The OECD Council, meeting at Ministerial level, endorsed the revised principles by Council Recommendation in June 2004. They provide non-binding guidance and do not aim to give a full, detailed description for national legislation.

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30. There are four types of NCP structure presently in use: single government office, multi-departmental government office, tripartite body, and quadripartite body. A number of NCPs involve NGOs and other stakeholders in their work, for example, through their structure, or via an advisory committee.

The Principles are used as a basis for ongoing dialogue on experiences and improvements that can be made – they are a living document. The discussions include not only government representatives but also a very large number of practitioners from the private sector, representatives from international organisations and civil society. Moreover, the OECD works closely with a large number of developing and emerging market countries. In particular, the OECD organises Regional Corporate Governance Roundtables Asia, Latin America, Eurasia, Southeast Europe and Russia. These Roundtables have used the OECD Principles as a reference in the development of regional reform priorities and are now actively engaged in implementing these recommendations. More recent corporate governance initiatives have been launched in China, the Middle East and North Africa.

These policy dialogue programmes and exchange of experience will continue in order to ensure that the Principles are widely disseminated, actively used and adapted to meet the needs of various communities, including. policy-makers, regulators, and standard setters.

Guidelines on Managing Conflict of Interest in the Public Sector

Policy community that developed the Conflict of Interest Guidelines

The Guidelines on Managing Conflict of Interest in the Public Sectors were elaborated by the Expert Group on Conflict of Interest under the direction of the OECD Public Management Committee.

Aims and audience

The primary aim of the Conflict of Interest Guidelines is to help countries, at central government level, review and modernise existing Conflict of Interest policy and practice relating to public officials -- including public servants/civil servants, employees, and holders of public office -- who work in the national public administration. The Guidelines can also provide general guidance for other branches of government, sub-national level government, and state-owned corporations.

The Guidelines are also extensively used by civil society groups, professional associations, trade unions as a benchmark for their own efforts in the area of conflict of interest management. For example, the International Federation of Consulting Engineers has used it recently to in support of its policy development in the area of conflict of interest.

Legal status and follow up

The Guidelines were approved in the form of a Recommendation by the OECD Council in 2003. They provide the first international benchmark in this field. The Public Governance Committee reports back to the Council on progress made by member states in implementing the Recommendation. A report scheduled for 2006 will review development in emerging areas. The OECD has also developed and tested a set of practical Tools to help public organisations put the Guidelines into practice.

OECD Best Practices for Budget Transparency

Policy community that developed the Best Practices

At its 1999 Annual Meeting, the OECD Working Party of Senior Budget Officials asked the Secretariat to draw together a set of Best Practices in this area based on Member countries' experiences. The Working Party is a major international forum for analysing and evaluating budget policies and practices.

Aims and audience

The Best Practices are designed as a reference tool for Member and non-member countries to use in order to increase the degree of budget transparency in their respective countries. The Best Practices are organised around specific budget reports for presentation purposes only. It is recognised that different countries will have different reporting regimes and may have different areas of emphasis for transparency. NGO's have used the instrument in their work to evaluate countries on the degree of budget transparency.

Legal status and follow up

The Best Practices are a non-binding instrument designed to be a reference tool for member and non-member countries to use in order to increase the degree of budget transparency. It is not meant to constitute a formal 'standard" for budget transparency since states have different reporting regimes and may have different areas of emphasis for transparency. The Best Practices have been used as a benchmark in country reports on budget transparency.

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions

Policy community that developed the Anti-bribery Convention

In 1997, OECD and associated countries adopted two essential instruments to address bribery in international business transactions:

- The OECD Revised Recommendation of May 1997 which contains a list of agreed preventive and repressive measures.

- The OECD Convention against Bribery of Foreign Public Officials in International Business Transactions went into effect on 15 February 1999. The Convention makes it a crime to offer, promise or give a bribe to a foreign public official in order to obtain or retain international business deals. The binding criminal law Convention on Combating Bribery of Foreign Public Officials in International Business Transactions Convention of December 1997 which focuses on the criminalisation issue.

The OECD Working Group on Bribery in International Business Transactions is in charge of monitoring the implementation the Convention and related instruments.

Aims and audiences

OECD initiatives against bribery in international business transactions developed out of the pledge by industrialised nations to *level the playing* field for international commerce. The Convention represents a landmark in international cooperation to fight bribery and corruption. For the first time, the world's largest trading and investment partners, which together account for more than 70 per cent of world trade and 90

per cent of foreign direct investment, acted in concert to halt the flow of bribes to foreign public officials in international business transactions. The Convention seeks to assure functional equivalence among the measures taken by the Parties to sanction bribery of foreign public officials, without requiring uniformity or changes in fundamental principles of a Party's legal system.

Legal status and follow-up

The Convention was signed on 17 December 1997 by OECD member and 5 non-member countries. Thirty-five signatories have ratified and enacted laws criminalizing trans-national bribery. Countries that accede to the Convention agree to make bribing foreign public officials in international business transactions a criminal offence. They also accept the OECD Revised Recommendation on Combating Bribery in International Business Transactions, which contains broader measures to prevent and combat trans-national bribery.

To ensure the effective implementation of the Convention and of the revised Recommendation, Parties adopted a monitoring process based on the OECD peer review principles. The monitoring process is divided into two main phases: Phase 1 evaluates whether the legal texts through which State Parties implement the Convention meet the standard set by the Convention. Phase 2 studies the structures put in place to enforce the laws and rules implementing the Convention and the Revised Recommendation and to assess their application in practice.

The Working Group recognises that, if the Convention is going to have any real effect, companies must become fully implicated in ensuring compliance with the Convention and with national anti-bribery laws. It consults regularly with non-governmental organisations and provides information to the public on its work. Non-OECD actors also refer to the Convention. It is used as one of international benchmarks for non-OECD countries' reform efforts and the Organisation is continuing its policy dialogue with non-members in many regions of the world. An OECD survey of the top-100 multinational enterprises' anti-corruption policies showed frequent reference to the Convention.[31]

31. Survey work performed for the 2003 Roundtable on Corporate Responsibility shows that the Convention is among the international instruments that multinational enterprises refer to most frequently. This is based on a review of the published policy statements of the top-100 multinational enterprises. The full study is published in the 2003 Annual Report on the OECD Guidelines for Multinational Enterprises.