

# I N T E R N A T I O N A L A L E R T

## **RESPONSE TO OECD DAF PROJECT ‘CONDUCTING BUSINESS WITH INTEGRITY IN WEAK GOVERNANCE ZONES’**

### **INTERNATIONAL ALERT**

#### Introduction

The OECD DAF Working Party of the Investment Committee initiative to conduct a project on ‘Conducting Business with Integrity in Weak Governance Zones’ is a welcome step towards clarifying the guidance offered by the OECD to member states’ companies when operating abroad, and useful in its effort to synthesise existing instruments in order to maximise their utility.

As stated in the Note DAF/INV/WP(2004)1, this project is in part a response to the United Nations Panel Report on illegal exploitation of natural resources in the Democratic Republic of Congo (DRC). It also states that it builds on earlier work by the Investment Committee on ‘Multinational Enterprises in Situations of Violent Conflict and Widespread Human Rights Abuses’ (Working Papers on International Investment No.2002/1, May 2002); and on work of the OECD DAC on conflict prevention.

Given these origins, in particular its intention to respond to the United Nations Panel Report, which claimed OECD companies had failed to observe the OECD Guidelines in their operations in the DRC, it is a significant weakness of the project is that it does not violent conflict as a specific type of operating context that OECD companies can invest in. Focusing more generally on ‘weak governance zones’ serves to blur these specific challenges, and precludes a full analysis of the strengths and weaknesses of existing company practice, and of existing OECD instruments, in such contexts.

While important issues such as corruption and bribery, transparency, relationships with SOEs etc are addressed through these existing instruments, key issues that have been overlooked as a result of the narrow focus of the project, which presented themselves as challenges to companies in the DRC and which remain outstanding challenges to OECD companies and by implication member states both in the DRC and other contexts, are:

- Security arrangements – how to protect staff and installations in the midst of near to armed conflict;
- Human rights – how to conduct business activities in the midst of human rights abuses, perpetrated both by armed groups and the government;
- War crimes – how to conduct business activities in the midst of war crimes, including pillage and plunder and the use of child soldiers;
- Dealing with armed groups – how should companies interact with armed groups, and/or respond to extortion

There is learning on these characteristics of conflict zones within the OECD, specifically within the OECD DAC – it is a missed opportunity that the two agencies of the OECD have not supported a more rounded output to guide member states' companies on conducting business in conflict zones.

The project proposes that an output will be a 'risk management' tool, based on the findings of the multi-stakeholder dialogue on its key questions. Unless the core conflict issues listed above are addressed, any such tool will be limited in its ability to help companies to manage risk in such environments.

Finally, a crucial component of conducting business with integrity in conflict zones has to be improved understanding of the two-way interaction between company investment and conflict. The project emphasises the risks posed to companies in such contexts – in the absence of thorough analysis of the context itself, and of the likely interaction of the spectrum of business activities with that context in order to ensure that these 'do no harm' – companies themselves can also impact on the conflict. In worse case scenarios their presence can become a resource on which parties to conflict will draw to further their aggression. Or, the conduct of their security forces can contribute to perpetration of human rights abuses and further militarisation. In such instances, the standard of whether investment should proceed must be reassessed if companies, and OECD countries, are to avoid future accusations of complicity in conflict.

It is therefore critical, not only in the risk management interests of companies themselves, but also for member states whose foreign policy and development agency goals prioritise international peace and security, that the OECD take more ambitious steps towards equipping companies with appropriate conflict risk analysis and management tools.<sup>1</sup>

## QUESTIONS FOR A MULTI-STAKEHOLDER DIALOGUE

### 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?

*Yes, companies should draw on their own core competencies to partner with others to promote reform in critical areas of revenue management, rule of law, human rights protection, local governance. Priorities should be based on analysis of the specific challenges facing a particular country, and could take the form of dialogue with political elites, or partnership with civil society actors working on these issues.*

2. If companies have such a role,

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

*In weak governance zones promoting institution-building is all the more important. Weak governance and institutions severely limits the chances of investment having beneficial effects on society.*

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

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<sup>1</sup> Examples include the Voluntary Principles on Human Rights, [www.voluntaryprinciples.org](http://www.voluntaryprinciples.org); the UN Global Compact 'Business Guide to Risk Management', [www.unglobalcompact.org](http://www.unglobalcompact.org); and International Alert's *Conflict-Sensitive Business Practice: Guidance for Extractive Industries* (London, UK: International Alert – forthcoming March 2005 [www.international-alert.org](http://www.international-alert.org)).

*Contributions to the reform process should be based on analysis of the challenges facing the country, and made with full transparency and in partnership with other international and local actors.*

- 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.)?

*Multi-stakeholder dialogue between different actors to identify common problems and develop shared solutions will enable different actors' to pool their core competencies towards these goals. It will also facilitate the development of stronger inter-relationships, coordination and transparency.*

### **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?

*Companies should not proceed with investment if their analysis shows that they will not be able to do business in accordance with their own business principles or international law (including the OECD Convention on Combating Bribery). Relying on cultivation of political ties to protect investment is an indicator that the impacts of investment on host country development and institutions is likely to be weak. It can also fuel competition between elites for control of resources..*

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?

*Under the emerging doctrine of ‘complicity’, companies can find themselves open to accusations of war crimes and human rights violations if they can be shown to have known about such wrongdoing on the part of their contractors or partners or in the locality. In all instances of such crimes, companies should be prepared to bear witness and notify political authorities (including international) and the humanitarian community.*

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

*The only difference would be that the types of wrongdoing are likely to be more egregious, and the local authorities by definition weaker – therefore alerting international organisations or other agencies mandated to address humanitarian issues of concern will be required. It is not appropriate for companies to assume that just because government is weak locally, a ‘business as usual’ approach in the face of wrongdoing is acceptable.*

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

*The priority should be the lives of those living in war – ultimately companies have a business interest in combating such wrongdoing, failure to do so can lead to reputational threat and even law suits.*

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?

*In the absence of such mechanisms and where institutions are weak, serious questions over the overall benefits of investment need to be asked. At a minimum, companies should be prepared to commit resources towards supporting reform efforts in these areas.*

- 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?

*If they are providing monetisation services to elites that are known to be taking advantage of weak financial and fiscal controls then they cannot avoid either the appearance of the reality that they are aiding and abetting this dynamic. For reputational reasons, and in the interests of longer-term stability of operating markets, companies should take all possible steps to avoid fuelling this practice, firstly through conducting thorough conflict impact assessment and due diligence prior to investment and on an ongoing basis, and through encouraging transparency and fiscal reform, including in partnership with other international actors (including through full support and implementation of the Extractive Industry Transparency Initiative); or in worse case scenarios, through reconsidering investment.*

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?

*Given that the impact of revenues invested in non-transparency host societies is likely to have a destabilising effect on that host society companies should take all possible steps to promote transparency, both through their agreements with government and in their own internal practice, in order to send a clear signal and standard to political authorities.*

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)?

*OECD member states have an interest in ensuring that all private sector entities operate in line with OECD standards and international best practice. Where less scrupulous companies are involved, this should include communicating these standards actively, requiring them to register with embassies above all in conflict affected countries where the potential impacts of their operation on violence are significant, and through measures such as that recommended in the case study.*

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

*Companies operating in weak governance or conflict-prone states should be required to meet international standards regardless of their size. Juniors have shown themselves to be immune to the pressures that larger companies are subject to in this regard however, and governments need to get more active in raising the bar with these actors. Where companies have applied for export credit, this can be used to leverage better practice; embassies should be more active in dialoguing with companies, as above, and companies who act in defiance of voluntary standards and in such a way as to generate legal actions should be held to account.*

- 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?

*Weak rule of law means that the challenges will be different.*

- 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?

*Due diligence and conflict impact assessment stakeholder mapping will ascertain the risks associated with doing business with SOEs, both to the company itself and to the wider society. Companies should*

*insist that international law and best practice be observed by all contractors and business partners, including international human rights law.*

- 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?

*Yes of course – and the two are related – for in situations where citizens’ rights are not protected the likelihood of companies becoming targeted or caught up in instability and other risks increases. There are also several cases of companies being prosecuted for alleged complicity in human rights abuses. Winning a social licence to operate through developing good relationships with communities and being a ‘good neighbour’ is recognised by most industry leaders as a key part of doing business.*

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

*Yes where possible companies should transfer skills and build capacity.*

## **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?

*Yes as above.*

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

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

*The Extractive Industry Transparency Initiative provides useful guidance on best practice and rationale in these areas – companies should follow it and there is also learning for other sectors.*

- 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?

*Yes very much so – and the fact that the OECD also has legislation on this issue is of particular significance. The link between bribery and corruption and poor development is well-documented – as is the cycle of bribery, extortion and violent conflict. Paying bribes directly implicates companies in these dynamics, opening them to accusation and to further political risk.*

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

*Companies should send a strong signal on business ethics to all partners.*

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

<p><b>Transparency</b></p> <ul style="list-style-type: none"><li>• Does the SOE disclose financial and non financial information according to international best practices? (CGP)</li><li>• 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.</li><li>• 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)</li><li>• Is the SOE subject to an annual independent external audit under the conditions prescribed by the IOSCO Principles for Auditing? (CGP)</li></ul> <p><b>Nomination and role of the board of directors</b></p> <ul style="list-style-type: none"><li>• Has the government established a structured and transparent nomination process for SOE boards? (CGP)</li><li>• Do SOE board members act in the best interests of the company and treat all shareholders equally? (CGP)</li><li>• Are SOE boards independent from management and any direct political interference? (CGP)</li></ul> <p><b>Conflict of interest:</b></p> <ul style="list-style-type: none"><li>• 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)</li><li>• 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)</li><li>• 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)</li><li>• Is abusive self dealing by the officers of the SOE prohibited? (CGP)</li><li>• 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)</li></ul>
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**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.