

## **HOW EFFECTIVE ARE CORPORATE CODES IN COMBATING CORRUPTION?**

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I very much appreciate the opportunity to participate in the 9<sup>th</sup> International Anti-Corruption Conference's workshop on corporate governance and business ethics. There are three reasons why our discussion is vital to any concerted global anti-corruption initiative:

First, the interest in governance and company codes is part of what University of Chicago professor Saskia Sassen has called the "new geography of power" and the "privatisation of norm-making". There is little doubt that the global financial, product, and service markets have blurred the distinction between public and private sector rule making. In this new power equation, trans-national businesses (as they now like to be called) have enormous leverage for two reasons. First, their example is likely to be emulated and smaller businesses will respond to their leadership. Second, in Sassen's words, they are "strategic agents" in the sense that they are an ideal network and site for the implementation of global standards. To note just one example of the hard logic of this view, is there any doubt that Wal-Mart's policies on buyer acceptance of vendor gifts is a more widely accepted and easily enforced behavioural norm than almost any kind of public sector rule making initiative?

Second, this new geography of power strengthens the argument that addressing corruption's supply side is much more than one of several options, it is a critical priority. Significantly, for the first time since the U.S. Foreign Corrupt Practices Act first introduced

this notion, a significant number of companies active in global markets agree.

Third, public opinion is shifting in many countries where corruption is believed to be rampant. For example, a survey of Cameroon citizens (the country that was last in Transparency International's most recent "Corruption Perception Index") found that nearly half the respondents (47 percent) said that company failure to resist the demands of corrupt officials was the primary cause of Cameroon corruption. These results confirm the common sense conclusion that if no bribes are paid people will stop asking for them. The pressure is growing on companies to make more effort to cut off corruption's supply side.

Corporate codes are the prevalent company instrument world-wide for establishing uniform business conduct standards. As such, they provide the organising principles for private sector self-regulation.

Today, most large companies that are active in global markets have them. There is a growing consensus among these trans-national companies as to why codes are necessary, who should participate in their formulation, what issues they should address and how they should be introduced. The code processes of formulation, dissemination and monitoring for effectiveness have improved considerably since I first examined them in 1987. Thus, an analysis of codes can tell us a great deal about the strengths and limitations of company efforts to combat corrupt practices.

## **HOW AND WHY CODES HAVE IMPROVED**

In the twelve years since the first Conference Board ethics practices study, three trends affirm the growing seriousness of codes both for companies and the public.

**Codes are public documents.** In 1987, a handful of survey participants returned their code with a completed survey, but in 1998-99, over two-thirds responded affirmatively

to our request for a copy. In 1991-2, when we conducted the second survey, it was already evident that the globalisation of markets was generating pressures on companies to develop codes as public statements of core principles that were universally applicable. For example, one respondent said, "As we do a larger share of business outside the United States, there is a need for a code as a focal point."

By 1998-9, the need for common business conduct standards in global operations had become the most frequently cited business justification for having a code. Two-thirds of the responding code companies agreed with the statement "establishing core principles for global operations" was "most important" as a business justification for their code. Consistent with this view, eighty-six percent of the companies used the same statement world-wide (other than translations). As befits proclamations of core principles, codes can now be found on company web-sites. The open sharing of codes suggests that a growing number of companies want to use these statements to establish some kind of a dialogue with their stakeholders and the public.

**Codes are an accepted part of the governance process.** The frequency of board participation in code drafting nearly doubled between 1987 (21 percent) and 1991 (41 percent) and again in 1998 (78 percent). In more than half of the cases where the board is engaged, the responding companies characterised their board's involvement as "heavy."

Director interest may be somewhat more common in the United States due to the 1991 Revised Federal Sentencing Guidelines and the 1996 Delaware Chancery Court's *Caremark* decision. The Guidelines provide for significant mitigation of sentences where companies can demonstrate that they have an effective compliance system and director involvement communicates high level commitment to the company's compliance efforts.

*Caremark* asserts the proposition that part of a director's "duty of care" is to assure that the company has an "adequate" corporate information and reporting system. Under

some circumstances, failure to do so may result in director personal liability "for losses caused by non-compliance with applicable legal standards." Despite the decision's stern language, the *Caremark* directors avoided liability.

**Code texts demonstrate greater ethical sophistication.** The growing sophistication of code texts affords evidence that the ethical literacy of senior managers and MBA degree recipients has improved considerably within the last twelve years. Many company ethics training programs now include discussions of complicated hypothetical questions in which ethical problem solving methods are used to reconcile legal requirements, company policies, and conflicting cultural norms. The MBA ethics curriculum is no longer limited to cautionary tales of well meaning companies that came to grief because of the ethical insensitivity of a few employees. The new courses offer rigorous philosophical problem solving methods, game theory discussion, and summaries of relevant legal precedents.

These developments may be responsible for a change in the justifying language and tone of many corporate codes. Twelve years ago both U.S. and European company statements were heavily prescriptive. Most U.S. codes focused on legal compliance and many of the European documents recited the company stakeholder obligations that were and still are mandated or customary in European countries.

In contrast, among the U.S. codes examined for the 1999 report, the dominant tone is instrumental. Instead of focusing on rules and the harsh penalties for breaking them, recent U.S. codes are more likely emphasise that ethical requirements are essential for sound and profitable business practice. European companies are now most likely to rely on a values-based rationale in which certain behaviour and attitudes are deemed essential for company employees and representatives. Rather than directing a particular outcome, both of these approaches underscore the decision-maker's responsibility to make decisions in accord with the company's core values.

## **WHY CODES HAVE HAD LIMITED SUCCESS IN COMBATING CORRUPTION**

Despite the significant potential of codes afforded by the new geography of power and the growing ethical sophistication of business practitioners, it is fair to say that the impact of codes on corruption has been limited –perhaps even disappointing. There are four reasons why, thus far, codes have not achieved their full potential.

### **Codes focus primarily on company processes and employee behaviour.**

Understandably, the key objective of a code is to establish an organisation's own business conduct standards. Companies do not consider themselves responsible for the behaviour of those parties with whom they deal. Still, it is revealing that more of the survey respondents impose limits on gift acceptance than on gift giving. Company policies do not appear to be rooted in the scriptural injunction that "it is more blessed to give than to receive". Instead, as one manual explains in so many words, it is up to each company to set and monitor standards for its own performance. This asymmetry between acceptance and giving policies suggest a less than full understanding of the most effective ethical strategy for deterring corruption.

**Code principles are not always binding on suppliers, vendors, and joint venture partners.** Forty-five percent of the code companies insist that suppliers and vendors subscribe to the company's anti-bribery provisions and 27 percent require joint venture code compliance. Although these numbers are encouraging, the demand for agent and partner compliance needs to be more common for codes to be a significant factor in deterring corruption.

**Code effectiveness depends in large measure on whether or not they are introduced in an environment of trust.** Absent a system that encourages employees to expose inappropriate conduct, codes will never achieve their full potential to deter wrongdoing. For most employees outside of the United States, the concept of whistle blowing has a pejorative connotation or no real meaning at all. For example, U.S. operations in Western Europe report little employee use of the company's "hotline" to report abusive practices. The picture is similar elsewhere and it is sometimes complicated by other conditions such as the fear of reprisal and reported shortages of workplace telephones in certain regions.

Companies need to strengthen code **compliance verification procedures.** Precatory words are insufficient weapons for effective action. Recognising this principle, Shell has undertaken an initiative that relies on its code as a major tool in combating corruption. Shell country managers are required to certify that "neither the company nor its authorised representatives has been party to the offering, paying or receiving of bribes" and that "no payments have been made which knowingly violate the laws of the country in which the company has operated". Where such assurances are not possible, a discussion of the reasons why and a description of specific incidents must be noted. Follow-up reports that document actions taken are also required.

Shell offers a good model, but ultimately third party review and certification of company procedures for rigor and effectiveness are essential for code credibility. Such efforts are already underway in the monitoring of fair labour standards.

### **CODES OF CONDUCT: WHAT DOES THE FUTURE HOLD?**

The foregoing review suggests that in the new geography of power, corporate codes have significant rule-making potential for a large network of participants. Moreover, major companies doing business in global markets have already reached a consensus on a

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number of key code issues. Most of them have codes that are in agreement on strong, virtually identical prohibitions against corrupt practices.

Nonetheless, corporate codes are not yet the key factor that they could be in deterring corrupt practices. Both internally and externally, companies have work ahead to make their codes fully effective. As the Shell experience demonstrates, internal procedures that demand greater disclosure and accountability are key elements in a code's rule-making authority. Few companies have achieved the necessary climate of trust that can overcome the cultural resistance and genuine fear that remain significant barriers to the reporting of improper incidents. Ultimately, no code provisions are entirely credible without third party certification of the company's monitoring practices.

Corporate codes have a potentially vital role in the new geography of power but, for the most part, companies have yet to acknowledge and to rise to the challenge of these new possibilities. Ultimately, global companies need to recognise that if they are serious about deterring corruption, a properly formulated, implemented, and monitored code is essential.