

STATE-OWNED ENTERPRISES AND CORRUPTION

What are the risks and what can be done?

Highlights

What is an SOE?

The OECD Guidelines on Corporate Governance of State-Owned Enterprises lay out that any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership, should be considered as an SOE. This includes joint stock companies, limited liability companies and partnerships limited by shares. Statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities, or parts of their activities, are of a largely economic nature.

What are corrupt and irregular practices?

Corruption refers to the abuse of public or private office for personal gain. This includes the active or passive misuse of powers of public officials (appointed or elected) for private financial or other benefits (OECD, 2008). Irregular practices are referred to as broader instances of breaking SOE integrity policies, including internal company programmes, functions, people, processes or controls that seek to prevent, detect or address risks of waste and abuse. Such irregular practices, harmful in their own right, may be linked to or open avenues for corrupt behaviour.

Who should do what?

The OECD Guidelines for SOEs imply that; the state, on a whole-of-government basis, should implement an ownership policy; a designated “ownership entity” within the state should be responsible for defining the objectives of individual SOEs and monitoring their performance; the SOE's board of directors should be responsible for approving strategy and monitoring management; and the management should be responsible for the SOE's corporate operations.



State-owned enterprises (SOEs) are a main conduit for states to exercise their roles as economic actors. The benefits of SOE ownership are economic, political and social. So too are the costs when mismanagement or abuse occurs.

Today, SOEs account for 22% of the world's largest companies and their role as global competitors is growing as the boundaries of markets increasingly extend beyond geographic borders. They are often concentrated in sectors with strategic importance for the state and society and are increasingly operated like private firms.

The more pronounced presence of SOEs in the global marketplace has been marked by certain high-profile scandals and occasional evidence of a susceptibility of SOEs to corruption. This raises questions about what might make SOEs susceptible to corruption and how policy makers can act to maximise their productivity by raising their integrity.

The OECD report on SOEs and corruption answers these questions in two ways:

- Through an analysis of the perceptions and recent experiences of 347 high-level SOE officials and board members.
- Through a review of legal frameworks and approaches at the state level as reported by representatives of national state-ownership agencies or ministries.

The report analyses data collected through two surveys spanning 37 OECD and non-OECD countries. The surveys focused on both the most severe forms of corruption, such as bribery, and on other rule-breaking and irregular practices that are harmful in their own right and that may be representative of both corporate and public governance gaps.



What is the scale of corruption in SOEs?

42% of respondents reported observing corrupt acts or other irregular practices in their company over the last three years. The instances of corruption reported most often involved employees and mid-level managers.

Source: Based on 347 responses to the 2017 OECD Survey of anti-corruption and integrity in SOEs.

The risk of corrupt practices in and around SOEs

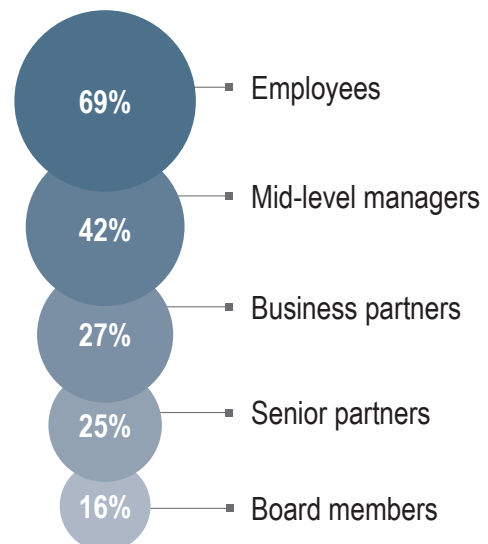
In almost half of the participating SOEs (comprising 42% of all respondents), at least one respondent reported that corrupt and related irregular practices took place in their company in the last three years. In the last year alone, 47% of all respondents reported that an average of 3% of annual corporate profits were lost to corruption and other irregular practices. SOEs that received complaints through their claims and advice channels in the last 12 months estimated that 40% were linked to corruption or related irregularities.

These perception data provide a strong indication that the threat of corruption and irregular practices in and around SOEs is real. Digging deeper, the report compares perceived experiences with corruption over the last three years with the risks and challenges of the present.

Key findings

- The instances of corruption that were reported most often involved non-management employees and mid-level managers. Executive managers, charged with their oversight, reported less corruption and fewer irregularities in their company compared to other categories of respondents. This is despite being, in some cases, from the same company and reporting similar corruption risks and obstacles as their fellow respondents.
- Respondents in oil and gas, mining, postal, energy and transportation and logistics sectors report to have witnessed corrupt and other irregular practices more often than average. These sectors are the most highly regulated, are likely to have natural market monopolies and are engaged in high-value public procurement projects.
- The greatest obstacles to integrity in SOEs relate to relations with the government (including a perceived lack of integrity in the public and political sector), and with employee behaviour (including opportunistic behaviour by individuals). To a lesser degree, challenges also arise from ineffective control and accountability (including ineffective internal control or risk management) and the company culture (including a lack of awareness amongst employees of the need for integrity).
- SOEs with public policy objectives – whether well-defined or more implicit – report higher risks of corruption or other irregularities. They also report taking fewer actions to avoid known corruption risks than those SOEs with entirely commercial objectives.
- SOEs with entirely commercial objectives are more likely to see the allocation of operational budget to integrity as more of an investment or asset than SOEs with public policy objectives. Overall, SOEs see financing integrity as more of a cost or expense than private companies.
- In face of known corruption risks, SOEs generally appear less risk averse or less ready to take action than private companies. This could reflect the fact that SOEs are legally obliged to conduct certain activities, and consequently have less freedom than private firms to walk away from dubious propositions.

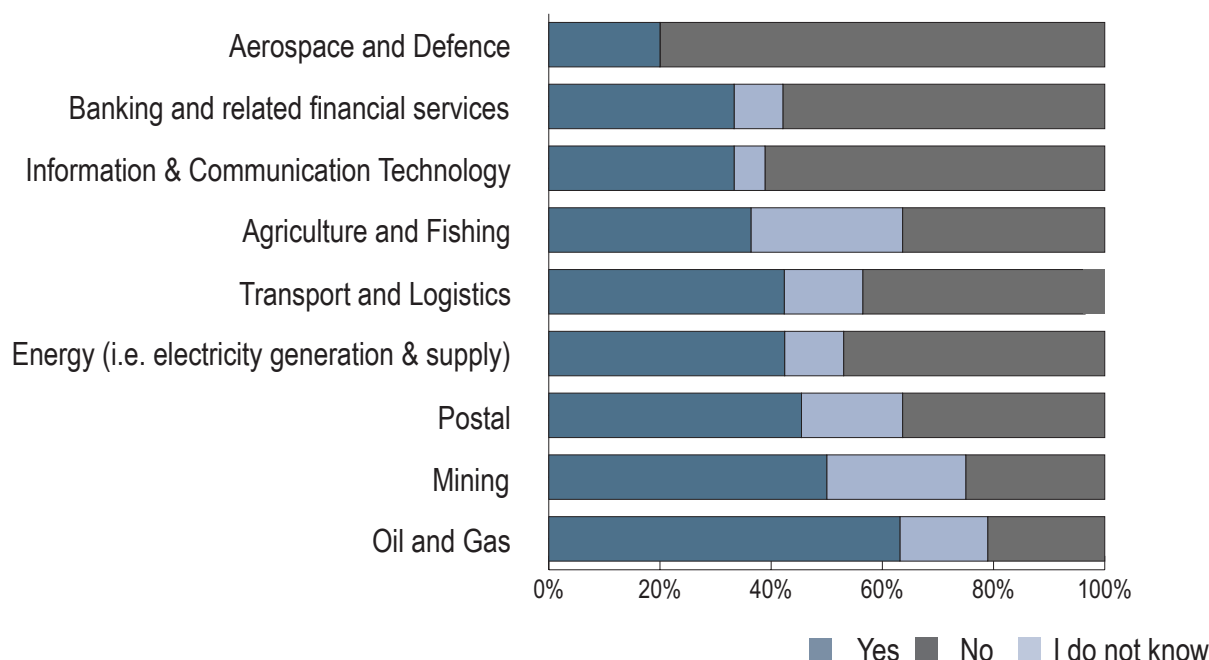
Who engages in corrupt behaviour?



Source: Based on 347 responses to the OECD 2017 Survey of anti-corruption and integrity in SOEs.

Note: Respondents were able to select more than one actor.

What sectors are the most vulnerable?



Source: Based on 289 responses to the 2017 OECD Survey of anti-corruption and integrity in SOEs.

Understanding the specific challenges for SOEs

Non-management employees and managers in private firms face many of the same incentives and opportunities to engage in corrupt practices as those in SOEs. However, the report provides perception-based evidence that some of the risks are increased for SOEs. Opportunistic behaviour leading to corruption may be derived from a “too public to fail” mentality in which SOEs are protected by their state ownership, their market dominant position or their involvement in the delivery of public services, and are insulated from the same threat of bankruptcy and hostile take-over that private companies face. Opportunistic behaviour may also arise out of SOEs’ operations in sectors with high value and frequent transactions or within complex regulatory frameworks that, unless well-designed, can provide a smokescreen for non-compliant behaviour.

SOE respondents consider the greatest corruption-related risks to be both internal and external to the company. External pressures, such as undue influence by the state in SOE operations, may push employees and managers to break rules and/or provide opportunities for exploiting their position. On the one hand, SOEs with public policy objectives may be more able to justify illicit activity to compensate for financial losses or reduced profit margins that can be associated with delivering on policy objectives. On the other hand, SOEs (and other firms) with entirely commercial objectives may try to justify corruption because of the pressure to remain competitive or to perform. The latter scenario is considered more of an obstacle for SOEs with entirely commercial objectives.

Corruption risk avoidance and mitigation: what are SOEs doing?

The majority of SOEs have rules and mechanisms in place to mitigate corruption risks. In the last year, SOEs allocated an estimated 1.5% of their operational budgets to preventing and detecting corruption. Almost half of respondents considered this as an asset or worthwhile investment, but 40% also indicated that the financial and human resources available to invest in integrity are “at least somewhat” inadequate. Just over half of respondents reported that their company provides anti-corruption or integrity-related training to all employees, board members and management.

Ninety percent of SOEs treat corruption and integrity risks explicitly in risk assessment, most often categorised as compliance risks or, less often, as strategic risks. Those that conduct risk assessments on an annual basis, as is most common, report fewer risks and consider their internal control and risk management systems to be more effective. Boards and executive management are not always privy to the same internal materials about risks, internal controls or the efficacy of the internal integrity mechanism.

SOEs employ a host of rules and codes to reduce the risk of corruption. Those most common are to do with conflict of interest, charitable contributions and engagement in public procurement. Some SOEs use a variety of approaches to third-party due diligence, with one third of SOEs having severed a business relationship because of the risk of or exposure to corruption. Companies often offer multiple channels for complaints that are more often classified as confidential and reported to the CEO or a board member, or both.

Although the majority of SOEs have some arrangements for risk management and internal control, the evidence in this report demonstrates either a lack of controls, an ineffectiveness of controls, or an override of controls. Investments in integrity may continue to be rendered less effective until the more systemic issue of a lack of a culture of integrity is reversed.

1.5%

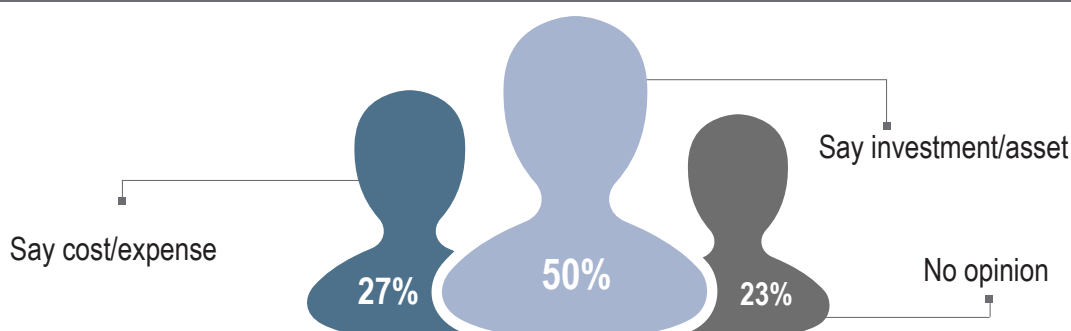
The operating budget that 80% of SOEs allocate to detecting and addressing corruption and breaches of integrity.

Internal rules for managing corruption risk

1. Conflict of interest
2. Public procurement (as procurer)
3. Charitable contributions and sponsorships
4. Asset/income disclosure
5. Public procurement (as bidder)
6. Political party financing or engagement
7. Lobbying

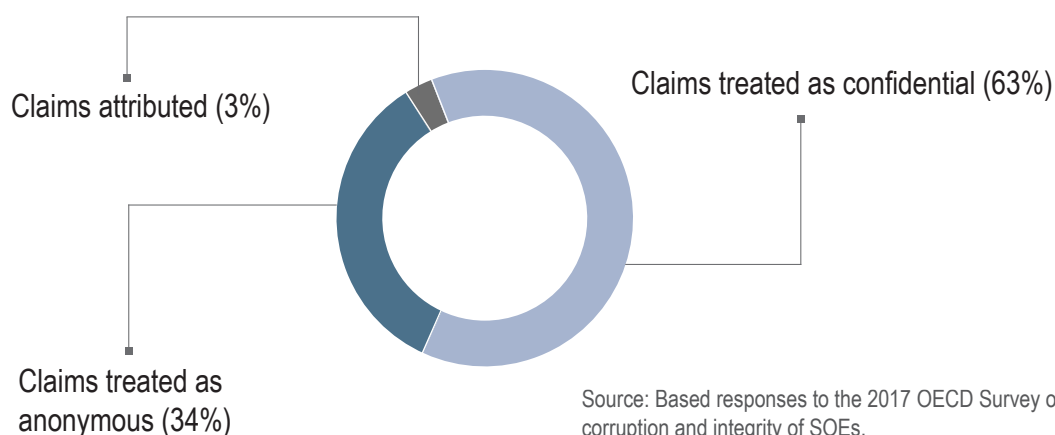
Note: in order of most commonly reported.

How do SOEs view the allocation of budget to promoting integrity?



Source: Based on 347 responses to the 2017 OECD Survey on anti-corruption and integrity of SOEs

How do SOEs treat claims and complaints



Where are the breakdowns in the system?

We see that many of the SOEs that witnessed corruption or other irregular practices in their company in recent years had a series of integrity mechanisms in place, including corruption-specific controls and risk management processes, internal and external audit, reporting mechanisms and codes of conduct or ethics. The evidence shows that there is more work to be done in better assessing a company's risk profile in order to adopt internal controls that are more tailored to the risks faced. In some cases there is a need to increase their efficiency.

However, the greatest obstacles facing SOEs have to do with human behaviour and relationships. Controls are a critical part of corporate governance, but must be coupled by a culture of integrity to counter pressure and undue influence where corruption is a systemic issue and opportunistic behaviour by individuals where it is not.

The top 10 obstacles to integrity in SOEs

- 1 A lack of a culture of integrity in the political and public sector
- 2 A lack of awareness among employees of the need for, or priority placed on, integrity
- 3 Opportunistic behaviour of individuals
- 4 A lack of awareness of legal requirements
- 5 Perceived likelihood of getting caught is low
- 6 A lack of a culture of integrity in the company
- 7 Overly complex or burdensome legal requirements
- 8 Inadequate financial or human resources to invest in integrity and prevent corruption
- 9 Ineffective internal control or risk management
- 10 Ineffective channels for whistle-blowing / reporting misconduct

The importance of transparency and disclosure by SOEs

A baseline established in the OECD Guidelines on Corporate Governance of State-Owned Enterprises is that all SOEs should disclose material financial and non-financial information on the enterprise, including areas of significant concern for the state as an owner and the general public. Large and listed SOEs should disclose according to high quality, internationally-recognised standards.

Disclosure by an SOE should be dictated by a clear policy developed by the ownership entity. The policy should identify what information should be publicly disclosed, the appropriate channels for disclosure and the mechanisms for ensuring quality of information.

According to respondents, just over one-third of SOEs disclose material foreseeable risk factors and measures taken to manage such risks, recalling that one in ten companies do not explicitly treat corruption risks as part of risk assessments. Red flags may be falling between the cracks. There is also room for improvement in disclosure of financial assistance from the state, as well as material transactions with the state and other entities.

Degree of disclosure by SOEs

Information suggested for disclosure	Respondents whose companies disclose
A clear statement to the public of enterprise objectives and their fulfilment (for fully-owned SOEs, this would include any mandate elaborated by the state ownership entity)	78%
Enterprise financial and operating results, including where relevant the costs and funding arrangements pertaining to public policy objectives	96%
The governance, ownership and voting structure of the enterprise, including the content of any corporate governance code or policy and implementation processes	81%
The remuneration of board members and key executives	72%
Board member qualifications, selection process, including board diversity policies, roles on other company boards and whether they are considered as independent by the SOE board	52%
Any material foreseeable risk factors and measures taken to manage such risks	34%
Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE, including contractual commitments and liabilities arising from public-private partnerships	40%
Any material transactions with the state and other related entities	43%

Note: This list is based on items suggested for disclosure in the OECD Guidelines on Corporate Governance of SOEs.

Source: Based on 347 responses to the 2017 OECD Survey on anti-corruption and integrity of SOEs.

Preventive and remedial action: what is the state doing?

But what exactly can and should the state do as the owner? The report addresses this question through an analysis of state ownership entities' practices in 28 OECD and non-OECD countries across four continents, insights from Supreme Audit Institutions and comparisons with findings from other international studies.

The answer is guided by existing international standards such as the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The Guidelines imply that the state, on a whole-of-government basis, should implement an ownership policy; a designated "ownership entity" within the state should be responsible for defining objectives of individual SOEs and monitoring their performance; the board of directors should be responsible for approving strategy and monitoring management; and the management responsible for the SOE's corporate operations.

More than four out of five SOE respondents reported that relevant national laws, regulations, bylaws or governance codes clearly establish expectations and that the ownership entity clearly communicates expectations regarding integrity and anti-corruption. The majority of ownership entities communicate their expectations through existing laws, provision of supporting documentation (e.g. guidance or memorandums) or further yet, through in-person interactions such as annual general, investor, quarterly or ad-hoc meetings, and increasingly in seminars and workshops.

Anti-corruption and integrity is a specific topic of discussion between some, but not all, ownership entities and their SOEs. In a few instances, anti-corruption and integrity is built into the objectives of the company, often couched under requirements for corporate social responsibility. State ownership entities' may leave integrity and anti-corruption entirely to the devices of the board under the guise of providing SOEs with functional independence. Conversely, in some countries where SOEs are incorporated in a legal form identical to that of private firms, the authorities take the position that the existent corporate legal framework is, or should be, sufficient in itself to ensure integrity and deter corruption.

Selected tools available to state ownership entities bases on existing country practices



Only a handful of ownership entities specifically hire relevant skills and resources, such as audit, compliance or risk management expertise to provide a high degree of assurance in their oversight and monitoring. Co-ordination across relevant public institutions on the subject is largely ad-hoc, with the potential for improving professional relations that strengthen awareness and monitoring of corruption in SOEs as well as a measured response in the case of potential or real corruption.

The report aims to advance the global discussion on corruption in SOEs, not by pointing the finger at SOEs alone, but by identifying the obstacles that undermine integrity efforts of both SOEs and their owners. So far, advice on corporate governance has largely focused on performance and implementation of governance arrangements that create the conditions necessary for success. This paves the way for providing further guidance for governments by combining existing corporate governance and anti-corruption instruments, and developing new guidance to shine the light into the grey area between general government and private business that SOEs occupy.

What else can be done? Towards anti-corruption and integrity guidance for SOEs

The OECD is developing new guidance for states as owners to help them promote integrity and anti-corruption in the SOEs they own. The guidance will be rooted in the existing OECD Guidelines on Corporate Governance of State-Owned Enterprises and will cover, to a certain degree, the following areas:

Integrity of the state

- Applying high standards of integrity to those exercising ownership of state-owned enterprises on behalf of the general public
- Establishing ownership arrangements that are conducive to integrity

Ownership and Governance

- Ensuring clarity in the legal and regulatory framework and in the state's expectations
- Acting as an informed and active owner with regards to integrity in state-owned enterprises

Corruption prevention and detection at the SOE level

- Requiring adequate risk management systems within SOEs
- Requiring adoption of high quality integrity mechanisms within SOEs
- Safeguarding the autonomy of SOEs and their decision-making bodies

Accountability of SOEs and of the state

- Requiring objective external review of state-owned enterprises and the ownership function
- Taking action and respecting due process for investigations and prosecutions
- Inviting the inputs of civil society, the public and the press

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This booklet reproduces highlights from the OECD report on SOEs and corruption. The report analyses survey responses received from 347 SOE board members, executive managers and heads of legal, audit or similar departments, as well as 28 state ownership entities, covering 37 countries across four continents.

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