Anti-corruption, ethics and compliance in Russia

Practical information from leading companies

Executive Summary

The full report is available at www.ethicalcorporationinstitute.com/russia

Ethical Corporation Institute

NOVEMBER 2008
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# ANTI-CORRUPTION, ETHICS AND COMPLIANCE IN RUSSIA

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Foreword

Anti-corruption has resurfaced as a critical issue among multinational businesses, NGOs and governments. Corruption by business people and government officials persists in many emerging markets, such as Russia.

Transparency International’s latest Corruption Perceptions Index ranked Russia in the bottom 20% of countries complying with international compliance law. What does this mean for companies? It presents real risks to business such as legal fees, time, operational disruptions, staffing, and excess taxes.

Increasing trade and foreign direct investment have encouraged joint anti-corruption initiatives such as: the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; World Economic Forum Partnering Against Corruption Initiative; United Nations Global Compact: Principle 10; The Council of Europe Criminal Law Convention on Corruption; and the International Chamber of Commerce Rules of Conduct to Combat Extortion and Bribery.

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Executive summary

This report has been compiled to address the complexities of corporate ethics and compliance for multinational businesses that operate in Russia. It incorporates a special focus on anti-corruption. This industry-diverse country offers many business opportunities to foreign investors, but its complex systems need careful analysis when planning market entry.

One of the chief challenges to businesses in Russia concerns the level of corruption associated with business activity. Russia’s ranking of 147th out of the 180 countries in Transparency International’s latest Corruption Perceptions Index is not reassuring. Corruption in Russia affects all types and sizes of organisations, public and private, local and foreign, and it appears to be on the increase, both in terms of the level of corruption and of its cost to companies. The general public does not approve of corruption, but people do not see how it can be eradicated.

A major review of anti-corruption legislation is being carried out in accordance with a new Presidential Plan. President Medvedev established a special committee in order to implement the legislative review and to introduce new anti-corruption laws to the Russian parliament. These are expected to be passed by January 2009. This initiative has been welcomed by the business and public sector; it raises the profile of corruption issues and institutes a much-needed review of laws that, to date, have been poorly enforced. In a society governed strictly by a vertical hierarchy such as Russia, this top-level commitment has boosted the public debate on corruption in the country.

Another positive indication concerns Russia’s engagement in several of the major international anti-corruption conventions, including the United Nations Convention against Corruption and the Council of Europe Criminal Law Convention on Corruption, which Russia ratified in 2006. Russia has also made a public commitment to accession to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. These global initiatives have helped provide the framework for the planned Russian legislation.

As well as committing to international conventions, Russia has many national and regional initiatives dedicated to fighting corruption. At a national level, many of these initiatives are supported by a variety of government ministries. It is hoped that the new anti-corruption legislation will give additional support to these efforts, which should help promote greater coherence in regulatory implementation in Russia’s regions, where the authorities to date have had room to interpret such regulations in extremely loose terms. There are also a number of active private-sector initiatives, providing information and support to Russian and foreign-owned companies.

Leading foreign companies active in Russia are all operating according to codes of conduct that generally have clear policies on compliance issues such as bribery, gifts and the use of suppliers and agents. These companies run training programmes on these issues for employees so that they know how to act when they encounter unethical activity.

Ethical Corporation Institute’s research indicates that high-profile Russian companies are following the lead established by their foreign counterparts with regard to corporate codes of conduct, ethics and compliance. Increased exposure to a western-style compliance culture has influenced the Russian business environment so that it now presents a very different picture to that of the 1990s. However, for smaller companies, it is more difficult to avoid bribery and extortion, and in some instances accepting a certain level of corruption may appear to be the only effective way to sustain business operations.

There is also the fact that despite the more positive developments, there are significant cultural differences in Russia concerning anti-corruption which date back to Soviet times, and attitudes to what is acceptable or not vary in comparison with other business cultures. Added to this is the reality that once a company has resorted to bribery and other non-ethical activities, it is much more vulnerable to further extortion and blackmail, and in the worst case can risk losing its entire business along with all its assets.

Our research highlights the costs to foreign companies of ensuring compliance with local laws and regulations. The process of obtaining permits and licences and of ensuring that offices and premises meet all the various requirements in areas such as fire and health and safety, can take a great deal of time and money. In addition, these situations typically provide officials with opportunities for bribes and favours. From the company’s perspective, it is essential to have a clear zero-tolerance policy in place, as once bribes are condoned, then the company culture is irrevocably compromised.

Our interviews revealed a variety of specific corruption challenges, and they illustrated the point that compliance in itself does not always produce the required results. Some of the companies profiled did
not manage to combat corruption successfully, despite a commitment to ethical behaviour and to the rule of law.

There is no doubt among foreign investors that there are many positive aspects of doing business in Russia, which they think compensate for the difficulties of complying with all the regulation affecting business in the country. It should be noted also that certain sectors are much more restrictive to foreign investors, particularly those named in the Strategic Industries Bill, which came into force in May 2008. This includes the natural monopolies, such as energy and extraction, where there has been a concerted effort by the Russian Government in recent years to ensure control of these industries under a new generation of oligarchs selected by the state.
Introduction

Corruption as a significant risk to business

According to the World Bank, corruption is the single greatest obstacle to economic and social development. The World Bank estimates that corruption costs more than 5% of the world’s gross domestic product (GDP), nearly $3tn. Companies spend huge sums annually to secure benefits and advantages for their business operations. In certain countries, many government officials expect an illegal payment or bribe to enable or speed up a company operation.

There are many reasons why the last 15 years have seen a steady move against corruption, spearheaded by many international organisations, including the UN, World Bank and OECD, and supported by governments and industry. Corporate governance and responsibility have assumed an increasing importance on the corporate agenda, and companies can no longer afford to be seen as engaging in unethical business practices. The international anti-corruption organisations highlight a number of issues that need to be considered:

Ethical and social issues
Corruption is fundamentally wrong and unfair to society as a whole. It is an abuse of the power base of the democratic structure of society, debases legitimate structures and has a particularly strong impact on the poorer and weaker sectors of society. Corruption undermines people’s trust in the economic and political system of a country, and leads to a loss of integrity. These outcomes can lead to a lack of accountability by a country’s leadership.

Economic and financial issues
Corruption discourages economic growth, deters investment, distorts market competitiveness and hampers the development of transparent market structures. It can add up to 10% to companies’ costs of doing business, and can generate an additional 25% or more in costs to companies when engaging in public procurement.

Legal issues
Legislation such as the US Foreign Corrupt Practices Act applies to a company’s operations both within and outside the country where it is registered, so participating in corrupt activities anywhere in the world is very high-risk. Furthermore, companies can be held responsible for the actions of associates or intermediaries acting on their behalf. Corrupt activity can resonate throughout the supply chain and result in court cases and other civil actions.

Reputational issues
Companies associated with corrupt activity at best risk losing status in the business community and, in the case of prosecution for such activity, can experience long-term and possibly irrevocable damage to their reputation. The growth of business initiatives and international anti-corruption conventions has strengthened the role of business in fighting corruption. As it is often the companies that are paying bribes to officials to achieve their business objectives, the alternative is that by insisting on transparency and compliance they can raise awareness of the issue and help reduce corrupt behaviour.

Also, once employees know that their company is engaging in unethical activities, they are more likely to condone corrupt activity themselves, and this can include unethical behaviour towards their employer. Another risk is that such a company will end up being blackmailed, which can be damaging for all parties and can quickly spiral out of control.

Local and environmental issues
Environmentally questionable projects are often the focus of corrupt activity, providing an opportunity for companies to bribe officials and achieve economic gains, to the detriment of the environment. Funds that were intended to develop a local project can end up being diverted to corrupt officials, which in turn reduces the capital available for locally useful and sustainable projects.

Corruption and related issues in Russia
There is no doubt that corruption is a major problem for businesses in Russia.

In July 2008 the Foreign Investment Advisory Council of Russia (FIAC) released the latest ‘Foreign Direct Investment in Russia’ report, which looks at the investment climate in Russia. The publication’s aim is to build a picture of how foreign investors perceive Russia in terms of investment opportunities. Fifty chief executives and board members of foreign companies operating in Russia were surveyed on a range of issues affecting investment. One of the questions focussed on companies’ concerns regarding how the rule of law is enforced in Russia, and we reproduce a graph of the responses to this question below. As can be seen, corruption challenges in Russia are linked to problems with legislation, lack of transparency and other administrative issues. We discuss these issues over the following pages.
In September 2008, Transparency International issued its annual Corruption Perceptions Index (CPI). The CPI, first published in 1995, is a ranking of 180 countries by their perceived levels of corruption as determined by experts and through opinion surveys. Transparency International has an advisory committee of economists, statisticians and social and political scientists that have helped develop the tools used to measure levels of corruption. The CPI scores countries on a scale from 0 (highly corrupt) to 10 (highly clean). In the latest CPI, Russia was in position 147 in the league table, with a low score of 2.1. This was one position down from 2007, when Russia scored 2.3, so there is no substantial improvement as yet.

**Legislation and global initiatives**

In Chapter I we provide a detailed summary of developments in Russian legislation that relate to anti-corruption, and these are situated within global initiatives in this field in Chapter 2. At the time of writing, the Russian Government is conducting a thorough review of its anti-corruption legislation, which is part of a strongly worded commitment from President Medvedev that corruption should be stopped. Recent figures quoted by The Committee for the Fight against Corruption in Russia would suggest that these measures are timely: of the criminal cases brought in 2008 against persons convicted of corruption, 757 – or almost a quarter of these – were brought against individuals working in administration or the law, including inspectors, public prosecutors, lawyers, judges, and municipal and regional deputies. It is estimated that the illegal income of corrupt officials currently exceeds one-third of the national budget of the Russian Federation.

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