



**STATE-OWNED ENTERPRISES:
BEACONS OF INTEGRITY?
THE CASE FOR IMPLEMENTING
THE 10 ANTI-CORRUPTION PRINCIPLES
FOR STATE-OWNED ENTERPRISES**

Transparency International is the global civil society organisation leading the fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, we raise awareness of the damaging effects of corruption and work with partners in government, business and civil society to develop and implement effective measures to tackle it.

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INTRODUCTION

State-owned enterprises (SOEs) play critical roles in developing, protecting and managing many nations' wealth and essential services. They are present globally, nationally and locally, and are central to the daily lives of citizens, providing employment, goods and services in sectors such as transport, utilities, telecommunications, postal services and health. Recognising the importance of SOEs, their high level of responsibility as publicly owned entities and the business case for addressing their special corruption risks, Transparency International has developed the [10 Anti-Corruption Principles for SOEs](#) to help and guide SOEs, supported by their state-owners, to reach high standards of integrity and transparency.

SOEs number among the world's largest companies and also include large state entities, such as railways and health services. SOEs form 20 per cent of the Fortune Global 500 companies. However, while large SOEs have high profiles and attract widespread attention, most countries' SOEs exist at the regional and municipal levels. SOEs are important in emerging markets, where SOEs can often account for more than 50 per cent of the gross national product. SOEs are used by states as tools to protect, influence and develop economies and societies, and form part of a spectrum of state capitalism which includes sovereign welfare funds, state pension funds, development banks and portfolio investments. SOEs serve many state purposes, including working for the public good, managing essential public services, driving economic and social development, exploiting and protecting critical resources, protecting national security, and fostering innovation.

SOEs, whether state agencies or privatised, face similar corruption risks to private sector companies but they have specific higher vulnerabilities coming from their closeness to governments and politics, the scale of assets they control, the considerable value of the public contracts they award and the challenges of the markets and sectors they operate in. Their activities present a range of concerns for governments, the business sector and the public, including corruption, inefficient practices (which often facilitate corruption), high debt levels and preferential treatment (which undermines fair competition). These concerns are compounded where there is improper political intervention, poor governance and a lack of transparency and accountability.

This paper sets out the case for countering corruption and for why SOEs should follow the anti-corruption framework of Transparency International's 10 Anti-Corruption Principles for SOEs. The paper builds on the results of Transparency International surveys that have shown that though SOEs have weaker practices of transparency than other businesses, given their public ownership they should be beacons of integrity and transparency for the societies they serve.

10 ANTI-CORRUPTION PRINCIPLES FOR STATE-OWNED ENTERPRISES

The SOE board and management, supported by all its employees, shall follow these principles:

1 Operate to the highest standards of ethics and integrity

- embed an organisational culture of ethics and integrity
- commit to advancing integrity in societies
- commit to an anti-corruption policy and programme
- provide tone from the top

2 Ensure best practice governance and oversight of the anti-corruption programme

- implement governance that conforms to accepted global best practice
- ensure that board directors act in the best interests of the SOE
- apply a rigorous and transparent procedure for the appointment of directors to the board
- structure the SOE's board so as to have a balance of skills, experience, knowledge, diversity and independent directors
- set a clear division of responsibilities between the board and the chief executive
- carry out vigilant oversight of the anti-corruption programme and ensure accountability

3 Be accountable to stakeholders through transparency and public reporting

- set and observe best practice in accountability to stakeholders
- report publicly on the anti-corruption programme
- apply organisational transparency and country-by-country reporting
- engage with stakeholders
- be transparent on the relationship with the ownership entity

4 Ensure human resources policies and procedures support the anti-corruption programme

- design personnel policies and procedures to support the anti-corruption programme
- incentivise ethical behaviour and integrity
- assign responsibilities for the anti-corruption programme
- integrate the anti-corruption programme into the organisational structure
- apply disciplinary procedures

5 Design the anti-corruption programme based on thorough risk assessment

- risk assessment should be the basis for the design of the programme
- identify risk factors
- understand forms of corruption and related risks

6 Implement detailed policies and procedures to counter key corruption risks

- implement controls to counter risks related to vulnerable functions and transactions
- commit to fair trading practices
- provide transparency of contracting and procurement processes
- counter the highest corruption risks
- establish and maintain internal accounting controls
- maintain accurate books and records
- subject the anti-corruption programme to regular internal audits
- develop an incident management plan

7 Manage relationships with third parties to ensure they perform to an anti-corruption standard equivalent to that of the SOE

- apply general standards in all dealings with third parties
- implement controls for specific forms of third parties:
 - controlled entities, investments and mergers and acquisitions
 - joint ventures and consortia
 - agents and other intermediaries

8 Use communication and training to embed the anti-corruption programme

- establish effective internal and external communications
- provide general and tailored training

9 Provide secure and accessible advice and whistleblowing channels

- position advice and whistleblowing channels within an organisational culture of openness and trust
- provide accessible and secure advice channels, including hotlines
- adopt a policy and procedure that provides secure and accessible channels for whistleblowing

10 Monitor, assess and continuously improve implementation of the anti-corruption programme

- implement systematic, continuous monitoring and improvement
- undergo regular independent review
- provide regular leadership reviews and make improvements as appropriate

ABOUT THE 10 ANTI-CORRUPTION PRINCIPLES FOR STATE-OWNED ENTERPRISES

Transparency International's 10 Anti-Corruption Principles for SOEs (the "SOE Principles") provide comprehensive guidance for SOEs of all types and sizes for anti-corruption best practice. Each principle is of equal importance and is supported by detailed clauses and commentary.

Transparency International has developed the SOE Principles primarily for the use of boards of directors and managers of SOEs, but also to be used as a reference for state-owners, inter-governmental bodies, regulators, lawmakers, prosecuting agencies and professionals. They can also be referred to by any other kind of state-controlled entity or agency since the underlying system for designing and implementing an anti-corruption programme is universal, and the risks faced by these entities are often similar to those faced by SOEs.

The ways SOEs use the SOE Principles will depend on their particular circumstances and corruption risks. Smaller SOEs that may not yet have developed anti-corruption practices can use these SOE Principles as a guide to areas they should be striving towards in developing their anti-corruption programmes. The SOE Principles do not provide implementation guidance but they can be used as a basis for SOEs and their stakeholders to develop practical tools, including frameworks for assessing performance, such as on transparency and public reporting.

The design of the SOE Principles draws upon the Business Principles for Countering Bribery, a code for business initiated by Transparency International, developed with multiple stakeholders and first published in 2003.¹ The Business Principles have contributed substantially to the development of other codes and have shaped a range of tools produced by Transparency International, its chapters and other organisations. It is hoped that the SOE Principles over time will have a similar impact. The SOE Principles are also designed to complement the Organization for Economic Co-operation and Development's ("OECD's") recommendations to governments on the corporate governance and anti-corruption measures of SOEs. The SOE Principles were developed through a multi-stakeholder process, with guidance and advice from a working group whose members were drawn from SOEs, companies, inter-governmental bodies (including the OECD), and independent experts, together with a three-month public consultation.

DEFINING SOEs

There is no universal definition of an SOE but commonly they are considered to be commercially active enterprises owned fully or partially by the state, and they can also include agencies set up by the state, such as health services or museums. Some states define SOEs as where the state has a majority of the shares. SOEs can also be defined as where the state has effective control through voting rights, a golden share or influence. Russia, exceptionally, defines an SOE as where the state has over 25 per cent of the shares. This paper uses the broad definition of SOEs given in the 10

Anti-Corruption Principles for SOEs and extends the scope to cover sovereign wealth funds, state pension funds and significant state and SOE minority shareholdings in companies.

“An SOE is an enterprise in which the state has ownership, control or significant investment. The SOE Principles extend the scope by providing that the SOE Principles can be referred to not only by SOEs but by any other kind of state-controlled entity or agency since the underlying system for designing and implementing an anti-corruption programme is universal and the risks faced by these entities are often similar to those faced by SOEs”.

Definition from 10 Anti-Corruption Principles for SOEs

STATE-OWNED ENTERPRISE HEALTHCHECK: A CONTINUOUS IMPROVEMENT TOOL

Transparency International has designed the State-Owned Enterprise Healthcheck (SOE Healthcheck), a checklist to aid SOEs in the design and improvement of their anti-corruption programmes. The tool can be downloaded from the [Transparency International website](#).

TRANSPARENCY: THE BEST PROTECTION AGAINST CORRUPTION

While the leadership of SOEs may strive to implement best anti-corruption practices, their efforts will be undermined if, as unfortunately is all too commonly the case, the state, politicians and public officials are determined to use SOEs for corrupt purposes. The most effective check against corruption is transparency. Stakeholders, whether investors, civil society or the public, cannot hold SOEs and governments to account where there is a lack of transparency and poor standards or wrongdoing can be hidden. For these reasons, the SOE Principles emphasise the critical roles of governance, accountability, stakeholder engagement – and, above all, transparency and public reporting.

Transparency means having a comprehensive approach to opening organisational structures, operations, policies and procedures to public view and reporting publicly on commitment to integrity and the implementation of measures to counter corruption. Transparency should be constrained only by the needs of commercial confidentiality and privacy, and the exceptions should be narrowly defined to avoid them being exploited to keep transactions from view. Transparency should include disclosing the beneficial ownership and control of the SOE, as well as its corporate governance, organisational structure, key financial information for domestic and foreign operations on a country-by-country basis, and commercial and public good priorities. It should also include reporting on the appointment processes for board directors and senior management, conflicts of interest related to key decisions or contracts, opening up critical processes (such as contracting and procurement) to public scrutiny, and reporting and engaging with stakeholders on the SOE's measures to counter corruption.

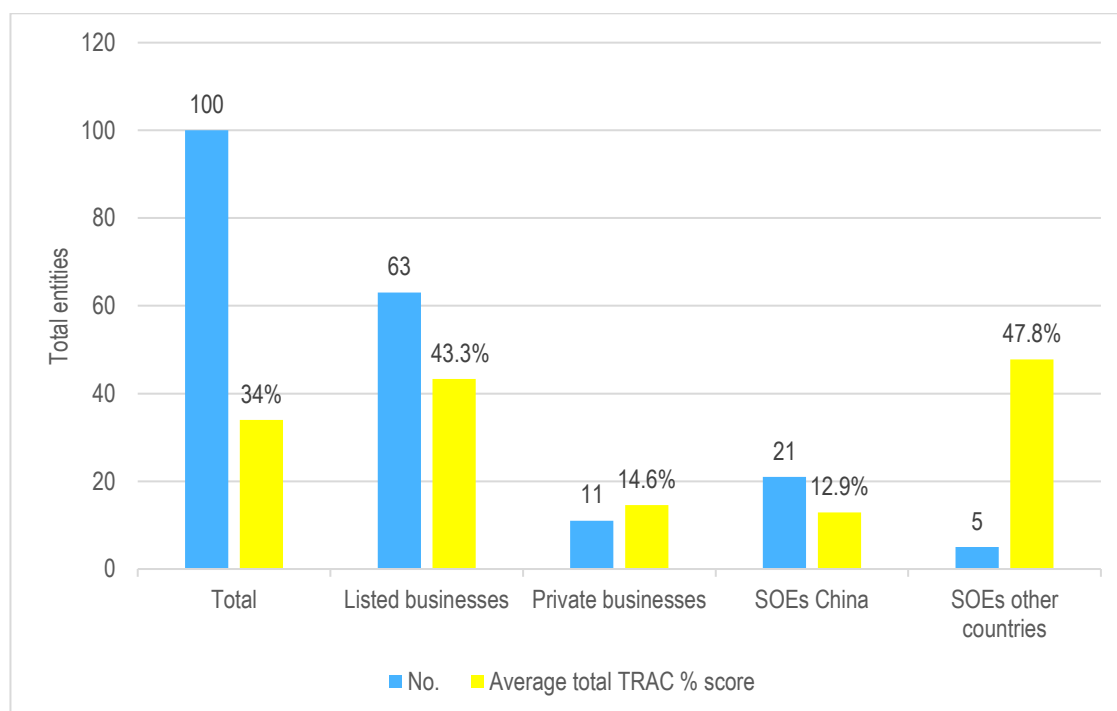
NORWAY'S SOVEREIGN WEALTH FUND: A COMMITMENT TO TRANSPARENCY

“Transparency is a foundation of good governance practices. Promoting the highest standards of corporate transparency is an important engagement theme for the fund. In 2016, we prioritised engagements on transparency of corruption risk mitigation and executive remuneration policies.”

Responsible Investment: Government Pension Fund Global, Norges Bank, 2016

SOEs are less transparent than businesses: There is not yet a consistent level of good practice in SOE transparency. In a 2016 Transparency International study of 100 multinational enterprises from emerging markets, 21 Chinese SOEs scored only 12.9 per cent of the available marks, against the 43.3 per cent achieved by other businesses.ⁱⁱ In contrast, the five non-Chinese SOEs scored better, with 47.8 per cent. The survey covered the public reporting of key elements of SOEs and businessesⁱⁱⁱ based on three dimensions: anti-corruption programmes; organisational structures and holdings; and country-by-country financial reporting. SOEs and other businesses both showed weak disclosure of organisational structures and country-by-country reporting.

Figure 1: Transparency in corporate reporting: comparison of multinational businesses and SOEs from emerging markets



Source: *Transparency in corporate reporting of multinationals in emerging markets*, Transparency International, 2016

PUBLIC TRUST, PUBLIC GOOD, THE HIGH SOE RESPONSIBILITY

SOEs provide a way for states to operate in markets and pursue political, economic and social goals. Power is entrusted to SOEs by citizens, who are their ultimate owners. This means states and their SOEs have a high level of responsibility to act with integrity and transparency to ensure accountability to citizens and to work for the public good. This expectation regarding SOEs' responsibility provides the framework for how SOEs should manage assets, invest, set the risk approach, select third parties and contribute to improving the well-being of citizens, both in their home countries and in other countries in which they may operate or have an effect. The expectation regarding their responsibility should also shape the design and implementation of SOEs' anti-corruption programmes.

“Because SOEs are owned by the public, they should be beacons of integrity and transparency. Unfortunately, this does not always seem to be the case.”

Delia Ferreira Rubio, chair, Transparency International^{iv}

The extent to which an SOE pursues social goals will be set by the mandate from the state-owner and these may include specific goals, such as pursuing the Sustainable Development Goals – as in the example of the Swedish Government in the box below.^v

THE SWEDISH GOVERNMENT'S POLICY FOR SOEs ON THE PREVENTION OF CORRUPTION

- To promote long-term sustainable value growth in state-owned enterprises, sustainable business is to be integrated into corporate governance. State-owned enterprises should thus serve as role models in the area of sustainable business and otherwise act in a manner that generates public confidence.
- For the state in its capacity as owner, it is particularly important that state-owned enterprises work towards high standards of business ethics and active prevention of corruption and responsible conduct in relation to taxes.

From: *The state's ownership policy and guidelines for state-owned enterprises*, Government Offices of Sweden, 2017

The high level of responsibility of SOEs should guide the design of their risk approach, which should be more stringent than other businesses. However, the OECD, in a 2016 survey of 33 OECD

member countries, found that the majority of countries reported that risk rules for SOEs were very similar to those applicable to private companies.^{vi}

Boards of SOEs and their management leadership need to understand and accept for their SOEs the higher burden of responsibility they should bear as publicly owned enterprises to act ethically and with integrity, and they should ensure that they know the requirements of their state-owners and the expectations of their stakeholders in this regard. The higher burden of responsibility should be translated into a clear anti-corruption policy and a best practice anti-corruption programme to ensure their business practices and relations with their governments are free from corruption. Furthermore, they should recognise and act on their roles as examples of integrity in the markets in which they operate.

THE CASE FOR SOEs TO COUNTER CORRUPTION

The power entrusted by the state, and ultimately by the public, place upon SOEs a responsibility to operate to the highest level of ethics and integrity, and to ensure a high and achievable standard in countering corruption. Some SOEs may see themselves as disadvantaged in commercial markets by taking a strong anti-corruption stance but there is a compelling business case for this stance, with benefits which can lead to improved efficiency, innovation, customer satisfaction, market advantage and business returns. Here are some reasons why best practice anti-corruption programmes make sound business sense for SOEs:

They benefit societies

- **They advance economic and social development:** Best practice anti-corruption programmes contribute to national and global economic and social development, wealth and employment by ensuring that the SOE is free from corruption, and invests and operates efficiently, with quality and innovation.
- **They raise integrity standards:** Best practice anti-corruption programmes help societies by bringing integrity and anti-corruption standards to business partners, supply chains, small and medium-sized enterprises and communities, and by promoting local and international investment in markets in which the SOE operates.
- **They support sustainable development:** Best practice anti-corruption programmes contribute to achieving the state's commitment to the UN Sustainable Development Goals, including the target for countering corruption.

They strengthen the workforce

- **They build the enterprise's integrity culture:** This is the foundation for countering corruption.
- **They help attract the right people:** Appointment processes free from undue interference and corruption will make it more likely that motivated and talented board members and employees are appointed. SOEs with a reputation for integrity are more attractive for talented people.
- **They motivate employees:** The integrity culture will be a successful one if employees are incentivised, motivated, act following clear ethical principles, have trust in the integrity of the SOE and are confident that the SOE will support them when resisting corruption.

They build and protect reputation

- **They support the state:** A reputation for a high degree of integrity will not only be favourable to the SOE's operations but will also support the reputation of the state. In turn, this will enhance the state's ability to support and invest in the SOE, as well as attracting foreign direct investment.
- **They give confidence to stakeholders:** If it has a best practice anti-corruption programme, the SOE will meet stakeholders' expectations of the SOE as a publicly owned

body. These will include the expectation that it acts honestly, responsibly, efficiently, and provides accessible, quality services and products, and that the SOE is transparent about its ownership, internal organisation and operations, and communicates clearly and accessibly.

- **They deter the corrupt:** A reputation for integrity can deter those who might otherwise seek to introduce corruption into the SOE and it can protect employees in their duties and interactions with others.
- **They allow access to finance:** If it has a best practice anti-corruption programme, the SOE will be better placed to obtain loans and equity financing, thus removing a potential burden on the national budget and reducing the cost of finance from the state, investors and international development institutions. Investors and funders are increasingly demanding anti-corruption standards and, in their due diligence, are looking for evidence of a comprehensive anti-corruption programme that meets their lending and investment standards.
- **They make an SOE a partner of choice:** Third parties are more likely to enter into an association with an SOE if it has a best practice anti-corruption programme, and this can generate opportunities for commercial ventures.
- **They enable access to global markets:** With the increasing participation of SOEs in global markets, governments in the markets they are entering may be concerned about the standards they bring with them and that they are under the control of a foreign government. Governments may screen the foreign SOEs' integrity standards. Having a best practice anti-corruption programme can help an SOE be accepted.

They protect and improve the business

- **They help an SOE achieve quality and excellence:** A well-designed anti-corruption programme is an expression of excellent management, with processes for continuous improvement and innovation.
- **They ensure the integrity of the business model:** Corruption distorts a business model, research and operations.
- **They help an SOE avoid the costs and penalties of corruption incidents:** There can be severe disruption and high costs from corruption incidents and sanctions. Having a well-designed anti-corruption programme helps an SOE avoid these.

THE PROTECTION OF A BEYOND-COMPLIANCE ANTI-CORRUPTION PROGRAMME

Compliance with anti-corruption and related laws is an obligation for all entities but the anti-corruption programme should be driven by the commitment of the SOE to its anti-corruption policy and not solely by the aim of avoiding prosecution and sanctions under anti-corruption laws. A best practice anti-corruption programme will provide protection as it will match or exceed the requirements of most laws and it will be designed for the right reasons: out of a desire to behave ethically and with integrity, rather than just as a response to laws.

Ensuring compliance with relevant anti-corruption and related laws is a bedrock of an anti-corruption programme and its importance is heightened by ever-tightening national and international anti-corruption legislation and increasing risks from investigations and sanctions. When SOEs enter global markets, this exposes them to the laws of many jurisdictions and there are increasing risks from laws with extra-territorial reach, such as the UK Bribery Act and the US Foreign Corrupt Practices Act (FCPA), as well as growing cooperation between investigating authorities. There can be severe legal consequences from corruption incidents, with substantial costs for legal and other fees, diversion of board and management attention and time, and business disruption. If an SOE is convicted of corruption, the consequences can include reputational damage, damage to share price, substantial fines, risk of debarment from markets, and perhaps prison and fines for officers and employees. The scale of the risks is shown by the Petrobras and Telia bribery scandals, which resulted in the then largest ever bribery fines and other substantial costs, and prosecutions of directors and executives. It can also lead to civil actions. For example, Petrobras, as described in the case study on page 27, agreed in principle in January 2018 to pay US\$2.95 billion^{vii} to settle a shareholder lawsuit in the United States in respect of the Operation Car Wash bribery scandal.^{viii}

SOEs should ensure their officers and employees are aware of the risks from laws. They may assume that as public officials they are safe under sovereign immunity from anti-corruption laws such as the FCPA but the FCPA is far more far-reaching than many officials understand. And there is a risk of enhanced sentencing for employees of SOEs if they are treated as “government officials” under local law. Also, there may be other extra-territorial laws, such as those for money laundering or the US Travel Act, which can place an SOE’s employees and officers at risk.

THE ROLES OF SOEs

SOEs are a long established economic and social tool of governments that have evolved over several hundred years. Their persistence and growth, despite privatisations, show they remain valuable for a variety of objectives, as illustrated in Figure 2. But they can have significant flaws: SOEs are often less profitable, heavily loss-making and debt-laden. Their effectiveness can be impaired when objectives are ill-defined or clash when social objectives are prioritised at the expense of economic objectives, such as when the state mandates low-cost utilities to be supplied to the public or structures favoured trading between SOEs at the expense of fair market competition.

Recent decades have seen large scale privatisation of SOEs after the collapse of communism and moves by many countries to adopt free market approaches. Privatisation has been seen as a way of bringing the market-driven efficiency of the private sector to SOEs but with states often retaining control. Conversely, there has been a resurgence in the past two decades of SOEs fuelled by governments' aims to develop global markets and protect strategic sectors, such as oil and financial services. States are also intervening in economies and markets through other state-owned entities and methods that can be termed collectively as state capitalism. This includes sovereign wealth funds, state pension funds and development banks. Other methods may be less apparent to the public, such as direct or indirect investments in companies, cross-trading between state entities, and controlling markets through regulators. As well as direct investments by the state, SOEs, sovereign wealth funds, pension funds and development banks may also make investments. In regard to governance, most SOEs are incorporated and governed under corporate laws. The OECD, in a 2017 report, found that 92 per cent of the SOEs surveyed were incorporated and the other eight per cent were statutory corporations governed by law.^{ix} Privatised SOEs are commonly listed on stock exchanges and will be governed by stock market regulations, and may also be subject to regulators, depending on the sector in which they operate.

This evolving model of state capitalism brings a requirement for the state to ensure that the power entrusted in it by the public is expressed responsibly in its market interventions, and that it requires (and monitors) responsible behaviour of its SOEs, other entities and investments through which it intervenes in markets.

SOVEREIGN WEALTH FUNDS FACE CORRUPTION RISKS LIKE SOEs

A sovereign wealth fund is a state-owned investment fund created from surplus government funds. Sovereign wealth funds have national economic and social policy objectives and achieve these through the definition of their investment strategies and the creation of institutional frameworks to implement these policies. As with SOEs, they are an instrument of state capitalism, intervening and participating in markets. They are growing in significance in global markets and the present total of 40 funds manage some US\$7.6 trillion.^x Norway's Government Pension Fund – Global, managed by Norges Bank, the Central Bank of Norway, is the world's largest such fund and manages approximately US\$1 trillion.^{xi} Sovereign wealth funds can be subject to poor governance and lack transparency, and can suffer from corruption. For example, in 2017, the US Department of Justice alleged that more than US\$4.5 billion in funds belonging to the Malaysian sovereign wealth fund, 1Malaysia Development Berhad (1MDB), had been misappropriated by high-level officials of 1MDB, and their relatives and associates.^{xii}

GLOBAL PENSION FUND GENERAL, NORWAY: EXPECTATIONS ON ANTI-CORRUPTION STANDARDS IN ITS INVESTEE COMPANIES

"Working against corruption is an important part of the board's responsibility. We expect boards to ensure that the company sets a clear policy on anti-corruption and that relevant measures are integrated into business strategy, risk management and reporting. We expect all companies we are invested in to have effective anti-corruption measures in place."

Yngve Slyngstad, CEO of Norges Bank Investment Management, 13 February 2018^{xiii}

Figure 2: Why states use SOEs^{xiv}



THE GLOBAL AND LOCAL IMPORTANCE OF SOEs

The presence of SOEs is vast: globally, nationally and locally. Large global SOEs grab the headlines but smaller SOEs, mostly in the utilities sectors, represent the bulk of the world's SOEs and, like small and medium-sized enterprises, may lack the skills and resources needed to counter corruption.

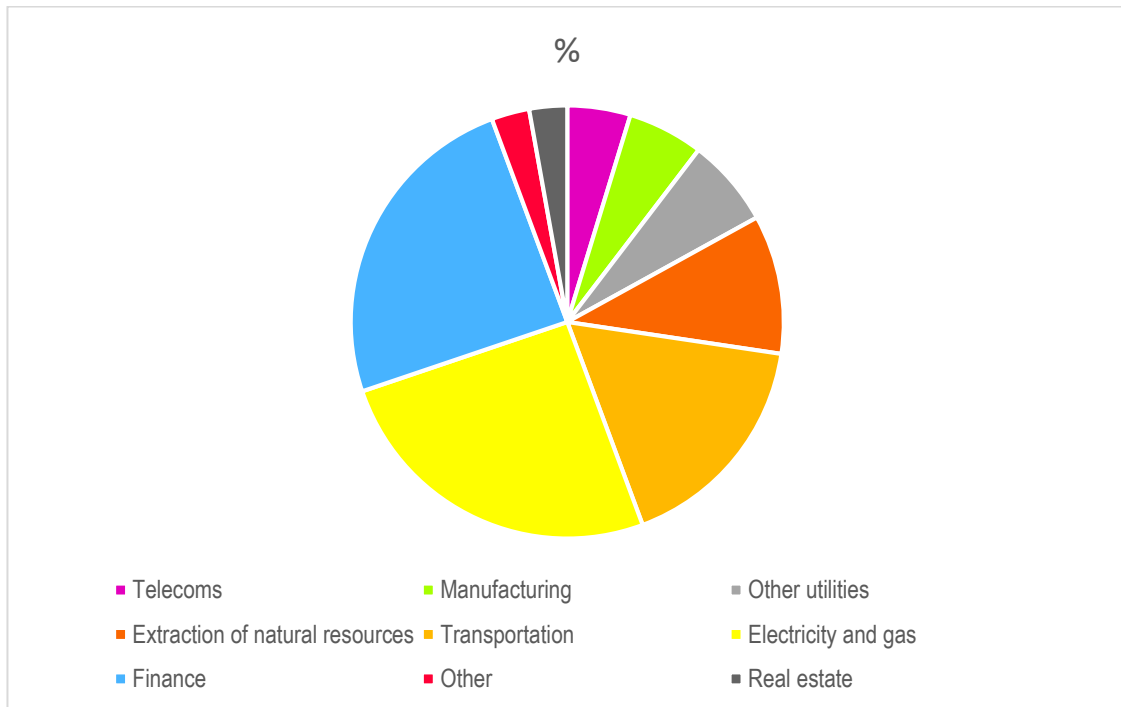
Local SOEs form the majority of the world's SOEs: for instance, in 2015 Germany had 16,206 SOEs, of which only 2.3 per cent were owned by the federal government.^{xv}

SOEs figure strongly in some countries' economies: SOE sectors in even relatively advanced emerging economies often account for 20–30 per cent of economic activity, and in resource-dependent and/or small developing economies the share can be significantly higher.^{xvi} The Russian state's share in GDP through SOEs rose from 35 per cent in 2005 to 70 per cent in 2015.^{xvii}

Incorporated SOEs are the norm and over half are listed: An OECD survey of 40 countries found that fully incorporated entities (i.e., those incorporated according to company law) are the predominant corporate form, representing 92 per cent of all SOEs by value and 84 per cent by employment. Among those fully incorporated entities, about half by value are listed on national stock exchanges and accounted for 45 per cent of all SOEs by value and 25 per cent of all SOEs by employment.^{xviii}

SOEs are concentrated in a few sectors: The OECD survey of 40 countries also showed that, excluding China, telecoms, electricity and gas, transportation and other utilities (including postal services) accounted for 51 per cent of all SOEs by value and 70 per cent by employment. The financial sector accounted for 26 per cent of all SOEs by value, making it the largest individual sector by this measure.

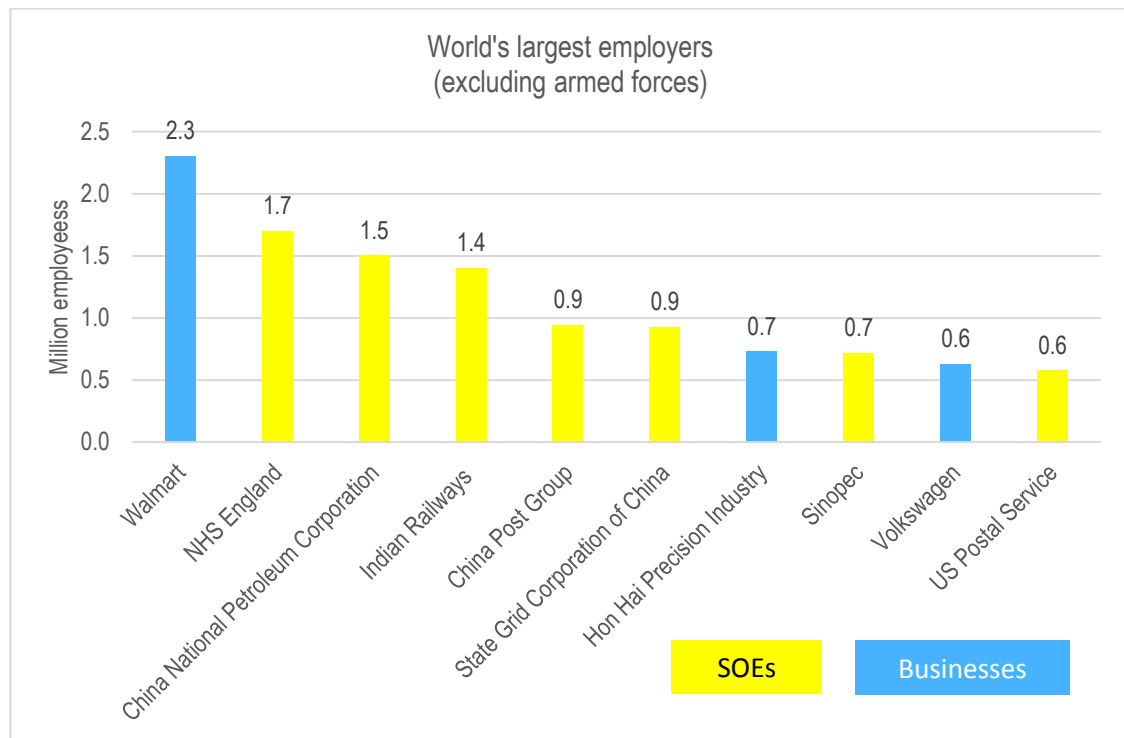
Figure 3: Sectoral distribution of SOEs by equity value (sample area excluding China) (end-2015)



Source: OECD, *The Size and Sectoral Disposition of State-Owned Enterprises* (Paris: OECD Publishing, 2016)

SOEs are global powerhouses: SOEs contribute approximately 10 per cent of the world's GDP.^{xix} Of the world's largest 100 companies, 22 are effectively under state control.^{xx} 20 per cent of the 2017 Fortune Global 500 are SOEs, by number and SOEs provide seven of the world's 10 largest employers (excluding armed forces).

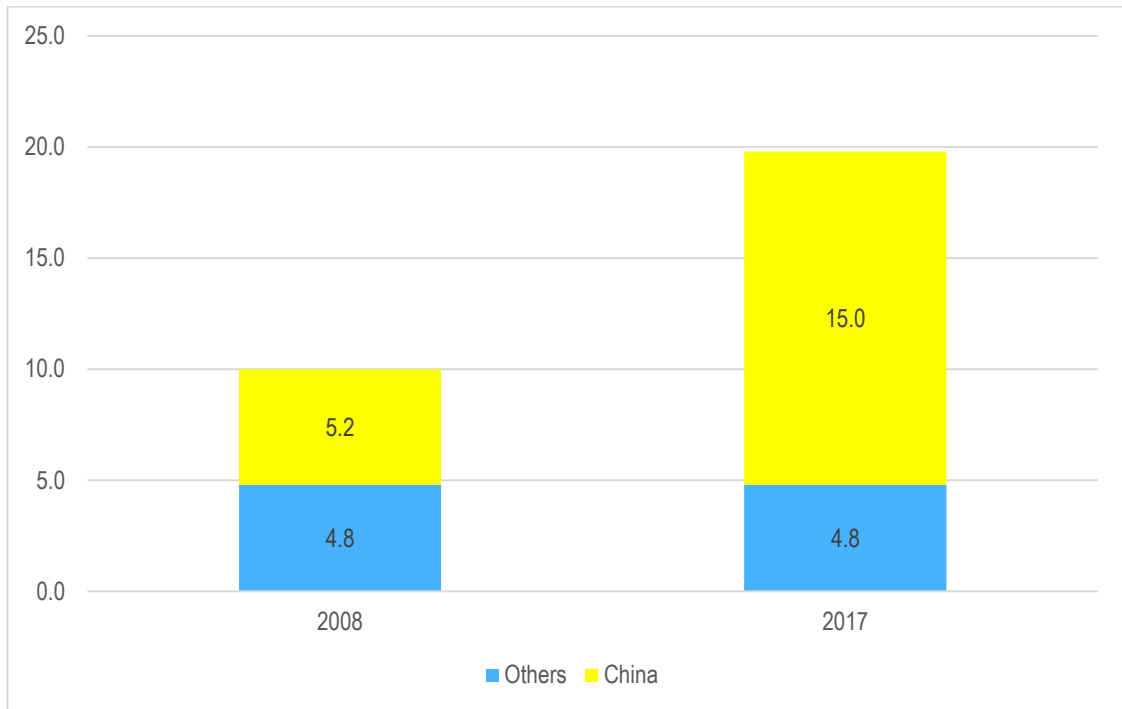
Figure 4: Seven of the world's 10 largest employers are SOEs



Source: Author

Chinese SOEs stand apart: Chinese SOEs dominate SOE statistics and this should be considered when making general statements about the growth of SOEs. The central government owns 51,000 SOEs, valued at US\$29.2 trillion and employing approximately 20.2 million people.^{xxi} The communist system, the size of the economy, its continuing growth and the government's support for its SOEs ensure that China has an ever-growing global SOE presence. Figure 5 shows that growth in the presence of SOEs in the Fortune Global 500 is due to Chinese SOEs. The non-Chinese SOE proportion has remained constant since 2008 but the Chinese SOE numbers have tripled, despite continuing Chinese reforms.

Figure 5: The rise of China's SOEs in the Fortune Global 500: a comparison of 2008 and 2017



Source: Author's analysis of Fortune Global 500 listings.

WHERE CORRUPTION RISKS LIE

SOEs face similar corruption risks to businesses but they are particularly vulnerable to corruption because of their closeness to politicians and public officials, and the scale of the resources, contracts awarded and operations they control. Smaller SOEs form the bulk of the world's SOEs, and the corruption risks for them should not be overlooked.

SOEs need to identify and understand the characteristic forms of corruption, the risk factors which can heighten the corruption risks (such as countries and sectors of operation) and the transactions which are vulnerable. They should prioritise and mitigate the risks through anti-corruption controls. The move to privatisation and mixed ownership of SOEs can diminish the opportunities for corruption engendered by politicians and officials, but this is no guarantee – as shown by the unparalleled Petrobras and Telia scandals discussed in the case studies on page 27. The growing presence of SOEs in global markets brings them greater exposure to corruption and may also introduce corruption risks to foreign markets in which they operate.

VULNERABLE FUNCTIONS, VULNERABLE TRANSACTIONS

Corruption can show itself in a wide range of SOEs' activities. Some of the main risk areas for SOE operational functions and transactions are listed below.

- **Purchasing and contracting:** High corruption risk areas, these are discussed in the next section.
- **Sales, marketing and business development:** SOEs that provide commercial services and products may be exposed to management and use of corruption to enter or expand markets, win contracts, gain critical licences, rights or concessions, or provide preferential allocation of products in short supply. Politicians can influence SOE contracts and selling prices to corruptly favour a related party. Positions may be given to relatives of customers as bribes to win contracts.
- **Research and development:** Corruption can distort research and development, resulting in inferior projects and services that are unaligned to market needs and are more costly than need be.
- **Third-party management:** Poor systems for appointment and management of third parties can allow corrupt third parties to be introduced to the SOE with sham transactions and channelling of bribes.
- **Supply chain:** Bribes may be used to obtain critical licences, approvals and concessions. SOE employees may routinely give small bribes to speed goods through ports and customs, or to gain inspection certification.
- **Asset sales and purchases:** Mergers and acquisitions may be made at inflated prices and assets sold at less than market value. SOE managers may embezzle state assets through management buy-outs of enterprise shares, with transactions hidden from public view.
- **Routine public services:** SOEs' employees may demand small bribes systemically to expedite or favour the installation or delivery of public services.

- **Human resources:** Bribery, patronage, cronyism, nepotism and other favouritism can be used to influence appointments within SOEs. Union officials may be bribed to influence labour negotiations.
- **Intellectual property and data:** Corruption may be used to obtain access to an SOE's intellectual capital and confidential information. The threat from organised crime in this area is growing.
- **Corporate affairs:** The function may become a channel for trading in influence, illegal political donations, undue lobbying and charitable donations, and sponsorships made as bribes.
- **Gifts, hospitality and expenses:** These can be a legitimate business activity but are often given or received corruptly to influence the outcome of transactions.
- **Finance:** The function is highly vulnerable to embezzlement of assets, manipulation of accounts, tax evasion, insider trading, corrupt asset transactions, money laundering and bribery of officials.
- **Facilities management:** Bribery may be used to purchase development land, planning permission, utilities installation and supply; there may be corrupt use of premises and assets.
- **Security, health and safety:** Security and safety systems can be weakened by corruption and risks from crime and terrorism can be heightened. Police may be bribed by the SOE in order to obtain security service for the SOE.

CONTRACTING AND PROCUREMENT: HIGH CORRUPTION RISKS FOR SOEs

Public contracting is a very high-risk area for SOEs in regard to corruption because of their vulnerability to political interference or corruption by employees in the contracting process. The consequences for the public of such corruption can be severe: raising costs, reducing the quality of projects and services, damaging public confidence and even leading to injury and death. To counter corruption, all steps in a contracting and procurement process need to be transparent so stakeholders can scrutinise the process and raise concerns where corruption is suspected.

"Construction firms in Eastern Europe believe that a typical payoff made for securing a government contract in their industry is around seven per cent of the contract value."^{xxii}

SOEs' contracting processes can be vulnerable to a range of corruption schemes, including: bribes, kickbacks, abuse of conflicts of interest, patronage, cronyism, trading in influence, bidding collusion by third parties, related-party trading, use of suppliers owned by public officials or their relatives, or giving illegal insider information. Corruption risks are heightened for SOEs where the employees are poorly paid in relation to their responsibilities.

The scale of corruption in international business involving SOEs is shown by a 2014 OECD survey of data on bribery of foreign public officials from the 427 foreign bribery cases that had been concluded since the entry into force of the OECD Anti-Bribery Convention in 1999.^{xxiii} The report identified that employees of SOEs or public enterprises were the largest category of foreign public officials who were bribed, receiving bribes in 27 per cent of cases, and that 81 per cent of the total bribes in the analysis were promised, offered or given to SOE officials.

"Of the total value of bribes in 427 bribery cases that were promised, offered or given, 81 per cent involved SOE officials."

Foreign Bribery Report, OECD, 2014

There are a range of measures that SOEs can use to counter corruption in public contracting. These include:

- transparency of contracting processes, including bidding, awarding and delivery
- e-procurement
- rigorous processes for selection and appointment of third parties, including due diligence

- public registers of approved third parties
- monitoring and progressing contracts and projects
- acting on 'red flags', such as rush orders or changes in contract specifications after a project has started
- whistleblowing lines for raising concerns about bids and contracts
- Integrity Pacts^{xxiv}

SOE USES INTEGRITY PACTS IN THAILAND

Since 2015, PTT, the Thai oil and gas SOE, has used Integrity Pacts for large projects. An Integrity Pact is a tool developed by Transparency International to prevent corruption in public contracting by ensuring that all activities between a particular government agency (project owner) and bidders are handled in a corruption-free manner, and that important project information is transparent.^{xxv} For example, in 2017 a pipeline project with a budget of US\$3.1 billion (96,500 million Baht) and a liquefied natural gas receiving terminal project with a budget of US\$1.3 billion (38,500 million Baht) were selected by the Thai government's anti-corruption cooperation committee to be managed as PTT Integrity Pacts. A signing ceremony for the memorandum of understanding for the pacts was attended by government and PTT officials and representatives of the bidders for the projects. Integrity Pacts protect the integrity of contracts by the use of independent monitors who ensure all parties uphold their commitments under the agreement, bringing transparency and oversight to all stakeholders in a contracting process. In this respect, the PPT memorandum was signed by nine observers, who were distinguished guests from the public and private sectors.

THE LESSONS OF THE PETROBRAS AND TELIA SCANDALS

Two of the largest ever bribery scandals involved SOEs: Petrobras and Telia. Both of these scandals offer lessons for anti-corruption practice for SOEs and state-owners.

PETROBRAS AND THE OPERATION CAR WASH SCANDAL

Context: Petrobras is a Brazilian SOE and the country's largest company. The state, by law, has a controlling interest in the SOE and the power to elect a majority of members of the board of directors. In 2014, before the scandal broke, Petrobras was viewed as an exemplary flagship global company, ranked 38 out of 541 multinationals in the Geneva-based Covalence Ethical Ranking in 2008. In parallel to the Petrobras bribery case, there was an associated scandal involving Odebrecht, a huge and globally important Brazilian engineering company, and its affiliate company, Braskem. From 2001 to 2016, Odebrecht and Braskem paid approximately US\$788 million in bribes, in association with 100 projects in 12 countries.^{xxvi} The companies hid the bribes through carefully disguised payments routed through a network of shell companies, as well as through suitcases of cash left at arranged locations.

The corruption schemes: Petrobras was at the centre of Operation Car Wash, one of the largest ever corruption scandals.^{xxvii} The Petrobras bribery was based on orchestrating three corruption schemes:

- **Bid-rigging:** There was a long-standing bid-rigging cartel for Petrobras contracts with engineering and construction companies, including Odebrecht. This would later be exploited by Petrobras executives to generate funds for illegal political funding.
- **Patronage:** In January 2018, a Brazilian Appeals court upheld the conviction in 2017 of former president Luiz Inácio Lula da Silva for bribery and money laundering and increased his sentence from 9 years and 6 months to 12 years and 1 month. The sentence may be subject to appeal by a higher court. He was convicted in July 2017 for bribery and money-laundering during his 2003–2010 presidency. Lula was found guilty of receiving a seaside duplex apartment worth about £540,000 (\$755,000) from a construction company called OAS. In exchange, prosecutors said, the company was able to obtain lucrative contracts from Petrobras, the state-controlled oil giant.^{xxviii xxix}
- **Illegal political funding:** The appointed executives needed to fulfil their obligations to politicians and political parties by providing illegal funds generated from Petrobras. The executives exploited the opportunity of kickbacks from the bid-rigging cartel to provide the funds, as well as keeping funds for themselves.

The consequences: The bribery scandals have had catastrophic results for Petrobras, Odebrecht and other construction companies, and for Brazil. Investigations by the Brazilian and US authorities are continuing at the time of writing into Petrobras' role in bribery schemes, but, as at February

2018, former executives have been imprisoned and its former CEO is being investigated. The company has settled numerous shareholder lawsuits and in January 2018 agreed to a US\$2.95 billion settlement to end a class-action lawsuit, thought to be the then largest such agreement for a foreign issuer in the US. In the agreement, Petrobras expressly denied liability, stating that the settlement reflected its status as a victim.^{xxx} The scandal has been cataclysmic for Odebrecht, including a slump in its market value, asset sales, the layoff of nearly 100,000 employees, the sentencing in March 2016 of Marcelo Odebrecht, its former CEO, to 19 years in prison, and an agreement in April 2017 to pay US\$3.5 billion to settle with the US, Brazilian and Swiss authorities.^{xxxi} This was, at the time of writing, the largest ever global foreign bribery resolution. The wider Car Wash scandal has led to substantial damage to the economic and political environment in Brazil, and the investigation and jailing of hundreds of executives and politicians, including the former president Lula, and also contributed to the fall of former president Dilma Rousseff in 2016.

TELIA USED BRIBERY TO ENTER THE UZBEKISTAN MARKET

Context: Telia, a Sweden-based telecommunications company, is part-owned by the Swedish and Finnish governments (37.3 and 3.2 per cent, respectively).

The bribery schemes: From 2007 to at least 2010, Telia routed bribes totalling at least US\$330 million to Gulnara Karimova, daughter of the then Uzbek President.^{xxxi} The bribes generated more than US\$ 2.5 billion for Telia. Karimova was also an Uzbek government official and exerted significant influence over other Uzbek officials in the governmental body that regulated the telecom industry. Telia used bribery schemes to enter the market and gain licences. The schemes involved corrupt third parties and sham consulting contracts, for which no services were delivered. The board and management of Telia were involved in the bribery schemes by approving and the payment of bribes to Karimova. Also, the leadership of Telia knew that, under Uzbek law, only the government could approve the grant of telecommunications licenses and therefore gaining approval through bribes to Karimova was a red flag for corruption.

The consequences: In September 2017, the US and Dutch authorities announced one of the largest ever criminal corporate bribery and corruption settlements. Telia and COSCOM, its Uzbekistan subsidiary, agreed in September 2017 to pay a combined total penalty of US\$965 million in fines in separate settlements with the US and Netherlands authorities. In 2017, the Swedish authorities brought criminal charges against three former executives of Telia, including the former CEO, related to the bribery in Uzbekistan.

THE MANY LESSONS FOR SOEs AND STATE-OWNERS FROM THE PETROBRAS AND TELIA SCANDALS

- **High SOE vulnerability:** The cases show the high vulnerability to corruption of SOEs, the significant sums and assets that can be involved, and the severity of consequences.
- **Leadership oversight was lacking and executives were complicit:** Board oversight was inadequate – the Telia bribes were specifically approved by the highest level of Telia, including senior executives and the board of directors, and Petrobras' senior managers were active in the corruption schemes.

- **Independent directors need to be a check on the company:** There was no evidence reported of independent directors questioning the activities of the leaderships of the companies in relation to countering corruption. The right of the Brazilian state to appoint directors may have opened the way to the patronage that led to the Petrobras corruption.
- **Third parties should be appointed through a rigorous process:** Petrobras dealt with corrupt engineering and construction companies. Telia and Odebrecht used sham third parties or shell companies.
- **Growth of extra-territorial cooperation by authorities:** The Telia case illustrates the leading role by US authorities in prosecuting global bribery and the growth in extra-territorial application of anti-bribery laws. There was extensive international cooperation between the US, Netherlands and Sweden, as well as five other authorities. Similarly, authorities from multiple jurisdictions have been involved in the Petrobras and Odebrecht cases.
- **State-owners must set standards and carry out monitoring:** The Swedish state was passive regarding the entry of Telia into high-risk markets and did not provide a framework for SOEs' anti-corruption measures, including monitoring and reporting on them. The Brazilian state, through its Committee on Public Ethics, ostensibly audited Petrobras but it failed to detect corruption in Petrobras' board appointments and its contracting.
- **SOEs must be prepared for privatisation:** When it was privatised, Telia was not up to the demands of changing its corporate integrity culture.
- **Boards must ensure SOEs have anti-corruption skills:** Telia had no previous experience of high-risk corruption countries and lacked risk management and requisite management skills.
- **Red flags must be identified and acted on:** Key red flags were ignored by Telia, including the use of sham third parties for services never received, the fact that Karimova was the president's daughter, the fact that payments were made to her through a Gibraltar-based company, and the fact that licences could only be granted only by the government.
- **Corruption breeds corruption:** The Petrobras corruption schemes showed how existing corruption (the bid-rigging cartel) can feed greater corruption.
- **Stakeholders need to be demanding in their assessment of companies' anti-corruption standards:** There was over-confidence in markets about the integrity of Petrobras and Telia.
- **Spin can hide corruption:** Before the exposure of corruption, both Petrobras and Telia professed to have high standards of ethics and anti-corruption programmes.
- **After-the-event improvement is too late:** It is common for companies that have suffered a corruption scandal to then introduce best practice anti-corruption programmes, as Petrobras and Telia have done. Boards should challenge the quality of anti-corruption programmes, remove complacency and ensure that the programmes are tested by public transparency and exposure to independent review.

RECOMMENDATIONS FOR ACTION

To SOEs:

- understand the high level of responsibility of SOEs to counter corruption and promote integrity
- implement the provisions set out in the 10 Anti-corruption Principles for SOEs
- follow the transparency and public reporting provisions of the SOE Principles, including public disclosure of beneficial ownership, organisational structures and key financial information on a country-by-country basis
- report publicly on the design and implementation of SOEs' anti-corruption programmes
- apply best practice governance, as set out in the SOE Principles and OECD guidance^{xxxiii}
- require contractually that third parties with whom SOEs deal have equivalent anti-corruption standards
- know the business case for anti-corruption

To governments, regulators and authorities:

- encourage, or require, SOEs to apply the SOE Principles
- provide supporting legislation and frameworks for SOEs to counter corruption
- be transparent on how the state directs and works with SOEs
- use high SOE anti-corruption standards as a way of reducing the risk of corruption in business
- assess and report publicly on SOEs and their implementation of anti-corruption programmes
- provide the public with channels for raising concerns regarding SOEs, including ombudsmen
- when carrying out anti-corruption investigations, use the SOE Principles as a reference when assessing the adequacy of SOEs' anti-corruption programmes

To the business sector:

- as part of third-party due diligence, when appointing or investing in SOEs check that they have anti-corruption programmes that match the provisions of the SOE Principles
- require, contractually, that an SOE a company deals with or invests in has anti-corruption standards equivalent to those set out in the SOE Principles

To professional firms:

- use the SOE Principles as a reference for the firms' own work, and for providing SOEs with anti-corruption guidance, consultancy, tools, auditing and other professional services

To institutional and private investors and lenders, and international financial institutions:

- use the SOE Principles as a due diligence benchmark when deciding on investing in or financing an SOE

To civil society:

- advocate for the use of the SOE Principles to governments, state ownership entities, regulators, SOEs, and businesses and investors that deal with SOEs
- assess and report on the transparency, public reporting and activities of SOEs against the framework of the SOE Principles and call for improvement where practice falls short

To the public:

- understand your rights to access, fairness of treatment, quality service, goods and information from SOEs
- raise questions and challenge SOEs when you feel they are lacking
- raise issues with the proper authorities or an ombudsman when corruption is suspected or use whistleblower hotlines where available

RESOURCES

Transparency International

10 Anti-Corruption Principles for State-Owned Enterprises (Berlin: Transparency International, 2017)

www.transparency.org/view/publication/8077

Business Principles for Countering Bribery, third edition (Berlin: Transparency International, 2013)

www.transparency.org/whatwedo/tools/business_principles_for_countering_bribery

Wilkinson P., **Commentary on the Business Principles for Countering Bribery** (Berlin: Transparency International, 2015)

www.transparency.org/files/content/publication/2015_BusinessPrinciplesCommentary_EN.pdf

Kühn S. and Sherman L. B., **Curbing Corruption in Public Procurement: a practical guide** (Berlin: Transparency International, 2014)

www.transparency.org/whatwedo/publication/curbing_corruption_in_public_procurement_a_practical_guide

Daka A. et al., **Integrity Pacts: a How-to Guide from Practitioners** (Berlin: Transparency International, 2016)

www.transparency.org/whatwedo/publication/integrity_pacts_a_how_to_guide_from_practitioners

Wilkinson P., **Global Anti-Bribery Guidance Portal** (London, Transparency International UK)

www.antibriberyguidance.org/

OECD

OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition (Paris: OECD, 2015)

www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm

Boards of Directors of State-Owned Enterprises: an overview of national practices (Paris: OECD, 2013).

www.oecd-ilibrary.org/governance/board-of-directors-of-state-owned-enterprises_9789264200425-en

OECD Guidelines for Multinational Enterprises (Paris: OECD, 2011)

<http://mneguidelines.oecd.org/>

G20/OECD Principles of Corporate Governance (Paris: OECD Publishing 2015)

www.oecd.org/daf/ca/principles-corporate-governance.htm

OECD Foreign Bribery Report, an analysis of the crime of bribery of foreign public officials (Paris: OECD Publishing 2014)

<http://dx.doi.org/10.1787/9789264226616-en>

Recommendation on Public Integrity (Paris: OECD Publishing, 2017)

<https://legalinstruments.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=353&InstrumentPID=476&Lang=en&Book=False>

The Size and Sectoral Distribution of State - Owned Enterprises (Paris: OECD Publishing, 2017)

www.oecd.org/publications/the-size-and-sectoral-distribution-of-state-owned-enterprises-9789264280663-en.htm

Risk Management by State-Owned Enterprises and their Ownership (Paris: OECD Publishing, 2016)

www.oecd.org/publications/risk-management-by-state-owned-enterprises-and-their-ownership-9789264262249-en.htm

World Bank

Corporate Governance of State-Owned Enterprises: a Toolkit (Washington DC: World Bank Group, 2014)

<http://documents.worldbank.org/curated/en/228331468169750340/Corporate-governance-of-state-owned-enterprises-a-toolkit>

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- ⁱ www.transparency.org/whatwedo/tools/business_principles_for_countersing_bribery/1/
- ⁱⁱ *Transparency in corporate reporting: assessing emerging markets multi-nationals* (Berlin, Transparency International, 2016).
- ⁱⁱⁱ (Note: the term 'businesses' is used in this paper to distinguish SOEs from companies with no state ownership, control or significant state investment in them).
- ^{iv} Transparency International media release for the SOE Principles, 28 November 2017.
- ^v The Sustainability Development Goals were adopted by all 193 UN Member States at the United Nations Sustainable Development Summit on 25 September 2015. These include an anti-corruption target (Target 16.5).
- ^{vi} OECD, *Risk Management by State-Owned Enterprises and their Ownership* (Paris: OECD Publishing, 2016).
- ^{vii} Note: Transparency International takes "billion" to refer to one thousand million (1,000,000,000).
- ^{viii} www.investidorpetrobras.com.br/en/press-releases/petrobras-signs-agreement-principle-settle-class-action-us
- ^{ix} OECD, *The Size and Sectoral Distribution of State - Owned Enterprises* (Paris: OECD Publishing, 2017).
- ^x *Sovereign Wealth Funds Rankings* (SWFI, accessed at 19 February 2018).
- ^{xi} SWFI *ibid*, accessed at 19 February 2018.
- ^{xii} www.justice.gov/opa/pr/us-seeks-recover-approximately-540-million-obtained-corruption-involving-malaysian-sovereign
- ^{xiii} www.norges-bank.no/en/Published/News-archive/2018/18-13-02-forventninger-om-anti-korrupsjon
- ^{xiv} Icons: Flag, parthenon and tank by Abdo; money by Marie Van den Broeck; oil platform by BomSymbols; tap by Davo Sime from the Noun Project.
- ^{xv} The German Federal Statistics Office maintains a database of SOEs from all three levels of government (federal, state and municipal).
- www.destatis.de/DE/ZahlenFakten/GesellschaftStaat/OeffentlicheFinanzenSteuern/OeffentlicheFinanzen/FondsEinrichtungenUnternehmen/Tabellen/Jahresabschluesse_Eigner.html
- ^{xvi} OECD, *State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity?* (Paris: OECD Publishing, 2016).
- ^{xvii} The Federal Antimonopoly Service of the Russian Federation, October 2016.
- <https://themoscowtimes.com/articles/russian-state-doubles-economy-presence-over-past-decade-55529>
- ^{xviii} OECD, *The Size and Sectoral Disposition of State-Owned Enterprises* (Paris: OECD Publishing, 2017). The OECD defines listed SOEs as enterprises whose shares are traded on a stock exchange and in which the state holds at least 50 per cent of equity capital, or otherwise exercises an equivalent degree of control.
- www.oecd-ilibrary.org/governance/the-size-and-sectoral-distribution-of-state-owned-enterprises_9789264280663-en
- ^{xix} Peng, Bruton, Stan and Huang, "Theories of the (state-owned) firm", *Asia Pacific Journal of Management*, June 2016.
- ^{xx} OECD *ibid*.
- ^{xxi} OECD, *The Size and Sectoral Disposition of State-Owned Enterprises* (Paris: OECD Publishing, 2016).
- ^{xxii} Kenny C., *Publishing Construction Contracts and Outcome Details*, (Washington DC, The World Bank, 2010).
- <https://core.ac.uk/download/pdf/6250200.pdf>
- ^{xxiii} OECD, *OECD Foreign Bribery Report: An analysis of the crime of bribery of Foreign Public Officials* (Paris, OECD Publishing, 2014).
- ^{xxiv} The Integrity Pact is a tool developed by Transparency International that can be of particular value for preventing corruption in large, high-risk projects. The tool requires use of an independent monitor for projects – a role commonly carried out by a civil society organisation.
- ^{xxv} Daka A. et al., *Integrity Pacts: a How-to Guide from Practitioners* (Berlin: Transparency International, 2016).
- www.transparency.org/whatwedo/publication/integrity_pacts_a_how_to_guide_from_practitioners
- ^{xxvi} www.justice.gov/opa/press-release/file/919911/download
- ^{xxvii} The title Operation Car Wash refers to how the bribery scandal was revealed in 2014, by an investigation into money laundering through car washes and petrol stations that led to a Petrobras executive and then to the revelation of vast bribery schemes and illegal political funding, not only by Petrobras but by leading Brazilian and foreign companies.
- ^{xxviii} www.theguardian.com/world/2018/jan/24/brazilian-court-upholds-corruption-conviction-for-ex-president-lula
- ^{xxix} www.nytimes.com/2017/07/12/world/americas/brazil-lula-da-silva-corruption.html
- ^{xxx} www.investidorpetrobras.com.br/en/press-releases/petrobras-signs-agreement-principle-settle-class-action-us
- ^{xxxi} www.justice.gov/opa/pr/odebrecht-and-braskem-plead-guilty-and-agree-pay-least-35-billion-global-penalties-resolve
- ^{xxxii} US Securities and Exchange Commission, Release No. 81669 / September 21, 2017.
- www.sec.gov/litigation/admin/2017/34-81669.pdf
- ^{xxxiii} OECD *Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 Edition (Paris: OECD, 2015).
- www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm

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