



Business Case for Collective Action Against Corruption



Why **Collective Action** against corruption?



Corruption is a crucial problem for all – companies, governments, and citizens alike. Over the past decade, the amount of attention devoted to corruption has grown exponentially. Yet, while we increasingly talk about the problem and recognize that it must be dealt with – the need for effective anti-corruption tools remains pressing.

One of such tools is Collective Action. The idea is simple – get companies working together with their competitors and other stakeholders to create markets where decisions are driven by economic considerations and not by corrupt transactions. Implementing this idea, however, is more difficult. How do we convince companies that it is in their interest to work with their competitors to eliminate bribery? How do we convince them that it makes economic sense to invest their individual resources to reduce bribery? What are the key components of Collective Action against corruption? What is the business case for it? Where should companies begin?

These are all interesting questions that we'll attempt to answer. But before we get into Collective Action, it is useful to take a closer look at the different faces of corruption and how it affects the private sector. Similarly, we must look at the private sector not as a monolith – but as a complex web of companies with different priorities, resources, and perspectives. Doing so will help us set the ground work for understanding what Collective Action is all about.

Different Views of Corruption



Short definition:

Corruption is the misuse of entrusted power for personal or private gain



Different types of private sector corruption:

Bribery	Kickbacks
Extortion	Political financing
State capture	

We can broadly define corruption as the misuse of entrusted power for personal or private gain.

However, we must dig deeper beyond the traditional definition to see that corruption is much more than bribery. In reality, corruption has many different faces, **and recognizing which is which** is absolutely crucial to effective anti-corruption programs.

From the private sector perspective, corruption can be separated into several distinct areas – such as bribery, extortion, state capture, political financing, and others.

Particularly important is the difference between bribery and extortion. While in the case of bribery the private sector may be seen as a facilitator of a corrupt transaction, in the case of extortion, companies may actually fall victim to public officials with discretionary authority.

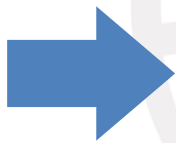
Also interesting is the state capture concept. The idea behind it is that companies may utilize the weak rule of law institutions to stifle competition and obtain favorable market positions. Such processes are often difficult to observe and capture, especially in developing countries where transparency is lacking.

There are other examples. But, simply put, we must not think of corruption as a monolith - a company may be in a different position depending on what type of corruption it is exposed to.

Business Costs of Corruption

Corruption may appear to be necessary, but actually it ...

- Carries costly fines and penalties for **Companies**
- Results in costly fines , penalties and jail terms for **Individuals**
- Results in loss of **Business Reputation**
- Disrupts **Business Operations**



Costs of corruption for industries, economies and countries

The traditional view of corruption suggests that it is good for business – some have said, for example, that it is necessary to “grease the wheels of commerce.” But is this really the case?

What we’ve seen around the world is that while corruption may benefit individual companies in short-term – for example in gaining ground on competition in individual transactions – over time it becomes a real barrier to development and business growth. It becomes a barrier to development on the company level, on the industry level, on the national economy level, and on the global level as well.

In other words – from the private sector perspective, corruption is about costs.

Corruption is about personal costs – it can ruin careers and reputation and result in criminal, civil, or employment sanctions.

Corruption is about company level costs – it increases costs of doing business, it undermines innovation, and it diverts investment elsewhere. For example, the world bank estimates that costs of corruption have surpassed \$1 trillion. The recent survey by Ernst and Young also highlights the costs that corruption has for companies in terms of lost market opportunities or fines and penalties.

Corruption is about economic and social costs – it undermines the rule of law and keeps foreign investors at bay – preventing job creation and limiting sustainable development. Think about it this way - Transparency International estimates that former Indonesian leader Suharto embezzled anywhere between 15-35 billion US dollars from his country, while Ferdinand Marcos in the Philippines, Mobutu in Zaire and Abacha in Nigeria may have embezzled up to 5 billion US dollars each. These are the money that could have gone towards developing a sound economic base – providing a better life for whole sectors of society by creating jobs and generating wealth .

Different Views of the Private Sector



Different companies
have
Different resources & interests

Business – just like corruption – is not a monolith. It has many different faces. It is important to recognize the different forms of the private sector – because different companies wield different power in an economy and therefore are affected differently by corruption. For example, while a handful of powerful business elites and cronies may monopolize access to government, smaller firms and informal entrepreneurs will have very different interests.

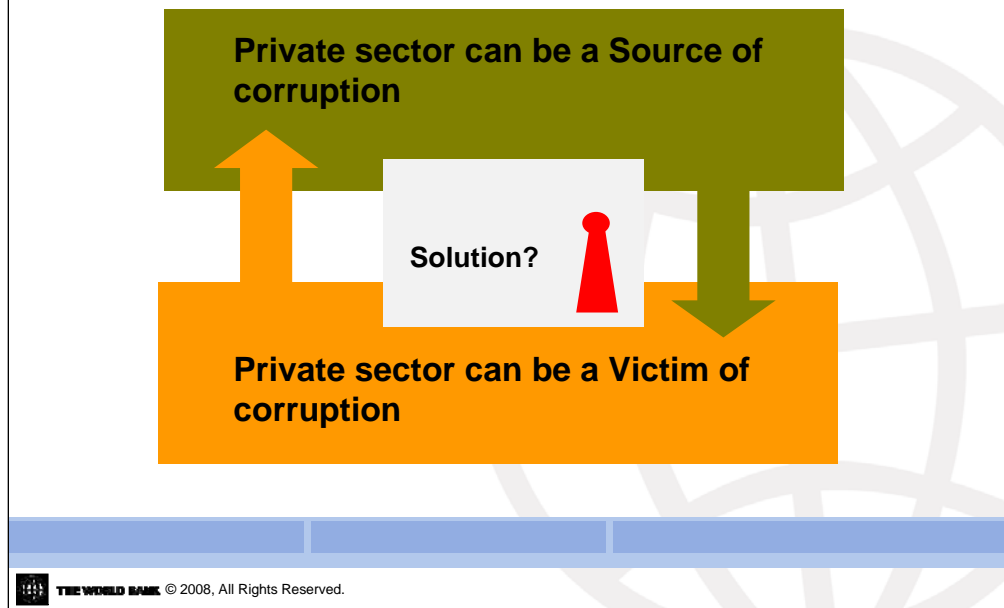
Generally, it is useful to subdivide companies into the following sectors:

- National/multinationals companies
- Small and medium sized enterprises
- State owned enterprises
- Informal sector firms
- Leading edge firms

There are, of course, others – but these categories capture more broadly the different faces of business. Consider, for example, leading edge firms – those seeking to attract investment and to develop new technologies - on the one hand and informal sector firms on the other. They operate in different markets, interact with different government agencies and while they may suffer from the overall problem of corruption – they will approach it differently. It may be more difficult for an informal sector company to stand up to corruption, while a larger firm may be more concerned with putting in place internal governance tools to detect and prevent bribery.

The bottom line – different companies have different resources and interests and the private sector should not be thought of as a monolith but rather a number of different firms.

Corruption Dilemma



As we already established, we have a variety of different companies and many different forms of corruption. So here we get to the corruption dilemma!

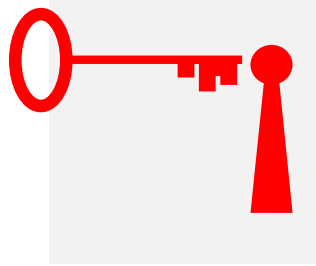
In some cases, as commonly recognized, the private sector can be a source of corruption. One example is companies providing bribes to get a favorable transaction approved or trying to win tenders over competitors.

In other cases, however, the private sector can be a victim of corruption. Increasingly, the negative impact of corruption which business faces in its normal operations is becoming recognized, although the understanding is still not as widespread as with companies being a source of corruption. For example, we are seeing in many developing countries that the costs of corruption for SMEs and broader economic development are becoming a key electoral issue. How do we reconcile these two views – that the private sector can be both a victim and a source of corruption? We can look at corruption from yet another angle and declare that the private sector can be in a fact a solution to the corruption problem. How is this possible?

Well, the private sector can do many things. Some solutions can come in the form of mobilizing the business community for reform. Some can come in the form of saying “No” to corruption. Companies also can seek to reform their internal institutions – this is where corporate governance comes into play. Lets look at how the private sector can be a solution to corruption in more detail.

Private Sector Solutions

Two types of anti-corruption efforts from the private sector perspective:



Setting up internal mechanisms to prevent corruption

Reforming internal operating environment to reduce corruption opportunities

Generally, private sector solutions to corruption can be divided into two different categories. On the one hand, companies may seek to reform internally, to reduce opportunities for corruption. This is where good corporate governance comes in as an effective anti-corruption tool. Not only good governance within companies makes bribes harder to give, it also makes them hard to conceal. And good governance can be effective in reducing corruption at all levels – both on the board level and on the staff level as well. It does so by making sure that anti-corruption policies are not just statements and that they are actually implemented. Cleaning up internal company climate is important for another reasons as well – companies themselves must be transparent before they try to convince the government and the public broadly to stand up to corruption. A useful tool developed by Transparency International that can help companies put in place effective internal anti-corruption policies are the Business Principles for Countering Bribery.

On the other hand, companies may engage in efforts to reform the environment within which they operate. This relates to broader issues of institutional and business climate reform. This also includes efforts to mobilize the business community and working with your competitors. Why would companies seek to do this? Because simply put, more effective markets with transactions within a rule of law system present more opportunities for business growth and development. In other words, companies not only take advantage of markets – they also want to create new market opportunities. Consider public procurement projects in corruption prone countries. Although companies may seek to make each individual transaction transparent – they may also engage in a broader effort to streamline procurement laws and create a climate where decisions are less susceptible to discretion and corruption.

Sources of Corruption



Lack of transparency and accountability in the public sector

Lack of transparency and accountability in the private sector

Poor regulation of political contributions

Low public sector wages

Weak enforcement of laws and regulations

Lack of free and independent media

Excessive discretionary authority of public officials

What these different private sector approaches to combating corruption mean is that there are different sources of corruption. In other words – since corruption is so complex and is caused by a variety of factors, no one approach alone will be successful in reducing it.

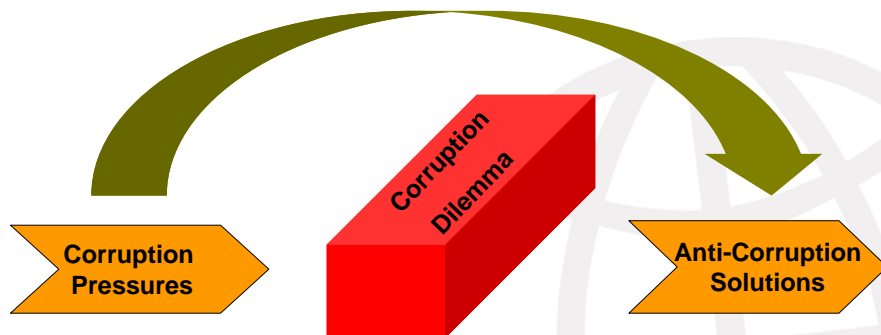
So, what are these sources of corruption?

The reality of doing business in developing countries is that opportunities for corruption often arise when companies explore ways to avoid inefficiency. In other words, corruption thrives in systems plagued by inadequate, unclear, excessive, unpublicized, and frequently changing laws and regulations. Similarly, such systems create incentives for companies to exploit inefficiencies, driving corruption as well.

In addition to weak legal and regulatory systems, sources of corruption include:

- Lack of transparency and accountability in the public sector
- Lack of transparency and accountability in the private sector
- Poor regulation of political contributions
- Low public sector wages
- Weak enforcement of laws and regulations
- Lack of free and independent media
- Excessive discretionary authority of public officials

Dilemma of Private Sector



In a high risk environment:

- How does one ensure that partners and competitors are ethical?
- How does one change the culture of doing business?
- How does one get competitors and stakeholders on board?



But here is a key dilemma for companies seeking to combat corruption and build more competitive markets – how do you engage your competitors? How do you engage those who feel that they don't have the resources to stand up to corruption (such as SMEs) or those who benefit from individual corrupt transactions?

This is important because at the end of the day, as we established, to combat corruption you need to reform the environment within which companies operate and clean up individual transactions. You need to mobilize the business community.

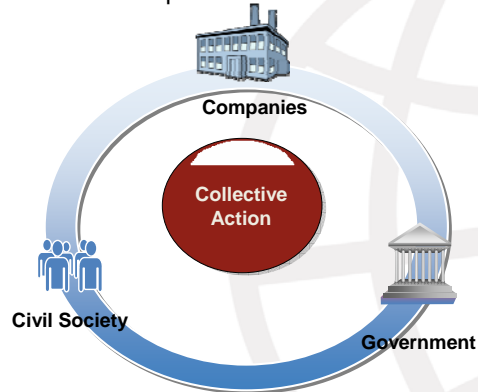
Imagine yourself as a company that decides to stand up to corruption. If you are just one fish swimming against the current – without broader business support, can you be successful in reducing corruption or will you fall a victim to it?

For multinationals operating in weak rule of law countries there is a similar dilemma. Often times they may be held to a much higher standard and it is difficult to compete on an equal footing with companies with weak governance or political protection and insider connections.

So how do you get the rest of the business community on board and ensure that your competitors as well are transparent and ethical?

Collective Action

Collective Action usually involves multiple stakeholders



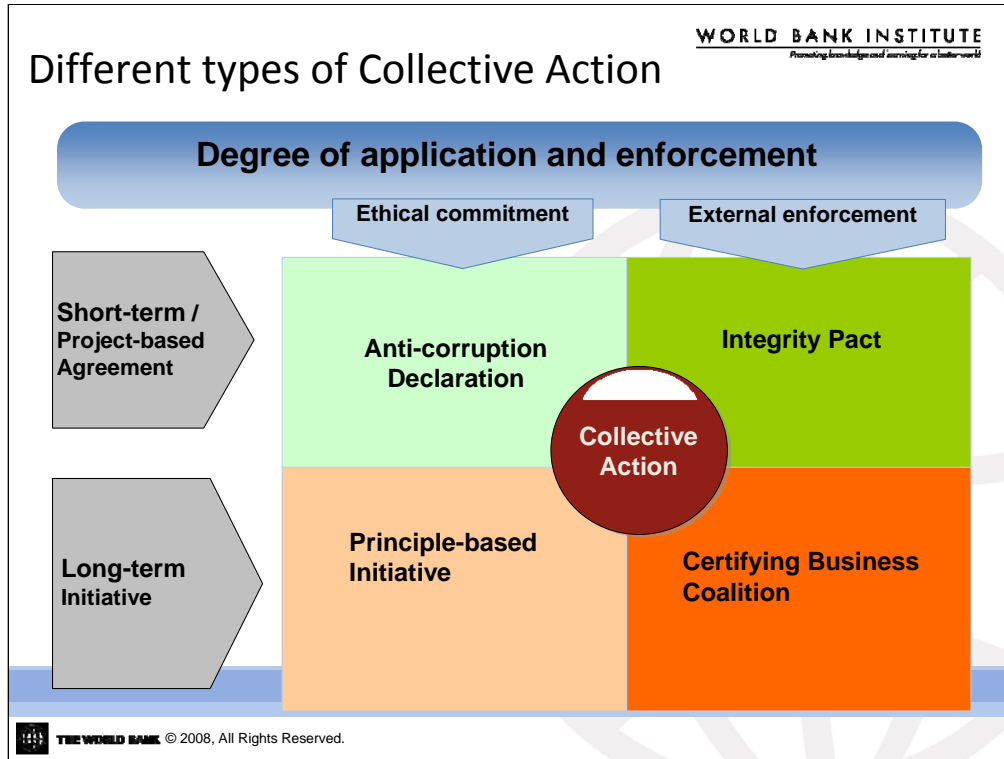
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What we are talking about is trying to figure out how to make collective action work.

The term collective action was popularized in politics, business, and economics by Mancur Olson, who began exploring a free-rider problem in business associations. Applied to the anti-corruption climate, a free rider concept means that at the end of the day each individual company will benefit from a more competitive, transparent climate, but few will be willing to individually invest their own resources or risk their own existence to achieve such a climate. A solution to solving this collective action problem is private incentives. If you can create incentives for companies to be more transparent, to be ethical, or to share resources (even in weak rule of law countries) you may begin to chip away at corruption.

But think about engaging the public sector as well as various civil society organizations in anti-corruption – as the field gets more complex and the number of stakeholders grows, it is so much more difficult to develop and implement effective anti-corruption programs. Yet, it doesn't mean its impossible.

So how do we create those incentives and, more importantly, what are the tools that help companies solve the collective action problem and come together in the quest to reduce corruption and build a more competitive, predictable, and transparent business climate?



There are different types of anti-corruption collective action programs – and while they all help achieve a common goal – lower levels of corruption – each works differently depending on the country environment, human and financial resources available, etc.

More broadly, there is a difference between project- and transaction-based agreements and long-term initiatives. The difference is very intuitive – some efforts may seek to ensure that individual transactions are free of corruption while more long-term initiatives seek to put in place institutions that will prevent overall corruption.

Within these two categories – short-term and long-term – we can also think about different types of programs. On the one hand, we have programs that are based on the ethical commitments of the participants; on the other we can also develop programs that have stricter enforcement mechanisms. Each of the types of programs will have its own set of benefits that have to be mapped across participants, country environments, etc.

Within this framework, we outline four different types of programs – it doesn't mean there aren't others – but these four capture the essence of what collective action against is all about. The four types of programs are:

- Integrity pacts
- Anti-corruption declarations
- Certifying business coalitions
- Principles-based initiatives

This website provides additional resources on how these different initiatives work.

Fighting corruption collectively with all stakeholders increases the impact of individual action

Key characteristic

Collective Action usually involves multiple stakeholders



"Collective Action":

- Is a collaborative and sustained process of cooperation between stakeholders.
- Increases the impact and credibility of individual action.
- Brings vulnerable individual players into an alliance of like-minded organizations.
- Levels the playing field among competitors.
- May complement, or temporarily substitute for and strengthen, weak local laws and anti-corruption practices.

BUT: Collective Action is not easy or quick, and requires patience, hard work, and expertise.

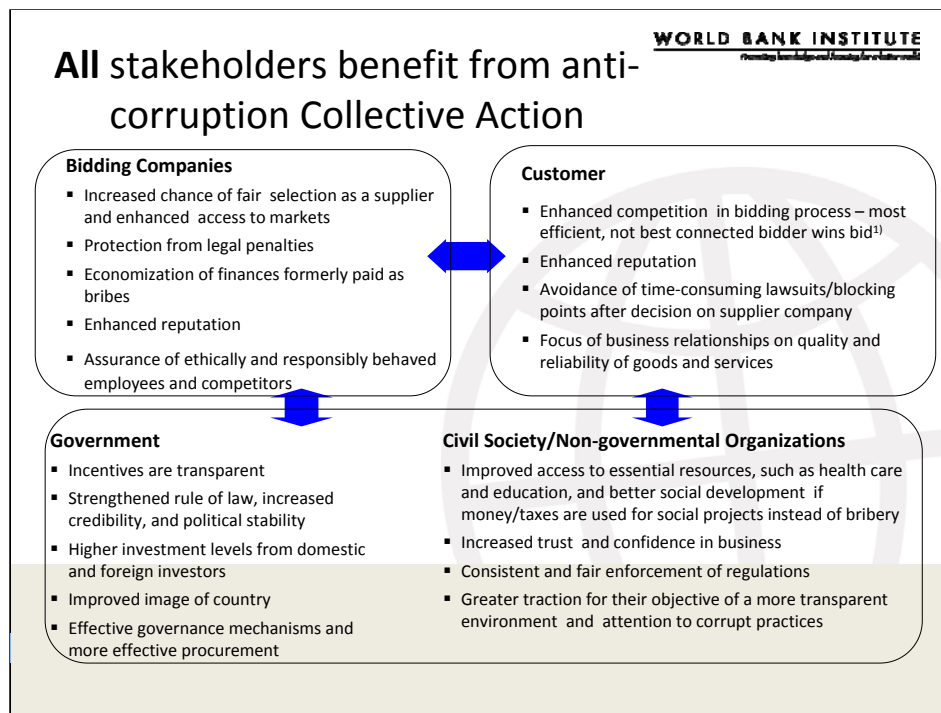
All along we've been talking about the business case for collective action – why does it make sense for companies to engage with other stakeholders to reduce corruption? Overall, it makes sense because, simply put, "companies can't do it alone!"

But engaging in collective action provides a host of private benefits (incentives) to companies. Think about it as return on investment. You invest time and resources and in return you not only reduce opportunities for corruption, you also:

- Increase the impact and credibility of individual action
- Level playing-field between competitors
- Improve the quality of legal and regulatory systems
- Develop new markets for products and services
- Introduce transparency and predictability in business transaction in emerging markets

The point on transparency and predictability is particularly important. Time and time again we see that while at certain points in time corruption may help resolve individual transactions, once it becomes institutionalized – companies suffer because it is impossible to predict how markets will work. In other words, in a corrupt environment it is impossible to predict how a legislation will be enforced, who will make decisions, and why certain decisions will be made. How can you plan your business activities and decide on resource allocation and investment in such an environment?

Most importantly, collective action increases an individual company's impact by making fair business practices more common and elevating individual action or vulnerable individual players such as SMEs into an alliance of like-minded organizations.



At the end of the day, with proper programs in place, everyone benefits.

Bidding companies on major projects have an increased chance of fair selection as a supplier and enhanced access to markets. They also save money formerly paid as bribes.

Customers benefit from enhanced competition in the bidding process and avoid time-consuming lawsuits. Instead they can focus on building business relationships and improving reliability of goods and services.

Civil Society and Non-governmental organizations gain improved access to essential needs, such as health care and education. They also benefit from consistent and fair enforcement of regulations.

Governments strengthen rule of law, increase their own credibility and can attract more investment from domestic and foreign investors.



This website provides a wealth of materials that help companies make collective action work. It's useful to keep a few things in mind.

The real benefit of collective action is the process by which the various initiatives come to fruition. This is why it is not enough to simply copy a law or a set of principles. When stakeholders come together, debate, discuss problems, and come up with solutions they do more than develop an anti-corruption program. They also:

- Come up with local solutions to their own problems.
- Create a sense of ownership. This is very important – if stakeholders participate in developing the initiative themselves, if they invest their own resources, they have additional incentives to commit to it and see that it actually works.
- Build trust – trust is particularly important in weak rule of law countries, where institutions to reinforce transactions and enforce contracts are weak or missing altogether.

Collective action is by no means THE solution to the corruption problem. But it is a very useful tool that has a successful track record. We hope that resources presented here will help you launch your own programs and will help reduce corruption and build more competitive markets in your country.