EXPERT GROUP MEETING ON

“Small Business Development and Corruption”

6-7 March 2006

DISCUSSION PAPER (DRAFT)
INTRODUCTION

Corruption within and between public and private sectors has become one of the leading problems for businesses all over the world and the recent inclusion of an anti-corruption principle in the U.N. Global Compact, endorsed by more than 2,000 members further emphasizes the ever-growing importance of the private sector in the global fight against corruption.

The private sector has come to realize the risks of corruption, which distorts fair competition and the rules of a free market economy, has a negative impact on the quality of products and services, weakens the prospects for economic investment and undermines business ethics. Bribe payments shift money away from potentially productive investments. Non-economic transaction costs keep the level of enterprise development low in relative terms.¹ Corruption is detrimental to business for all types of company – large and small, multinational and local. It is, however, the smaller firms that are more likely to be affected. According to the Business Environment and Enterprise Performance Survey (BEEPS), conducted jointly by the World Bank and the European Bank for Reconstruction and Development in transition countries, more than 70% of the SMEs perceive corruption as an impediment to their business (compared to approximately 60% in the sphere of large companies).²

Recent scandals have shown that in the long run business cannot prosper without appropriate and responsible corporate governance. Even if the corrupt deals remain undiscovered, short-term gains are made at the cost of long-term profitability. Over time, companies that spend their resources on financing corrupt deals rather than investing in the development, manufacturing and marketing of quality products and services will increasingly lose their competitiveness, thus becoming even more dependent on bribery as a means of maintaining their market share.³

In this respect, numerous initiatives by international organizations and advocacy groups have led to an array of international instruments addressing in particular the role of the private sector in corrupt practices, and have produced guidelines and manuals providing businesses with the necessary tools to ensure that employees comply with both, regulatory frameworks and principles of sound business practices.⁴ At the same time, several other initiatives have emanated from the corporate world itself.

However, the primary focus of these efforts lies on large enterprises and multinationals, which have been given most attention by governments, the civil society and the media. Little has been done in the sphere of SMEs, which make up for about 90% of all established businesses worldwide⁵. Due to the enormous structural

² BEEPS (2000); Question: How problematic is corruption in the business environment?
³ Russ Webster (2002), Corruption and the Private Sector, prepared by Management Systems International for USAID
⁵ Global Development Research Center (2005); Resources for Small and Medium Enterprises
differences that exist between larger and smaller companies, the question arises whether the findings of general private sector assessments are valid for SMEs to the same extent, and whether the resulting generally formulated anti-corruption tools and corporate strategies can be applied directly to smaller business units. Due to the fact that SMEs have characteristics and potentials that clearly distinguish them from large companies, existing programs have to be revised and adapted to meet the specific needs of this sector and to be in line with the capacities available in those firms. This project aims at filling this knowledge gap and tries to provide SMEs with successful tools to defend themselves against corruption in their business environment.

**Objectives of this Expert Group Meeting**

The objective of this meeting is to form a discussion platform where various experts from the field analyse the questions that are pointed out in this discussion paper and, as appropriate, identify additional issues relevant in order to derive at a comprehensive set of arguments, explanations and opinions that touch the most important issues in that respect. As the participants have different expertises and backgrounds (International Organizations, NGOs, business associations, SMEs, large companies, independent experts, etc.) and come from various fields (sectors), the discussions will be enriched by different inputs and views, and agenda items will be analysed from different angles, leading to a comprehensive assessment of the problem.

At the end of this meeting the participants are supposed to have discussed the following main questions:

- In how far does a corrupt business environment affect the development of SMEs?
- With what types of corruption are SMEs mostly confronted with and which of those constitute the biggest obstacles for them?
- What are the main incentives/disincentives for SMEs to engage in corruption?
- What are the main differences between SMEs and larger companies in the sphere of corruption and the resulting negative effects?
- Are there different corruption patterns in different economic and industry sectors?
- What are the institutions that could assist SMEs to cope with corruption in their business environment and what kind of tools, measures and programmes have to be created for this purpose?
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I. CORRUPTION AND SMEs

1. TYPES/FORMS OF CORRUPTION AFFECTING SME DEVELOPMENT

| Q | What forms of corruption other than bribery have a significant direct impact on SMEs? |

The main form of corruption perceived as such by the private sector in general is bribery, referring to the offering (accepting) to (by) a public official of any undue advantage in order that the official act or refrain from acting in the exercise of his or her official duties. Taking into consideration SME perception surveys, it can be observed that very often those enterprises still combine corruption with the idea of money in an envelope passing over the desk of a government official. Nearly one-third of the SMEs surveyed in Hungary, for instance, consider bribery to be a general or relatively general phenomenon in their business sector. The main activity identified as corruption by Bulgarian SMEs is the acceptance and offering of bribes in the process of fulfilling public services (78.1%).

However, the question arises whether bribery is the only form of corruption that plays a major role in the sphere of SMEs, or, whether there are other types of corrupt conduct that could have a significant direct influence as well, such as embezzlement/misappropriation of funds by own employees, extortion, fraud, etc.

2. PARTIES ENGAGING IN CORRUPT TRANSACTIONS WITH SMEs

| Q | What kinds of public sector agents are most frequently involved in corruption with SMEs? |
| Q | Do SMEs face problems with acts of corruption that involve other private sector entities? |

According to a series of interviews conducted with SME owners, the most damaging form of corruption for those businesses appears to be the “sale of rights granted by the government” (licenses, permits, contracts, tax incentives or dispensations, etc.) by public officials for personal gain. This is particularly problematic for SMEs because they cannot compete with larger companies in terms of resources and thus are likely to be last in line when the “favours” are handed out.

In Bulgaria, customs officers, inspectors, lawyers and police officers are the public sector officials who exercise the highest level of corruption pressure on SMEs. The firms usually pay for getting licenses and permits, accelerating procedures, company registration, obtaining state subsidies/grants, state contracts and loans, inspections, to deal with taxes and tax collection, etc.

SMEs could potentially face corrupt conduct in all their interactions with the public sector – in this case bureaucratic institutions at federal, regional and municipal/local level. However, smaller companies are mainly affected by the behaviour of local officials situated in their region.

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6 Gallup Organization Hungary (2000); Corruption in the Sphere of Small and Medium-Type Privat Enterprises
7 Vitosha Research Agency (2002); Corruption in Small and Medium-Sized Enterprises
8 s.a.
9 According to a Mexican SME survey, the respondents stated that they mainly provide unofficial payments to public officials at municipal and local level while only few incidents occur on federal level
Apart from those purely public sector related problems, requests for unofficial payments from so-called natural monopolies or ‘network industries’ (public services provided by private sector entities; e.g. the delivery of services such as electricity, water and gas supply), often constitute a severe obstacle to SMEs as they cannot run their business without those services. The problem here constitutes the fact that due to limited consumption SMEs do not have bargaining power and therefore have to play according to the rules imposed on them.

In this context, it is important to investigate which of those institutions can harm SMEs. Are all of the above-mentioned incidents harming SMEs in the same negative way or are there some forms that are particularly destructive due to their frequency or relative cost?

Another question, which has not received much attention so far, is whether SMEs face severe problems of corruption with private sector entities (suppliers, customers, banks, etc.). Corrupt interactions also occur within the private sector in terms of e.g. embezzlement by employees and bribery or extortion of employees of larger companies in order to obtain contracts. Corrupt bank officials, for instance, are often targeted to approve loans that do not meet basic financial criteria and can therefore not be collected later on. There have been a variety of reported incidents in that respect, but the question is whether private-to-private sector corruption poses a challenge on SMEs.

3. FREQUENCY/PREVALENCE OF ACTS OF CORRUPTION AFFECTING SMEs

<table>
<thead>
<tr>
<th>Question</th>
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<tbody>
<tr>
<td>Are SMEs in general more frequently confronted with acts of corruption than larger enterprises? And if this is the case, what are the reasons for that?</td>
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<tr>
<td>Are certain business sectors more frequently affected by corruption than others or can this issue be neglected when focusing on SMEs?</td>
</tr>
<tr>
<td>Is there a correlation between the frequency of acts of corruption SMEs are facing and procedural complexity in the public sector?</td>
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</table>

Available research data shows clearly that corruption in the sphere of SMEs is not an exception. A survey of SMEs in Croatia revealed that 86% of the respondents had already faced corruption related problems personally, as victims or as witnesses.10 In Mexico, 43% of the SMEs that responded to another survey conducted in 2004 admitted that they frequently provided extra-official payments to public officials, while 35% claimed to regularly make such payments.11 Those are only two examples that show that some SMEs even perceive corruption as almost omnipresent in their environment. Interestingly, a survey conducted in the Philippines showed that more SMEs than larger businesses believed that corruption is “part of the way things work in the country”.12

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10 S. Kosanovic & A. Bussard (2001); The Problem of Corruption in Small and Medium Enterprises in Croatia
11 A. Castillo & E. Ampudia (2005); Diagnóstico sobre el Impacto del Fraude y Corrupción en las PyMES
More SMEs than larger businesses believed that corruption is “part of the way things work in the country”.

In general SMEs perceived corruption in the public as well as in the private sector to be more pervasive than large companies.

More SMEs than large enterprises stated that they have been asked for bribes in order to obtain licenses or permits from the local government and in relation to the payment of income tax.

The majority of managers of SMEs were convinced that either all (26%) or most companies (34%) are involved in bribery to acquire government contracts (the respective percentages for large companies are only 17% and 28%).

The majority of large companies surveyed believed that corrupt conduct is wrong because it is immoral while most SMEs placed the negative impacts on national development on first place.

Table 2: Comparison of perceptions of small and large companies in the Philippines

But can this scenario be observed in other countries as well and does it reflect the situation of SMEs in general? Would it be correct to conclude that smaller companies are more frequently confronted with acts of corruption than larger enterprises? And if this is the case, what are the reasons for that notion/perception?

- Do SMEs depend on and interact more often and in a more direct way with the public sector?
- Are SMEs an “easy target” because they lack the bargaining power to reject requests for bribes and have less knowledge about their rights and how to defend them?
- Is it true that SMEs do not have the time and financial resources required to afford to stay away from corrupt practices because of the negative consequences?
- Are SMEs less likely to be heard by authorities concerning corruption related problems they are facing?

Sector-specific differences are often regarded as important when focusing on the frequency/prevalence of corruption involving the private sector. According to the Bribe Payers Index (BPI) published by Transparency International in 2002, the business sectors most frequently engaged in acts of corruption are public works and construction, arms and defence, oil and gas, real estate and property, telecommunications, power generation, mining and transportation/storage. Companies operating in the sectors of forestry, IT, fishery, light manufacturing and agriculture are seen as less affected (no reference to company size). But to what extent do business sectors play a major role in the sphere of SMEs, taking into consideration that those enterprises mainly face small scale/administrative corruption, which occurs in all industries to some extent?

Moreover the question arises whether the frequency of corrupt acts committed/faced by SMEs in a certain country correlates with the number of procedures those enterprises have to deal with?

When exploring the question “what do SMEs pay for”, referring to administrative corruption, one can distinguish between corruption to avoid fees, corruption to avoid costs of compliance and corruption to speed up bureaucracy. Regulation is one of many key areas where the interests of business people and regulators stand in sharp

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14 TI (2000), Bribe Payers Index
contrast to each other and where many opportunities for corruption arise. The amount of required procedures not only increases the opportunities for public officials to initiate or respond to acts of corruption, but also represents a positive stimulation for businesses to apply corrupt practices in order to accelerate matters. It is therefore worthwhile to explore, whether the frequency of corrupt conduct faced by SMEs augments whenever the number of procedures, that are required in order to do business in a certain country, increases?

4. NEGATIVE IMPACT OF CORRUPTION ON SME DEVELOPMENT

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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<tbody>
<tr>
<td>To what extent do corrupt practices affect SME development in a negative way?</td>
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<tr>
<td>Are smaller business units impacted more severely by corrupt practices than large ones?</td>
<td></td>
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<tr>
<td>What are the opportunity costs corruption imposes on small businesses and in how far does it influence certain business decisions?</td>
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<tr>
<td>Does corruption encourage informality in the sphere of SMEs?</td>
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</table>

Another issue, which needs to be explored, is the negative impact that corruption has on the development of SMEs. E.g. in a survey conducted in Mexico, more than 50% of the interviewed SMEs saw their business severely affected by corrupt practices (81% saw themselves affected due to rising operating costs, 83% mentioned lost contracts and 79% limited access to public procurement in this respect). More specifically, the question is how corruption affects the profit margins, growth and expansion of SMEs.

Small firms surveyed in Bulgaria, mentioned that the most expensive corruption-related practices include obtaining bank or other credit facilities and the signing of contracts with large enterprises. However, more important than focusing on absolute costs, which differ significantly from one region to another, is to concentrate on relative costs. Mexican SMEs, for instance, stated that extra-official payments account for approximately 10% of their annual income (taking average incomes as a calculation base this amount would be equivalent to 4.5% of the GDP). But do SMEs actually face a disadvantage in terms of relative costs compared to large companies? Are the profit margins of smaller business units impacted more severely by corrupt practices than those of complex and powerful corporations?

One important aspect, which is still missing in this context in order to assess the real damage of corrupt behaviour, refers to the opportunity costs that acts of corruption impose on small businesses. A survey of SMEs in Hungary conducted by Gallup revealed that almost a quarter of the respondents had decided in the past not to make major investments because of the fear of having to pay bribes. But what are those opportunity costs? Opportunity cost is defined as the value of the best alternative that was not chosen in order to pursue the current endeavour (i.e. what could have been accomplished with the resources expended in certain undertaking). It represents opportunities forgone.

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15 Opportunity cost (also called economic cost) is defined as the value of the best alternative that was not chosen in order to pursue the current endeavour (i.e. what could have been accomplished with the resources expended in certain undertaking). It represents opportunities forgone.
16 A. Castillo & E. Ampudia (2005); Diagnóstico sobre el Impacto del Fraude y Corrupción en las PyMES
17 Vitosha Research Agency (2002); Corruption in Small and Medium-Sized Enterprises
18 A. Castillo & E. Ampudia (2005); Diagnóstico sobre el Impacto del Fraude y Corrupción en las PyMES
19 Gallup Organization Hungary (2000); Corruption in the Sphere of Small and Medium-Type Privat Enterprises
investments that are usually sacrificed in order to be able to provide unofficial payments?

To what extent does corruption influence the decisions of SME managers:

- to reinvest in their business,
- to expand their business,
- to look for customers abroad,
- to close down their business,
- to set up a business,
- to hire, dismiss and train workforce,
- to improve product quality,
- to invest in research and development, and
- to change location?

In a recent WB study the economist Simeon Djankov claimed that many businesses in the developing world prefer to operate in the informal economy because they do not want to expose themselves to intrusions by the public sector.\[20\] As the costs of regulatory compliance and dealing with bureaucratic inertia do not decrease in proportion to firm size, regulation at the federal, regional and municipal levels do affect SMEs disproportionately, as it imposes higher relative costs on SMEs compared to larger companies. In a legal and regulatory environment full of complex requirements, arbitrary decisions and frequent requests for bribes, companies are clearly discouraged from entering the formal sector, and formal sector firms might even be induced to “de-formalize” their operations. The question here is whether corruption itself is one of the main reasons why many SMEs decide to stay in the informal sector of the economy or whether this decision solely depends on the costs and time to deal with regulatory compliance?

5. REASONS FOR SMES TO ENGAGE IN ACTS OF CORRUPTION

<table>
<thead>
<tr>
<th>Q</th>
<th>Why do SMEs engage in corruption?</th>
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<tr>
<td>Q</td>
<td>What are the consequences of not engaging in acts of corruption?</td>
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<tr>
<td>Q</td>
<td>Is the attitude of SMEs towards corruption different from that of larger businesses?</td>
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<tr>
<td>Q</td>
<td>What other SME specific characteristics influence business ethics (e.g. recruitment structure, informality, communication structure, etc.)?</td>
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<tr>
<td>Q</td>
<td>Do different motives that stand behind the decision to set up a business influence willingness of business leaders to engage in corruption?</td>
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There is a need to identify the main driving rationales behind the decision of SME managers to take part in acts of corruption.

According to a survey conducted among SMEs in St. Petersburg, 51% of the respondents believed that it is impossible at all to avoid corruption, while 33.4% believed that it was possible to run a business without engaging in acts of corruption. However, only less than half of those who shared this opinion had not made use of corruption during the last year.\[21\] This finding indicates that even though corruption could be avoided, some SMEs chose voluntarily to engage in corrupt behaviour in order to “facilitate issues in the short run”. In Slovakia, for instance, almost half of the

\[21\] Center for Independent Social Research (2004); Fighting Corruption in State-Business Relationships (Small and Medium Business in St. Petersburg)
SMEs surveyed believe that they can reach their business objectives through common channels without any bribe payments, but that the process would be very slow then.22

The reason why SMEs engage in corruption is often linked to problems with regulatory compliance and bureaucracy. As the costs of dealing with burdensome regulations at national, regional and municipal levels usually affect SMEs disproportionately. The costs imposed on SMEs in this respect are very arduous and therefore in many cases might encourage smaller business units to engage in corrupt behaviour.

In comparison to larger companies SMEs lack the bargaining power and the influence to oppose requests for unofficial payments and similar solicitations, as they usually do not have strong ties and connections to higher bureaucrats or politicians. Consequently, corrupt officials do not have to fear much resistance or counter-actions from their side. Annex II clearly reflects this situation, showing that whether a business manager can go to another official or to superiors in order to get correct treatment without recourse to unofficial payments whenever a government official acts against the rules, depends on the size of the firm and on its resulting influence.

Assuming that SMEs do not have the bargaining power to obtain basic public services without the provision of bribes at all or on time, and that those businesses usually depend more on their respective approvals than larger companies because they often do not have the funds to compensate temporal losses with other income or reserves, could one argue that even so-called grease payments, which are mostly related to profit maximizing behaviour or the intention to obtain undue benefits in the case of large firms, happen out of certain necessity in the sphere of SMEs?

Assuming that in many cases SMEs do not have any other alternative than to respond positively to requests for bribes, it becomes necessary to explore the consequences that SMEs would have to face if they decided not to participate in any form of corruption while other companies do. Is such a decision affordable at all or does it imply even more severe consequences?

A variety of SMEs dispose of proper codes of conduct and try to stay away from corruption. However, many firms are convinced that corruption forms part of daily business and that it is hardly possible to survive without it. Why is this the case? A possible explanation for this notion could be the fact that in a region where corruption is endemic, SMEs that refuse to provide officials with additional payments, while most of the others do, will sooner or later have to face marginalization. They will not get necessary permits and licenses on time or at all, they will not receive public contracts, or they will not succeed complying in the case of inspectors, deteriorating the companies’ competitive position in the market. The question in this context that should receive further attention is “does non-participation in acts of corruption from the side of SMEs automatically imply their marginalization in a corrupt environment?”

22 M. Benfodová, A. Bussard & M. Markus (2000); The Problem of Corruption in Small and Medium Enterprises in Slovakia
So far particularly the values and ethics of large enterprises have been subject to considerable research and debate, which has found expression through the adoption of the principles of Corporate Social Responsibility (CSR) by many large businesses. By contrast, little is known about the ethics and values of SMEs and if those enterprises behave differently when being confronted with corruption.

Smaller business units usually serve their local communities, and thus reflect their communities’ sets of values. The question that arises in this respect is “do those strong linkages to a certain community actually influence (in a positive or negative way) the decision of SMEs to engage in corrupt conduct?” What other SME specific characteristics influence business ethics in terms of corrupt behaviour? Assuming that, for instance, SMEs, particularly those situated in developing countries, usually count with a recruitment structure that is quite different from that of large enterprises (management staff with different levels of education, importance of interpersonal/informal relations and friendship, etc.) – does this have an effect on the compliance with ethical standards?

Another important concept to be taken into consideration is the difference between necessity based entrepreneurship and opportunity based entrepreneurship. Whereas the first group refers to entrepreneurs who cannot find a job and consequently choose to start a business in order to survive (more prevalent in developing countries), the second group refers to those who seek to take advantage of business opportunities. Does this distinction of motives impact on the decision of business leaders to engage in corrupt conduct? Is it justified to conclude that SME owners who see in their business the only key to survival are more willing to leave ethics behind than those pursuing lucrative or innovative business ideas?

**II. MEASURES/TOOLS ASSISTING SMEs TO COPE WITH A CORRUPT BUSINESS ENVIRONMENT**

<table>
<thead>
<tr>
<th>Q</th>
<th>What kind of measures and programmes could assist SMEs to cope with corruption in their business environments and which institutions/bodies should participate in the development, implementation and coordination of such measures?</th>
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The most effective anti-corruption instruments frequently mentioned by SMEs are the implementation of clear and transparent legislation, the punishment of corrupt persons and the focus on the morality of individuals and the whole society. However, this analysis will only focus on tools and measures that can are directed specifically towards smaller business units, enabling them to defend themselves in a better way when being faced with corrupt conduct, and on initiatives and programmes specifically targeted to the needs of SMEs, that have to be launched by other institutions.

**1. MICRO LEVEL: MEASURES ADJUSTING BUSINESS PRACTICES TO BE APPLIED INTERNALLY**

<table>
<thead>
<tr>
<th>Q</th>
<th>What measures and programmes are implemented currently in the private sector?</th>
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<tr>
<td>Q</td>
<td>Are they applicable to SMEs?</td>
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Global Entrepreneurship Monitor (2004), *Global Report*
The following section contains a list of already available private sector measures and toolkits, like those developed by the International Chamber of Commerce, Transparency International or the Organisation for Economic Co-operation and Development. Existing instruments, however, often set their main focus on large companies, referring to different levels of management or shareholders, which do not exist in many SMEs, and often assume that the required financial, human and technological resources as well as the necessary know-how for correct implementation are available. The main questions that have to be tackled in this context are:

- To what extent are those frequently cited tools useful in the sphere of SMEs?
- What difficulties could SMEs come across in the implementation of such tools and measures?

1.1. Codes of Conduct/Codes of Ethics

The UN Convention Against Corruption, which entered into force in December 2005, mentions the importance of “promoting the development of standards and procedures designed to safeguard the integrity of relevant private entities, including codes of conduct for the correct, honourable and proper performance of the activities of business and all relevant professions and the prevention of conflicts of interest, and for the promotion of the use of good commercial practices among businesses and in the contractual relations of businesses with the State”.

The introduction of a code of conduct, prohibiting all forms of corruption, including facilitation payments is the main tool applied internally by companies in order to prevent and sanction corruption. Many large companies that are subject to greater public scrutiny have introduced some set of ethical standards. However, the situation of SMEs seems to be quite different. Only 10% of the SMEs surveyed in Mexico have implemented a code of conduct, which explicitly forbids bribery. Out of those 10%, only 20% have initiated internal proceedings against corrupt conduct or sanctioned an employee for such behaviour.

A survey of SMEs in Bulgaria revealed that 45% of the respondents share the view that owners and managers usually do not discuss the matter of unofficial payments with their employees. This raises the question whether codes of conduct are the right tool for SMEs.

SMEs are often driven by the values of the owner/founder (due to their size and scope), which are often community based, and dispose of a rather informal communications structure. Thus specific attention has to be given to the difficulties SMEs face in terms of creating, implementing and monitoring such standards. It also raises the question whether a code of conduct for SMEs should differ from the one applied by a large corporation.

Many institutions suggest a work split between different levels of management for the proper implementation of codes of conduct in businesses. As those organizational structures often do not exist in SMEs, the owner/manager of the company tends to assume all management responsibilities. How should such codes be designed and

24 United Nations Convention Against Corruption (UNCAC); Article 12.2.a
25 A. Castillo & E. Ampudia (2005); Diagnóstico sobre el Impacto del Fraude y Corrupción en las Pymes
26 Vitosha Research Agency (2002); Corruption in Small and Medium-Sized Enterprises
implemented in order to overcome the problem of limited human resource capacity and funds?

1.2. Training

Training for managers and employees is often cited as an important tool for effective anti-corruption prevention. The problem in this respect constitute the financial constraints of smaller companies, which often do not allow them to develop training materials and conduct regular training in a cost effective manner. Taking into consideration that SMEs are often driven by the values of the business leader, it might be more efficient to provide training only to managers/owners, leaving the responsibility to instruct the other employees to them. Which institutions are best equipped to organize such training, how should it be organized (information circulation, seminars, etc.) and what exactly has to be taught?

1.3. Adequate Reporting Mechanisms and Whistle Blower Protection

Another common tool to detect corrupt conduct is an appropriate reporting mechanism, which implies the establishment of a certain facility (a reporting hotline, for instance), allowing reports to be made anonymously. Available toolkits recommend that the facility may be internally staffed or outsourced to a service provider. But due to the low number of employees working for small business units and the relatively high degree of informality, anonymity might be difficult to guarantee when a person working for the same company runs such a facility. At the same time the hiring of a professional service provider for this purpose is often too costly and therefore no efficient alternative. The question that arises is “what can be done to overcome these problems?” Which institutions could provide an accessible mechanism for anonymous reporting of acts of corruption in SMEs? What role could NGOs or business associations as intermediaries play in this respect?

1.4. Imposing Anti-Corruption Standards on Business Partners

Currently available anti-corruption toolkits also include provisions dealing with the assessment and monitoring of business partners (agents, suppliers, etc.) in order to ensure that those adhere to the same ethical standards – a measure that is mainly targeted at multinational companies. The question here is whether this should also apply to SMEs, as they are often part of the lower end of supply chains and consequently do not have the necessary negotiating power to demand such standards from their business partners. What can SMEs do in order to influence anti-corruption compliance of their business partners?

1.5. Compliance with Anti-Corruption Law

The compliance of companies with anti-corruption legislation is generally considered to be essential. SMEs frequently face difficulties in accessing information on such legislation and in tracking amendments and changes of laws and regulations. Besides of that, smaller companies might not have the necessary know-how to interpret those
legal texts correctly, and to make use of them when facing acts of corruption. Therefore, the question that arises here is “what can be done in order to facilitate the access to and interpretation of anti-corruption legislation for SMEs and which institutions should be responsible for such initiatives?”

1.6. Other Relevant Tools

Another measure that is often mentioned in this context is the setting up of human resource policies that adequately reward ethical behaviour and appropriately sanctions corrupt conduct. Other measures include internal accountability and controls, financial recording and auditing as well as overall transparency (the UN Convention Against Corruption requires private enterprises to have sufficient internal auditing controls to assist in preventing and detecting corruption and that the accounts and required financial statements of such are subject to appropriate auditing and certification procedures27), as well as external accountability requiring the public disclosure of information, so that watchdog groups and the media can monitor this information and complain about irregularities. Are there any specific issues that have to be taken into account with regard to such other anti-corruption tools? Are there other measures that could be useful in the sphere of SMEs even though they are usually not applied by large corporations?

2. Meso Level: Collective Business Initiatives and Institution Building

| Q | To what extent are collective approaches and joint actions important for SMEs in this respect? |
| Q | What are the institutions that could assist SMEs to cope with corruption and what kind of tools and measures have to be created for this purpose? |
| Q | In which ways could business partners (in particular large companies) support anti-corruption efforts of SMEs? |
| Q | Are the driving forces that encourage SMEs to become socially responsible businesses different from those of larger companies? |

The involvement of other institutions and organizations in the public and private sectors is of particular importance to the success of anti-corruption efforts in the sphere of SMEs, as they usually face human, financial and managerial resource constraints. Besides, taking into consideration that SMEs might face severe troubles in a corrupt environment if they decided not to engage in acts of corruption, the active engagement of other bodies is essential. At the same time SMEs supposedly implement internal measures more easily and faster than large companies. However, internal measures alone without the support of other institutions and bodies will not have considerable impact. Therefore a comprehensive multi-stakeholder approach is required, involving various institutions and bodies that offer their support in the course of the implementation of anti-corruption measures and complement the efforts of SMEs wherever the necessity arises. The question that has to be raised in this respect is “which institutions are best placed to assist SMEs to cope better with the

27 United Nations Convention Against Corruption (UNCAC); Article 12.2.f
problem of corruption in their business environments, and what could they do in this respect?”

Another aspect, that has to be taken into consideration when creating tools, is that small companies often lack attention from the government, the civil society the media, which mainly focus on large corporations when it comes to cases of corruption. One of the reasons why corporate social responsibility has historically been associated with large corporations can probably be explained with the high profile those companies are maintaining—both locally and internationally. The question here is whether this missing attention influences the behaviour of SMEs regarding corrupt activities, taking into consideration that those companies usually do not have to fear the consequences of a bad reputation the same way that this is true for large corporations. It is therefore crucial to explore what (alternative) driving forces could encourage SMEs to become socially responsible businesses, such as stakeholder pressure, government regulations and expected financial rewards.

2.1. Collective Initiatives and the Role of Business Associations and NGOs

Business associations that bring together SMEs of a certain region or business sector could be another alternative to increase the efficiency of the anti-corruption initiatives of those enterprises. Collective action has the advantage of being more structured, coordinated and cost-effective. Business associations could serve as platforms for mutual agreements and commitments to ethical standards and other joint action to prevent corrupt practices. This would have the advantage that those businesses could have to fear less negative repercussions that usually appear when some companies oppose corrupt conduct while the majority of businesses keeps paying. Would SMEs therefore implement anti-corruption compliance programs rather on a collective basis—incorporating most SMEs of one sector/region—in order not to face any competitive disadvantages?

What services could business associations provide that are of interest to SMEs and how should such services be set up in order to be accessible to a broad mass of those companies and enjoy strong business support and participation? What kind of information could such an association gather, store and channel in order to be of use to businesses themselves, and what role could they play in terms of awareness raising? To what extent could business associations support or complement the tools applied by SMEs internally?

Many SMEs indicated in the course of various surveys and interviews that they would highly value the setting up of a neutral non-governmental organization publishing proven corruption practices anonymously in the mass media. 37.7% of the SMEs surveyed in Bulgaria are even willing to make known before a neutral anti-corruption organization the size of bribes as well as the name of the person who asked for it, providing that their anonymity is guaranteed. In a survey of small Croatian enterprises 69% of the respondents said that, even after having paid a bribe, they would declare cases of corruption and those involved in them if their anonymity would be guaranteed.

28 Vitosha Research Agency (2002); Corruption in Small and Medium-Sized Enterprises
29 S. Kosanovic & A. Bussard (2001); The Problem of Corruption in Small and Medium Enterprises in Croatia
These survey results suggest that NGOs are generally more trusted by SMEs than government agencies. But what kind of assistance could such anti-corruption NGOs provide, which would be of relevance to SMEs, and to what extent would such initiatives differ from standard programs that are usually run by such NGOs?

2.2. Business-to-Business Assistance in the Sphere of Corruption Prevention

Moreover, the question arises what can large enterprises do in order to support SMEs that form part of their supply chain in terms of overcoming corruption related difficulties? There are numerous examples for successful partnerships between multinational companies, in particular those forming part of the U.N. Global Compact Network, and SMEs in improving business processes and ethics, encouraging entrepreneurship and promoting sustainable business growth. To what extent can anti-corruption components be integrated in those already existing programs? What kind of incentives/disincentives could be introduced in business agreements between large and small companies that might encourage SMEs to stay away from corrupt practices? In which ways could SMEs and business associations benefit from existing international networks like the Global Compact in this respect?

2.3. Business Promotion Schemes and the Role of Trade Chambers

Trade chambers have been identified as important players that could also assist SMEs in their fight against corruption. But what kinds of assistance schemes could be offered in that context? What services could be provided by trade chambers (e.g. information exchange, consulting services, discussion platforms, etc.)? What kind of incentives (in form of services, grants, etc.) could trade chambers offer that would encourage SMEs to adhere to anti-corruption standards?

2.4. The Importance of other Institutions to Promote Anti-Corruption Compliance

Are there any other institutions that are of relevance in this context and that have to be taken into further consideration? What could, for instance, financial institutions do in order to “award” and support the decisions of SMEs to refuse corrupt conduct (e.g. facilitated access to credit for socially responsible companies, etc.)?

2.5. Training of Institutions

As there is not a lot of information on corruption related problems in the sphere of SMEs available yet, many entities, both in the public and private sector, could face problems in the elaboration, implementation and coordination of anti-corruption initiatives. A variety of international organizations offer training to these institutions in their respective fields of competence. The question that arises here is “what kind of training and other services are needed that could be offered by the U.N. and other organizations, and to whom should such services and training be provided?”

30 E.g. special field research and assessments, pilot programs, conferences, etc.
**3. MACRO LEVEL: PUBLIC SECTOR MEASURES**

In the course of a variety of surveys, SMEs indicated intransparent laws and regulations, the inefficiency of courts and intransparency in public procurement systems and government spending as the main factors making corruption possible and constituting impediments to their business environment. Therefore all of the above mentioned initiatives couldn’t replace or substitute the government’s responsibility to create a clean business environment and an incorruptible public sector. Improving the business environment for SMEs requires the complex interplay between corporate and government action and the creation of effective partnerships between the public and the private sector. Frequently mentioned public sector tools to prevent and control corruption include an effective legal and regulatory framework and social policies, enhanced transparency and accountability, and the elimination of government-created barriers that foster cultures of rent seeking. The question that arises in this respect is “what can be done by public sector agencies to assist SMEs in particular with regard to corruption related problems?”

**3.1. Justice System**

Even though corruption constitutes a problem for many business people, only 7.1% of the SMEs surveyed in Slovakia, for instance, have lodged a complaint in connection with unfair practices in the past. 51.8% of the companies stated that they would not lodge any complaint at all – particularly out of fear for their own security and due to mistrust in the courts; 23.3% of the surveyed SMEs indicated that they would do so anonymously. However, only 10% of the respondents felt that the grounds leading to complaint and the following disclosures would result in a just sentence and the punishment of the offenders. 26.7% of those surveyed believed that nothing would happen to the accused person and the whole matter would be ignored. More than half of the respondents shared the view that in the end everything would turn against the person who has lodged the complaint. 31 A survey of SMEs in St. Petersburg revealed that only 2.7% of the respondents who had faced bureaucratic extortion appealed to the court. 32 In Bulgaria, 81% of the SMEs surveyed have no trust in the judicial system at all. 33

Reflecting on these outcomes one has to raise the question what can be done in order to overcome those fears and restore the trust of SMEs in those public institutions responsible for upholding the rule of law? What kinds of programs/changes could be introduced by the judiciary system in order to encourage SMEs, which in many cases lack the legal expertise and the financial resources, to go to the courts whenever they face corrupt conduct and to defend themselves successfully against such acts? What

31 M. Benfoddová, A. Bussard & M. Markus (2000); The Problem of Corruption in Small and Medium Enterprises in Slovakia
32 Center for Independent Social Research (2004); Fighting Corruption in State-Business Relationships (Small and Medium Business in St. Petersburg)
33 Vitosha Research Agency (2002); Corruption in Small and Medium-Sized Enterprises
could be done in order to make the court system accessible – financially and know-how wise – and to facilitate the use of available judicial mechanisms?34

3.2. Transparency of Laws and Law Enforcement

As already mentioned in the previous section, another common problem constitutes the fact that in many cases SMEs are not even aware of the legal framework dealing directly or indirectly with corruption. For example, 48.2% of the SMEs that responded to a survey conducted in Slovakia admitted that they are neither familiar with anti-corruption laws, nor with what laws to apply to protect them against corrupt practices.35

What can the government in particular do in order to change this situation? How can the existing legal framework and subsequent changes in laws be made easily accessible to (and understandable for) SMEs?

3.3. Promoting Integrity in Public Procurement

Public procurement is widely seen as an area that provides fertile ground for corruption. A decrease of corrupt practices in public procurement would particularly benefit SMEs, as they would not be able to compete with large companies in a corrupt system even though they fulfilled all technical requirements. How could conventional measures to encourage a higher SME participation in public procurement (e.g. set-asides, fair access to such mechanisms, etc.) and anti-corruption measures be combined in order to solicit greater SME participation in public procurement?36

4. AWARENESS RAISING AND THE CRUCIAL ROLE OF THE MEDIA

A survey conducted in Croatia shows that 43% of the SMEs interviewed believed that official pressure through public media is a “must” in the fight against corrupt practices.37 However, SMEs are usually not granted that much attention by the media compared to larger companies, which might affect the behaviour of those firms and that of public officials towards them. The question that arises is “does the fact that SMEs count with much less media coverage and attention than larger firms encourage (miss to discourage) corrupt behaviour?” What could the media do in order to raise awareness of the problem in the sphere of SMEs?

5. NEXT STEPS AND THE ROLE OF UNODC AND UNIDO

34 see also United Nations Convention Against Corruption (UNCAC); Article 11
35 M. Benفodová, A. Bussard & M. Markus (2000); The Problem of Corruption in Small and Medium Enterprises in Slovakia
36 see also United Nations Convention Against Corruption (UNCAC); Article 9
37 S. Kosanovic & A. Bussard (2001); The Problem of Corruption in Small and Medium Enterprises in Croatia
Due to the fact that a multi-stakeholder approach is required, there is a need for coordination in order to avoid a duplication of efforts. But how is such coordination conducted in the best way and who should be responsible for it?

Besides, there is a need for prioritization. There are some basic tools that usually have to be applied first in order to pave the way for the proper implementation of others. But which are those? What kind of anti-corruption tools are supposed to have the highest impact on SMEs in the long and in the short run? Is it possible to draw some kind of “pyramid of priorities” which helps SMEs to record successes even if the resources are limited, and countries to design well-structured and comprehensive long-term SME support programs?

Is it also possible to link the effectiveness of certain measures to country/sector specific characteristics? (e.g. the facilitation of public procurement procedures and enhanced transparency in order to reduce the possibility of corruption might be of particular relevance to SMEs in the construction sector).

Furthermore, the question arises, what kind of assistance could U.N. Institutions, in particular the United Nations Office on Drugs and Crime and the United Nations Industrial Development Organization, offer in this context?
APPENDIX

Appendix I: Corruption perceived as a major business obstacle by SMEs and large companies (%)\(^{38}\)

Appendix II: If a government official acts against the rules, how often can you go to another official or his superior, to get the correct treatment without recourse to unofficial payments?\(^{39}\)

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\(^{38}\) WB; Investment Climate Survey

\(^{39}\) WB/EBRD; Business Environment and Enterprise Performance Survey
Appendix III: Readiness of large, medium and small companies to pay additional taxes to eliminate corrupt practices

Would you be willing to pay additional taxes to eliminate corruption?

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<th>Small</th>
<th>Medium</th>
<th>Large</th>
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<tr>
<td>Yes</td>
<td>59.93%</td>
<td>56.38%</td>
<td>50%</td>
</tr>
<tr>
<td>No</td>
<td>40.07%</td>
<td>43.62%</td>
<td>50%</td>
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Appendix IV: Perception of companies regarding the integrity of the court systems in resolving disputes

Corrupt System Perceived as Honest and Uncorrupt

Always

Never

Seldom

Sometimes

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<th>Small</th>
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<tbody>
<tr>
<td>Always</td>
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<td>Mostly</td>
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<td>Frequently</td>
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<td>Sometimes</td>
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40 WB/EBRD; Business Environment and Enterprise Performance Survey
41 WB/EBRD; Business Environment and Enterprise Performance Survey
Appendix V: Some important toolkits and guidelines developed by international organizations targeting private sector anti-corruption compliance

|     | → Rules of Conduct to Combat Extortion and Bribery (1977; periodically revised)  
| OECD: | → Principles of Corporate Governance (adopted 1999)  
|     | → Guidelines for Multinational Enterprises (adopted 1976; revised 2000)  
| TI: | → Corruption Fighters’ Tool Kit  
|     | → Business Principles for Countering Bribery  
|     | → TRACE Standard for Doing Business with Intermediaries Internationally |

Appendix VI: Case Study showing the types of business transactions corruption could occur

Case II. Croatian Farmer – Egg Production

Thinking about new, more efficient ways of how to distribute a bigger quantity of eggs, which until now he only sold in a very small scale to his neighbours, a Croatian Farmer called Vlado decided to sell his eggs at the local market. He went to the local municipality in order to find out how to do this and to arrange permission. When he went to the director who is managing the rent of the locations, he learned that he needed to fill in some papers. After signing the agreement, Vlado went home, thinking that his work was done. As he did not hear anything after several weeks, he started to contact the director more often, but nothing happened.

Only after 3 months, the director called him and invited him to have a talk. Vlado went and met the director who asked Vlado to choose a strategically good location. When Vlado made his choice, the director said: “I am sorry, but this place is not available anymore.” What a pity, Vlado thought, when suddenly the director said: “But we can change this. If you pay me 5 000 DEM.” Vlado, knowing that he has no other alternative he finally decided to pay the money, in order to solve the problem (hopefully) forever because it is that difficult to get a place on the market.

7 months later, suddenly a new managing director came to the market changed and made a completely new distribution of locations, so that almost all the vendors needed to change. What should Vlado do? Pay again or risk having a “strategically bad” location where not many clients would find him? Vlado paid again, being convinced that this would now be definitive.

6 months later, the Ministry of Health made an inspection. Some eggs were found to be infected, so that the Ministry decided to close all egg-stands. Of course, those who paid bribes to the Ministry of Health could keep on doing their business, those who did not need to close definitively.

6 months later, the director changed again. Now he introduced the obligation for all people who were selling eggs to keep their eggs in the refrigerator... In order to be able to use the refrigerator, people needed access to electricity. But the access to electricity was not “for free” either! Those who decided to purchase a refrigerator needed to pay bribes in order to get electricity installed.

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42 S. Kosanovic & A. Bussard (2001); The Problem of Corruption in Small and Medium Enterprises in Croatia