

## *Executive Summary*

State-owned enterprises (SOEs) are a main conduit for states to exercise their role as economic actors. The benefits of SOE ownership are economic, political and social. So too are the costs of any mismanagement or abuse. Today, SOEs account for 22% of the world's largest companies and are often concentrated in sectors with strategic importance for the state and society, including for development. More and more, SOEs operate like similar private firms, increasingly active internationally and accounting for a greater market share.

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

The report answers these questions in two ways:

- Through an analysis of the perceptions and recent experiences of 347 high-level SOE officials and board members.
- Through a review of legal frameworks and approaches at the state level as reported by representatives of 28 national state-ownership agencies or ministries.

Together, the two surveys span 37 OECD and non-OECD countries. They focus on both the most severe forms of corruption, such as bribery, and on other rule-breaking and irregular practices that are harmful in their own right and that may be representative of both corporate and public governance gaps.

### **The risk of corrupt practices**

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

These perception data provide a strong indication that the threat of corruption and irregular practices in and around SOEs is real. Digging deeper, this report compares companies' perceived experiences with corruption in the last three years with their risks and challenges of the present. From the survey, the following key findings suggest themselves:

- The instances of corruption that were reported most often involved non-management employees and mid-level management. Executive management, charged with their oversight, reported to have witnessed less corruption and fewer irregularities in their company compared to other categories of respondents –

despite being, in some cases, from the same company and despite reporting similar corruption risks and obstacles as their fellow respondents.

- Respondents in oil and gas, mining, postal, energy and transportation and logistics sectors report to have witnessed corrupt and other irregular practices more often than average. These sectors are mostly highly regulated, may have natural market monopolies and are engaged in high-value public procurement projects.
- SOEs report that the greatest obstacles to their companies' integrity relate to relations with the government (for instance including a perceived lack of integrity in the public and political sector), and with behaviour (including opportunistic behaviour of individuals that may be internal or external to the company). SOEs report that challenges also arise from ineffective control and accountability (including ineffective internal control or risk management) and, to a lesser degree, the company culture (including a lack of awareness amongst employees of the need for integrity).
- SOEs with public policy objectives – whether well-defined or more implicit – report higher risks of corruption or other irregularities than those that have entirely commercial objectives. For instance, they are more likely to perceive that the risk of undue influence in decision-making will materialise, that they experience pressure to break the rules and that they are challenged by their proximity to government. They also report taking fewer actions to avoid known corruption risks than SOEs with entirely commercial objectives. SOEs with public policy objectives disclose financial assistance received from the state, including guarantees and commitments, less often than SOEs with entirely commercial objectives.
- SOEs with commercial objectives are more likely to see the allocation of operational budget to integrity as more of an investment or asset than SOEs with public policy objectives. Overall, SOEs see financing integrity as more of a cost or expense than private companies.
- In face of known corruption risks, SOEs generally appear less risk averse or less about to take action than private companies. This could reflect the fact that SOEs are legally obliged to conduct certain activities and consequently have less freedom than private firms to walk away from dubious propositions

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

Internal or external pressures, such as undue influence by the state in SOE operations, may further put employees and managers under pressure to break rules and/or provide opportunities to exploit their position. On the one hand, SOEs with public policy objectives may be more able to justify illicit activity to compensate for financial losses or reduced profit margins that can be associated with delivering on policy objectives. On the other hand, SOEs (and other firms) with entirely commercial objectives may try to justify corruption because of the pressure to remain competitive or to perform.

## Risk avoidance and mitigation by state-owned enterprises

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

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

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

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

## Preventive and remedial action by the state

But what exactly can and should the state do as the owner? The report addresses this question through an analysis of state ownership entities’ practices in 28 OECD and non-OECD countries across four continents, insights from Supreme Audit Institutions and comparisons with findings from other international studies. The answer is guided by existing international standards such as the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The Guidelines imply that the state, on a whole-of-government basis, should implement an ownership policy; a designated “ownership entity” within the state should be responsible for defining objectives of individual SOEs and monitoring their performance; the board of directors should be responsible for approving strategy and monitoring management; and the management responsible for the SOE’s corporate operations.

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

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

Only a handful of ownership entities specifically hire relevant skills, such as audit, compliance or risk management expertise for oversight and monitoring. Co-ordination across relevant public institutions on the subject is largely ad-hoc, with the potential for improving professional relations that strengthen awareness and monitoring of corruption in SOEs as well as measured responses in the case of potential or real corruption. Where it occurs, most ownership entities will act as observer to related investigations, with a few more actively following-up with the SOE upon a case's conclusion.

The report puts forward a number of suggestions for the state as a whole to effectively encourage SOEs to better prevent corruption risks from materialising and detecting them when they do, as well as to enforce the letter of the law accordingly. It must however be emphasised that such efforts will be rendered ineffective if states do not themselves adhere to high standards of integrity.

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



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