



# BUSINESS REVIVAL THROUGH GOOD GOVERNANCE

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## Business Revival through Good Governance

The economic downturn of 2008 left many countries in a state of shock. Economies worldwide could not avoid the devastating impact, due to the diversified economic bases now common in the global market. It is difficult to pinpoint a single reason for the crash, but many indicate that the underlying reason for the crisis was people risking other people's money - without their knowledge, understanding, and consent - in investments backed by implicit government guarantees. When risky investments failed, they brought down small businesses and large corporations alike. In the end, governments had to bail out some of the most important corporations.

The advanced economies were worst hit by the crisis, mainly due to their huge dependence on exports and the major decline in consumer items like automobiles and electronic goods, which aggregated to an average contraction of 7% in GDP<sup>[1]</sup>. The small economies did not plummet like their advanced counterparts, but faced the brunt of the global crisis with a decline in export orders and reduced consumer purchasing power due to higher commodity prices in domestic markets. The average contraction of economies for growing economies has been estimated at 4%. Like other small economies, Pakistan was also hit by the crisis, evidenced by an unprecedented price hike in food, energy, and other essential goods. Presently, the challenges faced by Pakistan's economy are fiscal deficit, trade deficit, debt servicing, low GDP, and low Human Development Indices. Recovering from each is a daunting task.

The crisis peaked between August 2008 and January 2009. World economic indicators have started showing slight improvement as of first quarter 2010. The basic lesson learnt from the global crisis is that only those countries where business sustainability has been ensured can grow in a globally free trade environment. Sustainability not only means new products, capturing new customers, better economical means of manufacturing / service, but also requires challenging ourselves to find various ways the company can affect the society beyond its direct footprint, in areas such as environmental issues, labor standards, human rights, and ethical ways of business.

The private sector is seen as an essential player in shoring up the Pakistani state, which is presently fighting a war against terrorism, suffering from grinding poverty, and lacking effective institutions. All of these factors are interrelated and world experts believe that special emphasis should be placed on boosting

trade with Pakistan; investing in developing its energy, water, and transportation infrastructure; and making economic aid programs more transparent. In order to maximize benefits from this improved global attitude towards Pakistan, the private sector should build business structures in line with those of global standards.

Figures for the country show that the real GDP, which was at 6.0 in 2008, touched the lowest ebb at 2.5 in 2009, which is much lower than its neighbors India and Bangladesh [Table -1]. On the other hand Pakistan is ranked at 85 (2009 and 2010) as per the World Bank's DOING BUSINESS 2010<sup>[2]</sup>, which provides objective measures of business regulations and their enforcement across 183 economies at the sub-national and regional level. Neighboring countries Bangladesh and India are at 115 and 133 respectively, demonstrating that the legal and regulatory framework of Pakistan seems to be more conducive to attracting investors and global businesses to develop business relationships with local companies as compared to its close neighbors. The biggest impediment to international investment, however, seems to be the overall image of the country, particularly business competitiveness. The World Economic Forum's Global Competitive Index [GCI] places Pakistan at 101st place out of 133 countries, based on its survey for 2009-2010<sup>[3]</sup>, in which Pakistan slid 9 notches downwards from last year's GCI. Pakistan's GCI ranking showed the highest obstacle as "Government/ Political instability." The second hurdle for business competitiveness was "Corruption."

This is a worrying situation for Pakistani businesses, since the country saw a downward revision in its perception in the list of corrupt countries, including the areas of dealing with construction permits, getting credit, protecting investors, paying taxes, trading across borders, registering property, and enforcing contracts. The Corruption Perception Index (CPI) shows that Pakistan is at 139 out of 169<sup>[4]</sup> countries surveyed for this report; it was at 134 in 2008. Transparency International reports that corruption eats up about Rs 500 billion every year in Pakistan, which includes direct bribes and indirect cost to the exchequer due to corrupt practices. This is a serious point of concern for all. In March 2009, a World Bank report defined corruption as a serious and growing obstacle to the investment climate in Pakistan. The report also expressed dissatisfaction over the issue of governance in the country, both at the state functionary levels as well as that of petty corruption. This was substantiated by the State Bank of Pakistan's report on Foreign Direct Investment issued in June 2009, which states:

*"Net foreign investment in Pakistan fell 47.5 per cent to \$2.22 billion in the first 11 months of the 2008/09 fiscal year compared with \$4.23 billion in the same period last year."*

The dynamics of corruption follow the basic economic transaction of “Supply” and “Demand”. The Supply side is defined by the existence of a person who is willing to offer certain services for a specific cost, while the Demand side is existence of a person who is willing to part with that specific cost against certain benefits.<sup>[5]</sup>

The incidents of corruption are more likely to occur in the following cases:

- Where legal structure is too complex and the policies keep changing frequently, the discretionary powers of public officials are magnified and can be used to extort bribe out of businessmen or individuals.
- Where government officials use their discretion in issuing licenses, tax certificates, customs clearance, etc and can be decisive in creating market forces in favor of a particular person or company.
- Where the international standard of reporting in accounts and audit are non-existent, as bribery money will often originate from undeclared wealth. Bribes are often paid out of slush funds, from amounts hidden in off-the-books accounts. Sometimes this effect can also be achieved by keeping two sets of books – one official and one reflecting the real state of affairs.
- Where the public accountability system is weak or non-existent due to political instability or lack of will of the government. The public accountability may include independent institutions like Auditor General, Accountability Agency, Ombudsman and competent judiciary.
- Weak judiciary and / police or other law enforcing mechanisms or the absence of systems like alternate dispute resolution systems [ arbitration, mediation, etc] to achieve justice may multiply the effects of corruption as individuals would not have access to remedies in case of dishonored business contracts.
- In poor or developing countries, the salary structure of public officials may be below cost of living and the bribes extorted may be perceived as an extra source of income by such officials.
- Where public officials can use their discretion to enforce, relax, or amend regulations towards the “capture economy” in order to benefit certain individuals or companies.
  - In the absence of transparent policies and systems for selection and appointment of public officials, clearly stated procurement procedures etc, the social evils like nepotism, favoritism, and even “sale of vacancies” may be nurtured. The “Eradication of Corrupt Business Practices Ordinance, 1998” was the first effort for mitigating corrupt practices. However, in the absence of transparent systems, the concerned officials have a great propensity to exploit the situation to extort bribes.

## Initiatives to fight corruption

*“Making a commitment to anti-corruption is only the first step, the true challenge lies in implementation as well as meaningful and transparent disclosure.”*

Georg Kell, Executive Director of the UN Global Compact.

As highlighted by the situations described above, the potential exists for any business to fall for corrupt practices, as naturally every business wants to have an edge over its competitors. For many years, the private sector has been voicing protests at being a victim of greedy officials extorting bribes, which in turn distorts fair competition, has a negative impact on quality of goods and services, weakens the prospects of investment in the country, and destroys the ethical fabric of society. But corruption is not limited to transactions between a public representative and private concern/ individual. Corrupt practices can also prevail in private to private sector transactions. This is a serious concern in the face of privatization of state-owned enterprises. Corruption in private sector has been prevalent in a number of corporate scandals, where the businesses and their shareholders have suffered colossal losses due to unethical practices, like political donations, tax evasion, tax holidays, price regulations, licenses for regulated businesses, wealth transfer to offshore business allies, and others.<sup>[6]</sup> Improved corporate governance is the best solution for installing ethical systems and best practices into businesses, which in turn is beneficial for business sustainability.

Governance can be gauged by Worldwide Governance Indicators (WGI), which covers six dimensions of governance in a country namely: (i) Voice and accountability; (ii) Political stability; (iii) Government effectiveness; (iv) Regulatory quality; (v) Rule of law; and (vi) Control of corruption. The first five indicators pertain directly to the government or lawmaker behavior, but the joint strength of civil society, business associations, and independent media may be effective in advocating for redefined policies and the right reforms. Corruption in international trade, especially bribery of licensing and customs officials, is one of the most common and costly forms of corruption, causing a loss of billions of dollars each year in revenues in concerned countries. The last indicator, control of corruption, is where the private sector can play its role directly to improve governance and reap the benefits. In countries where corruption is not as prevalent, the fight against corruption is not that difficult as society, public functionaries, judiciary, and political leaders are all accountable to each other and the will to fight corruption can be established with relative ease. The international community has mobilized a number of initiatives to fight corruption, which include Transparency International [TI], Center for International Private Enterprise [CIPE] , United Nations Global Compact [UNGC], and the International Chamber of Commerce [ICC].

## Effective Anti Corruption Strategy

The fight against corruption is generally a long-term effort and consequently may span successive political administrations. That makes it critical for anti-corruption efforts to remain politically neutral, as a national goal and above personal or political interests. Corruption can be checked and eventually eradicated by using a multi pronged strategy which may include steps to address the following issues <sup>[7]</sup> :

- A. Accountability and Transparency
- B. Participation of Civil Society
- C. Well Informed and Integrated Private Sector
- D. Public Sector Reforms

## Role of Private Sector in anti-Corruption

The private sector must realize its potential as an extremely effective global stakeholder in the fight against corruption. Integrating and projecting transparency and using influence to help fight corruption can be the key to a bottom-up approach to bring the desired changes in regulations as well as to change the mind set of people. The private sector can also lead the necessary information campaigns that alert people to the effects of corruption on aspects of everyday life such as income, businesses, and education. Trade groups or business associations can also play a very substantial role in reforming the policies that provide openings for demand-side corruption, like anomalies in tariff, tax structure, business license procedures, and protection of investors' rights and by submitting their recommendations to the concerned public authorities. Business associations can also be effective in challenging corrupt behaviors through frameworks like TI's Integrity Pact for public procurement. Associations can also keep their members informed about the changes in regulatory policies and concerned laws, as small businesses can find themselves trapped into corruption through ignorance of their rights and duties.

Is there a business case for the private sector to push for corruption reduction? With globalization, businesses all over the world understand that corruption is detrimental to the economy. A number of global initiatives have been initiated to combat corruption, including Transparency International (TI), Centre for International Private Enterprise (CIPE), United Nations Global Compact (UNGC), and the Organization of Economic Co-operation and Development (OECD), and there is general consensus that the private sector must have a strong commitment at its leadership level to eradicate corruption. It is not always the public officials who are able to extract money out of firms (*speed money*). Firms are involved in various forms of corruption as well, including "*kick-backs*" and "*state capture*", when businessmen try to gain an edge over their competitors and /or to gain preferential treatment from the government.

The basic need is to have a deep-rooted commitment within the firm, at all levels, against bribery in all shapes, direct or indirect. Each organization should formulate policies against corruption, translating into action at all levels within the company, its dealers, business associates, suppliers, and others. There may be three steps to fight corruption for any company.<sup>[8]</sup> The first step may be to assess the corruption risks faced by the company, formulate policies and give adequate training to the employees to meet the challenges. The next step may be to share the policies, best practices, and experiences amongst external stakeholders for mutual learning. Once these experiences are shared with the stakeholders, it will help to build up business community consensus on the value addition of eradicating corruption. This would then lead to the possibility of building forums for collective action against corruption at various levels. One possible example includes bidders for any procurement project making a commitment to take joint action against any member violating the code of ethics jointly agreed upon. The collective action may be project based or have a long term commitment for inculcating behavioral changes in the corporate culture, which would enable the business circles to have leverage to form public voice for reforms to fight corruption. The public voice would then be able to bring the desired changes in the political / government systems to bring public sector reforms, which would decrease the demand side of the economies of corruption while the private sector should commit to address to the supply side and refrain from getting engaged in facilitating corruption.

## Challenges for businesses in fight against corruption:

In leading the fight against corruption, businesses face several challenges. Most notably, they include the following:

- Large companies face difficulties in creating global ethical values due to the cross cultural values which may differ from society to society for tolerance against corruption. Furthermore, the extent to which a population expects corrupt behavior or distrusts government and/or business creates a cultural tolerance for corruption. Only when a company nurtures its own internal culture of ethics can it rise above the challenges of operating in weak governance zones.
- Getting government and business leaders on board is difficult. Cronyism, where business leaders depend on personal and political connections, is rampant in many countries with weak institutions and poor governance. This system, as opposed to a meritocracy, is open to corruption, nepotism, and opacity.
- Ultimately, there is always a way to circumvent the system. Meaning, a solution to one problem may breed another opportunity for corruption.

## How should companies act?

The single most effective tool to combat corruption in companies is to follow the best practices of corporate governance. Ideally, the company is run by a Board of Directors, which acts in the interest of the business and all stakeholders in formulating transparent policies and incorporating effective internal controls, which would then be applied down the line by the management. The business should not only make recommendations for establishing fair policies to improve external environment but also bring their internal controls in line with best corporate governance practices.

All businesses, irrespective of size, sector, and location, must join hands to curtail corruption. Each company should formulate a well thought strategy against corruption, reflecting the various business risks faced by the firm due to corruption. After defining the scope of this drive, a policy framework should be designed, with input from employees and their representative bodies. The policies should then be communicated down the line, with ample training and discussions, so as to deeply embed ethical behavior in day to day operations and corporate culture. A system of formalized reporting should be encouraged by the management, which would raise awareness amongst employees and encourage ethical practices. Eventually this behavior will improve the reputation of the company and bring dividends.

Collective action against corruption is a relatively new mode of action suggested for the businesses operating in economies that face high corruption risks, usually in cases of procurement in a high risk public office. In such a case, bidders have a commitment to fight corruption. If done diligently, the supply side of the corruption equilibrium will be reduced, which will contract the demand side. Collective action has been effectively implemented in certain countries, for example Private sector played a significant role in reforming procurement process in Colombia.<sup>[9]</sup> The UN Global Compact's ten principles in the areas of human rights, labour, the environment and anti-corruption enjoy universal consensus and are derived from the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption. The Global Compact asks companies to embrace, support, and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption. The 10th principle was added in 2004, recognizing the negative impact of corruption on business. *"Businesses should work against corruption in all its forms, including extortion and bribery."*

The UN Global Compact suggests considering the following three elements when fighting corruption and implementing the 10 th principle.

- Internal: introduce anti-corruption policies and programs within their organizations and their business operations.
- External: Report on the work against corruption ; and share experiences and best practices through the submission of examples and case stories
- Collective: Join hands with all stakeholders, including industry peers.

### Action Points:

Businesses understand that they suffer immensely due to corruption. The excessive cost of contracts awarded or kick backs have a built-in cost factor. Also, the quality of work standards may be compromised, creating a vicious circle of debt burden and inferior service in the economy of developing nations. The best way to fight corruption is to prevent it, which can only be possible by improving efficiency, accountability, and transparency of systems, not only on a micro but also on a collective level.

- Creating awareness and commitment at the company level, by adopting policies and practices based on fair, ethical values.
- Involving various stakeholders, including business forums, government, investors, regulators, media, and civil society, by initiating and designing sustainable programs with the collaboration of all stakeholders to eradicate corruption.
- This collective action would then increase the impact of individual actions and place all players on a level playing field.
- Ethical practices can create transparency and enhance customers' and society's trust, which enhances the reputation of the business community and consequently that of the country.



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Table-1  
**Selected Asian Economies: Real GDP**

**WORLD ECONOMIC OUTLOOK-IMF**  
**April 2009**  
 Crisis and Recovery-

Country	2003	2004	2005	2006	2007	2008	2009	2010
China	10.0	10.1	10.4	11.6	13.0	9.0	6.5	7.5
India	6.9	7.9	9.2	9.8	9.3	7.3	4.5	5.6
Pakistan	4.8	7.4	7.7	6.2	6.0	6.0	2.5	3.5
Bangladesh	5.8	6.1	6.3	6.5	6.3	5.6	5.0	5.4

[1] : *World Economic Outlook- Crises and Recovery*; April 2009, IMF

[2]: *Doing Business through 2010; Reforming through Difficult Times*; Co-publication of IFC &The World Bank Report .< [www.doingbusiness.org](http://www.doingbusiness.org)>

[3]: *The Global Competitiveness Report 2009-2010*, World Economic Forum.

[4]: Transparency International Report-2009-*Corruption Perception Index*

[5]: CIPE Reform Toolkit -March 2008; "Combating Corruption: A Private Sector Approach"

[6] : Enron, Adelphia, and Satyam etc where individuals took advantage at the cost of small shareholders wealth.

[7] : A Handbook on fighting corruption; USAID

[8] : " *Fighting Corruption through Collective Action; A Guide for Business* " World Bank Institute.

[9] : " *The Private Sector's Role in Reforming Public Procurement: The Case of Colombia* " Ignacio Gómez and Jaime Arteaga . CIPE Economic Reform, April 2009.

[10] : 10th Principle of UNGC. UNGC had recommended 9 principles for business based on human rights, labour standards and environmental standards. The 10th Principle was added in 2004, recognizing the negative impact of corruption on business. "*Businesses should work against corruption in all its forms, including extortion and bribery.*"