Corruption & Shareholder Value: Why Should Investors Care?

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Corruption & Shareholder Value

- Who is Friends Ivory & Sime?
- A ‘Quiet Revolution’ in the City
- Does Corruption Affect Shareholder Value?
- What Do Investors Want?
- Next Steps
Friends Ivory & Sime

- 60 billion under management*
- Socially Responsible Investment:
  - 1984: first SRI fund in Europe
  - 1984-2001: SRI goes global and institutional
  - 2000: Responsible Engagement Overlay®

* 12/31/00

Groupwide commitment to Engagement
The City: A Quiet Revolution

- New Drivers of Change
- Pensions Disclosure Regulation
- Turnbull Report
- ABI Guidelines
Pensions Disclosure Laws

- UK Pensions Act
- France: Loi sur l’épargne salariale
- Germany: Riester Renten
- EC: CSR Green Paper

79% of UK Pensions Funds say: I do
The Turnbull Committee

- Governance movement
- Risk Management
  - Environment
  - Health & Safety
  - Reputation
    - Business Probity
- Materiality & Systems

CSR Issues Embedded in Risk Management
ABI Guidelines on CSR Issues

- Association of British Insurers:
  - £1.1 trillion assets under management
  - £600 billion global equities

- Risk Management Focus:
  - Assess, Mitigate, Monitor & Review

- Board Oversight and Accountability

Coming soon: Launch October 2001
What Are Investors Doing?
The FIS Approach

- From avoidance to **Engagement**
- **Financial materiality** of CSR issues
- Governance & Risk Management **Systems**
- **Collaboration:**
  - Academics, Industry groups, selected NGOs
  - Fellow investors

*Understanding Best Practice*
Corruption and Shareholder Value

- Are the risks posed by corruption material to shareholder value?
- What does corruption cost investors?
- What do investors expect of companies?
Corruption and Shareholder Value

- Will profits suffer if action is taken?
- Are investors policemen?
- How can investors measure effectiveness of anti-corruption systems?

Is Change Possible...?
Is Corruption a Material Risk?

- It’s “just a cost of doing business”
- Poor governance = Risk premium
  - up to 20% discount
- Top down vs bottom up valuation
  - Not a deal-breaker...
  - but an indicator of management quality

All Companies are Not Equal
Is Corruption a Material Risk?

- *Risk calculus is changing*

- Risks are probably underestimated:
  - OECD Convention
  - Public opprobrium/reputation
  - Joint venture/subcontractor standards

Superior risk analysis = profit opportunity
What Does Corruption Cost?

- Bribes paid: Our dividends
- Bribes received: Bad business decisions

Obvious and hidden costs
What Does Corruption Cost?

- Raises costs of basic services
- Undermines ALL business activities
  - staff incentive systems
  - procurement standards
  - product quality
  - safety
  - reputation

*Obvious and hidden costs*
What Do We Expect of Companies?

○ Systems for:
  ○ Training
  ○ Performance measurement
  ○ Audit
  ○ Whistleblower protection...

○ Transparency and openness
○ ‘Values culture’ vs Compliance
How Do We Measure Performance?

- Understand Best Practice
  - Dialogue
- Policy statements vs practical evidence
- Public commitment
- Better tools are needed
Taking action: Will profits suffer...?

- The hero in the un-level playing field
- Are investors policemen?
- Multilateral approach
- Investors play their part
What Next For Investors?

- Help develop effective management and reporting tools
- Promote their adoption
- Set high performance standards
FIS Approach

- FIS Benchmarking Study
- Support of specialist efforts
- Dialogue
- Collaboration with other shareholders