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Preparation Paper

United Nations Industrial Development Organization (UNIDO)

**"Corruption Prevention to Foster Small and
Medium Sized Enterprise Development"**

1. United Nations Industrial Development Organization

UNIDO was established in 1966 and became a specialized agency of the United Nations in 1985. It therefore also has its own constitution, its own member states, its own policymaking organs, its own executive head (Director-General Dr. Kandeh K. Yumkella) and its own regular budget. UNIDO also disposes of voluntary contributions to finance developmental activities.

UNIDO mobilizes knowledge, information, skills and technology in order to promote productive employment, a sound environment and a competitive economy. It enhances cooperation at global, regional, national and sectoral levels.

UNIDO is the only organization within the UN system promoting the creation of wealth and tackling poverty alleviation through manufacturing. It mainly focuses on three interdependent thematic priorities:

- Poverty Reduction through Productive Activities
- Trade Capacity-Building
- Energy and Environment

A main focus within the field of trade capacity building is on the development of the small and medium enterprise sector which is the key generator of wealth in most developing countries. Generally speaking, the organization has created the largest portfolio of projects related to trade capacity building in the UN system to improve standards of living through industries that are both internationally competitive and environmentally sustainable.

UNIDO is linked to the United Nations by a relationship agreement stating that UNIDO reports every two years to the UN General Assembly. Based on this report, the General Assembly (GA) adopts a resolution on Industrial Development Cooperation. The most recent Report of the UNIDO Director-General is the one which has been transmitted to the 1st session of the GA on 1 September 2006 (GA document A/61/305). The last resolution following a UNIDO report was adopted by the GA on 8 March 2007 (GA document A/RES/61/215). It was based on the Report of the Second Committee (GA document A/61/426/Add.2 dated 12 December 2006). UNIDO also reports to the Economic and Social Council (ECOSOC) and participates in its sessions. In addition to that, UNIDO takes an active role in the UN system with:

- contributions to the reports of the Secretary-General, including the integrated and coordinated follow-up to, and implementation of the outcomes of UN Summits and Conferences
- being one of six core agencies of the Global Compact and being the one especially assisting small and medium enterprises in their efforts to adhere to the principles of the Global Compact
- a cooperation with the UNDP
- a memorandum of understanding with the UNODC (signed in 2005) stating that joint programs are envisaged in up to five countries, focusing on UNIDO's SME and private sector development activities and UNODC's sustainable livelihood program.

2. Corruption

Corruption can take many forms varying from the minor use of influence to institutionalized bribery. The definition used by Transparency International is that corruption is "the abuse of entrusted power for private gain". Private gain can mean not only financial but also non-financial gain.

Corruption is a complex social, political and economic phenomenon which affects all countries worldwide. It undermines democratic institutions, it retards economic development and it contributes to government instability. Economic growth is stunted by corruption as outside direct investment is discouraged and small businesses within the country often don't find an opportunity to overcome the "start-up costs" required because of corruption. After the World Bank Institute, more than \$ 1 trillion dollars (US\$ 1,000 billion) are paid in bribes every year. The cost of corrupt activities is therefore equal to a full 3 percent of the world's gross domestic product.

On 24 June 2004, during the UN Global Compact Leaders Summit, it was announced that the UN Global Compact includes a tenth principle against corruption. The UN Global Compact was launched in July 2000 and is both a policy platform and a practical platform for companies committed to sustainability and responsible business practices. It seeks to align business operations and strategies everywhere with ten universally accepted principles in the areas of human rights, labor, environment and anti-corruption. Its tenth principle states that "Businesses should work against corruption in all its forms, including extortion and bribery."

OECD Guidelines for Multinational Enterprises defines the term ‘extortion’ in the following way: “The solicitation of bribes is the act of asking or enticing another to commit bribery. It becomes extortion when this demand is accompanied by threats that endanger the personal integrity or the life of the private actors involved.”

Bribery is defined by Transparency International’s Business Principles for Countering Bribery in the following way: “Bribery: An offer or receipt of any gift, loan, fee, reward or other advantage to or from any person as an inducement to do something which is dishonest, illegal or a breach of trust, in the conduct of the enterprise’s business.”

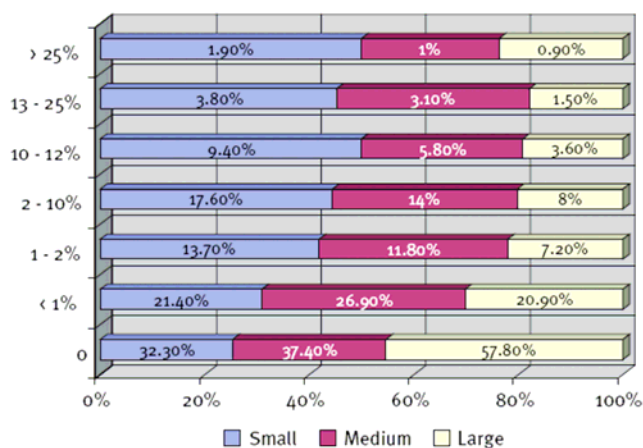
The international legal fight against corruption has gained momentum lately through the entering into force of the first globally agreed instrument, the United Nations Convention Against Corruption (UNCAC) in December 2005, as well as through the Organization for Economic Co-operation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

3. Small and Medium Sized Enterprises (SMEs) and Corruption

Out of the 75 million companies existing across the globe, around 90 percent are small and medium sized enterprises (SMEs). The importance of SMEs for long-term economic stability and the development of an efficient market economy are obvious. Corruption is a major obstacle to SME development.

Available data strongly suggests that SMEs are most likely to be affected by corruption. A country-specific example of this phenomenon was provided by a survey comparing the perceptions of corruption of small and large companies in the Philippines. It figured out that more SMEs than larger businesses believe that corruption is “part of the way things work in the country”. More SMEs were asked for bribes in order to obtain licenses or permits from the local government.

Figure 2. Percentage of revenues paid for bribes to public officials per annum



Source: WB/EBRD (2000), Business Environment and Enterprise Performance Survey

In general, SMEs are more likely to be affected by corruption because of their structure, their short-term vision and perspective, their limited financial resources, their inability to exert a strong influence over officials and/or institutions and their capital structure.

SMEs have a greater degree of informality and closer relationships between staff and a culture where corruption is more easily tolerated. While larger companies have the capacity to look ahead and consider long-term effects of corrupt practice, the staff of many SMEs only thinks about the present or very short-term future. Therefore, there is a tendency for SMEs to see the benefits of corruption while they forget to think about the hidden costs that will arise over time. Because of a shortage of capital and smaller profit margins, SMEs cannot always afford to refuse to pay bribes or other unofficial payments as the repercussions of refusing to engage in corruption could put a SME out of business.

SMEs have a lack of bargaining power and influence and therefore cannot oppose requests of unofficial payments as they do not have strong ties and connections to higher bureaucrats or politicians. Corrupt officials do not have to fear much resistance or counteractions on the part of SMEs. While larger companies are generally publicly quoted and dependent on the public perception of their prospects and are subject to even stricter stock exchange regulations, SMEs are often tightly held, without a clear separation between shareholders, management and board of directors.

The most well-known form of corruption affecting SMEs is bribery. SMEs are frequently faced with the request for additional payments for services they are entitled to anyway. Acts of bribery can be a burden to business but also advantageous. If, for an example, a bribe is provided with the aim of winning a contract, it clearly is an advantage or benefit to the entity paying it, whereas an undue payment, required for an example to get an electricity supply connection, is obviously a burden. These two types of transactions need to be dealt with in different ways.

But in fact bribery is not the only form of corruption that plays an important role for SMEs. Embezzlement or misappropriation of funds by a company's own employees, extortion, fraud, nepotism, trading in influence, and protectionism, all have a significant direct influence. Unfortunately, there is no data available comparing the relative importance or extent of these different forms of corruption. The establishment of a clear picture of the extent of this problem is complicated by the fact, that SMEs are often involved in informal networks where favors, rather than cash, are exchanged.

Reasons, why SMEs engage in corruption, are concerns to maximize profit, to survive among competitors, to deal with bureaucracy and to establish themselves in new market segments.

Corruption has many negative impacts on SMEs. Many SMEs have to pay up to 10 percent of their revenue in unofficial payments to public officials. In general, there is a lack of awareness among SMEs concerning the long-term hidden costs of corruption, such as sinking staff loyalty and retention, staff involvement in fraud, and damage to reliable supply chain relationships and investor confidence.

4. Anti-Corruption Measures

Private sector anti-corruption strategies are linked closely to corporate social responsibility (CSR) practices focusing on internal measures that are implemented by the individual company. But even though internal measures are usually implemented more easily and quicker in SMEs than in larger companies, internal codes of conduct and compliance programs alone are in many cases not helpful for the SMEs. The risk of being driven out of their market by competitors that do not adhere to such standards is far too high. Measures need to be taken in order to enable SMEs to defend themselves in a better way when faced with corruption. These measures have to be on the micro, the meso and the macro level.

On the "micro level" measures adjusting business practice to be applied internally by SMEs are to be addressed. One can refer to Article 12 of the United Nations Convention against Corruption specifically addressing the private sector. It requires State Parties taking measures in order to prevent corruption to involve the private sector, enhance accounting and auditing standards in the private sector and provide penalties for failure to comply with such measures. These measures include, for an example, the development of standards and procedures designed to safeguard the integrity of companies, including codes of conduct promoting honorable business standards and the use of good commercial practices by contractual partners.

The code of conduct prohibiting all forms of corruption is one of the main tools applied internally by companies in order to prevent and sanction corruption. However, the situation within the SMEs seems to be quite different as research findings reveal that many smaller businesses feel uncomfortable introducing such codes, or do not expect any gains or advantages from doing so.

The promotion of a code of conduct within a business association or an industry sector, instead of focusing on individual companies, could be a possible way to overcome this problem. This way, firms would not face competitive disadvantages when they no longer engage in corruption. Another measure that can be taken is to train the employees. As smaller companies often face a lack of financial resources and are therefore unable to provide appropriate training materials, other institutions such as business associations, chambers of commerce or NGOs could play an important role in facilitating that process. Another tool to detect corruption is an appropriate reporting mechanism, for instance a telephone hotline that allows reports to be made anonymously. For smaller businesses it might be helpful to let this task be fulfilled by an independent agency as there exists a high degree of informality in SMEs which makes it hard to guarantee anonymity.

Measures on the “meso level” involve other institutions and organizations in the public and private sector. This is very important for the success of anticorruption efforts in the sphere of SMEs as these businesses typically face a variety of human, financial and managerial resource constraints. The active involvement of other bodies does also help to take the fear of SMEs to get disadvantages in a corrupt environment.

Business associations bringing together SMEs of a certain geographical region or business sector can support anti-corruption initiatives. They can serve as platforms that reach agreements, make commitments to ethical standards, monitor adherence and carry out joint actions. Business associations can also establish help-desks, give advice to companies and launch forms of corporate citizenship awards.

Non-governmental organizations (NGOs) can assist SMEs by conducting research, publishing information, educating businesses and raising awareness.

Measures that can be taken on the “macro level” are for instance funds that could be made available in order to allow small businesses to go to court and claim damages caused by corruption involving public officials. In accordance to Article 35 UNCAC measures need to be taken to ensure that SMEs who suffered financial or other economic damage as a result of acts of corruption have the right to initiate legal proceedings against those responsible for that damage in order to obtain compensation. There is also the need to adjust measures that provide protection against any unjustified treatment for persons reporting act of corruption, as foreseen in Art. 33 of the UNCAC.

The cooperation between the private sector and national authorities is highly important, especially in terms of reporting acts of corruption to national investigating and prosecuting authorities (UNCAC Art. 39).

Media does also play an important role in the fight against corruption as it can help to raise awareness.

UNODC and UNIDO have to support relevant institutions, organizations and set-ups that are lobbying to change the environment SMEs are operating in and to assist SMEs to cope with corruption by facilitating and encouraging collective actions to take place in an organized and efficient manner.

5. The Work of the Expert Group on Corruption

In March 2006, an Expert Group Meeting was organized in Vienna. The aim is to discuss the problems smaller businesses face in generally corrupt environments as well as to try to find possible measures to support those businesses. The view is that SMEs are the first to be negatively affected by corruption. Joint action and collective measures therefore have promising views in that field.

6. Project development and assessment missions

UNIDO and UNODC jointly conducted a series of project development and assessment missions to Croatia, Indonesia and Malawi trying to get a more in-depth knowledge concerning the problems small companies face when dealing with corruption. Now, these missions are completed and another publication focusing on tools and measures to support SMEs in their fight against corruption is in preparation. The necessity of further missions needs to be thought over.

7. A joint “service concept” of the UNIDO and the UNODC

At the very moment, both UNIDO and UNODC are developing a joint “service concept” which shall support smaller businesses in their fight against corruption. UNIDO and UNODC are looking for potential pilot countries to carry out such project.

8. Review of the situation by the United Nations Industrial Development Organization

In the upcoming session UNIDO will focus on the negative impact corruption has on the sustainable development of SMEs. Attention will be paid to possible measures to prevent corruption in order to guarantee an environment where SMEs can carry out their business in the best possible way.

The work of the expert group, as well as the project development and assessment missions and the joint service concept of the UNIDO and UNODC need to be reviewed in order to guarantee an efficient fight against corruption carried out by these two organizations in the future.

New measures to fight corruption need to be thought of. Considering the fact that corruption is a problem of worldwide importance special attention is paid to measures on the macro level involving every member state.

9. Further information

Please have a look at the following web pages

<http://www.un.org>

<http://www.un.org/aboutun/chartlg.html> (UN organization chart)

<http://www.unido.org/index.php?id=5651> (UNIDO main page on corruption)

<http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/anti-corruption.html> (Principles of the UN Global Compact)

http://www.unglobalcompact.org/Issues/transparency_anticorruption/index.html (Main Page on Anticorruption of the UN Global Compact)

http://www.transparency.org/policy_research/surveys_indices/gcb/2007 (Global Corruption Barometer 2007 from Transparency International)

http://www.transparency.org/news_room/in_focus/2008/cpi2008/cpi_2008_table (Corruption Perceptions Index)

<http://www.unodc.org/unodc/en/corruption/index.html> (Page on Corruption by UNODC)

<http://www.unodc.org/unodc/en/treaties/CAC/background/index.html> (United Nations Convention Against Corruption)

http://www.oecd.org/document/21/0,3343,en_2649_34859_2017813_1_1_1_1,00.html#Text_of_the_Convention (Convention on Combating Bribery of Foreign Public Officials in International Business Transactions)

http://www.oecd.org/document/44/0,3343,en_2649_37447_42217196_1_1_1_1,00.html (OECD page on Corruption)