

Rules of Engagement for Confronting Corruption in Emerging Markets

As horizons expand internationally and emerging markets become more attractive investment options, corporations expose themselves to an increasing amount of risk. For stability operations organizations that regularly support government and private sector operations in the most dangerous places around the globe, such exposure is not new and is often unavoidable. The use of risk-based due diligence to vet operating environments and third-party relationships has therefore become standard operating procedure; yet, in the volatile environments in which these companies most frequently operate, the use of tactical level due diligence to review individuals and entities on a per-project basis is no longer sufficient.

To thrive in emerging markets—indeed, to operate most effectively—corporations, including stability operations organizations, must develop new Rules of Engagement to confront corruption. Stability operations companies must set specific guidelines for how they conduct global business operations, especially in jurisdictions where the rule of law is limited or non-existent, where institutions are weak, and/or where corporate governance in the local private sector is limited. Despite the upfront costs, companies that get ahead of this regulatory curve are likely to increase their efficiency, protect their investments, and earn a reputation for responsible and ethical practices in venues where they will continue to operate in the future.

Ahead of the law: The regulatory forces behind Rules of Engagement

The regulatory environments in which stability operations organizations work have always been complex and difficult to navigate. To address the legal and ethical challenges encountered in high-threat, high-risk environments, US regulators have tried to target corruption 'down-range'. Myriad non-governmental, not-for-profit, and for-profit organizations have also promulgated guidance and standards, or 'soft law', to which companies may choose to adhere—or not—when dealing with third parties.

Thought leaders and organizations such as the Organisation of Economic Cooperation and Development (OECD); the World Economic Forum – Partnering Against Corruption Initiative; Transparency International; and the Special Representative of the UN Secretary General on Business and Human Rights, who guided the development of the Montreux Document affirming states' obligations to oversee private security companies, provide some guidance, primarily with respect to compliance program design. Such 'soft law' has sprung from the recognition that investors in high-risk regions must encourage smart business practices among themselves if they are to avoid new regulations that may hinder growth and innovation.

Despite the prevalence of these standards, however, there is little affirmative 'hard law' directing how to navigate high-risk business operations and relationships, particularly in emerging markets. The standards noted earlier are generally not affirmative legal obligations and do not detail the specific actions those responsible for a company's governance must take when operating in uncertain environments. Without clearly enumerated Rules of Engagement, questions continuously arise, and the risk of ethical transgressions increases.

When the resources needed to enter an emerging market are at a premium, it's difficult to envision the benefit of getting ahead of the 'hard law' to create rigorous, self-enforcing policies without being explicitly told to do so by a regulator or independent body. However, the stewards of compliance are wise to establish such Rules of Engagement for their companies to protect and enhance their business interests in the long term.

When engagements are as highly visible as they are for the stability operations community, critical stakeholders need to feel confident that their interests are protected. Should a company experience a regulatory breach, the existence of compliance-based Rules of Engagement will demonstrate to regulators that the company is committed to adherence to the rule of law and good corporate governance—a vital

mitigating factor when regulators determine consequences. The benefits of well-managed compliance programs also include the overall efficiencies that arise from having robust operating procedures, as well as the financial benefits realized by avoiding investigations that allege wrong-doing and incur extraordinary penalties for non-compliance with the law.

In addition, developing increased familiarity with potential partners regardless of the business need is critical to reducing exposure to moral hazard, the concept that in principal-agent relationships, agents may be more inclined to act recklessly if they are not likely to bear consequence from risky behavior.¹ Perhaps most importantly, the reputation of a company that proactively manages threat and risk is likely to have a positive effect on investment potential.

Finally, the ability to anticipate regulatory change and proactively address it places a company ahead of the curve, leaving it less likely to play catch up when unexpected regulations require steep expenditures to immediately correct business procedures. As global investment in emerging markets continues to increase, focused regulation will surely follow. By considering these issues now, stability operations organizations will prepare to participate successfully in the new regulatory theater.

Developing Rules of Engagement

Successful navigation in the jurisdictions described here requires preparation and agility. Rules of Engagement will dictate how a company operates, engages with peers, and manages its image in the media. When establishing Rules of Engagement for dealing with third-party relationships, three critical components should inform the guidelines.

First, as previously noted, is risk-based due diligence and third party selection. This component enables a company to understand not only who the third party is, but also to determine what additional risk that partnership might present, and what further contractual safeguards are necessary as a result. Moving beyond the 'check-the-box' standard requires robust desk research combined with on-the-ground diligence to validate and enhance the intelligence. These efforts often yield valuable information that is critical when evaluating partnership decisions and are therefore worth the time and resources it takes to conduct them.

¹ See Ware, G., Salas, S & Folsom, S, Reducing Risk by Disrupting Moral Hazard, Law 360 at <http://www.law360.com/whitecollar/articles/337914/reducing-corruption-risk-by-disrupting-moral-hazard>

Second, once a third-party relationship is entered into, continuous monitoring of the relationship is essential. Such oversight promotes consistency of business operations and increases the likelihood that any red flags will be recognized and appropriately addressed early on. The willingness to terminate a poorly performing third-party agent is not only smart business, but it also signals to regulators that a company is ready and able to self-regulate. Monitoring allows the principal to balance the relationship against long-term business needs and to make changes easily where necessary.

Third, an internal controls system to monitor payments is necessary—and it's a component regulators will expect. Such a system will help prevent fraud while decreasing the likelihood that fraudulent activity will go unnoticed.

Concurrently, monitoring payment processes proactively means business can operate smoothly without valuable time lost on payment disputes. These three components, with a strong emphasis on the initial due diligence, provide a solid framework for developing and implementing Rules of Engagement.

Uncertainty is inherent in risk. This does not suggest, however, that all risks are unavoidable. Knowing with whom you are doing business and setting the terms of the relationship—legal, ethical and operational—at the outset is of paramount importance. Conducting risk-based due diligence on third parties enables decision-makers to make informed choices about the merits of engaging with those potential partners. Weighing due diligence results with a company's strategic objectives creates a framework for designing Rules of Engagement that better position the company to confront corruption and thrive in a high-risk, competitive marketplace. Adequately established, Rules of Engagement will enable a company to identify and select a higher performing ethical group of third parties, reducing the threat to itself, and encouraging greater business success.

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