

ANALYZING BRIBERY AND CORRUPTION

INTRODUCTION

While there is no one-size-fits-all approach to assessing and financializing bribery/corruption risks, we lay out some of what we have learned when approaching this issue in our investment process. Analyzing this issue requires deep fundamental research, coupled with a focus on active ownership and engagement. Since there is no one governance model that will ensure the elimination of these issues, our assessment of these issues and ongoing engagement with management is always case-by-case and company-specific. That said, there are certain risk factors and company-specific flags that can be helpful in the research process to identify companies with higher risk of exposure to bribery/corruption.

Financializing the risk of bribery/corruption or a known allegation is also fraught with difficulty (e.g., inherent imprecision of fine estimates; limits to what management can know, disclose and control) but nevertheless important when assessing the range of outcomes for a given investment. We lay out some of the tools at our disposal to help financialize this risk.

Active and ongoing engagement with management can help us get ahead of these issues and is also essential in the wake of a scandal to hold management accountable for failures. We detail some of the lines of enquiry we have found most helpful when discussing this issue with management teams.

We conclude with an example of how we have approached bribery/corruption for companies under coverage to bring to life our ESG integrated investment process.

DIMENSIONS OF BRIBERY/ CORRUPTION RISK

GENERAL RISK FACTORS

1. Geography

- a. % of revenue or profits coming from countries at higher risk of bribery/corruption
- b. Transparency International Corruptions Perception Index

SCORE COUNTRY/TERRITORY

88	Denmark
88	Finland
88	New Zealand
85	Norway
85	Singapore
85	Sweden
84	Switzerland
82	Netherlands
81	Luxembourg
80	Germany
78	United Kingdom
76	Hong Kong
74	Canada
74	Iceland
74	Ireland
74	Estonia
74	Austria
73	Australia
73	Belgium
73	Japan
73	Uruguay
71	France
70	Seychelles
69	United Arab Emirates
68	Bhutan
68	Taiwan

67	Chile
67	United States of America
65	Barbados
64	Bahamas
63	Qatar
62	Korea, South
62	Portugal
61	Lithuania
61	Spain
59	Israel
59	Latvia
59	Saint Vincent and the Grenadines
58	Cabo Verde
58	Costa Rica
57	Slovenia
56	Italy
56	Poland
56	Saint Lucia
55	Botswana
55	Dominica
55	Fiji
55	Georgia
54	Czechia
54	Malta
54	Mauritius
53	Grenada

53	Cyprus
53	Rwanda
53	Saudi Arabia
52	Oman
52	Slovakia
49	Armenia
49	Greece
49	Jordan
49	Namibia
48	Malaysia
47	Croatia
46	Cuba
46	Montenegro
45	China
45	Romania
45	Sao Tome and Principe
45	Vanuatu
44	Jamaica
44	South Africa
44	Tunisia
43	Ghana
43	Hungary
43	Kuwait
43	Senegal
43	Solomon Islands
42	Bahrain
42	Benin

42	Burkina Faso
42	Bulgaria
41	Timor-Leste
41	Belarus
41	Trinidad and Tobago
40	India
40	Maldives
39	Kosovo
39	Colombia
39	Ethiopia
39	Guyana
39	Morocco
39	North Macedonia
39	Suriname
39	Tanzania
39	Vietnam
38	Argentina
38	Brazil
38	Indonesia
38	Lesotho
38	Serbia
38	Turkey
37	Gambia
37	Kazakhstan
37	Sri Lanka
36	Cote d'Ivoire
36	Ecuador

36	Moldova
36	Panama
36	Peru
35	Albania
35	Bosnia and Herzegovina
35	Malawi
35	Mongolia
35	Thailand
34	El Salvador
34	Sierra Leone
33	Egypt
33	Nepal
33	Philippines
33	Zambia
33	Algeria
32	Eswatini
32	Ukraine
31	Gabon
31	Mexico
31	Niger
31	Papua New Guinea
30	Azerbaijan
30	Bolivia
30	Djibouti
30	Dominican Republic

30	Laos
30	Paraguay
30	Togo
30	Kenya
29	Angola
29	Liberia
29	Mali
29	Russia
28	Mauritania
28	Myanmar
28	Pakistan
28	Uzbekistan
27	Cameroon
27	Kyrgyzstan
27	Uganda
26	Bangladesh
26	Madagascar
26	Mozambique
25	Guatemala
25	Guinea
25	Iran
25	Tajikistan
24	Lebanon
24	Nigeria
24	Central African Republic
23	Cambodia
23	Honduras

23	Iraq
23	Zimbabwe
22	Eritrea
21	Congo
21	Guinea Bissau
20	Chad
20	Comoros
20	Haiti
20	Nicaragua
20	Sudan
19	Burundi
19	Democratic Republic of the Congo
19	Turkmenistan
17	Equatorial Guinea
17	Libya
16	Afghanistan
16	Korea, North
16	Yemen
14	Venezuela
13	Somalia
13	Syria
11	South Sudan

Source: Pzena analysis, Q2 2022

Note - less of a quantitative screen (perception-based only) and more of a way to compare investment risk profiles

DIMENSIONS OF BRIBERY/ CORRUPTION RISK

2. Government involvement
 - a. Flows of money to government or pseudo-government entities
 - b. Reliant on government for approvals/license to operate
3. Size of contracts at stake
4. 3rd party involvement
 - c. Use of subcontractors
 - d. Reliance on agents and/or lobbyists
 - e. Active JVs and participation in consortiums

While the issue is technically sector agnostic, some industries have particular exposure to these risk factors and so have developed a reputation for ongoing issues.

EXAMPLES OF HIGHER RISK INDUSTRIES	RISKINESS OF GEOGRAPHY	DEGREE OF GOVERNMENT INVOLVEMENT	SIZE OF CONTRACTS	DEGREE OF 3RD PARTY INVOLVEMENT
Aerospace & Defense	High	High	High	High
Extractives	High	High	High	High
Engineering and Construction	Medium	High	High	High
Telecom	Low	Medium	Medium	Medium
Distilleries	Low	High	Low	Medium
Pharma/Healthcare	Low	High	Medium	Low
Banks	Banks play a supporting role for financing all industries and so are often the conduit of illicit funds			

Source: Pzena analysis, Q2 2022

COMPANY-SPECIFIC FLAGS

1. Undue success in one or more specific regions (i.e., is the company always winning contracts)
2. Unusual flows of money
 - a. Significant charitable donations in one or several regions
 - b. Significant entertainment expenses
3. Staff movements/resignations

FINANCIALIZATION - DIRECT:

- Fines:
 - If fines are already known/disclosed then these can be incorporated directly into the model
 - If fines are unknown, then they can be estimated using past precedent. This is particularly true when falling under domestic anti-corruption statutes, e.g., Foreign Corrupt Practices Act FCPA and UK Bribery Act (UKBA)
- Position-Sizing:
 - Since the range of fines will vary, position sizing should account for inherent riskiness of these fines and any uncovered issues
 - We can mitigate portfolio risk by maintaining a smaller position size for companies impacted by this risk factor

FINANCIALIZATION - INDIRECT:

- Regulatory Penalties:
 - Companies may be subject to consent decrees or other government-imposed penalties, e.g., a bank may be held to higher capital requirements or a company may be prevented from paying bonuses which could lead to talent attrition
- Reputational Damage:
 - Widens the range of outcomes for an investment, e.g., risk of public backlash; diminished employee morale leading to talent attrition; reduced market access; and loss of customers
 - In extreme cases it can increase a company's cost of capital and/or close off certain markets

ENGAGEMENT TOPICS

Engagement on this topic can serve two purposes:

1. To try and get ahead of any risk of a bribery/corruption incident by better understanding the risk profile of an investment
2. Once an incident of bribery/corruption has occurred, it is important to continually engage to hold management accountable and understand the range of remediation activities and the inherent associated tradeoffs.

Some lines of enquiry that can help when probing management on this issue include

- Company governance
 - Tone from the top on these issues
 - Board effectiveness (independence, experience, independent effectiveness review, etc.)
 - Agenda of audit committee
 - How different levels of the organization are incentivized
- Anti-bribery/corruption policies and controls:
 - How they are implemented and monitored
 - How effectiveness is determined/assessed
- Use of agents/lobbyists
 - Sourcing process
 - Operating practices and oversight capabilities
- Remediation
 - Sense of ownership for remediation, e.g., full cooperation with authorities vs. denial
 - How and why these issues will never happen again
 - Reasons for executive resignations (as appropriate)

CASE STUDY

ANDRITZ: ENGINEERING & CONSTRUCTION

- ESG/Investment controversy: engineering & construction is a high-risk industry for bribery and corruption issues
- Research Insight:
 - Analyzed and engaged on the following to get comfortable that Andritz was a responsible operator:
 - History of company financials, including balance sheet strength, margins, etc.
 - Company process to determine whether to reject or bid for a project
 - Operating policies and procedures, including project management risk assessments that include environmental and social issues
 - Allegations made by one third party ESG data provider of lax operating standards in one prior project were dated and unrelated to projects operated by Andritz
- Research challenges: strong policies, procedures and operating practices are not a guarantee that there will be never be any future issues
- Ongoing engagement objective: continually probe on the issues above to make sure there is no change in our assessment of the risk profile of the investment

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