

# **Building Integrity and Reducing Corruption in Defence**

**A Compendium of Best Practices**



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## Chapter 20

# The Defence Industry as an Ally in Reducing Corruption

For an anti-corruption regime to function effectively, the defence industry must be associated with it. Defence suppliers increasingly recognise the importance of corporate social responsibility and legitimisation, associated with greater transparency. This chapter presents the integrity policies of two major defence contractors and outlines further measures that can be taken by the defence industry and governments to enhance the integrity of the defence sector.

## 1. Defence Industry as Part of the Solution to Reducing Corruption: An American Perspective

Some argue that corruption in certain marketplaces is simply a cost of doing business within that market. The implication of this premise is that efforts to fight corruption are futile and unnecessary. One should simply accept this tax on doing business and move on. This view ignores the very real evils of corruption. It destroys public trust in governments and corporations, lessens the quality of products and services procured using public funds and undermines the efficient functioning of the free marketplace. Fortunately, this view is becoming less credible in today's interconnected world where large scale corruption—which in the end is almost always discovered—is publicized and criticized to the detriment of all parties involved.

In recent years, the defence industry has been buffeted by allegations of corrupt behaviour around the globe. This has significantly weakened confidence in an industry that largely depends on public funds. It may seem incongruous therefore to say that a partnership between industry and government represents the only effective means to fight corruption. If one steps back, however, it seems logical that the problem of corruption must be attacked from both the supply side—typically the defence industry—and the demand side—typically government agencies or personnel.

This section examines the supply side of corruption, focusing on best practices undertaken by major defence corporations within the United States, Lockheed Martin in particular, to ensure that business is conducted in accordance with high ethical standards.

### The Defense Industry Initiative (DII)

Most of the major defence contractors within the United States belong to the DII. The initiative was established in 1986 in response to an erosion of public confidence in the

industry caused by widely reported instances of fraud, waste and abuse both within industry and the Department of Defense. All DII signatories agree to adopt and adhere to six self-governance principles, presented in Box 20.1.

Each DII signatory agrees to complete a detailed annual questionnaire relating to their ethics programs and practices. The results of this questionnaire are compiled and reported upon in the annual DII Public Accountability Report.<sup>1</sup>

While all members of the DII adopt their own approach to compliance with these six principles, over time and through the sharing of best practices, the ethics programs of major US defence contractors have come to share certain common elements.

## Elements of an Effective Ethics Program

### *a. Codes of Ethics or Conduct*

Every DII signatory has adopted a code of ethics, also referred to as a code of conduct. A code of conduct sets forth the values and standards that the company and its employees are expected to uphold. To be effective, a code should reflect the company's culture and commitment to integrity. Many codes adopted by US companies set forth compliance standards, in addition to expressing the company's values. DII member codes typically include standards that address issues ranging from discrimination and harassment to business courtesies, anti-corruption and anti-kickbacks.

Lockheed Martin's code, "Setting the Standard, Code of Ethics and Business Conduct,"<sup>2</sup> has been in existence since the corporation's beginning. The code emphasizes

### **Box 20.1. Self-governance Principles of the Defense Industry Initiative**

1. Each signatory shall have and adhere to a written code of business conduct. The code establishes the high ethical values expected for all within the signatory's organization.
2. Each signatory shall train all within the organization as to their personal responsibilities under the code.
3. Signatories shall encourage internal reporting of violations of the code, with the promise of no retaliation for such reporting.
4. Signatories have the obligation to self-govern by implementing controls to monitor compliance with federal procurement laws and by adopting procedures for voluntary disclosure of violations of federal procurement laws to appropriate authorities.
5. Each signatory shall have responsibility to each other to share their best practices in implementing the DII principles; each signatory shall participate in an annual Best Practices Forum.
6. Each signatory shall be accountable to the public.

*Source: Charter of the Defense Industry Initiative, Article III: [www.dii.org](http://www.dii.org).*

<sup>1</sup> The annual reports since 2003 are available on the DII website: [www.dii.org](http://www.dii.org).

<sup>2</sup> Available for download at [www.lockheedmartin.com/data/assets/corporate/documents/ethics/setting-the-standard.pdf](http://www.lockheedmartin.com/data/assets/corporate/documents/ethics/setting-the-standard.pdf).

Lockheed Martin's commitment to the highest standard of integrity and the important role that each employee has in maintaining that commitment. It informs employees of the values that are important to Lockheed Martin and their role in upholding those values. Every employee must certify that they have received the code, read and understood it and agreed to abide by it.

Thus, for example, one section of the code entitled "Do Business Ethically Outside the United States," states that Lockheed Martin's commitment to the highest standards of ethical conduct extends globally. The code also states:

*Bribery, violations of export and import laws, and participating in illegal boycotts, erode confidence in the marketplace, undermine democracy, distort economic and social development, and hurt everyone who depends on trust and transparency in the transaction of business.*<sup>3</sup>

This reflects Lockheed Martin's value, "Do What's Right." The section goes on to require employees to comply with the national and local laws of the countries in which Lockheed Martin operates. The section expressly directs employees to pay particular attention to compliance with anti-corruption laws, including those adopted under the Organisation for Economic Cooperation and Development's (OECD) Convention on Combating Bribery of Foreign Officials and the US Foreign Corrupt Practices Act, among other international anti-bribery conventions.<sup>4</sup>

### *b. Formal Ethics Organizations*

Most large US defence contractors have formal ethics organizations that manage and implement the company's ethics program. Formal ethics programs help ensure that a company's code of conduct is meaningful. Typically, such a program serves at least two critically important functions: (1) communication, training and outreach with respect to the company's values, commitment to the code, and compliance; and (2) enforcement of the code.

When fulfilling its communications and outreach efforts, the organization basically is seeking to ensure that a commitment to integrity is embedded in the company's culture. In many ways, this is the most important function that a formal ethics program can fulfil. The most effective means to prevent misconduct or corruption is to ensure that you create a culture where all employees understand that they will be held accountable for their improper actions.

A culture of integrity will not take root, however, if employees believe that the organization's values and code are mere words on paper and do not represent how the company really operates. Therefore, it is very important to balance the need to protect the privacy of employees with the need to inform them about the consequences for those who choose to ignore the company's code.

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<sup>3</sup> Lockheed Martin, *Setting the Standard: Code of Ethics and Business Conduct* (Bethesda, MD: Lockheed Martin Corporation, October 2008), 12.

<sup>4</sup> *Ibid.*, 12.

The placement of the organization within the company's governance structure is also important. It must be high enough within the organization to reinforce the importance of ethics and integrity to the organization and to ensure its independence. In the US, the majority of ethics programs report to the company's General Counsel, or directly to the CEO. Most also have established lines of reporting and/or communication with the Board of Directors.

Finally, the most effective ethics organizations have full or part time ethics officers embedded within their major lines or business. Ethics officers represent the human face of the ethics organization and are available for consultation and guidance, as well as to investigate instances of alleged misconduct. By being embedded within the business, ethics officers can also proactively offer guidance while business is being conducted.

At Lockheed Martin, the ethics organization reports to the chairman, CEO and president of Lockheed Martin, as well as to the Board of Directors. The organization has more than sixty-five full and part-time ethics officers who are embedded within the lines of business.

#### *c. Hotlines, Helplines or Reporting Channels*

An essential element of most US ethics programs is a means by which an employee can report their concerns to, or ask for guidance from, the ethics organization. Most US ethics programs have established many different avenues for employees to report their concerns, or seek guidance on ethical issues. These include in-person visits to ethics officers, sending e-mails directly to a particular ethics officer or to a corporate ethics e-mail box, posting on a designated website, or sending faxes or letters. The most important reporting channel, however, is a hotline or helpline. Typically, this is a toll-free phone number, which connects employees directly to the ethics organization. Such hotlines generally allow employees to report their concerns anonymously if they do not want to identify themselves. They also have an established means by which an employee who leaves an anonymous report can call the same hotline and receive an update on the ethics organization's investigation into their concerns.

Effective reporting channels ensure that employees who observe misconduct or feel pressure to participate in corruption have an avenue to ensure that their concerns are heard and resolved. To be effective, the company must strongly reinforce the fact that it will not permit retaliation against employees who avail themselves of these reporting channels in good faith. Fear of retaliation is one of the primary reasons that employees do not report their concerns to the company.

#### *d. Training and Outreach*

Most US ethics programs also include compliance training and training on the company's code of conduct. Compliance training is focused training that addresses particular areas of regulatory or legal risk a particular company faces in its industry. Code of conduct training, called "awareness training" at Lockheed Martin, may include compliance issues, but focuses more on a company's values, culture and ethical decision making. Neither compliance training nor code of conduct training attempts to turn em-

ployees into experts on particular laws or regulations. They are designed to raise awareness and help employees understand when they should seek guidance before acting.

At Lockheed Martin, employees are assigned computer-based compliance training based on the function they perform within the organization. For example, we do not require a mechanic who works on an airplane to take export/import training because their day-to-day responsibilities do not require them to know about this topic. All employees, on the other hand, are required to take the labour course because, as a US government contractor, this is an area about which all employees must be knowledgeable. In addition, each required compliance course must be repeated periodically – every one or two years. Finally, provision is made for those employees who do not have access to a computer or have special needs.

Awareness training is provided annually. Unlike the computer-based compliance training, the majority of Lockheed Martin's awareness training is delivered in person by the employee's leader. This is accomplished using a cascading process whereby Bob Stevens, Lockheed Martin's chairman, CEO and president, trains his staff, they train their staff, and on down through the organization until all employees are trained. The training generally takes an hour and is based on video scenarios and participative dialogue around the issues presented.

#### *e. Communication*

Effective ethics programs also expend significant effort on innovative communications vehicles to ensure all employees remember the importance of upholding the company's ethical standards. Companies use newsletters, e-mail messages, posters, postcards and websites to deliver target messages throughout the year relating to ethics and integrity. Creative communication vehicles engage employee's attention often better than required training. Many companies in the US increasingly are using technology to develop new means to deliver ethics messages to their employees. For example, companies are posting video vignettes of ethical dilemmas on YouTube and blogging about ethical dilemmas or current events involving ethical successes or failures.

At Lockheed Martin, *Integrity Minute* is the most popular communication vehicle that the ethics organization employs. The Lockheed Martin *Integrity Minute* is a short series of videos that are e-mailed to Lockheed Martin employees to complement annual awareness training by reinforcing ethics, diversity and Full Spectrum Leadership messages throughout the year. Lockheed Martin releases three *Integrity Minute* series each year. They are specifically targeted to trends that are observed in the workplace. Each series highlights important topics such as the proper conduct of international business, harassment, conflicts of interest, discrimination and other instances of employee misconduct. The scenarios are presented in two minute segments over the course of three weeks. The first two segments end with a cliff hanger and invite employees to tune in for the next week's segment to learn what happens.



## Specific Techniques to Fight Corruption

Backed by a strong ethics program which ensures that integrity is part of the fabric of our company's culture, the following is a summary of certain targeted techniques that Lockheed Martin has found effective in combating corruption:

- Code of Conduct sections dealing with anti-corruption, the giving and receiving of business courtesies and conflicts of interest.
- Detailed company policies that address kickbacks, business courtesies and conflicts of interest.
- Country-specific hospitality guidelines that establish appropriate limits for business courtesies in the countries where we operate. This guidance is easily available to our employees.
- Regular reports are required of any business courtesies that exceed the hospitality guidelines and for any facilitation payments made.
- Compliance and code of conduct training specifically addressing the company's anti-corruption policies.
- Audits of all aspects of our anti-corruption efforts.
- Rigorous due diligence is performed on all third-party agents and consultants in advance of engaging such individuals. Due diligence includes, at a minimum, a review of public source information, reference checks, inquiry with in-country embassies and a face-to-face interview.
- Third-party agents and consultants are required to abide by *Setting the Standard*, Lockheed Martin's Code of Conduct and, more specifically, Lockheed Martin's anti-corruption standards.
- Agreements with third-party agents and consultants are subject to periodic review, including repeated due diligence.

## 2. Policy of Integrity: The Example of a European Defence Contractor

Over recent years, major international companies have come to recognise that strict ethical standards and compliance with international laws and regulations have to be an integral part of their strategic vision. Responding to major changes in the global economic and geopolitical context and the increasingly global scope of their operations, companies have taken a long, hard look at the way they conduct aspects of their business ranging from human resource management to marketing and sales, industrial operations and stakeholder relations. Adopting its corporate responsibility policy in 2001, Thales was one of the first European companies to formally embrace these changes.

## A Complex, Changing Environment

Throughout its history, Thales has successfully adapted to changes in its environment. Ongoing transformations in the institutional framework governing the “sovereignty industry” in the early 21<sup>st</sup> century are at least as significant as any of these other changes.

Thales and the businesses it has acquired in other countries (the United Kingdom, Netherlands, Australia, etc.) operated for decades in a strictly national framework and under close state control. As the main customer and sometimes even a shareholder, the state was also involved in setting corporate strategy, funding research and development, granting export clearances and other aspects of the business.

Now that Thales is a “multidomestic” company, it no longer operates within a single, clearly defined and consistent national framework but rather in a strategic space with global dimensions. In this new context, tasks such as managing human resources or international business transactions are becoming ever more complex.

As global as they have become, the company’s businesses still rely on technologies that are sensitive, strategic and central to the national sovereignty of each state. This structural contradiction presents many challenges both to transnational companies and their regulators, and calls for a different set of management methods based on innovative concepts of corporate governance.

## More Transparency and Traceability

Adding to the complexity of this international economic environment, international organisations and national lawmakers continue to make new regulations and pass new laws, not always consistently, while stakeholders from civil society, including non-governmental organisations, continue to demand new and higher standards from the business community.

In the absence of a global model of governance, the sheer number and complexity of these different rules and requirements make the business environment even more incoherent – particularly considering that certain “soft law” codes and standards, many of them British or American in origin, are at odds with the legal systems of other countries. With increasingly globalised business and a complex legislative and normative context set by multiple bodies, demand for transparency is constantly growing, forcing companies to bring a much greater degree of openness and traceability to their business processes.

## Ethical Management

As pressure on governance practices mounts around the world, the sphere of influence of public bodies—the only bodies with the power to enact “hard law”—is gradually diminishing because no hard law is perfectly aligned with economic realities for very long. Frequent revisions and amendments are needed to make laws more specific but the more they are revised, the more obscure they tend to become. As a result, there is

a growing tendency for lawmakers to lay down little more than basic legislative principles, leaving it up to companies to define their own codes, baselines and standards of ethical conduct. The concept of ethics and corporate responsibility starts where the law ends.

This shift in the governance framework places greater responsibility on companies, directly impacting their management processes and business models. Several years ago, Thales established a comprehensive policy on ethics and corporate responsibility as part of its efforts to adapt to these new conditions. In a restrictive legal and normative framework, managers are constantly required to make choices about the applicability of different standards. They have to strike a balance between minimum effort and optimum effort, weighing up their options to determine the best way to ensure sustainable growth and profitability over the long term. These choices are a key part of the manager's responsibility and they become more difficult as the number of stakeholders increases and as their demands become more specific.

Management also has to embrace and reconcile the moral expectations of all company employees, whose cultural backgrounds and traditions clearly become more diverse as the company expands its international footprint. To manage companies effectively in this globalised context, it is important to move from the implicit to the explicit, from oral tradition to written requirements, from discretionary decision making to behaviours governed by accepted best practices. A new management paradigm has emerged.

## **Risk Management**

Any business undertaking involves a degree of risk. However, worldwide flows of sensitive technologies, growing legal complexity, new societal demands and ever more intense competition make it more important than ever before to identify and manage risks. In addition, the civil and criminal liability of companies and their leadership teams is being called into question more frequently as the business world becomes more litigious.

As a result, and in light of its sectors of activity, Thales's corporate responsibility policy is based not only on in-depth analysis of the risks of non-compliance but on rules of ethical conduct and integrity that are upheld by the company's most senior management bodies and communicated systematically to all employees. This approach boosts management awareness of the issues involved and provides a company-wide framework of continuous improvement that configures the development of the policy measures already in place.

## **Tailored Processes**

Thales believes that doing business responsibly means, first and foremost, complying with international trade regulations and, in particular, taking measures to avoid exports of sensitive technologies and defence equipment to countries classified as risks, thereby helping address the challenges posed by the proliferation of weapons of mass

destruction and global terrorism. Internal control procedures are being reinforced throughout the company to combat corruption as effectively as possible, in a sector where transactions represent considerable sums of money and may involve countries with little concern for ethical practices.

### **Rigorous Procedures to Prevent Corruption**

A coherent set of directives and strict procedures for delegating responsibilities is in place to ensure compliance with national and international anti-bribery laws. In particular, measures have been taken to ensure that operating units do not independently enter into contractual relationships with agents or external service providers to facilitate international business transactions. All resources supporting export sales and marketing efforts of operating units are managed by dedicated organisations, particularly by Thales International. These are the only organisations accredited by the company to handle these complex issues in their strict regulatory framework. This policy improves the efficiency of Thales's sales and marketing efforts and assures strict monitoring of the compliance of its international commercial transactions.

The procedures and directives apply to all external service providers, including individuals, consultancy firms and companies, that support Thales in marketing and sales operations involving public as well as private customers. Eligible consultants must be recognised as experts in their fields at the regional or international level. Stringent selection procedures are applied: a detailed application questionnaire must be completed, copies of company registrations and all other official documents, particularly annual reports, must be provided, and senior management must undertake to apply all legislation relating to ethical conduct in international trade. All this information is analysed and validated by an outside body. Risk factors are flagged when information provides grounds for closer investigation and referral to a higher level of management for a decision. Certain types of information are classified as "show stoppers" and bring the selection process to an immediate halt. Payments for these services are also subject to stringent procedures. For example, transfers may not be made to a financial establishment located in a tax haven, and all payments must correspond to an actual service and reflect the exact type of service provided.

All these procedures are laid down in the *Best Practices Handbook* developed and approved by Thales corporate management. A continuous improvement process is in place to increase both the exhaustiveness of the procedures and the measures taken to enforce them.

### **Development of Best Practices**

A company is at risk if its competitors are able to meet minimum legal requirements by making less ethical choices. A sector-wide approach is therefore needed so that common standards can be developed and adopted as best practice by all companies, thereby restoring a level playing field. Thales was involved in launching just such an initiative within the Aerospace and Defence Industries Association of Europe (ASD).

## Ethics and Corporate Responsibility at Thales

Thales corporate management recognises that an effective compliance policy needs to extend beyond international marketing and sales transactions to include all of the company's operations. The Thales ethics and corporate responsibility policy is anchored in a Code of Ethics issued to each employee, and in a number of company-wide sets of processes and procedures dealing with commercial, environmental, labour and societal issues. A dedicated organisation has also been established, with an Ethics and Corporate Responsibility Committee setting Thales policy and a dedicated corporate department in charge of implementing that policy. Local implementation—at the divisional and country level—is supported by a network of ethics officers.

At the same time, large-scale awareness, information and training campaigns, including an e-learning programme, have been developed to support employee engagement across the organisation and ensure that all employees share the company's ethical values.

## 3. Further Measures to Enhance the Integrity of the Defence Industry

Recently, major defence contractors in Western Europe and North America have made visible progress in adopting and enforcing codes of ethics and standards of zero-tolerance to corruption in all its forms. Associations of these industries have embarked on deriving lessons learned and enhancing industry standards. Box 20.2 provides an example of activities in the framework of the Aerospace and Defence Industries Association of Europe (ASD).

Addressing the supply side of corruption, major contractors and defence industry associations will continue to assess and attempt to increase the effectiveness of integrity codes and standards, to engage defence suppliers, including small and medium enterprises, and widen the geographical coverage of application. A level playing field and fair competition can be guaranteed only through application of consistent and harmonised standards among all exporting companies.

Prime defence contractors should also make sure that the sub-contractors, defence consultants, lobbyists and all other sorts of intermediaries they involve adhere to the same code of ethics, as they do. Only through full coverage of the "supply chain" may they convincingly claim that the supply they offer is free of corruption.

Governments are advised to shortlist only those participants in tenders that have endorsed common defence industry standards on integrity and corruption. Furthermore, they should debar defence suppliers that have used corruption in getting contracts and share that information with other governments. Defence industry associations would then be expected to strip such a company of its membership status.

## Box 20.2. ASD Ethics and Anti-Corruption Activities

In 2006, the CEO's representing the companies that make up the ASD Council confirmed their continued dedication to contribute to a marketplace free of corruptive practices, allowing all participants in the international market to compete on an equal and fair basis.

The industry expressed its commitment to observe and apply the rules embedded in national legislation implementing the 1997 OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, as well as in other applicable law. ASD formed an "Ethics & Anti-Corruption Working Group." This group has conducted a benchmarking exercise in order to assess present practices among participating companies. The internal codes of ethics of the companies have been analysed by an independent lawyer, who also chairs the Commission on Anti-Corruption of the International Chamber of Commerce (ICC).

These activities resulted in "Common Industry Standards for European Aerospace and Defence," approved by the council in April 2007. ASD National Associations members were asked to endorse the standards, and participating companies to sign a Company Statement of Adherence. Endorsement has been requested since October 2008 and a structured process with progress indicators to encourage and convince companies to sign up to the standards is underway.

ASD, with the support of the International Chamber of Commerce, contributes to initiatives to extend the geographical scope of its ethics and anti-corruption activities also to non-OECD countries.

*Sources:* Aerospace and Defence Industries Association of Europe, *Annual Report 2007* (Brussels: ASD, 2008), 20, [www.asd-europe.org](http://www.asd-europe.org); The "Common Industry Standards for European Aerospace and Defence" is available at: [www.asd-europe.org/Objects/2/Files/WEB Common Industry Standards.pdf](http://www.asd-europe.org/Objects/2/Files/WEB%20Common%20Industry%20Standards.pdf).

International organisations such as NATO may facilitate the development of an effective, balanced and comprehensive strategy to enhance the integrity of the defence supplier base. They may also encourage transparency in the defence industry, including transparency of ownership, and to support defence suppliers in meeting integrity requirements.

Only cooperation among governments and suppliers, intergovernmental organisations and industry associations can turn defence companies into reliable allies in the common fight against the corruption potential of the defence sector.