

Integrity and corruption risks within the Hungarian corporate sector

Summary

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The Institute for Economic and Enterprise Research operated by the Hungarian Chamber of Commerce and Industry (IEER or GVI in Hungarian) is a non-profit economic research institute indulging in applied research in several subfields of economics. Our mission is to provide empirically and theoretically substantiated knowledge and analysis of the economic and social processes that influence the actual situation and perspectives of Hungarian economy and Hungarian companies.

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Integrity and corruption risks within the Hungarian corporate sector – 2015

Abstract

In the summer of 2015, EY and IEER conducted their fifth joint research on integrity and corruption at the Hungarian companies. The focus of the research was to investigate corporate measures against corrupt behavior and misuse of information or position, the penetration of corruption, and to have Hungarian corporate leaders' opinion on corruption and their expected behavior about the subject. Our interviewers conducted personal interviews with owners and top management members of companies employing at least 50 people. The survey is based upon 305 interviews and can be considered representative concerning employment and ratio in the economic sectors. The research analyses the rule of law and the regulatory environment including the relationship with the government, the role of personal connections with state officials and the opinion of the managers on the recent governmental measures against corruption. In the second part of the paper we investigate the corporate governance and corporate rules against fraud and corruption such as ethical codes, ethics hotline, and handling of ethical misconduct. In the third part corruption risks are investigated considering corporate leaders' perception of corruption and, with an experimental approach, their answers for hypothetical situations involving corruption are studied. Finally the research also examines the measures of risk management and the data security applied by companies.

Keywords: integrity, corruption, company survey, statistical analysis

Introduction

Corruption has become a fundamental factor within Hungary's economic and social life, adversely impacting the Hungarian economy's medium- and long-term perspectives.¹

The uncertainties surrounding the application of enactments and laws regulating Hungary's economic life, the ambiguity and inconsistency of laws and rules, and the frequent changes of regulations aiming for the elimination of undesired effects all lead to increasing corruption risks.

The institutional and regulatory environment in which an economy's actors are forced to function fundamentally characterizes the economy's competitiveness and potential of progression. High risks of corruption and the uncertainty caused by corruption undermine the competitiveness of the economy, the contractual connections between enterprises, and the connection between enterprises and public institutions. Corruption fundamentally destroys trust within a society.

There's hardly any knowledge about the true extent and burden that corruption risks have on certain areas of today's Hungary's economic life, or how the burden changes over time. We're obviously not talking about the perception of corruption: there are many researches on economic actors', enterprises' and the population's perception and estimations concerning corruption in general, or its certain appearances.

We also have no knowledge on what measures enterprises and executives of public institutions are currently using to sustain adequate, fair businesses and what internal apparatus, rules, or departments they establish in order to redound the mode of operation that ensures the integrity of a given institution.

Until the start of our project, we had no research results concerning the Hungarian corporate sector. We wish to fill this void with our recurring pioneer research investigating the relation between integrity-based institutional operation and corruption risks in the Hungarian corporate sector. The research has been conducted annually since 2010 with the cooperation of Ernst and Young Ltd. (Hungary) and HCCI Institute for Economic and Enterprise Research (IEER). We examine corruption risks in a wide context, from the side of economic institutions: we analyze corporations' institutional and regulatory solutions to these problems and we examine various appearances and forms of corruption risks within the connections between enterprises and public institutions, or enterprises and enterprises. We use the results of empirical surveys conducted every year through personal interviews with 300 executives of enterprises employing at least 50 people.

In the synthesis below, we publish the results of said research in abbreviated form, adding emphasis on the analysis of occurrences of corrupt transactions. We examine the corporate leadership's direct experiences and – for the first time in Hungary – we can observe the respondents' decision-making process concerning hypothetical corrupt situations. Besides

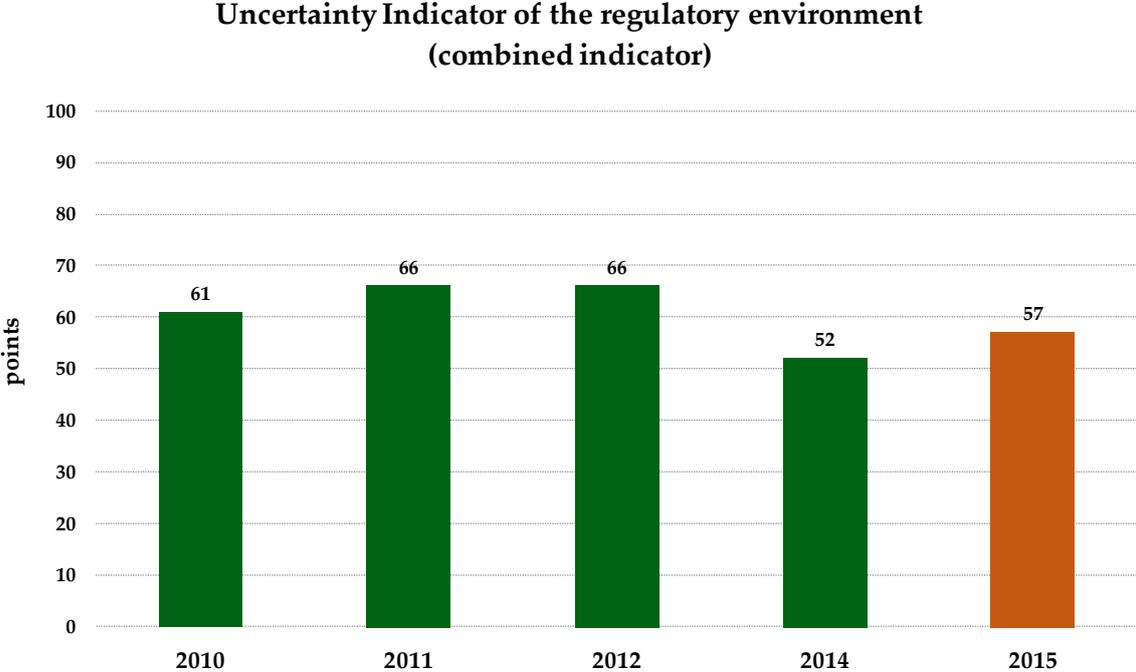
¹ The analysis below is an English summary of the main results of the 2015 study prepared by IEER on the behalf of Ernst and Young Ltd. (Hungary). See the original paper in Hungarian: <http://bit.ly/1Y2d6LN>

allowing us to observe the acceptance of corruption, this also allows us to develop and annually analyze an indicatory system created to measure change in the penetration of corruption in varied corrupt situations.

1. Regulatory environment

According to the interviewed corporate leaders, there was a slight growth of uncertainty in the business environment in 2015. The respondents rated the problems of regulatory environment of economic activities 57 on a scale of one hundred, compared to 52 in 2014 (see Figure 1.1). There is a slight growth in every component of the uncertainty of the regulatory environment. Nevertheless, corporate leaders continue to consider administrative burdens (83 points) to be the biggest issue, and – like last year – overregulation (76 points) and frequent changes (74 points) are also considered problematic (see Figure 1.2).

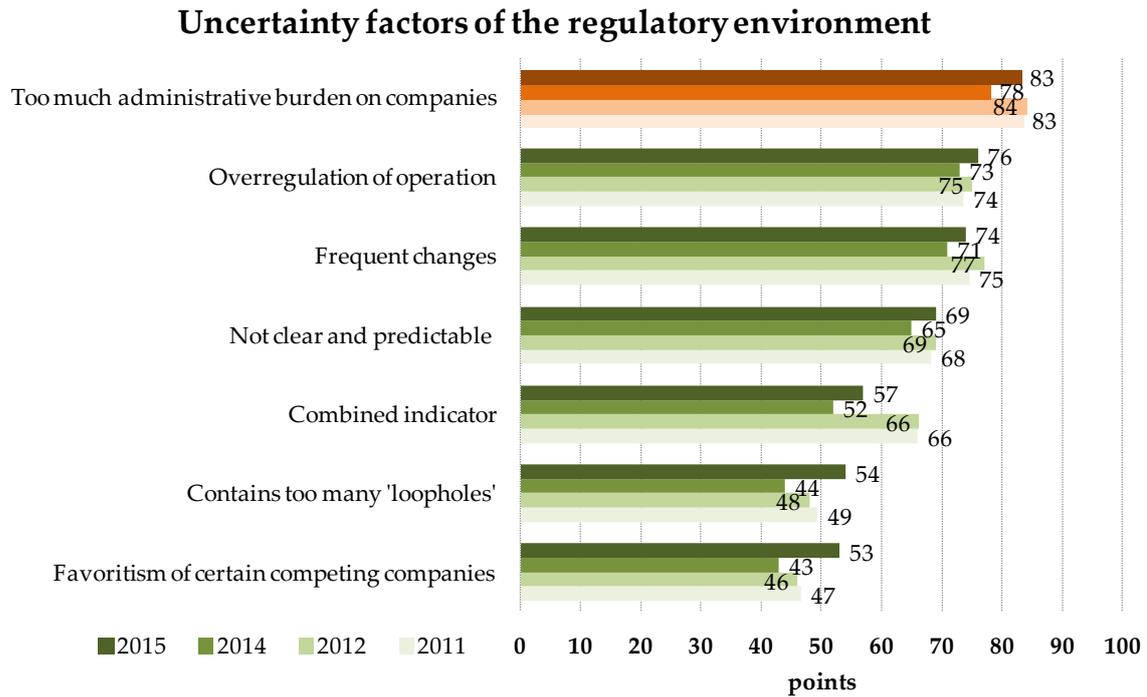
Figure 1.1: Uncertainty Indicator of the regulatory environment (combined indicator)



source: E&Y, GVI (n2010 = 270, n2011 = 275, n2012 = 311, n2014=296, n2015=269)

Note: the combined indicator is on a 100-points scale (Y axis), higher value means higher regulatory uncertainty

Figure 1.2: Uncertainty factors of the regulatory environment

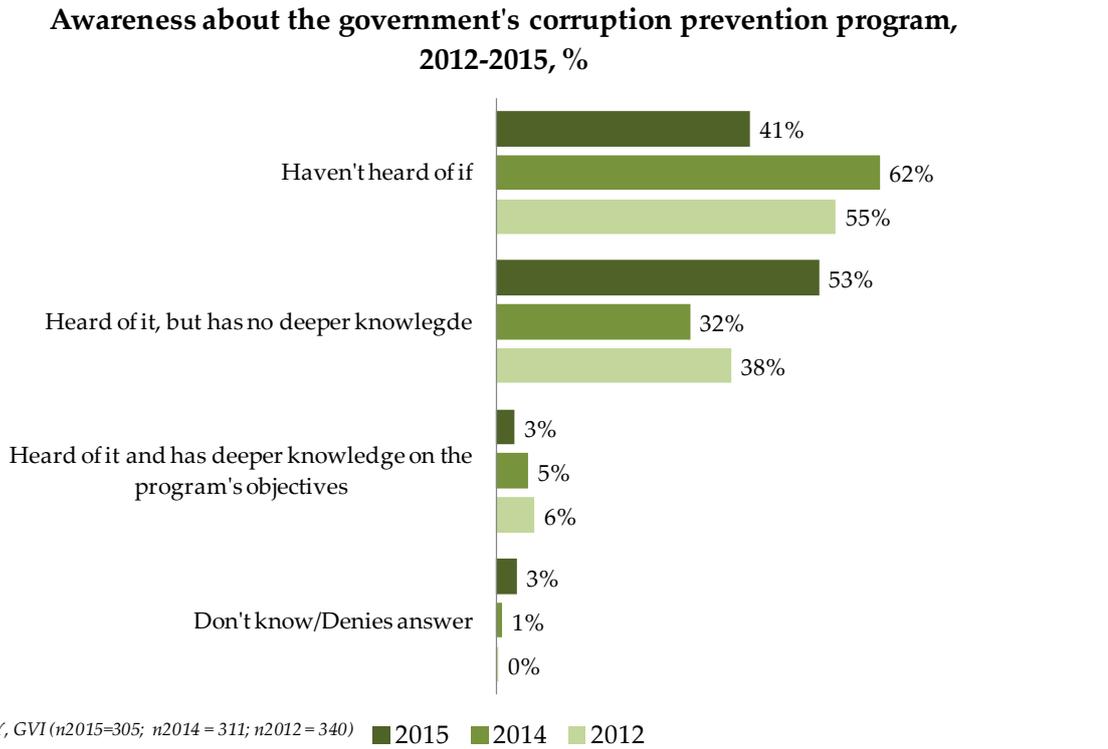


source: E&Y, GVI

(n2012 = 339, 339, 340, 337, 327, 318; n2011 = 298, 297, 298, 279, 290, 296; n2010 = 298, 298, 297, 295, 286, 277; n2014 = 308, 308, 308, 298, 304, 305, n2015 = 299, 300, 298, 277, 285, 292)

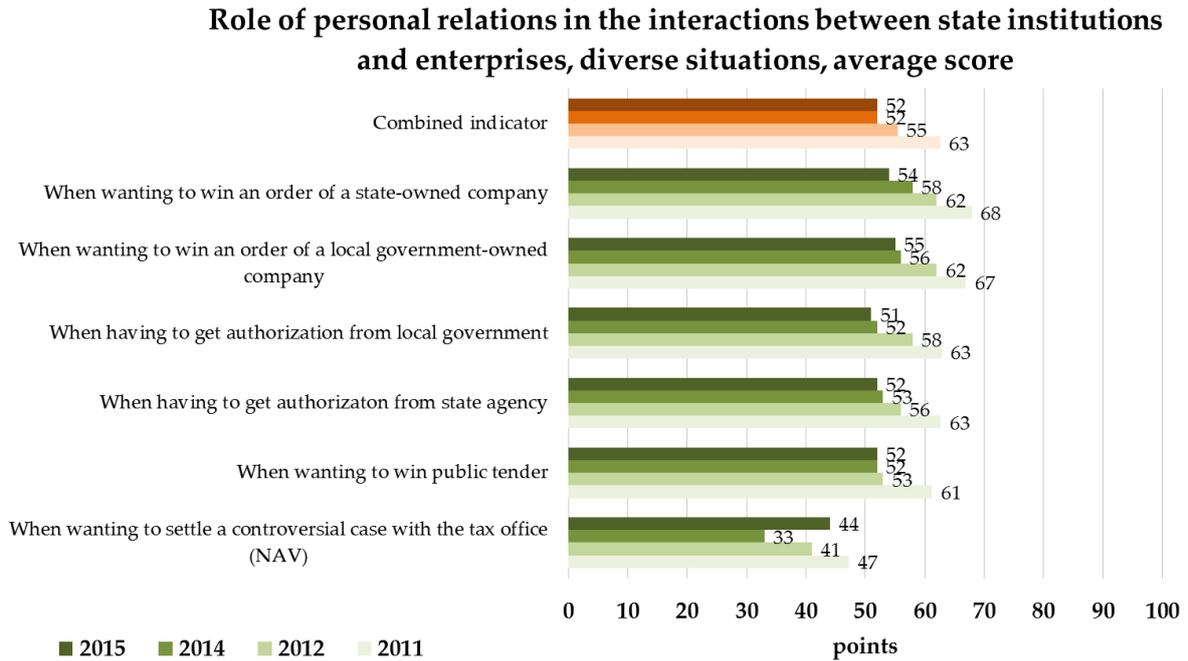
The proportion of companies that employ persons responsible for referring to or keeping contact with the government was low in each of the five examined years: 4% in 2010, 6,7% in 2011, 9,8% in 2012, 9,4% in 2014 and 4,5% in 2015. Only 3% of respondents have deep knowledge of the corruption-prevention program of the government, while 41% have not even heard of it (see Figure 1.3). 43% of respondents are aware of the law of complaints and notifications legislated in 2013, 74% know about the new regulation of the Civil Code concerning the responsibility of the leadership, and among those, 12% adjusted the supervision of the work of management because of the new law.

Figure 1.3: Awareness about the government's corruption prevention program, 2012-2015, %



According to corporate leaders, personal connections play an important part in the authorization process, and in winning the orders of public institutions or state companies, regardless of which public institution is in mind. The data show that according to the respondents' opinion personal connections mostly play role in cases of orders from state- and local government (see Figure 1.4). Considering business life in total, respondents rated the significance of personal connections lower compared to previous years. Personal connections mostly play role in cases of new orders (see Figure 1.5).

Figure 1.4: Role of personal relations in the interactions between state institutions and enterprises, diverse situations, average score

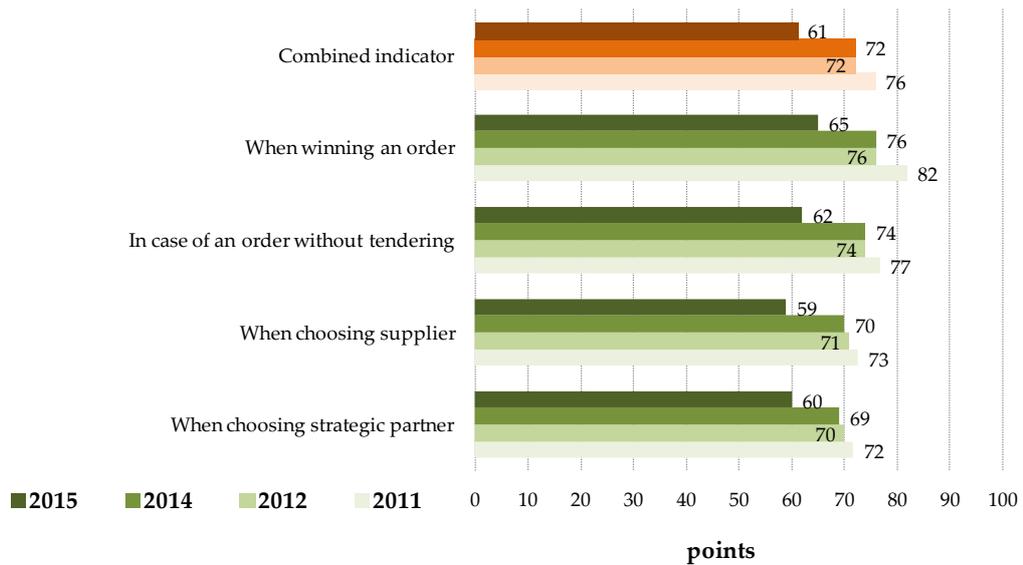


source: E&Y, GVI

(n2015=285, 284, 278, 281, 278, 271; n2014= 284, 283, 292, 292, 271, 288; n2012 = 315, 315, 327, 327, 314, 324; n2011 = 281, 282, 291, 288, 274, 288; n2010 = 271, 271, 287, 267, 290, 283)

Figure 1.5: Role of personal relations in business life, diverse situations, average score

Role of personal relations in business life, diverse situations, average score

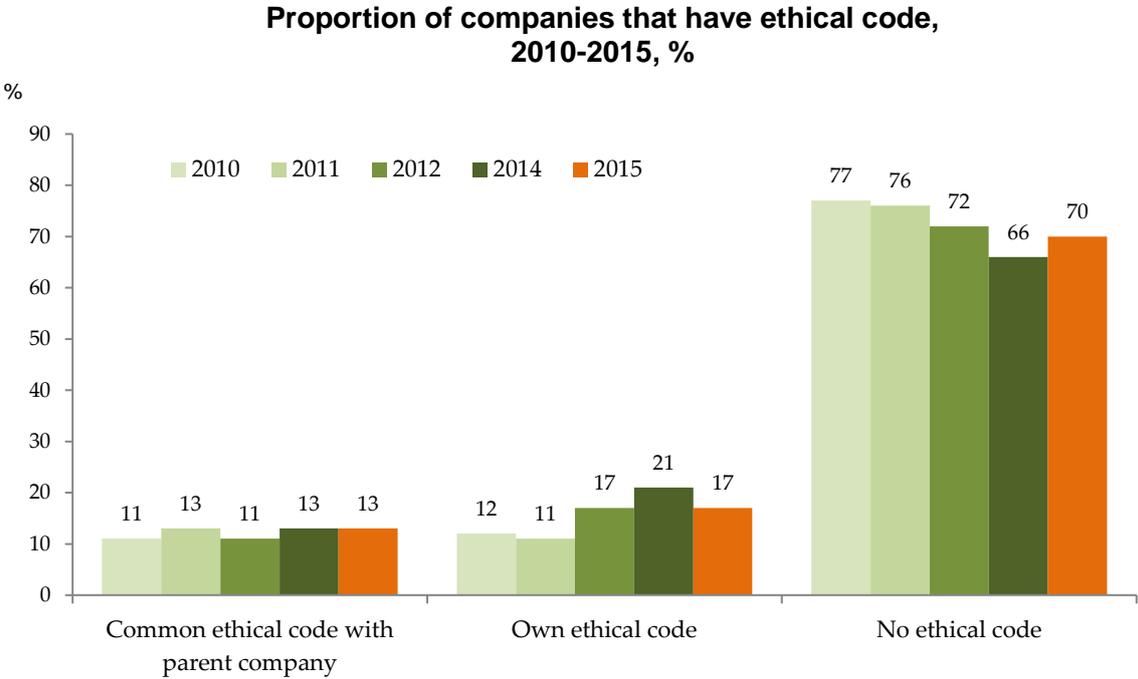


source: E&Y, GVI (n2015=290, 290, 291, 289, 289, 287; n2014 = 299, 297, 298, 296; n2012 = 335, 334, 336, 334; n2011 = 294, 299, 295, 298, 296)

2. Specifics of institutions – codes of ethics and handling ethical misconduct

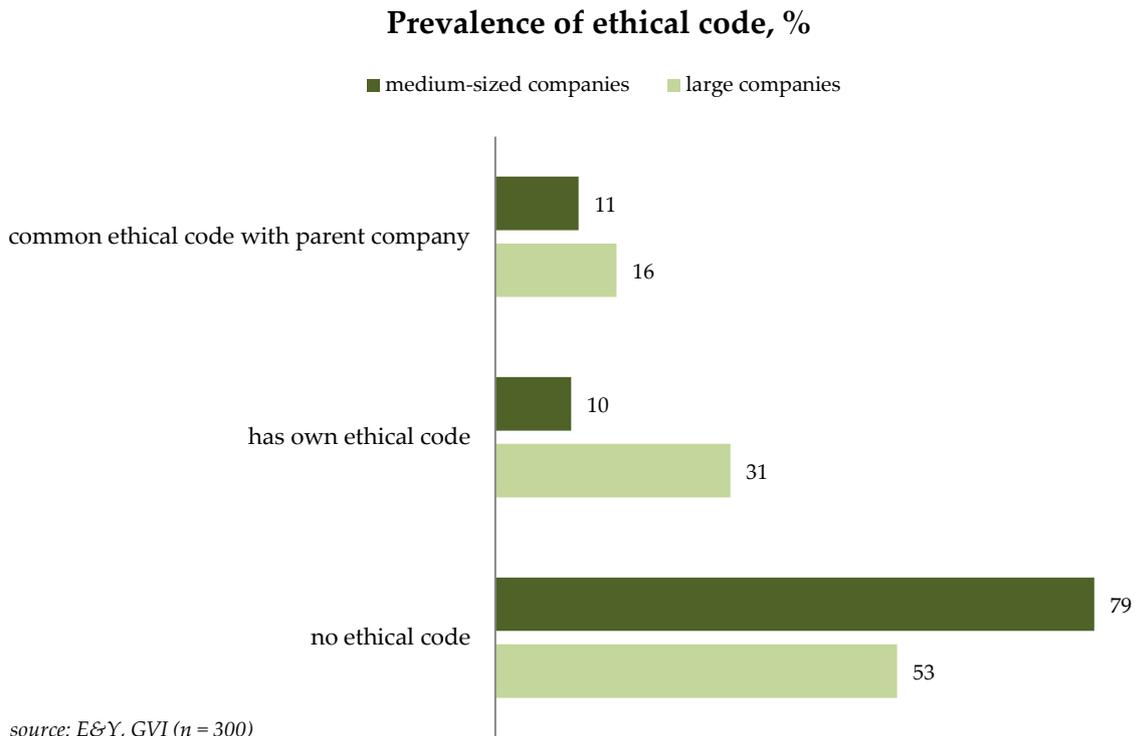
13% of the interviewed enterprises have a common ethical code with the parent company, 17% have got their own ethical code (see Figure 2.1) – more than quarter of the companies had such set of rules in 2015. These rates are not considerably different from the previous years’ percentages. According to this year’s results, the proportion of foreign owners, the presence in the stock market and the size of the company (if its personnel is larger than 250 people) make it more likely for the examined companies to have an ethical code. 31% of big firms have their own ethical code, while this proportion is only 10% in the medium-sized corporations’ cases (see Figure 2.2). Not independently from this, within the income categories of 5-10 billion forints and more than 10 billion forints, 39% and 57% use ethical codes, which is significantly higher than the 22-25% observed in the case of companies with lower incomes.

Figure 2.1: Proportion of companies that have ethical code, 2010-2015, %



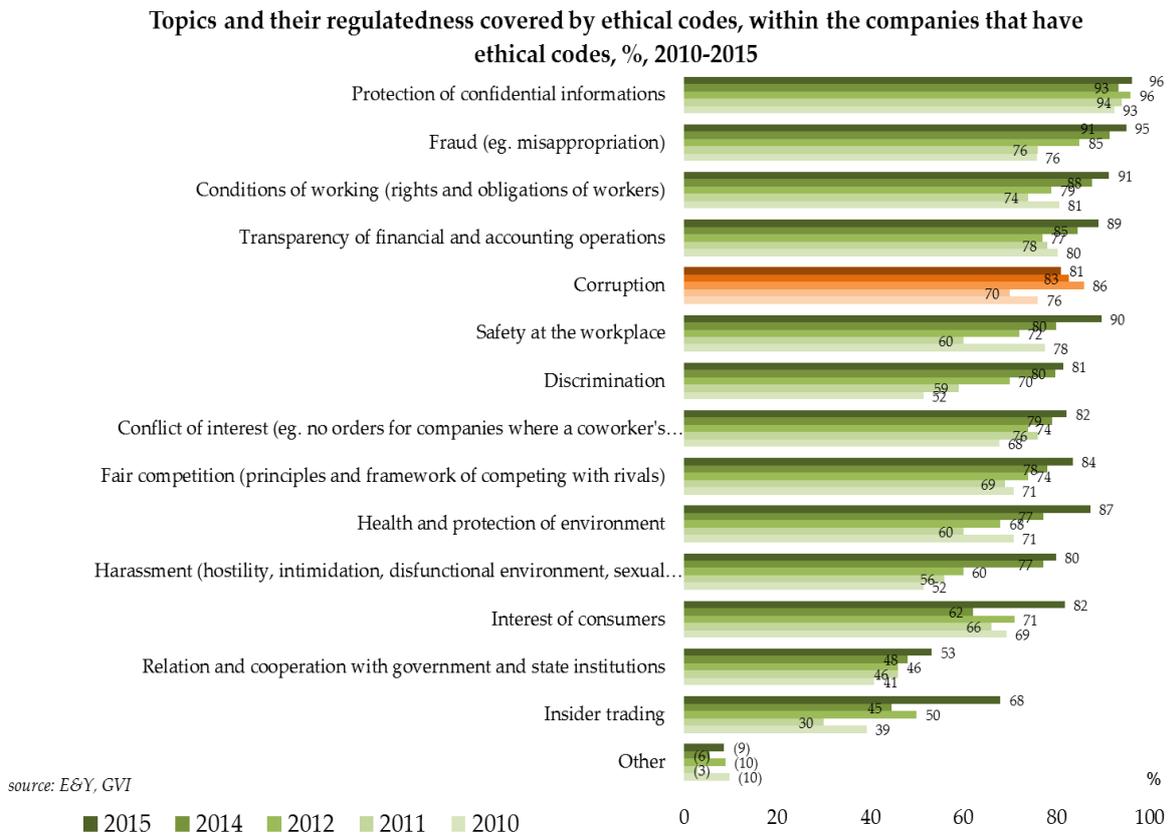
source: E&Y, GVI (n2010=300, n2011=300, n2012=340, n2014=309, n2015=305)

Figure 2.2: Prevalence of ethical code, %



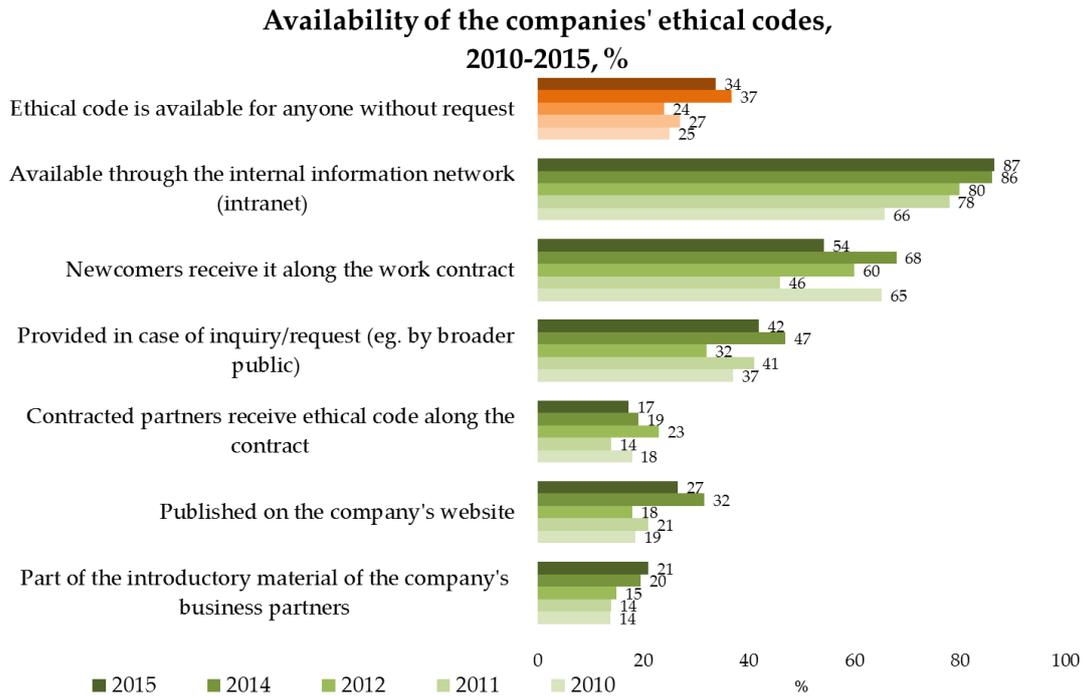
The most common subject of the ethical codes is the protection of confidential information; this topic is present in 96% of the respondents' ethical codes. Fraud (misappropriation) was the second most common subject, present in 95% of the ethical codes. 81% of ethical codes include rules on avoidance of corruption (see Figure 2.3). Most of the themes the questionnaire raised were incorporated in the codes of ethics, more of them in 2015 than in the 2014 version as respondents indicated.

Figure 2.3: Topics and their regulatedness covered by ethical codes, within the companies that have ethical codes, %, 2010-2015



Considering the availability of the enterprises' ethical codes, it could be stated that relatively few enterprises publish them (34%) – this proportion is lower than that of last year's. The examined companies decisively make their ethical codes available through internal sources of information (internal computer network, intranet); furthermore, new employees typically get the companies' set of rules along the work contract (see Figure 2.4).

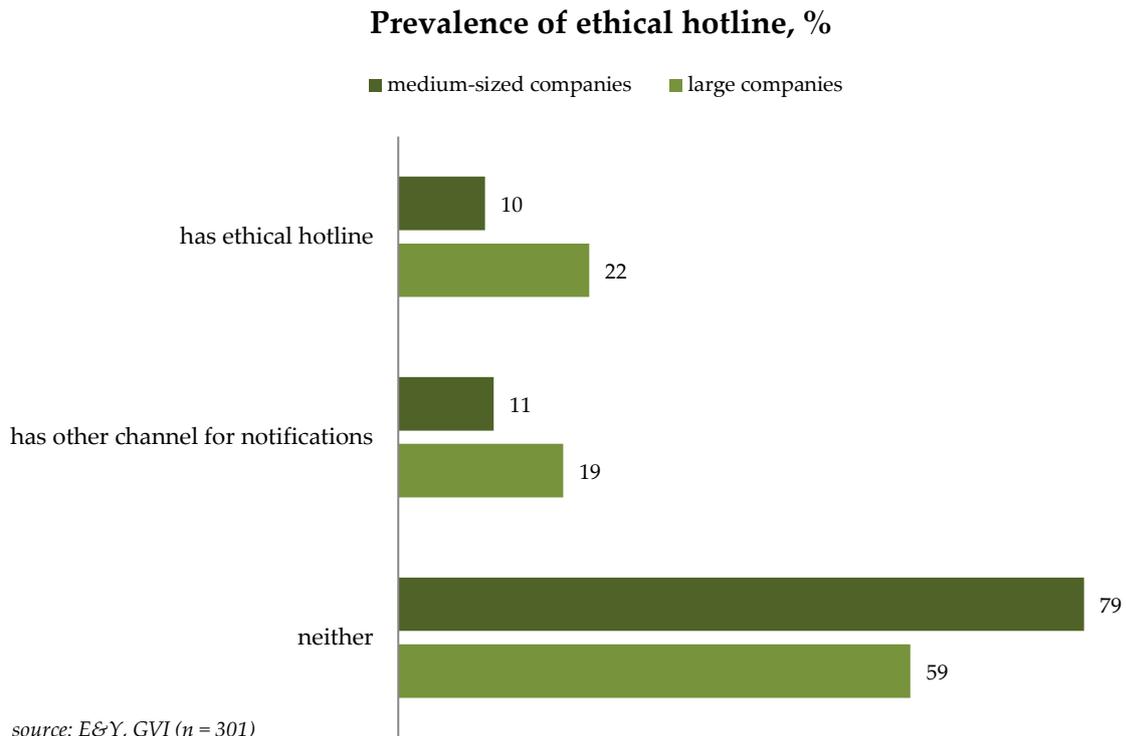
Figure 2.4: Availability of the companies' ethical codes, 2010-2015, %



source: E&Y, GVI (n2010=68, n2011=72, n2012=94, n2014 = 106, n2015=82)

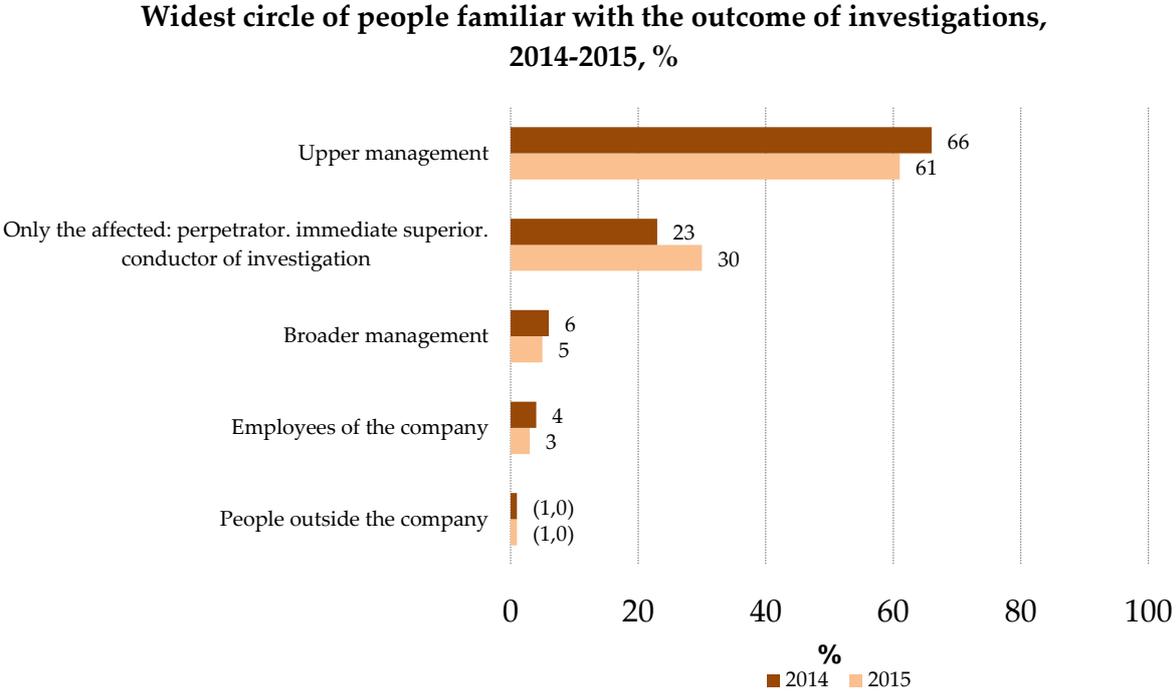
14% of the companies use ethics hotline, and another 14% make notification of misdemeanor possible through other channels. Similarly to ethical codes, ethics hotlines are more typical of major corporations (22% have ethics hotline) – with smaller corporations, the same proportion is only 10% (see Figure 2.5). Ethics hotlines are also similar to ethical codes in that they are more typical of companies with (partly) foreign owners and/or presence in the stock market, while the relative proportion of usage of other channels is higher in the rest of the companies.

Figure 2.5: Prevalence of ethical hotline, %



95% of respondents reported that the managers have no knowledge of ethical misdemeanor. 20% of companies employ a department or person responsible for handling cases of ethical misdemeanor and misuse of information or position. The proportion is a little higher in the case of companies that are present in the stock market and the companies that employ more than 250 people (29% and 26%). In case of ethical misdemeanor, the majority of the companies (78%) conduct investigation within the company. With most of the examined companies (61%), the outcome of the investigation of ethical rule-breaking is revealed to upper management (see Figure 2.6.).

Figure 2.6: Widest circle of people familiar with the outcome of investigations, 2014-2015, %

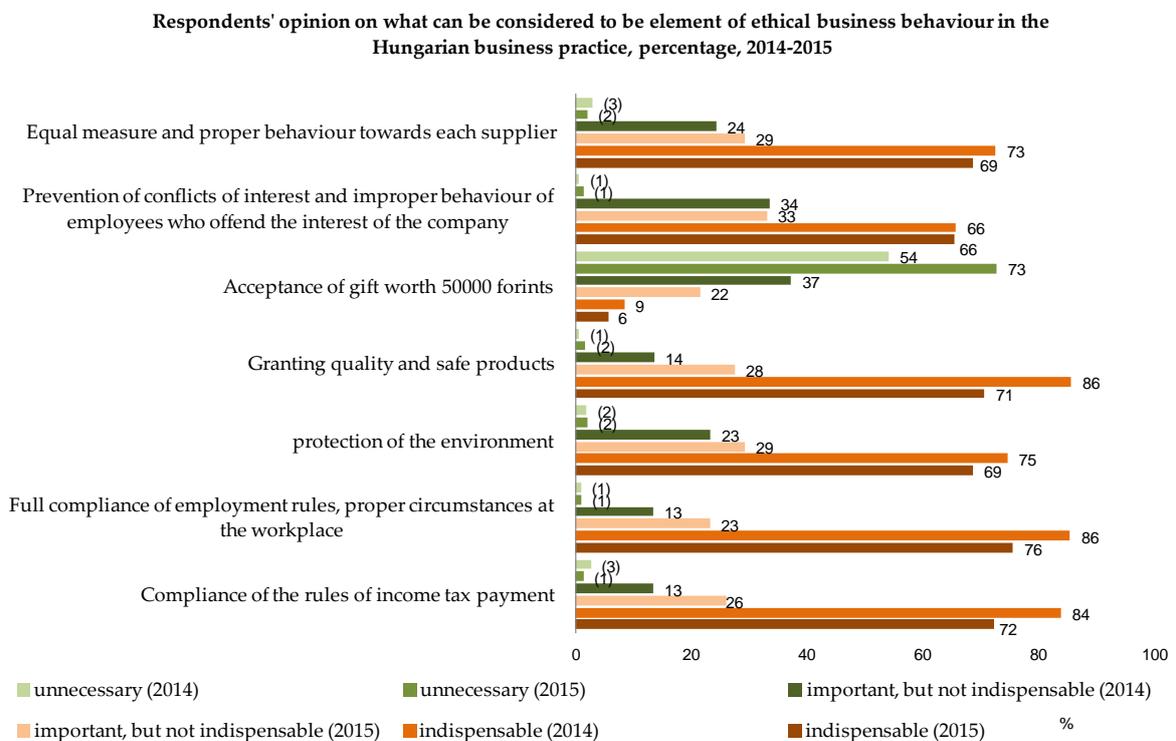


source: E&Y, GVI (n2014 = 283, n2015 =

3. Corruption risks

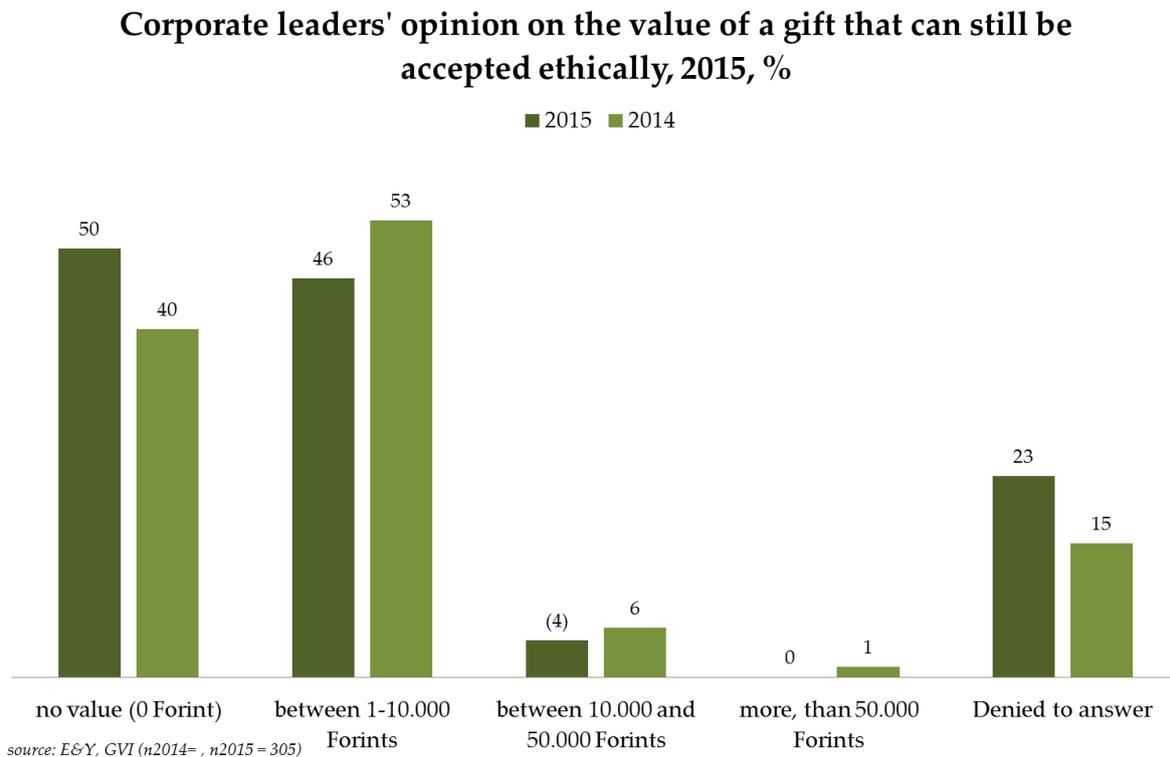
The 2015 survey was the third to include questions to study corporate leaders' opinion on what is considered ethical behavior in today's Hungary's business practice. According to three-quarters of the corporate leaders, full compliance of rules of employment, ensuring reasonable circumstances for the employees and compliance of rules of payment towards the employees can be considered indispensable elements for ethical business practice (see Figure 3.1). According to half of the corporate leaders interviewed, no gift can be ethically accepted while 23% of corporate leaders haven't responded to this question (see Figure 3.2). 12% of the questioned companies have regulations for giving and receiving gifts, this ratio is 38% in case of companies that are present in the stock market, while the same ratio is 10% in case of the rest of the companies.

Figure 3.1: Respondents' opinion on what can be considered to be element of ethical business behaviour in the Hungarian business practice, percentage, 2014-2015



source: E&Y, GVI (n2015=287, 288, 287, 287, 265, 287, 286, n2014= 300, 304, 304, 300, 304, 301, 279)

Figure 3.2: Corporate leaders' opinion on the value of a gift that can still be accepted ethically, 2015, %



Nearly one-fifth (19%) of the questioned corporate leaders have heard of cases, from their broader business environment, when magisterial representatives showed inclination to accept gifts or bribes. 12% have knowledge of case(s) when a gift or a bribe was openly asked for. Nevertheless, only six contractors (1%) claimed that he/she or an employee was asked to give gifts or bribes over the last 5 years.

Corruption is a latent phenomenon: both parties involved, the corruptor (who pays a corruption charge for a service) and the corrupted (who receives the charge for the service), are interested to hide the transaction, thus it is not possible to survey about the details of actual corruption transactions. Because of this the research examined the respondents' potential reactions to hypothetical situations involving corruption. The participants were asked to imagine that their company was in a bad situation and were asked how they would decide in four hypothetical scenarios which would each help their firm but at the same time these scenarios would involve corruption.

Respondents were asked the following question:

“Imagine that your company is in a bad business situation. The company's income fell by a third in one year. If no positive turn happens, a part of the employees would have to be dismissed. I will continue the story in four ways:”

This story was continued with cases where the respondent had to choose between possible behaviours in specific corruption situations. The four stories were the following:

- *“The first: You have prospects for a major order and during the negotiations the representative of the client company indicates that you could get the order in exchange of a 10% charge. What would you do in this situation?”*
- *“The second: You would like to start a new activity for which only one official permit is missing. The administrator implies that the permit generally takes a long time to be issued but it is possible to speed up the process. The administrator with other official documents gives you the brochure of a travel agency promoting one week tours for two to Austria. What would you do in this situation?”*
- *“The third: The national tax office comes for an inspection to your company. The inspector tells you that he found several problems in the accounting. He tells you that if these are recorded you have to pay 5 million forints subsequently plus the fine and interests but he implies also that for 10% he would set aside the official recording. What would you do in this situation?”*
- *“And the fourth: A public institution plans to announce a public procurement. An employee of the institution visits you and indicates that you could win the procurement in exchange of paying him a 10% charge. What would you do in this situation?”*

The respondents could choose the following behaviors and more could be chosen from the possibilities:

- „1 – I would immediately accept the offer*
- 2 – I would consider the offer*
- 3 – I would not take the offer into account, I would pretend that I did not hear it*
- 4 – I would report the case to his or her employer*
- 5 – I would notify the police*
- 6 – Other,:*
- 9 – no answer/ don't know”*

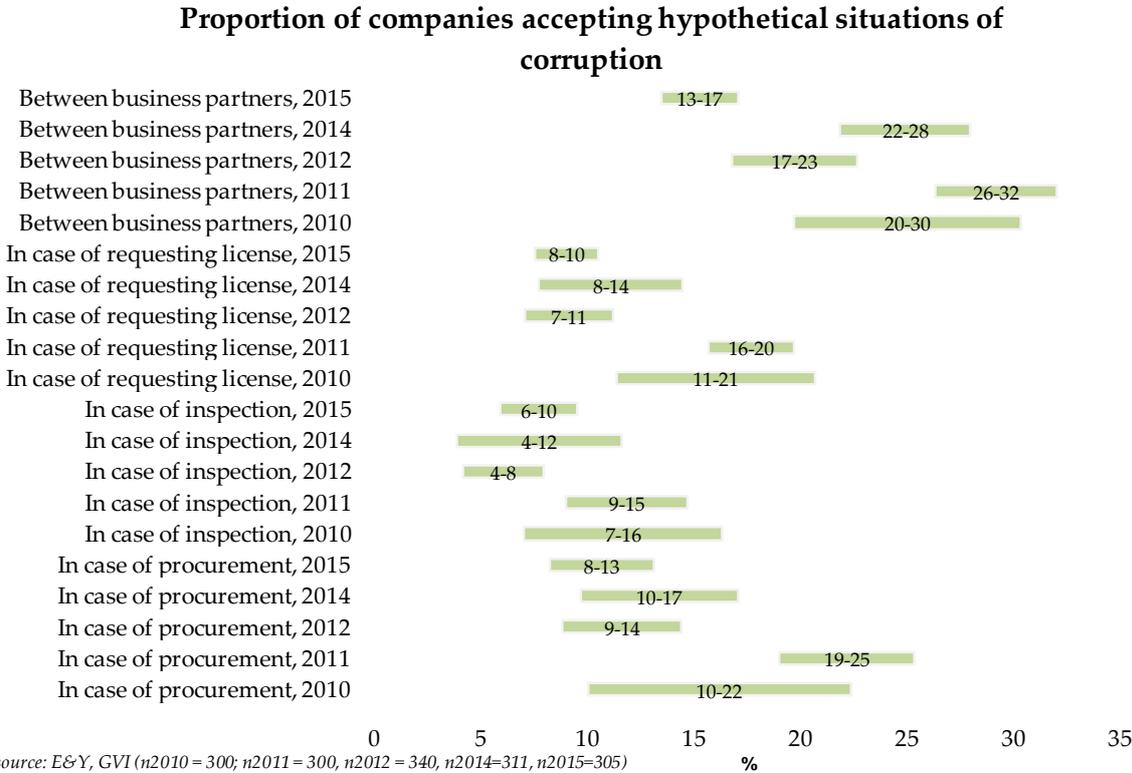
The questions were asked one after another and the company leaders could give an answer separately to each.

To hypothetical situations involving corruption, very few contractors answered that they would ‘accept offers of corruption right away’. Nevertheless, 4-11% would ‘consider the offer’. Although respondents were asked to decide in hypothetical situations some of them did not answer or gave a ‘don’t know’ answer to these questions. These reactions can be considered a form of hiding the answer and we can’t reject the possibility that behind a part of these cases

there is the acceptance of corruption offers and its denial in the survey situation. If these answers are also considered as a positive reaction, it can be claimed that a not negligible part of corporate leaders (6-17%) would not refuse these kinds of solutions right away. At the same time, the ratio of those who would contact the police in case of offers of corruption is relatively low (3-8%). Ergo, cases of corruption that were made public are only 'the tip of the iceberg'. Corruption within the business life is probably at least as widespread as corruption related to the government and enterprises. This confirms that lowering the risks of corruption at the corporations' level could be encouraged/achieved with specific comprehensive steps regarding business life as a whole by facilitating the integrity of organizations and by generating trustworthy business behavior.

The ratio of explicitly positive reactions to hypothetical situations involving corruption declined between 2014 and 2015. With that result, the tendency of 2010-2012, that came to a temporary halt in 2014, is continuing (see Figure 3.3). In the first, the second and the fourth situation the number of those who would consider a corruption offer and those who refused to answer declined. In the third situation the rate of those who would consider the offer rose but the refusal of response dropped which means fewer respondents on the whole who would potentially accept an offer. At the same time in each of the four situations the number of those who would report to the office and those who would report to their employer decreased.

Figure 3.3: Proportion of companies accepting hypothetical situations of corruption



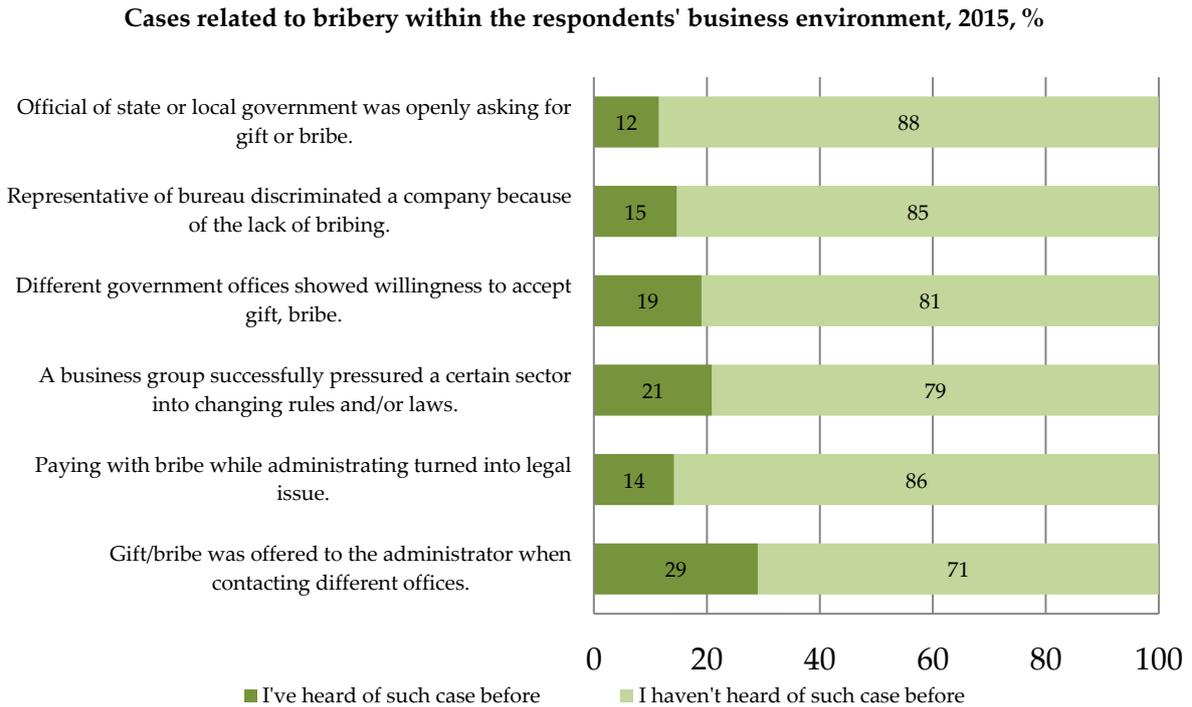
The potential acceptance or consideration of corruption offers do not differ significantly among company types, however, some slight differences can be observed. 3% of the leaders of the companies not present in the stock market would accept at least one of the offers, while

this rate among those who are in the stock market is 0%. Considering the number of employees the results show that in the case of companies with fewer than 100 employees 5% of them would accept at least one from the four corruption offers while in the case of companies with 100-250 employees this rate was only 3% and it was even lower in the case of bigger firms.

Examining the answers aggregated for the four corruption situations according to the results 16% of the company leaders would accept or consider to accept at least one of the hypothetical corruption situations (this rate was 27% in 2011, 22% in 2012 and 24% in 2014). Of course, this does not mean that corruption would occur in all of these cases: consideration might lead to the refusal of the offer. However, considering the number of those who refuse to answer, it can be assumed that the number of those who would not reject an offer immediately is higher in reality. We made the strong assumption that those who refused to answer could be comprised among those who would accept or consider a corruption offer, therefore, the rate of those who would not reject corruption right away was 20% in 2015. This rate was 37% in 2011, 28% in 2012 and 30% in 2014 so the rate of those who would not refuse a corruption offer right away decreased significantly in 2015. Considering the answers aggregated for the four corruption situations it can be stated that in 2015 9.5% of the company leaders would consider reporting the corruption offer to the policy (15% in 2011, 22% in 2012 and 20% in 2014).

Examining the perception of corruption based on the results of the survey, 19% of respondents heard of cases in their broader business environment when employees of the government sector showed willingness to accept gifts or bribes, 12% knew of case(s) when gifts or bribes were asked for. 14% heard of cases of discrimination towards a corporation when the bribe that was asked for wasn't given. Besides this, according to the respondents, regulatory capture (when a business group successfully pressures regulators into making their own interest visible) can be considered general. 21% of corporate leaders reported such case(s) in their broader business surroundings (see Figure 3.4).

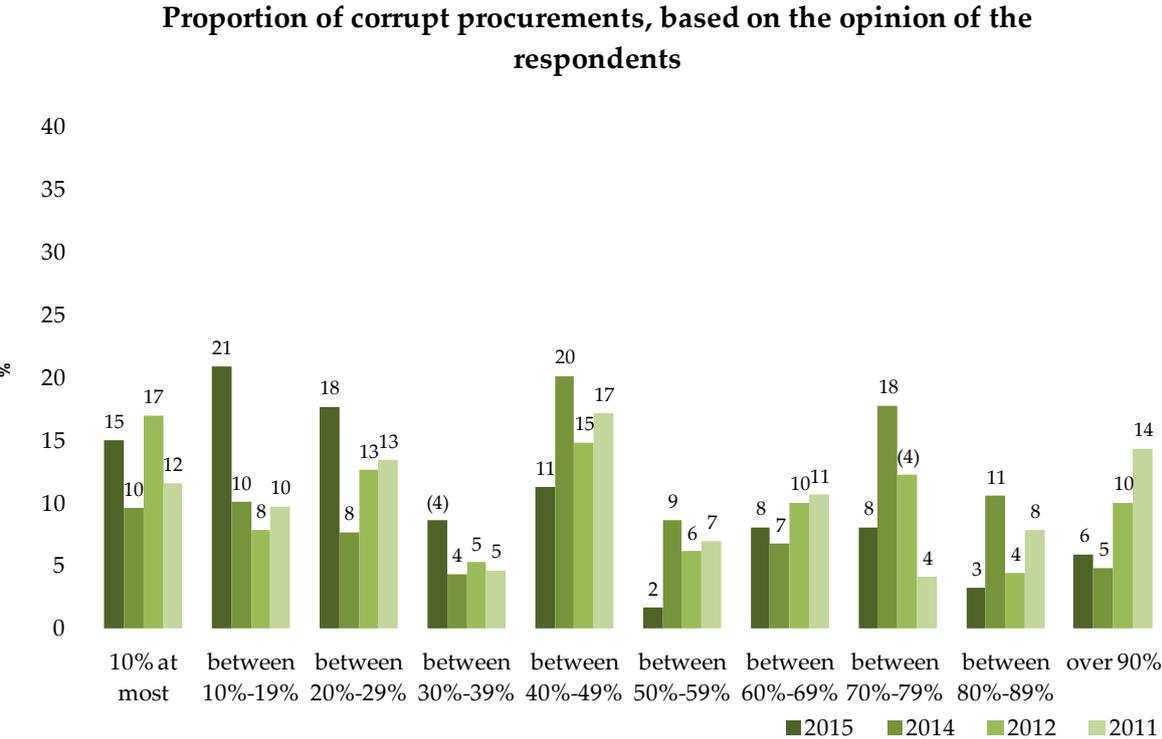
Figure 3.4: Cases related to bribery within the respondents' business environment, 2015, %



source: E&Y , GVI (277<n<281)

There is no significant diversion in the perception of corruption in terms of the size of corporations. There is also no significant diversion in the perception of how many procurement processes are corrupt out of 100 in Hungary: according to large corporations, this number is 38 on average, while according to medium-sized corporations 42 out of 100 procurement processes are corrupt in Hungary (see Figure 3.5). According to leaders of large corporations, 12 million –forint- bribe has to be paid when a 100 million forints worth of order is won through corrupt procurement process. Leaders of medium-sized corporations estimate 14 million- forint- bribe in such a transaction. Again, there’s no significant difference between the opinions of leaders by the size of the company.

Figure 3.5: Proportion of corrupt procurements, based on the opinion of the respondents

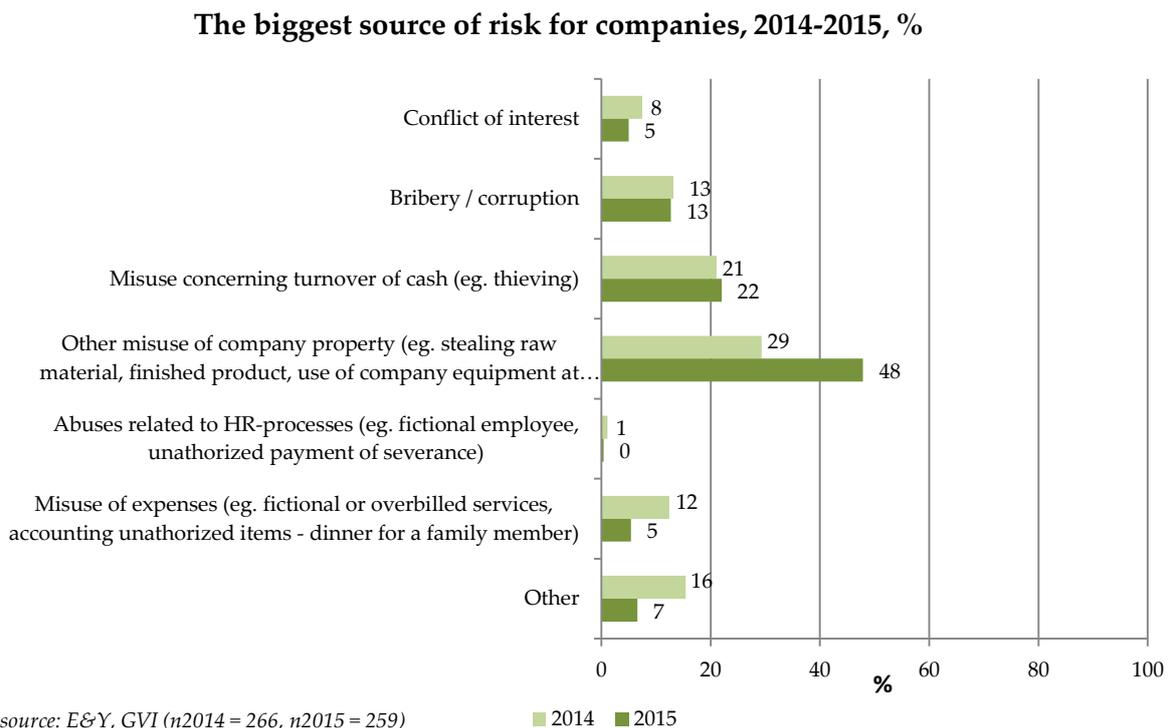


source: E&Y, GVI (n2011 = 217; n2012= 230; n2014=209, n2015=187)

4. Risk management

During the survey, besides the institutional surroundings and experiences concerning corruption, we also examined how conscious Hungarian corporate leaders are about risks of corruption and if they use leadership- and organizational techniques that can moderate said risks. 48% of corporate leaders see misuse of company property (usage of raw materials and tools at home, theft of finished products, etc.) as the main source of danger (see Figure 4.1). 19%, however, reported of systematic risk assessment.

Figure 4.1: The biggest source of risk for companies, 2014-2015, %

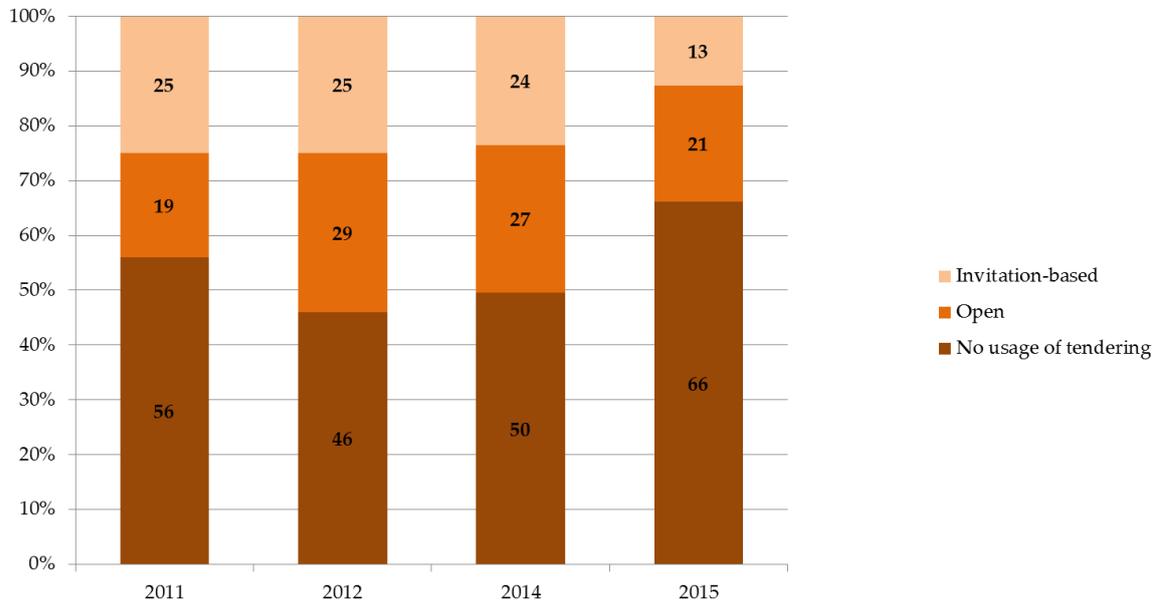


Among the risk factors, 30% of corporations monitor conflicts of interest – this ratio shows a decrease compared to 54% measured in 2014. The most common method to monitor conflicts of interest is the obligation of employees to report if they accept executive position in a financial institution or other organization.

In general, only one-third of the companies have procurement regulations, though 50% of those companies that are present in the stock market or have an income higher than 5 billion forints do set up procurement regulations. About two-thirds of the companies do not invite entries for tenders in case of procurements (see Figure 4.2). Among those which do invite for tenders, the highest percentage (53%) is of those companies where the CEO or the board of directors decides about the winner of the procurement.

Figure 4.2: Whether companies are using open, or invitation-based tendering when tendering a procurement, 2011-2015, %

Whether companies are using open, or invitation-based tendering when tendering a procurement, 2011-2015, %

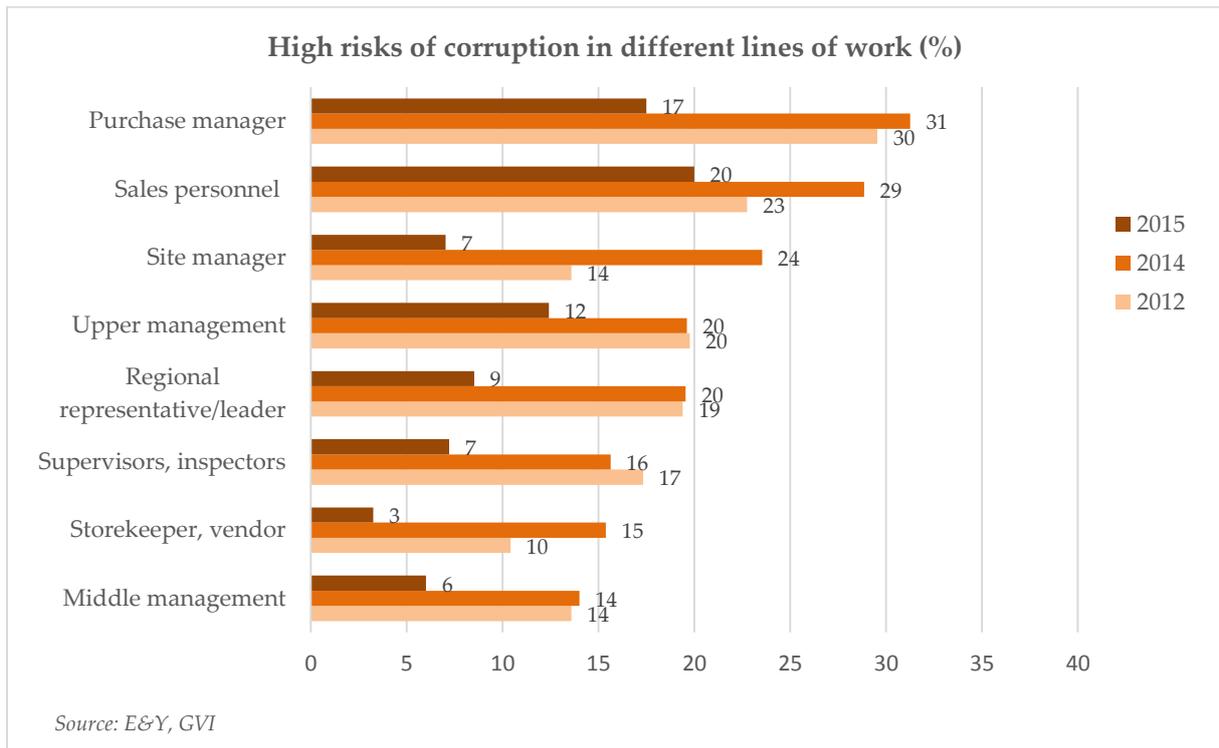


source: E&Y, GVI (n2011 = 300, n2012=324, n2014=293, n2015=277)

22% of respondents (65 companies) have regulations on conducting /how to conduct business meetings, that is a slight improvement compared to the 2014 data, where only 14% of respondents reported about such regulations. Only 4% of respondents have the general practice of holding business meetings at a neutral site, 37% occasionally practice this, however 58% exclude such possibility.

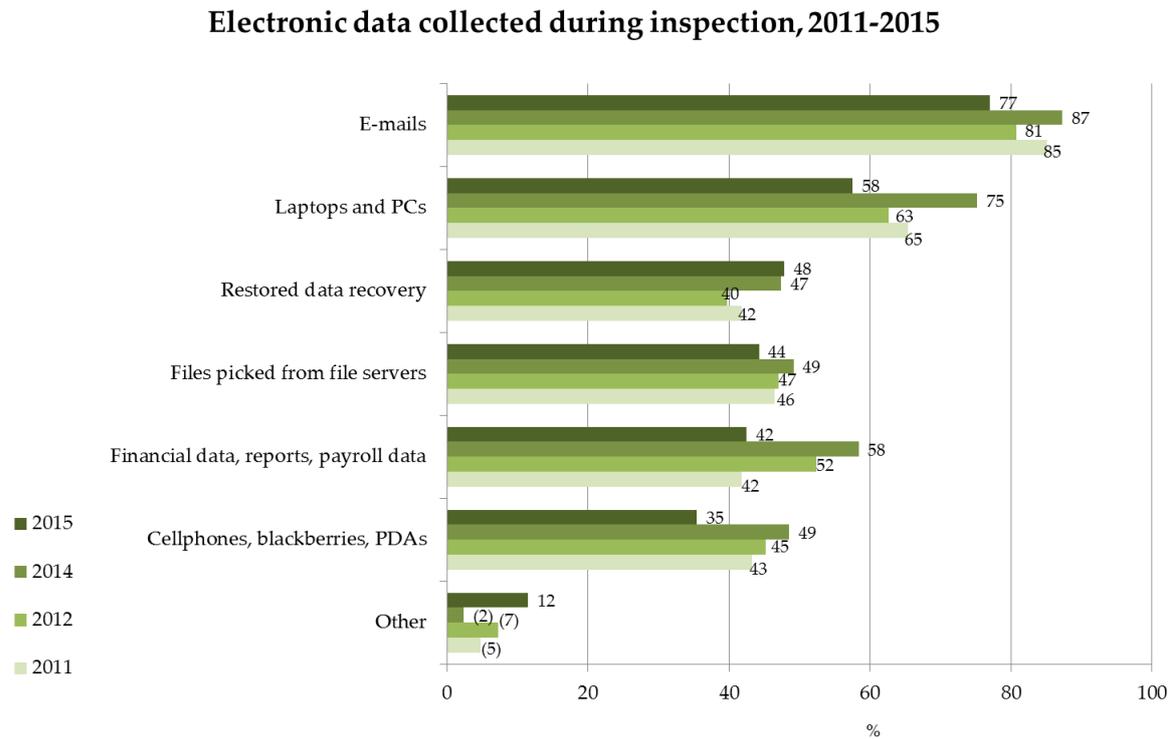
13% of the companies care to identify the key positions that involve risks of corruption. This is a decrease compared to 2014 when this ratio was 24%. The respondents assume risks in the positions of top management, purchase manager and sales personnel (see Figure 4.3). The generality of respondent companies (91%) analyze the CVs of applicants when recruiting, but only 24% check the authenticity of the documents submitted with the application.

Figure 4.3: High risks of corruption in different lines of work (%)



20% of companies employ a person or have a department responsible for handling misuse of what? or ethical misdemeanor. The percentage is slightly higher in the case of companies present in the stock market and companies that employ more than 250 people (29% and 26%). When exploring fraud and misuse of information or position in the workplace, 30% of the companies (31% in 2014 and 2012, 15% in 2011) took electronic documents into consideration in every emerging situation, while 18% (27% in 2014, 22% in 2012, 33% in 2011) did the same occasionally. The IT department and the management collect the electronic documents for examination at most of the companies. When investigating misuse of information or position, companies most often foreclose e-mails, laptops and PCs, and restored data recovery (see Figure 4.4). Less than three-quarters (73%) of the companies take privacy policy into account when conducting internal investigations. There is a slight decrease in this proportion compared to the previous year.

Figure 4.4: Electronic data collected during inspection, 2011-2015



source: E&Y, GVI (n2011 = 127, n2012=166, n2014=173, n2015=113)

Majority of corporate leaders (39%) believe that the highest risk from the technological point of view is company data leak to a third party by the personnel. There is no significant change in this compared to 2014. When employees quit the company, on a scale from 0 to 10, corporate leaders evaluated the frequency of taking corporate intellectual property with them at an average of 1.37. On the same scale, corporate leaders gave 1.8 points when asked about how much they are afraid of employees committing fraud within the IT system.

Popularity of certain areas of risk-handling is not varied between large and medium-sized corporations. One exception is in how positions with higher risk of corruption are identified and that is more specific to large corporations. In both categories, around one-third of respondents monitor the generation of possible conflicts of interest. There is also no difference in the case of regular risk assessment.